December 21, 2004

WILLIAM P. GALLIGAN
VICE PRESIDENT, DELIVERY AND RETAIL

LYNN MALCOLM
ACTING VICE PRESIDENT, FINANCE, CONTROLLER

SUBJECT: Audit Report – Automated Postal Center Program Management (Report Number CA-AR-05-001)

This report presents the results of our self-initiated review of Automated Postal Center (APC) Program Management (Project Number 04XG007CA000). Our objective was to determine whether the Postal Service acquired APCs that met functional requirements, capital funding levels, and schedule requirements specified in the approved Decision Analysis Report (DAR). Additionally, we determined whether the APC program office kept the Board of Governors and senior Postal Service officials fully and timely informed of program status.

On April 14, 2004, the APC program office began a phased, nationwide deployment of 2,500 APCs. As of August 11, 2004, the Postal Service reported it had installed 912 APCs that had collected approximately $11.1 million in revenue and planned to complete deployment of the remaining 1,588 APCs by November 2004. However, the process for selecting APC deployment sites needed improvement since the Postal Service incurred $68,742 for facility design and support for 46 sites no longer included in the APC deployment schedule. These costs represent unrecoverable costs for the Postal Service and will be reported as such in our Semiannual Report to Congress. Also, although deployed APCs generally met requirements, they were missing four functional capabilities described in the DAR and the APC development and deployment processes included control weaknesses that exposed the Postal Service to unnecessary risks. Additionally, APC capital investment costs may exceed the approved $95.43 million capital funding level. Finally, the program office generally kept the Board of Governors and senior Postal Service officials timely informed of changes in APC program status via the Investment Highlights reports, but did not disclose a potentially significant operational concept change and that four functional requirements described in the DAR were not included with deployed APCs.

1735 N Lynn St.
Arlington, VA 22209-2020
(703) 248-2100
Fax: (703) 248-2256

Management agreed with our recommendations to develop and document APC requirements, prepare schedules and cost estimates for planned future upgrades not already on contract, complete site security reviews, and ensure contractor employees obtain appropriate security clearances. Additionally, management agreed to coordinate the site selection process for future APCs with all affected stakeholders. Also, management agreed to submit quarterly DAR compliance reports that fully communicate missing APC functionality and operational concept changes and to submit a DAR Modification Request for Board of Governor consideration and approval, if necessary, that identifies additional capital funding requirements. Finally, management agreed to capitalize contractor Customer Acceptance Testing costs; however, they disagreed with our recommendations to capitalize certain other program costs. We consider management's disagreement with recommendations 7, 8, 10, and 11 as unresolved and plan to pursue these issues through the formal audit resolution process. Management's comments and our evaluation of these comments are included in the report.

The OIG considers recommendations 1, 2, 3, 7, 8, 9, 10, 11, 12, and 14 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 follow-up tracking system until the OIG provides written confirmation that the recommendations can be closed.

We appreciate the cooperation and courtesies provided by your staff during the audit. If you have any questions or need additional information, please contact Lorie Siewert, Director, Supply Management and Facilities, or me at (703) 248-2300.

/s/ Colleen A. McAntee

Colleen A. McAntee
Deputy Assistant Inspector General
for Field Operations

Attachment

cc: Richard J. Strasser, Jr.
John A. Rapp
Keith Strange
Janet L. Webster
Steven R. Phelps

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# EXECUTIVE SUMMARY

## Introduction

This report presents the results of our self-initiated audit to determine whether the Postal Service acquired automated postal centers (APCs) that met functional requirements, capital funding levels, and schedule requirements specified in the approved Decision Analysis Report (DAR). Additionally, we determined whether the APC program office kept the Board of Governors and senior Postal Service officials fully and timely informed of program status.

## Results in Brief

As of August 11, 2004, the Postal Service reported it had installed 912 APCs that had collected approximately $11.1 million in revenue and planned to deploy 1,588 more APCs by November 2004. However, the process for selecting APC deployment sites needed improvement since the Postal Service incurred $68,742 for facility design and support for 46 sites no longer included in the APC deployment schedule. These costs represent unrecoverable costs for the Postal Service and will be reported as such in our Semiannual Report to Congress. Also, although deployed APCs generally met requirements, they were unable to print forms for all certified mail classes and return receipts or provide hold mail, track and confirm, and change-of-address services as described in the DAR. In addition, APC development and deployment processes included control weaknesses related to site security reviews and contractor security clearances.

Furthermore, APC capital investment costs may exceed the approved $95.43 million capital funding level because the funding level was estimated before APC program requirements were sufficiently developed to prepare independent cost estimates or allow contractors to submit priced proposals. In addition, the Postal Service classified some program costs as expenses rather than capital investments.

Finally, the program office generally kept the Board of Governors and senior Postal Service officials timely informed of changes in APC program status via the Investment Highlights reports. However, the program office did not disclose that the deployed APCs did not include all functional requirements described in the DAR. In addition, the program office did not report the Postal Service plans to deploy approximately 1,000 of the 2,500 (40 percent) of the APCs to post offices without 24-hour, 7-days-a-week access (a potentially significant operational concept change).

**Summary of Recommendations**

We recommended Postal Service management:

- Develop and document APC requirements and prepare schedules and cost estimates for planned future upgrades not already on contract.
- Complete site security reviews and ensure contractor employees obtain appropriate security clearances.
- Properly classify capital costs and, if necessary, submit a DAR Modification Request for Board of Governor consideration and approval that identifies additional capital funding requirements.
- Coordinate with all affected stakeholders to develop criteria and select deployment sites for all APCs not yet scheduled for deployment and for any future APC acquisitions.
- Submit quarterly DAR compliance reports that fully communicate missing APC functionality and operational concept changes.

**Summary of Management's Comments**

Management agreed to develop and document APC requirements and prepare schedules and cost estimates for planned future upgrades not already on contract. Additionally, management agreed to complete site security reviews and ensure contractor employees obtain appropriate security clearances. Also, management agreed to coordinate the site selection process for future APCs with all affected stakeholders. Furthermore, management agreed to submit quarterly DAR compliance reports that fully communicate missing APC functionality and operational concept changes and to submit a DAR Modification Request for Board of Governor consideration and approval, if necessary, that identifies additional capital funding requirements. Finally, management agreed to capitalize contractor Customer Acceptance Testing costs; however, they disagreed with our recommendations to capitalize certain other program costs. Management's written comments, in their entirety, are included in Appendix B of this report.

Management provided additional information concerning estimated completion dates that has been incorporated into this report.

**Overall Evaluation of Management's Comments**

We consider management's comments responsive to recommendations 1, 2, 3, 4, 5, 6, 9, 12, 13, and 14. However, the Office of Inspector General (OIG) considers management's disagreement with recommendations 7, 8, 10, and 11 not responsive. Specifically, the OIG believes that in accordance with Postal Service policies and regulations, APC program costs associated with contractor program management and project office administration, APC backdrops, printer hardware, and APC collection boxes should be capitalized.

We view disagreements on recommendations 7, 8, 10, and 11 as unresolved and plan to pursue them through the formal audit resolution process.

# INTRODUCTION

## Background

The Postal Service Transformation Plan states, "In today's economy, creating customer value means both improving quality and affordability of products and services and providing the ability to access and use these products and services at times and places that are most convenient to the customer." It further states, "retail and products and services are the main areas of growth in the Postal Service."

On April 1, 2003, to help achieve Transformation Plan strategies, the Postal Service Board of Governors approved a Decision Analysis Report (DAR) authorizing the Postal Service to invest up to $95.43 million for the design, development, and deployment of 2,506 automated postal centers (APCs) by July 2004.

The purpose of the APC program was to provide Postal Service customers convenient and reliable 24-hour, 7-days-a-week automated access to a broad range of Postal Service products, services, and information. This included the ability to weigh letters and packages, purchase appropriate postage, purchase stamps, look up ZIP Codes, and initiate change-of-address actions. The APCs were designed to interface with existing information technology infrastructure, allowing customers to use debit or credit cards to pay for products and services without having to interface with Postal Service personnel.

In March 2003, the Postal Service entered into a contract for the advance design and development of APCs and in November 2003 awarded a contract to develop and deploy APCs nationally. Additionally, the Postal Service awarded major contracts for APC backdrops[1] and collection boxes.[2]

[1] The backdrop contract was for the design, development, construction, delivery, and installation of illuminated backdrop surrounds for the APC machines.
[2] The collection box/mail drop contract was for the purchase of 1,043 stand-alone collection boxes and 1,457 in-wall mail drops (2,500 total) designed to interface with the APC and enable the safe/secure collection of customer mail/parcels after utilizing the APC.


Exhibit A. An APC machine, backdrop, and collection box.

## Objectives, Scope, and Methodology

Our objectives were to determine whether the Postal Service acquired APCs that met functional requirements, capital funding levels, and schedule requirements specified in the approved DAR and to determine whether the program office kept the Board of Governors and senior Postal Service officials fully and timely informed of program status.

To accomplish the audit objectives, we interviewed program office personnel, Capital and Program Evaluation, Finance, personnel, and the assigned headquarters Facilities Coordinator. In addition, we performed limited testing of APC functionality at 13 post offices and stations within the [redacted]. We reviewed the following APC-related documents:

- DAR.
- Solicitations, proposals, and pre-award correspondence.
- Contracts and modifications, including statements of work.
- Test plans and reported results.
- Business impact assessment.
- Security code review.
- Abbreviated application risk assessment.
- Contractor employee security clearance status reports.
- Accounts Payable Accounts Reporting System reports.
- Remedy system problem tickets.
- Site survey and preparation cost reports.
- Deployment schedules.
- DAR compliance reports.
- Quarterly Investment Highlights reports.

Also, we compared APC DAR:

- Functionality requirements to program documents detailing the functionality of the deployed APCs.[3]
- Capital investment funding to contract prices and projected expenditures.
- Schedule requirements to program deployment schedules.

This audit was conducted from March 2004 through December 2004 in accordance with generally accepted government auditing standards and included such tests of internal controls, as were considered necessary under the circumstances. We did not rely on any computer-generated data to support the opinions or conclusions in this report. We discussed our observations and conclusions with appropriate management officials and included their comments where appropriate.

## Prior Audit Coverage

In an April 9, 2004, memorandum to the Chairman, Board of Governors, CA-OT-04-001, Automated Postal Centers, we reported that the Postal Service delayed awarding the APC contract because APC requirements were not developed in sufficient detail to prepare a statement of work at the time the project was approved by the Board of Governors.

Also, in a December 18, 2003, management advisory, DA-MA-04-001, Self Service Platform, we reported that the existing APC prototype met Retail's four objectives of providing customers with convenient access, reducing customer-wait time in line, reducing the cost of selling Postal Service products, and providing easier customer access to premium products. There were, however, three areas of concern including lobby mailbox collection, identification of Express Mail acceptance times, and universal service language options. Postal Service officials agreed with the recommendations contained in the management advisory and we considered their taken or planned actions responsive.

[3] Although we performed limited testing of APC functionality, we did not perform comprehensive tests of APC functionality and data security. The Office of Inspector General (OIG) is planning to perform an APC data security review in fiscal year (FY) 2005.

# AUDIT RESULTS

**Opportunities for Improved APC Program Management**

On April 14, 2004, the APC program office began a phased, nationwide deployment of 2,500 APCs.[4] As of August 11, 2004, the Postal Service reported it had installed 912 APCs that had collected approximately $11.1 million in revenue and planned to complete deployment of the remaining 1,588 APCs by November 2004. However, the Postal Service process for selecting APC deployment sites needed improvement. Although deployed APCs generally met requirements, they were missing four functional capabilities described in the DAR and APC development and deployment processes included control weaknesses that exposed the Postal Service to unnecessary risks.

APC capital investment costs may exceed the approved $95.43 million capital funding level because the funding level was estimated before APC program requirements were sufficiently developed to prepare independent cost estimates or allow contractors to submit priced proposals. In addition, the Postal Service classified some program costs as expenses rather than capital investments.

The program office generally kept the Board of Governors and senior Postal Service officials timely informed of changes in APC program status via the Investment Highlights reports. However, the program office did not disclose that four functional requirements described in the DAR were not included with deployed APCs. In addition, a potentially significant operational concept change was not revealed in the Investment Highlights report.

[4] Six of the 2,506 APCs planned for in the DAR were reserved for testing.

## APCs Provided Most DAR Functional Requirements

APCs generally met DAR functionality requirements. However, deployed APCs were missing four functional requirements described in the DAR.

In addition, APC development and deployment processes included control weaknesses that exposed the Postal Service to unnecessary risks.

### APCs Missing Some Functionality

Deployed APCs were missing some functionality described in the DAR. In April 2004, the Postal Service began installing Release 1.0 APCs that were not capable of printing forms for all certified mail classes and return receipts or providing planned services, to include hold mail, track and confirm, and change-of-address. The Program Manager stated that future APC upgrades (Releases 1.1 and 1.2) would provide all of the functionality described in the DAR. Specifically:

- Release 1.1 should enable previously deployed APCs to print forms for all certified mail classes and return receipt, and, according to the Program Manager, was already included in the contract price. However, the Program Manager did not anticipate implementing Release 1.1 until early 2005.

- Release 1.2 should provide customers hold mail, track and confirm, and change-of-address services. However, the Program Manager stated that Release 1.2 was not included in the contract price and would not be implemented until after Release 1.1.

Although the contract statement of work describes basic APC services that included registering for hold mail, tracking delivery confirmation, and initiating changes-of-address, Postal Service officials stated they shifted some requirements to Releases 1.1 and 1.2 because the contractor could not finish all development efforts and begin deployment in April 2004.[5]

Obtaining fully functional APCs may cost the Postal Service more than currently on contract. Additionally, deploying fully

[5] The deployment start date, as communicated in Investment Highlights reports beginning in September 2003, changed from December 2003 to April 2004.

functional machines that include services such as change-of-address enhances the potential for increased customer satisfaction.

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| **Recommendation** | We recommend the Vice President, Delivery and Retail, direct the APC Program Manager to:<br><br>1. Fully develop and document requirements for planned automated postal center upgrades. |
| **Management's Comments** | Management agreed with the recommendation and stated there is a Change Release process that is used for all planned upgrades. |
| **Evaluation of Management's Comments** | Management's comments are responsive to the recommendation and actions planned should correct the issue identified in the finding.<br><br>Management's comments did not include target completion timeframes; however, subsequent discussions disclosed that requirements planning for Releases 1.1 and 1.2 should be completed in the second quarter of (FY) 2005. |
| **Recommendation** | 2. Prepare development, production, test, and deployment schedules for automated postal center Releases 1.1 and 1.2. |
| **Management's Comments** | Management agreed with the recommendation and stated the Change Release process is being used for Releases 1.1 and 1.2. |
| **Evaluation of Management's Comments** | Management's comments are responsive to the recommendation and actions planned should correct the issue identified in the finding.<br><br>Management's comments did not include target completion timeframes; however, subsequent discussions disclosed that their Change Release processes would culminate with the deployment of Releases 1.1 and 1.2, planned for by the end of the third quarter of FY 2005. |
| **Recommendation** | 3. Develop cost estimates for planned automated postal center releases (specifically, Release 1.2 and any other planned upgrades not yet on contract). This effort should be coordinated with the development contractor and Capital and Program Evaluation (CAPE), Finance. |

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| **Management's Comments** | Management agreed with the recommendation and stated that part of the Change Release process includes obtaining prices from the vendor. They stated they would also include CAPE in the funding review for Release 1.2. |
| **Evaluation of Management's Comments** | Management's comments are responsive to the recommendation and actions planned should correct the issue identified in the finding.<br><br>Management's comments did not include target completion timeframes; however, subsequent discussions disclosed that planned actions would be completed in the second quarter of FY 2005. |
| **Recommendation** | We recommend the Vice President, Delivery and Retail, direct the APC Program Manager to:<br><br>[redacted] |
| **Management's Comments** | [redacted] |
| **Evaluation of Management's Comments** | Although management indicated only partial agreement with the recommendation, their comments are responsive to the recommendation since management actions planned should correct the issue identified in the finding. |
| **Recommendation** | [redacted] |
| **Management's Comments** | [redacted] |

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| **Evaluation of Management's Comments** | Management's comments are responsive to the recommendation and action taken should correct the issue identified in the finding. |
| **Recommendation** | We recommend the Vice President, Delivery and Retail, direct the APC Program Manager to: [redacted] |
| **Management's Comments** | [redacted] |
| **Evaluation of Management's Comments** | Management's comments are responsive to the recommendation and the action planned should correct the issue identified in the finding. |

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| **APC Costs May Exceed Approved Funding** | APC capital investment costs may exceed the approved $95.43 million capital funding level because the funding level was estimated before APC program requirements were sufficiently developed to prepare independent cost estimates or allow contractors to submit priced proposals. Specifically, the Postal Service incurred costs for some items not estimated in the DAR and exceeded certain DAR line item cost estimates. Additionally, the Postal Service classified some program costs as expenses rather than capital investments. If capital investment costs exceed the funding level specified in the DAR, the APC program may not generate the expected return on investment.<br><br>Handbook F-66, General Investment Policies and Procedures, February 2002, paragraph 7-4.4, requires the Program Manager to prepare a DAR Modification Request when total capital funding required exceeds the approved amount. |
| Costs Incurred for Some Items Not Estimated in the DAR | APC contract costs for program management and project office administration, APC backdrops, and support of customer acceptance testing were not included in individual DAR line item estimates.[6] Specifically:<br><br>• Postal Service personnel classified over $5.7 million of APC program management and project office administration contract costs as expenses because portions of these costs were associated with providing general support to the APC program office. Handbook F-66B, Investment Policies and Procedures – Major Equipment, February 2002, paragraph 3-4.1.1, requires nonrecurring expenditures be capitalized, including one-time contract labor. Since program management and project office administration contract costs in support of design, development, production, test, and delivery are nonrecurring, these costs should be capitalized.<br><br>• Postal Service personnel classified the $4.5 million APC backdrop contract costs as expense since the backdrops |

[6] DARs include itemized listings of estimated expenditures (by category) used to calculate projects' return on investment.

were not attached to the APC and did not cost at least $3,000 per unit.[7] However, Handbook F-26, paragraph 215, states, "capital equipment is composed of all component parts required for the equipment to operate as intended when it is acquired." Also, Handbook F-66B, Investment Policies and Procedures – Major Equipment, February 2002, paragraph 3-4.1.1, states that nonrecurring expenditures should be capitalized. APC backdrops inform customers of alternative access to Postal Service products and services to reduce customer waiting time. Since backdrops operate with each deployed APC and their acquisition was nonrecurring, the Postal Service should capitalize these costs.

- Postal Service personnel classified $172,985 of contractor customer acceptance testing support costs as expense. Handbook F-26, Personal Property Accounting, December 1991, paragraph 222, states specific cost elements of capital equipment include charges for testing in preparation for use. Based upon this review, Postal Service personnel reclassified $101,403 of contractor First Article Testing support costs from expense to capital investment. Like contractor First Article Testing support, contractor Customer Acceptance Testing support helped prepare APCs for use; therefore, the Postal Service should capitalize these costs.

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**Certain Costs Exceeded DAR Line Item Estimates**

APC and collection box contract costs exceeded individual DAR line item estimates. Specifically:

- APC development and deployment capital contract costs exceeded DAR lines estimates by approximately $12 million for:
  - Software/hardware design, development, and testing ($1 million).
  - Network infrastructure development ($2.4 million).
  - Hardware ($5.6 million).
  - Training ($0.2 million).
  - Deployment ($2.8 million).

[7] Handbook F-26, Personal Property Accounting, December 1991, paragraph 221(a), states capital equipment must have a unit cost of at least $3,000.

During this review, Postal Service personnel modified the APC development and deployment contract to reclassify approximately $2.1 million of hardware costs as expense. This reclassification could partially alleviate this issue. According to Postal Service personnel, when the contract was signed for $80.1 million, costs were not properly allocated between capital and expense contract line items. Specifically, per the Contracting Officer, the hardware capital line item was incorrectly priced at $41.9 million and did not reflect a $2.1 million concession for APC printers. However, based upon contract line item price notes and vendor correspondence, the $2.1 million was associated with the cost of APC forms printers, and the concession was reflected in expense line items to allow the overall contract price to remain at $80.1 million. As a result, these hardware costs should be capitalized.

- The APC collection box contract cost exceeded the DAR capital line item estimate by approximately $1.5 million. Specifically, the collection box contract amount was approximately $2.9 million; however, the hardware DAR line estimate only included approximately $1.4 million for collection boxes.

  During this review, Postal Service personnel reclassified the collection box costs as expense which could alleviate this issue. Management advised that they initially capitalized the collection boxes because an early APC design concept envisioned them being attached directly to the APCs. Since the final APC design resulted in collection boxes being separate from the APCs and costing less than $3,000 each, management subsequently expensed these costs.

  Handbook F-26, Personal Property Accounting, December 1991, paragraph 215, states "capital equipment is composed of all component parts required for the equipment to operate as intended when it is acquired." Also, Handbook F-66B, Investment Policies and Procedures – Major Equipment, February 2002, paragraph 3-4.1.1, states that nonrecurring expenditures should be capitalized.

The collection box contract prequalification package noted that collection boxes were an integral part of the APC and would interface with it to enable the safe and secure collection of customers' mail. Also, the DAR hardware requirements stated that free-standing or through the wall parcel acceptors will be provided with all machines.

Collection boxes allow the Postal Service to better accomplish its retail objectives of providing customers convenient access to products and services 24-hours-a-day, 7-days-a-week and reducing wait in line time.

Since collection boxes operate with each deployed APC and their cost was nonrecurring, these costs should be capitalized.

**Recommendation**

We recommend the Acting Vice President, Finance, Controller, in coordination with the Vice President, Delivery and Retail:

7. Capitalize contract costs for program management and program office administration.

**Management's Comments**

Management disagreed with our finding and recommendation. They stated contractor program management and project office administration costs were properly classified as expense since the documentation for these items indicates that they are recurring costs. Additionally, they stated contractor costs for delivery and installation are separately listed on the invoice and are correctly categorized as capital.

Also, management noted the report did not fully quote Handbook F-66B, Investment Policies and Procedures – Major Equipment, February 2002, paragraph 3-4.1.1, because it did not include the word "normally," and that indicates that not all one-time contract labor costs are capital.

Furthermore, management stated the sponsor consulted with Corporate Accounting in accordance with procedures and was advised to expense contractor program management and project office administration costs.

Finally, management noted that in accordance with Handbook F-66B, Investment Policies and Procedures – Major Equipment, February 2002, "some one-time costs" may be expensed.[8]

**Evaluation of Management's Comments**

Management's comments are not responsive to the finding and recommendation.

We agree that contractor delivery and installation costs are correctly categorized as capital. However, we disagree with management's statement that contractor program management and project office administration are recurring costs. Although contractor program management and project office administration activities are on-going during the course of the contract and may result in periodic invoices, we continue to contend they are nonrecurring expenditures for the one-time contract labor associated with fulfilling the overall contract requirement to develop and deploy APCs. Therefore, these costs should be capitalized.

Management correctly noted that we did not fully quote Handbook F-66B, Investment Policies and Procedures – Major Equipment, February 2002, paragraph 3-4.1.1. In addition, management correctly noted that Handbook F-66B, Investment Policies and Procedures – Major Equipment, February 2002, states that operating variances are generally recurring costs. However, we disagree with management's reliance upon the words "normally" and "generally" for determining the proper accounting treatment for contractor program management and project office administration costs.

We view the disagreement on recommendation 7 as unresolved and plan to pursue it through the formal audit resolution process.

**Recommendation**

We recommend the Acting Vice President, Finance, Controller, in coordination with the Vice President, Delivery and Retail:

8. Capitalize costs for automated postal center backdrops.

[8] Management's written comments cited Handbook F-66B, Investment Policies and Procedures – Major Equipment, February 2002, Section 4-4.1.2. The correct citation is Section 3-4.1.2.

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| **Management's Comments** | Management disagreed with the finding and recommendation. They stated backdrop costs were properly classified as expense since: (1) their intent is to advertise and promote the APCs, (2) signage will change over time to advertise other postal services, and (3) they are not attached to the APCs or required for them to operate as intended.<br><br>Also, management again noted that the report did not fully quote Handbook F-66B, Investment Policies and Procedures – Major Equipment, February 2002, paragraph 3-4.1.1, because it did not include the word "normally."<br><br>Finally, management stated the sponsor consulted with Corporate Accounting in accordance with procedures and was advised to expense backdrop costs. |
| **Evaluation of Management's Comments** | Management's comments are not responsive to the finding and recommendation.<br><br>We agree that signage displayed on the APC backdrops may change over time and that the backdrops are not attached to the APCs. However, we continue to contend that, in accordance with the objectives of the Decision Analysis Report, backdrops were developed and deployed with each APC to reduce customer waiting time by alerting customers of alternative access to Postal Service products and services. Since their acquisition was nonrecurring, the Postal Service should capitalize the backdrop costs. Finally, if backdrops are not necessary components for APCs to operate as intended, we question management's decision to acquire them at a cost of approximately $4.5 million.<br><br>Management correctly noted that we did not fully quote Handbook F-66B, Investment Policies and Procedures – Major Equipment, February 2002, paragraph 3-4.1.1. However, we disagree with management's reliance upon the word "normally" for determining the proper accounting treatment for APC backdrops. |

We view the disagreement on recommendation 8 as unresolved and plan to pursue it through the formal audit resolution process.

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| **Recommendation** | We recommend the Acting Vice President, Finance, Controller, in coordination with the Vice President, Delivery and Retail:<br><br>9. Capitalize costs for contractor Customer Acceptance Testing. |
| **Management's Comments** | Management agreed with the recommendation and has plans to capitalize costs for contractor customer acceptance testing. |
| **Evaluation of Management's Comments** | Management's comments are responsive to the recommendation and the action planned should correct the issue identified in the finding.<br><br>Management's comments did not include a target completion timeframe; however, subsequent discussions disclosed that their planned action would be completed in the first quarter of FY 2005. |
| **Recommendation** | 10. Capitalize costs for printer hardware. |
| **Management's Comments** | Management disagreed with the finding and recommendation and stated printer hardware costs were properly classified since negotiations to include the printer hardware did not result in an increase in the overall contract price. |
| **Evaluation of Management's Comments** | Management's comments are not responsive to the finding and recommendation.<br><br>We agree that negotiations prior to contract award resulted in the addition of printers at no increase in overall contract price. However, we continue to contend that based upon contract line item price notes and vendor correspondence, $2.1 million is associated with APC forms printers as reflected in the original contract and is not associated with the expense line items where it was subsequently reclassified. Thus, the $2.1 million associated with APC forms printers should be capitalized. |

We view the disagreement on recommendation 10 as unresolved and plan to pursue it through the formal audit resolution process.

**Recommendation**

We recommend the Acting Vice President, Finance, Controller, in coordination with the Vice President, Delivery and Retail:

11. Capitalize costs for automated postal center collection boxes.

**Management's Comments**

Management disagreed with the finding and recommendation and stated collection box costs were properly classified as expense since collection boxes are not an integral part of the APCs and the APCs could function without them. Additionally, management stated that when the design was changed to be separate from the APC units, the collection boxes were changed to an expense investment consistent with policy. Furthermore, management stated some collection boxes are not even located on the same lobby wall as the APCs.

Also, management again noted that the report did not fully quote Handbook F-66B, Investment Policies and Procedures – Major Equipment, February 2002, paragraph 3-4.1.1, because it did not include the word "normally."

Finally, management stated the sponsor consulted with Corporate Accounting in accordance with procedures and was advised to expense collection box costs.

**Evaluation of Management's Comments**

Management's comments are not responsive to the finding and recommendation.

We continue to contend that without APC collection boxes, customers would be required to take their packages with affixed APC-generated postage to window clerks during normal business hours, inhibiting the Postal Service's retail objectives of providing customers convenient access to products and services 24 hours-a-day, 7 days-a-week, and reducing wait in line time. Since APC collection boxes operate with each deployed APC and their acquisition was nonrecurring, the Postal Service should capitalize the collection box costs. Finally, if collection boxes are not necessary components for APCs to operate as intended, we question management's decision to acquire them at a cost of approximately $2.9 million.

Management correctly noted that we did not fully quote Handbook F-66B, Investment Policies and Procedures – Major Equipment, February 2002, paragraph 3-4.1.1. However, we disagree with management's reliance upon the word "normally" for determining the proper accounting treatment for APC collection boxes.

We view the disagreement on recommendation 11 as unresolved and plan to pursue it through the formal audit resolution process.

**Recommendation**

We recommend the Acting Vice President, Finance, Controller, in coordination with the Vice President, Delivery and Retail:

12. Submit a Decision Analysis Report Modification Request, if necessary, for Board of Governor consideration and approval that identifies additional capital funding requirements.

**Management's Comments**

Management agreed with the recommendation and indicated their intent to prepare a Decision Analysis Report Modification Request, if a change to the approved investment funding is necessary.

**Evaluation of Management's Comments**

Management's comments are responsive to the recommendation and action planned should correct the issue identified in the finding.

**APC Deployment Expected Within Revised Schedule**

As of August 11, 2004, the Postal Service reported it had deployed 912 APCs and expected to complete deployment of the remaining 1,588 APCs by November 2004.[9] However, as previously stated, some functional requirements described in the DAR were not included with deployed APCs. In addition, the Postal Service's process for selecting APC deployment sites needed improvement.

APC Site Selection Needed Improvement

The Postal Service process for selecting APC deployment sites needed improvement. The DAR stated, "site selection has been made based on a number of criteria . . . ." However, after the DAR was approved the program office provided headquarters Facilities personnel at least eight different deployment schedules.

According to the Program Manager, initial site selection was limited to Marketing and Retail managers and did not include district personnel. Additionally, the focus of the deployment site selection criteria changed after the original sites were selected. For example, initial deployment sites were selected based upon available space, 24-hour, 7-days-a-week customer access, and walk-in stamp sales revenue. Later in the process, the focus for selection changed to customer wait-time-in-line.

As a result, the Postal Service incurred over $68,700 in unrecoverable facility design and support costs for 46 sites no longer included in the APC deployment schedule (see Appendix A). Although circumstances may necessitate changes to the deployment schedule, proper coordination and planning should reduce the number of schedule changes.

**Recommendation**

We recommend the Vice President, Delivery and Retail, direct the APC Program Manager to:

13. Coordinate with all affected stakeholders to develop criteria and select deployment sites for all automated postal centers not yet scheduled for deployment and for any future automated postal centers acquisitions.

[9] According to the DAR, the Postal Service planned to complete APC deployment by July 2004. However, as communicated in the September 30, 2003, Investment Highlights report, deployment completion changed to November 2004.

| | |
|---|---|
| **Management's Comments** | Management agreed with the recommendation and stated they would coordinate the site selection process for future APCs with all affected stakeholders. Additionally, management stated that the appendix included in the draft audit report incorrectly identified five sites where unrecoverable facility design and support costs were incurred. |
| **Evaluation of Management's Comments** | Management's comments are responsive to the recommendation and action planned should correct the issue identified in the finding.<br><br>Subsequent review of the five sites identified by management disclosed that three sites[10] should not be part of the listing of sites no longer included in the APC deployment schedule. Management agreed and as a result, we revised Appendix A by reducing the number of sites no longer included in the APC deployment schedule from 49 to 46. |

[10] Fairfax, Virginia – Main Office; Worth, Illinois – Main Office; Eugene/Springfield, Oregon – Processing and Distribution Center.

## Changes to APC Program Status Timely Communicated

Generally, the program office kept the Board of Governors and senior Postal Service officials timely informed of changes in APC program status via the quarterly DAR compliance reports, which were reflected in Investment Highlights. Specifically, the September 30, 2003, Investment Highlights report revealed the deployment completion schedule changed to November 2004. Also, the December 31, 2003, Investment Highlights report disclosed possible capital funding concerns regarding underestimated DAR cost projections.

However, the program office did not disclose that four functional requirements described in the DAR were not included with deployed APCs. In addition, a potentially significant operational concept change was not revealed in the Investment Highlights report. Specifically, the DAR stated APCs would "provide customers with convenient access to the postal products and services they most frequently need 24 hours a day, seven days a week." However, Postal Service officials stated the Postal Service plans to deploy approximately 1,000 of the 2,500 (40 percent) of the APCs to post offices without 24 hour, 7-days-a-week access.

Program office personnel stated they had not communicated deployed APCs were missing four functional requirements described in the DAR because the missing functionality would not adversely affect the projected return on investment included in the DAR. Also, program office personnel indicated deploying APCs to post offices without 24-hour, 7-days-a-week access did not conflict with the DAR.

Handbook F-66B, Investment Policies and Procedures – Major Equipment, February 2002, Chapter 6, requires the Program Manager to prepare and submit DAR compliance reports quarterly to fulfill Investment Highlights reporting requirements. The Investment Highlights report provides a single source overview of investment projects approved by the Board of Governors.

Fully informing the Board of Governors and senior Postal Service officials of program status changes helps ensure they have information needed to make sound investment decisions.

The OIG plans to perform a separate review of Postal Service procedures for tracking, monitoring, and reporting the status of major development and acquisition programs to ensure the Board of Governors and senior Postal Service officials are fully informed of the status of major programs.

**Recommendation**

We recommend the Vice President, Delivery and Retail, direct the APC Program Manager to:

14. Submit quarterly Decision Analysis Report compliance reports that fully communicate missing automated postal center functionality and operational concept changes.

**Management's Comments**

Management agreed with the recommendation and stated they would provide information about the four missing functional requirements and clarity regarding locations offering 24 hour, 7-days-a-week access in the quarter IV (September 30, 2004) Investment Highlights report.

**Evaluation of Management's Comments**

Management's comments are responsive to the recommendation and action planned should correct the issues identified in the finding.

# APPENDIX A. SITES NO LONGER INCLUDED IN APC DEPLOYMENT SCHEDULE

**Unrecoverable Cost**:

Costs incurred for facility design and support $68,742

| Count | Area | Unit Name | City | State | Support and Design Costs |
|---|---|---|---|---|---|
| 1 | Capital Metro | Southwest Station | Washington | District of Columbia | $1,037.00 |
| 2 | Capital Metro | Georgetown Station | Washington | District of Columbia | 1,037.00 |
| 3 | Capital Metro | National Capitol Station | Washington | District of Columbia | 1,037.00 |
| 4 | Capital Metro | Ben Franklin Station | Washington | District of Columbia | 1,037.00 |
| 5 | Capital Metro | Main Office | Gaithersburg | Maryland | 1,037.00 |
| 6 | Capital Metro | Riverdale Station | Hampton | Virginia | 1,410.00 |
| 7 | Capital Metro | Main Office | Harrisonburg | Virginia | 1,410.00 |
| 8 | Capital Metro | Monticello Branch | Williamsburg | Virginia | 1,410.00 |
| 9 | Eastern | Main Office | Newark | Delaware | 1,325.79 |
| 10 | Eastern | Oakley Station | Cincinnati | Ohio | 1,315.50 |
| 11 | Eastern | Queen City Station | Cincinnati | Ohio | 1,315.50 |
| 12 | Eastern | German Village Station | Columbus | Ohio | 1,311.00 |
| 13 | Eastern | Mt Vernon Station | Columbus | Ohio | 1,311.00 |
| 14 | Eastern | Main Office | Findlay | Ohio | 1,315.50 |
| 15 | Eastern | Main Office | Warren | Ohio | 1,220.50 |
| 16 | Eastern | Retail Annex | Zanesville | Ohio | 1,311.00 |
| 17 | Eastern | William Penn Annex | Philadelphia | Pennsylvania | 1,325.79 |
| 18 | Great Lakes | Air Mail Facility | Saint Louis | Missouri | 433.62 |
| 19 | New York Metro | Main Office | Babylon | New York | 1,691.28 |
| 20 | Pacific | South Station | Bakersfield | California | 2,191.46 |
| 21 | Pacific | Main Office | Cotati | California | 2,191.46 |
| 22 | Pacific | Main Office | Fallbrook | California | 2,191.46 |

| Count | Area | Unit Name | City | State | Support and Design Costs |
|---|---|---|---|---|---|
| 23 | Pacific | Rowland Heights Branch | La Puente | California | 2,191.46 |
| 24 | Pacific | Belmont Shore Station | Long Beach | California | 2,191.46 |
| 25 | Pacific | Main Office | Los Altos | California | 2,191.46 |
| 26 | Pacific | Main Office | Poway | California | 2,191.46 |
| 27 | Pacific | Alta Loma Branch | Rancho Cucamonga | California | 2,191.46 |
| 28 | Pacific | Main Office | Temecula | California | 2,191.46 |
| 29 | Pacific | Retail | Westminster | California | 2,191.46 |
| 30 | Pacific | Main Office | Pearl City | Hawaii | 2,191.46 |
| 31 | Southeast | Sunset Point Branch | Clearwater | Florida | 1,840.70 |
| 32 | Southeast | North Palm Beach Branch | West Palm Beach | Florida | 2,000.00 |
| 33 | Southeast | Downtown Station | Delray Beach | Florida | 2,000.00 |
| 34 | Southeast | Downtown Station | Lakeland | Florida | 1,840.70 |
| 35 | Southwest | Main Office | Conway | Arkansas | 533.29 |
| 36 | Southwest | Main Office | Jonesboro | Arkansas | 2,198.00 |
| 37 | Southwest | Main Office | Bossier City | Louisiana | 1,416.00 |
| 38 | Southwest | Main Office | West Monroe | Louisiana | 1,416.00 |
| 39 | Southwest | Arsenal Station | San Antonio | Texas | 2,073.54 |
| 40 | Western | Minnetonka Branch | Hopkins | Minnesota | 860.94 |
| 41 | Western | St. Louis Park Branch | Minneapolis | Minnesota | 860.94 |
| 42 | Western | Brooklyn Center Branch | Minneapolis | Minnesota | 860.94 |
| 43 | Western | Diamond Lake Station | Minneapolis | Minnesota | 860.94 |
| 44 | Western | Richfield Branch | Minneapolis | Minnesota | 860.94 |
| 45 | Western | Fridley Branch | Minneapolis | Minnesota | 860.94 |
| 46 | Western | Industrial Station | St. Paul | Minnesota | 860.94 |
| **TOTAL** | | | | | **$68,742.35** |

## NOTES

Costs incurred for facility design and support represent charges for 46 sites no longer on the APC deployment schedule.

***UNRECOVERABLE COST*** - Costs that should not have been incurred and are not recoverable.

# APPENDIX B. MANAGEMENT'S COMMENTS

UNITED STATES
POSTAL SERVICE

September 30, 2004

COLLEEN A. MCANTEE
DEPUTY ASSISTANT INSPECTOR GENERAL
FOR FINANCIAL MANAGEMENT

SUBJECT: Automated Postal Center Program Management
(Report Number CA-AR-04-DRAFT)

The following is provided in response to the above-referenced report.

**Recommendation 1: Fully develop and document requirements for planned automated postal center upgrades.**

Response

We agree. There is a Change Release process for this program, and it is used for all planned upgrades.

**Recommendation 2: Prepare development, production, test, and deployment schedules for automated postal center Releases 1.1 and 1.2.**

Response

We agree. The Change Release process is being used for Releases 1.1 and 1.2.

**Recommendation 3: Develop cost estimates for planned automated postal center releases (specifically, Release 1.2 and any other planned upgrades not yet on contract). This effort should be coordinated with the development contractor and Capital and Program Evaluation (CAPE), Finance.**

Response

We agree. Part of the Change Release process includes obtaining pricing from the vendor. We will ensure CAPE is included in the funding review for Release 1.2 which is covered under capital in the Automated Postal Center (APC) Decision Analysis Report (DAR). All other releases will be covered under expense in the APC DAR.

475 L'Enfant Plaza SW
Washington, DC 20260
www.usps.com

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**Recommendation 4:** [redacted]

Response

[redacted] deployment.

**Recommendation 5:** [redacted]

Response

[redacted]

**Recommendation 6:** [redacted]

Response

[redacted]

**Recommendation 7: Capitalize contract costs for program management and project office administration.**

Response

We disagree. These costs are correctly categorized as expense.

The documentation for these items indicate that the program management/project office administration are recurring costs for overall management of the program and project management to track, control, report and administer the program (as stated in the invoice). These are not one-time costs.

The contractor costs for Delivery and Installation are separately listed on the invoice and are correctly categorized as capital.

In addition, the F-66B, section 3-4.1.1 is inaccurately quoted in the report. The actual statement in the F-66 is as follows: "Normally all one-time (or nonrecurring) expenditures are capitalized for a single project, including one-time contract labor and the initial supply of spare parts. "Please note that this statement from the F-66B begins by stating "normally". This was not included in the draft audit and indicates that not all one-time contract labor costs are capital.

This section closes with the following statement: "For further clarification of capital and expense classifications, refer to the appropriate accounting manuals or verify with the office of Corporate Accounting". This is exactly what the sponsor did and was advised that these costs are an expense.

In addition, section 4-4.1.2 Operating Variances states the following: "Operating variances include any changes from the baseline or current situation (i.e., all incremental costs and savings directly related to the project). Although there may be some one-time costs, operating variances are generally recurring costs (such as recurring spare parts costs)". This clearly states that "some one-time costs" can be an operating variance expense.

**Recommendation 8: Capitalize costs for automated postal center backdrops.**

Response

We disagree. These costs are correctly categorized as an operating expense based on the following:

> The intent of the backdrop is to advertise and promote the APCs. (The DAR included a line item in operating variance for "Advertising and Promotion".)
>
> The signage on the APCs will change over time to advertise or promote other postal services as appropriate.
>
> The backdrop is not attached to the APC and is not required to operate the APC as intended. (The 30 prototype machines operated as intended without the backdrop.)

Again, the F-66B, section 3-4.1.1 is inaccurately quoted by the report and did not include the statement that non-recurring costs are "normally" capitalized. This section closes by advising the reader to consult with Corporate Accounting which is exactly what the sponsor did and was advised that these costs are an expense.

**Recommendation 9: Capitalize costs for Customer Acceptance Testing.**

Response

We agree. The contractor costs associated with the customer acceptance tests will be changed to be classified as capital.

**Recommendation 10: Capitalize costs for printer hardware.**

Response

We disagree. The printer discount does not impact the capital investment.

Supply Chain Management negotiated with the vendor to include the printers without increasing the total contract costs. Since the printers are part of the APC unit, they are correctly categorized as part of the capital costs. The total contract costs did not change by the addition of the printers.

**Recommendation 11: Capitalize costs for automated postal center collection boxes.**

Response

We disagree. The APC collection boxes are correctly categorized as an expense item. They are not an integral part of the APC. The APC could function without the APC boxes. Any collection box would work. The fact that the DAR had "as capital" is not the final reason for the accounting classification. The collection boxes were originally listed as capital since they were envisioned as being part of the APC units. However, when the design was changed to be separate from the APC units, they were changed to expense investment consistent with the policy that collection boxes are an expense. In fact, some of the collection boxes are not even located on the same lobby wall as the APCs.

Again, the F-66B, section 3-4.1.1 is not accurately quoted by excluding that non-recurring costs are "normally" capital. This section closes by advising the reader to consult with Corporate Accounting which is exactly what the sponsor did and was advised that these costs are an expense.

**Recommendation 12: Submit a Decision Analysis Report Modification Request, if necessary, for Board of Governors consideration and approval that identifies additional capital funding requirements.**

Response

We agree. As with any DAR and consistent with the Investment Policies and Procedures, a DAR Modification is required for a proposed change to the approved investment funding contained in a DAR. If necessary, a Decision Analysis Report Modification Request will be prepared and submitted through the DAR review and approval process with final approval by the Board of Governors.

**Recommendation 13: Coordinate with all affected stakeholders to develop criteria and select deployment sites for all automated postal centers not yet scheduled for deployment and for any future automated postal center acquisitions.**

Response

We agree. The site selection process for future APCs will be coordinated with all affected stakeholders.

**Recommendation 14: Submit quarterly Decision Analysis Report compliance reports that fully communicate missing automated postal center functionality and operational concept changes.**

Response

We agree. The Quarter IV Investment Highlights will provide information regarding the status of the four missing functional requirements and will also provide clarity regarding locations offering 24/7 access.

**General:** We have reviewed the information regarding the 49 sites referenced in your memorandum as having costs associated with facility design and support totaling $72,787 in unrecoverable costs. Five of the 49 sites will, in fact, have APCs installed, reducing the amount to $64,360. These sites are:

| | | |
|---|---|---|
| - APC 63 | Fairfax, VA – Main Office | $1,197.80 |
| - APC 456 | Worth, IL – Main Office | $1,056.18 |
| - APC 1301 | Temecula, CA – Main Office | $2,191.46 |
| - APC 2482 | Westminster, CA – Retail | $2,191.46 |
| - APC 2314 | Eugene/Springfield, OR P&DC | $1,790.92 |

We believe the decision not to install at the other 44 sites was appropriate. If these costs are reported in the Semiannual Report to Congress, we recommend you provide it in terms of relative cost of the overall program; i.e., $64,360 of a $92M program represented unrecoverable costs for site surveys and facility design/support.

William P. Galligan
Vice President
Delivery and Retail

Lynn Malcolm
Acting Vice President
Finance, Controller