February 8, 2005

RUDOLPH K. UMSCHEID
VICE PRESIDENT, FACILITIES

LYNN B. MALCOLM
ACTING VICE PRESIDENT, FINANCE, CONTROLLER

SUBJECT: Management Advisory – Post Occupancy Review of the Greensboro, North Carolina, and Columbus, Ohio, Processing and Distribution Centers (Report Number CA-MA-05-001)

This report presents the results of our Post Occupancy Review of the Greensboro, North Carolina, and Columbus, Ohio, Processing and Distribution Centers (P&DC) (Project Number 04XR007CA000). The report responds to a request from the Executive Vice President, Chief Operating Officer, to review certain operating variance elements in the Greensboro, North Carolina, and Columbus, Ohio, Decision Analysis Reports (DAR).

## Results in Brief

Differences between projected and actual building maintenance and custodial workhours and utility costs variances were both favorable and unfavorable. We limited our scope to a comparison of projected and actual variances, and the reasons why those variances occurred. We did not evaluate the significance of the differences.

Opportunities exist to increase the accuracy of DAR projections for start-up costs. Specifically, the methodology for start-up costs did not result in reasonable projections of actual expenses incurred; and adequate documentation did not exist to enable validation of estimated start-up costs for the Greensboro P&DC.

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We recommended Postal Service management review and revise as appropriate, the current process for projecting start-up costs. We also recommended Postal Service management enforce compliance with the existing document retention requirement for new construction projects, and ensure that all new construction project implementations include a process to segregate start-up costs from operating costs.

Management agreed with the recommendations and stated that they will determine the appropriate course of action regarding revising the process for calculating start-up costs once additional facilities of varying sizes are reviewed. Management also stated that the retention criteria and start-up and operating costs must be reemphasized during the facility activation kick-off, which is currently part of the facility activation plan. While management did not provide corrective actions dates, we consider management's comments responsive as the Office of Inspector General (OIG) plans to conduct future reviews of various size facilities, and will make additional recommendations, as appropriate.

Management also commented that the report appeared to indicate that the DARs did not reasonably reflect the actual costs for maintenance. We did not intend to imply that the DARs did not reasonably reflect the actual costs for maintenance. Specifically, we did not evaluate the significance of the differences, and limited our scope to a comparison of projected and actual variances, and the reason why those variances occurred.

Finally, management stated that it would be beneficial to the facility activation process to have a representative from the OIG attend the facility activation kick-off meeting to define and discuss the required post occupancy review documentation. As noted above, the OIG plans to conduct future post occupancy reviews and we will make additional recommendations concerning documentation requirements, as appropriate.

Management's comments, in their entirety, are included in Appendix B of this report.

## Background

Capital new construction projects must be documented with a DAR. The purpose of a DAR is to ensure that investments are properly documented and reviewed. The DAR defines the problem and details the need for the expenditure, providing sufficient detail to enable the approving officials to make an informed decision.

Operating variances are one component of the DAR supporting documentation requirements for major facility projects. Operating variances include any changes from the baseline[1] and must be detailed by type, including start-up costs, custodial maintenance, building maintenance, utilities, labor, rent, transportation, and material handling economic justification.

## Objectives, Scope, and Methodology

The objective of our review was to determine if the justifications and assumptions for certain costs presented in the Greensboro, North Carolina, and Columbus, Ohio, DARs resulted in the expected cost benefits to the Postal Service. We limited our scope to a comparison of:

- Planned start-up costs versus actual start-up costs.
- Building maintenance costs at the prior location versus actual costs at the new location.
- Custodial costs at the prior location versus actual costs at the new location.
- Building utilities costs at the prior location versus actual costs at the new location.

Specifically, we compared the actual start-up costs to the projections contained in the DARs. We compared the prior facilities' building maintenance and custodial workhours and utilities costs to the second 12 months[2] after the acceptance date.

[1] The baseline generally represents the most recent full fiscal year of operating costs and must reflect all existing facilities, automation, material handling, and existing services, including space or environmental deficiencies.
[2] Based on discussion with Postal Service management, the second 12 months was used for comparison because during the first 12 months after acceptance, any maintenance issues were covered under the builder's warranty on the building and thus would not have resulted in any maintenance costs during that period.

To achieve the objectives, we reviewed applicable criteria, and interviewed headquarters personnel as well as personnel at the Greensboro and Columbus P&DCs. We also reviewed DAR supporting documentation, financial reports, Postal Service (PS) Forms 7381, Requisitions for Supplies, Services, and Equipment, utility records, and other documentation as appropriate.

This review was conducted from July 2004 through February 2005 in accordance with the President's Council on Integrity and Efficiency, Quality Standards for Inspections. We discussed our observations and conclusions with appropriate management officials and included their comments, where appropriate.

We obtained computer-processed data from WebEIS to determine labor costs and workhours charged to start-up costs. We also obtained computer-processed data from the Postal Service Corporate Database and the Financial Data Mart for utility costs and building maintenance and custodial services. However, we did not establish the reliability of this data due to the limited scope of this review. Nothing came to our attention to suggest data used was unreliable.

## Prior Audit Coverage

We did not identify any prior audits or reviews related to the objective of this review.

**Differences Between Actual and Projected Workhour and Cost Variances Both Favorable and Unfavorable**

Differences between projected and actual building maintenance and custodial workhours and utility costs variances are both favorable and unfavorable. We limited our scope to a comparison of projected and actual variances, and the reason why those variances occurred. We did not evaluate the significance of the differences. Additionally, opportunities exist to increase the accuracy of DAR projections for start-up costs.

The documentation in the DAR is intended to provide sufficient detail to enable the approving officials to make an informed decision about the proposed investment. However, if the DAR does not present realistic data, the Postal Service could commit unnecessary funds for new construction that could be put to other uses, and/or also incur interest costs for borrowed funds that were not needed.

Actual and Projected Differences

Actual and projected variances for building maintenance and custodial workhours and utility costs for the Greensboro, North Carolina, and Columbus, Ohio, P&DCs are shown in Appendix A of this report.

The Postal Service calculated projected variances for maintenance and custodial workhours based on planned and authorized position requirements provided by local Maintenance Managers for the new facility. However, not all of these requirements were actually filled at the new facilities. As a result, for the Greensboro P&DC project, projected variances for maintenance and custodial workhours exceeded actual variances by 24.9 and 47.2 percent, respectively. For the Columbus P&DC project, the projected maintenance workhours variance exceeded the actual variance by 9.4 percent but the projected custodial workhours variance was 1.1 percent less than the actual variance.

Postal Service management advised that DAR baseline utility costs that are used to calculate the projected variance represent the most recent complete prior fiscal year, escalated to the estimated occupancy date. Therefore, depending on the actual occupancy date, the baseline may be skewed. Postal Service management also advised that the projected DAR utility cost variance did not consider increased energy costs associated with new material handling systems (Tray Management System) that were placed in the new facility but did not exist in the prior facility. Considering these factors may result in a projected variance that more closely reflects the actual variance achieved.

On September 9, 2004, Postal Service management advised us that the Tray Management System is no longer placed in new construction buildings.

The differences between projected and actual variances were both favorable and unfavorable. The OIG plans to perform additional post-occupancy reviews to provide management with a more comprehensive evaluation of the reasonableness of DAR projections, considering various facility sizes, locations, and other relevant factors. Therefore, no recommendations are made at this time.

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Opportunity to Increase the Accuracy of DAR Start-up Cost Projections

Opportunities exist to increase the accuracy of DAR projections for start-up costs.[3] Specifically, the methodology for projecting start-up costs for the two P&DCs did not result in reasonable projections of actual expenses incurred, and adequate documentation did not exist to enable validation of estimated start-up costs for the Greensboro P&DC.

As a result, DAR projections for start-up costs at the Columbus and Greensboro facilities did not accurately predict actual expenses incurred. At Columbus, DAR projected start-up costs were $10.8 million while actual start-up costs were $7.6 million. At Greensboro, DAR projected start-up costs were $6.1 million while actual start-up costs were $3.3 million.[4]

[3] Start-up costs include adapting to the Postal Service environment, moving, training, normal disruption, salary for the Activation Coordinator, and one-time expense purchases.
[4] We were not able to validate all start-up costs in Greensboro due to a lack of supporting documentation available for those costs. However, we believe that the estimated amounts for start-up costs are a conservative measure of the actual expenditures.

The Postal Service calculated projected start-up costs based on the application of a fixed rate applied to total square footage. At the time the two P&DCs were planned, start-up costs were calculated based on planned square footage multiplied by $6.50. The results were then escalated at 5.5 percent[5] for each year after 1990 to the last year of investment and the first operating year (fiscal years 2000 and 2001).[6] This methodology resulted in start-up cost projections that exceeded actual start-up costs for the Columbus and Greensboro P&DC projects by about 29.6 and 49.1 percent respectively. Therefore, opportunities exist to improve the current process for projecting start-up costs that more closely reflect actual expenses incurred.

Regarding validation of start-up costs at the Greensboro facility, we were unable to segregate all start-up costs at the new facility from operating costs at the old facility. Postal Service management at the facility advised us that they had experienced significant turnover, and therefore some documents were either lost or destroyed. Additionally, the retention requirement for PS Forms 7381, Requisition for Supplies, Services or Equipment, is a maximum of two years.[7] Furthermore, start-up costs for the new Greensboro facility were included in the same finance number as operating costs for the prior facility.

Handbook F-66, General Investment Policies & Procedures, states that all major investment project implementations should be accompanied by a system that tracks current and after deployment performance and provides data for the cost study or audit. Additionally, it requires that all records showing complement, workhours, mail volumes, productivities, and expenses, regardless of the retention life cycle, be retained in one location from the time of project approval until the conclusion of the cost study or audit, which may be several years after move-in or final deployment. Therefore, although general retention requirements for PS Forms 7381 exist, Postal Service

[5]Escalation factors are established by the Vice President, Finance, Controller.
[6]Management Instruction AS-510-90-12, New Facility Start-up Costs for DAR Cash Flow, dated November 20, 1990.
[7]PS Form 7381 was used to document all requests for items necessary to construct and occupy the new P&DCs.

personnel should have had a system to track start-up costs and should have retained all documentation in the file.

In a meeting on August 25, 2004, management advised that the current process is to purchase all items needed for new construction through eBuy, a Web-based ordering system, instead of hardcopy PS Form 7381. The retention requirements stated in Handbook F-66 also apply to electronic information so the electronic ordering information for new construction projects should be maintained with the file until the cost study or audit is completed.

Management at the Columbus P&DC obtained a unique finance number to segregate start-up costs at the new facility from operating costs at the old facility. Segregating start-up costs enabled visibility to actual cost information that could be used to improve the accuracy of future investment projections.

**Recommendation**

We recommend the Vice President, Facilities, in coordination with the Acting Vice President, Finance, Controller**:**

1. Review, and revise as appropriate, the current process for projecting start-up costs to produce a more precise estimate for future new construction projects.

**Management's Comments**

Management agreed with the recommendation, and stated that they will determine the appropriate course of action regarding revising the process for calculating start-up costs once additional facilities of varying sizes are reviewed. Management also commented that the review did not provide an account of start-up by category, and that it would be useful to have equipment and material handling start-up costs separated from the other start up costs.

**Evaluation of Management's Comments**

Management's comments are responsive to the recommendation and actions planned should correct the issue identified in the finding. Although management did not provide specific dates for corrective action, we plan to conduct additional reviews of various size facilities in the future, and will make additional recommendations, as appropriate.

Also, we recognize the usefulness of the separation of start-up costs to management and plan to include an analysis of start-up costs by categories in future post occupancy reviews

**Recommendations**

We recommend the Vice President, Facilities:

2. Enforce compliance with existing retention criteria for supporting documentation associated with new construction projects.

3. Ensure that all new construction project implementations include a system that tracks current and after-deployment performance, to include a process to segregate start-up costs from operating costs.

**Management's Comments**

Management agreed with the recommendations, and stated that the retention criteria and start up, and operating costs are defined during the facility activation process, and these elements must be reemphasized during the facility activation kick-off. Management stated that this is currently part of the facility activation plan.

**Evaluation of Management's Comments**

Management's comments are responsive to the recommendations and the actions planned should correct the issues identified in the finding. Although management's comments did not provide specific dates for corrective action, they agreed that compliance with the existing retention criteria would be reemphasized during facility activation kick-off meetings.

We appreciate the cooperation and courtesies provided by your staff during the review. If you have any questions, or need additional information, please contact Janet Sorensen, Audit Manager, Facilities, or me at (703) 248-2300.

/s/ Colleen A. McAntee

Colleen A. McAntee
Deputy Assistant Inspector General
for Field Operations

Attachments

cc: Patrick R. Donahoe
Alexander Lazaroff
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# APPENDIX A
# ACTUAL AND PROJECTED DIFFERENCES

| Category | Prior Building Actual | Planned Post Occupancy Amount | Planned Variance* | Actual Post Occupancy Amount | Actual Variance** | Difference Between Actual and Planned Variance | Percentage Difference Between Actual and Planned Variance*** | Percentage Difference From Planned Hours/Dollars**** |
|---|---|---|---|---|---|---|---|---|
| Greensboro Building Maintenance Workhours | 38,000 | 46,965 | 8,965[8] | 44,734 | 6,734 | -2,231 | -24.9% | -4.8% |
| Greensboro Custodial Workhours | 60,267 | 80,303 | 20,036 | 70,855 | 10,588 | -9,448 | -47.2% | -11.8% |
| Greensboro Utility Costs | $545,273 | $768,002 | $222,729 | $847,803 | $302,530 | $79,801 | 35.8% | 10.4% |
| Columbus Building Maintenance Workhours | 65,165 | 82,908 | 17,743 | 81,234 | 16,069 | -1674 | -9.4% | -2.0% |
| Columbus Custodial Workhours | 111,181 | 148,196 | 37,015 | 148,589 | 37,408 | 393 | 1.1% | 0.3% |
| Columbus Utility Costs | $1,073,799 | $1,616,738 | $542,939 | $1,761,830 | $688,031 | $145,092 | 26.7% | 9.0% |

*Planned Post Occupancy Amount less Prior Building Actual.
**Actual Post Occupancy Amount less Prior Building Actual.
***Actual Variance less Planned Variance divided by Planned Variance.
****Difference between Actual and Planned Variance divided by Planned Post Occupancy Amount.

[8] The projected variance shown in the DAR was 4,235 and was based on a calculation that included input errors. We calculated the variance shown in the table by correcting the input errors.

# APPENDIX B. MANAGEMENT'S COMMENTS

UNITED STATES
POSTAL SERVICE

January 19, 2005

COLLEEN A. MCANTEE
DEPUTY ASSISTANT INSPECTOR GENERAL FOR FIELD OPERATIONS

SUBJECT: Draft Occupancy Review of the Greensboro, North Carolina, and Columbus, Ohio, Processing and Distribution Centers (CA-MA-05-DRAFT)

We have revised the management response that was previously provided to recommendation number 3. Please use this letter as the official response to all three recommendations, and discard the original response letter dated December 20, 2004.

1. Review, and revise as appropriate, the current process for projecting start-up costs to produce more precise estimates for future new construction projects.

__Management Response__: Management agrees with this recommendation to review and revise, as appropriate. While the review does disclose the potential for revising the process for calculating start-up, additional facilities of varying sizes will need to be reviewed for management to determine the correct course of action.

Additionally, the findings of the review do not provide an account of start-up by category. The start-up categories include the factor method using the proposed square footage, equipment relocation, and material handling (MH). Specifically, included in the Columbus start-up cost of $10.8M was an allocation of $1.7M for relocation of equipment and MH. It would be useful to have equipment and MH start-up separated out from the other start-up costs so that a comparison could be made by category; start-up factor, equipment relocation, and MH. Having this additional information would provide a more accurate account of start-up by category which would provide the necessary information from which to make revisions to the overall start-up costs, by category, for a new facility.

2. Enforce compliance with the existing retention criteria for supporting documentation associated with new construction projects.

__Management Response__: Management agrees with this recommendation. The retention criteria are defined in the facility activation process. This is a function of Headquarters Finance, Capital and Program Evaluation, and Headquarters Operations. This must be reemphasized during the facility activation kick-off. This is a part of the current facility activation plan and should already be in place.

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3. Ensure that all new construction project implementations include a system that tracks current and after-deployment performance to include a process to segregate start-up costs from operating costs.

**Management Response**: Management agrees with this recommendation. Both start-up cost and operating costs are defined in the facility activation process and the Decision Analysis Compliance reporting. This is a function of Headquarters Finance, Capital and Program Evaluation, and Headquarters Operations. This must be reemphasized during the facility activation kick-off. This is a part of the current facility activation plan and should already be in place.

**General Comments:**

- Under background page 2 - Operating variances should also include labor, rent, and transportation.
- The report seems to indicate that the Decision Analysis Reports did not reasonably reflect the actual costs for maintenance. When developing operating variances, and in particular maintenance, the Decision Analysis Report System (DARS) program compares two analyses; the factor method, and the estimate provided by the local office. The DARS program then uses the higher cost of those two analyses (conservative approach). This approach, while conservative, may result in overstating the estimated operating variance for maintenance.
- It would be a benefit to the facility activation process, and in particular to the facility activation teams, to have a representative from the OIG attend the facility activation kick-off meeting. At this meeting the items that will be required for the post occupancy review can be defined and discussed to ensure that the required documentation is available when the review takes place.

In conclusion, we appreciate the effort of the OIG audit team in the review of the Columbus and Greensboro facility projects and look forward to similar audit reviews during the course of our major facility construction program.

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Vice President, Facilities

Lynn Malcolm
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