



March 20, 2009

ANTHONY M. PAJUNAS  
VICE PRESIDENT, NETWORK OPERATIONS

SUBJECT: Management Advisory Report – Time-Definite Surface Network Risk  
Mitigation (Report Number EN-MA-09-001)

This report presents the results of our review of Time-Definite Surface Network Risk Mitigation (Project Number 08XG045EN000) and responds to a request from the Vice President, Network Operations. Our objectives were to determine what actions management took to mitigate previously identified concerns and risks associated with bulk mail center (BMC) outsourcing and whether there are any additional concerns and risks associated with the current Time-Definite Surface Network (TDSN) strategy. This review addresses strategic, financial, and operational risks. [Appendix A](#) presents additional information about this audit.

### **Assessment of Risk Mitigation Strategies**

Management requested the U.S. Postal Service Office of Inspector General (OIG) to review the status of risks and concerns identified in a previous OIG report.<sup>1</sup> We determined that the concept of contracting out BMC operations may have merit; however, various risks and concerns remain for management to address. Our review identified 12 risks associated with the U.S. Postal Service's BMC outsourcing initiative. We considered three risks critical<sup>2</sup> to the success of this initiative: political risk, cost factor analysis, and capacity of the contractor. Table 1 shows the risks, status of each risk, and those risks we consider critical to the success of this initiative.

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<sup>1</sup> *Bulk Mail Center Outsourcing* (Report Number EN-WP-07-001, dated April 25, 2007).

<sup>2</sup> We define critical risks as highly significant. If the Postal Service does not adequately address the risks, each could negatively affect the outcome of this initiative.

**Table 1. Status of Identified Risks**

<b>Risk</b>	<b>Status</b>	<b>Critical</b>
Political	Newly Identified Risk	√
Cost Factor Analysis	Not Addressed	√
Most Efficient Internal Operation (MEIO) Analysis	Not Addressed	
Aggressive Implementation Date	Addressed	
Capacity of the Contractor	Addressed - OIG Concerns Remain	√
Scope of Outsourcing Effort	Addressed - OIG Concerns Remain	
Revenue at Risk	Addressed - OIG Concerns Remain	
Untested Decontainerization <sup>3</sup> Efficiencies	Partially Addressed	
Stakeholder Interest (Communications)	Partially Addressed	
Internal Control and Quality Assurance	Newly Identified Risk	
Contractor Conflict of Interest or Misconduct	Newly Identified Risk	
Contingency Planning	Newly Identified Risk	

We recognize that management may address some of these issues as the initiative progresses. Although it may be difficult for management to successfully mitigate all of the identified risks, we believe they should be attentive to them and to our concerns as they proceed with this initiative. See [Appendix B](#) for our detailed analysis of this topic.

We recommend the Vice President, Network Operations:

1. Develop a written plan to address risks and concerns prior to moving forward with the Time-Definite Surface Network initiative.

### **Management's Comments**

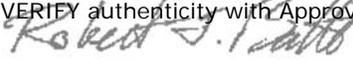
Management explained they are no longer pursuing the outsourcing of BMC work at this time. Instead of outsourcing, management will reengineer product flows through their current infrastructure. Testing of the concept will begin in the spring of 2009. Management agreed to take steps to mitigate those risks identified that are relevant to the new direction. See [Appendix C](#) for management's comments, in their entirety.

### **Evaluation of Management's Comments**

The OIG considers management's comments responsive to the recommendation and corrective actions should resolve the issues identified in the report.

<sup>3</sup> Mail is unloaded from large standardized containers and floor loaded into trailers.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Michael A. Magalski, Director, Network Optimization, or me at (703) 248-2100.

E-Signed by Robert Batta   
VERIFY authenticity with ApproveIt  


Robert J. Batta  
Deputy Assistant Inspector General  
for Mission Operations

Attachment

cc: Patrick R. Donahoe  
William P. Galligan, Jr.  
Katherine S. Banks

## APPENDIX A: ADDITIONAL INFORMATION

### BACKGROUND

The Postal Service's strategic objectives state that it is committed to improving its operational efficiency by consolidating mail processing operations. The agency's *2006-2010 Strategic Transformation Plan* includes efforts to create a flexible network to increase productivity and effectiveness. In addition, the President's Commission found the Postal Service had more facilities than needed and recommended optimizing the network by closing and consolidating unneeded processing centers. Further, the Postal Act of 2006 required the Postal Service to provide a strategy for rationalizing the facilities network and removing excess processing capacity and space from the network.

The Postal Service operates 21 BMCs to support mail distribution and transportation for surface parcel products, catalogs, and advertising mail. The BMC network relies heavily on containerized dispatches. In February 2007, the Postal Service developed a proposal to outsource BMC operations. This proposal sought to implement industry best practices for floor-loading trailers, reduce costs, and improve service. Management issued a draft request for proposal in July 2008. During our review, management was evaluating alternatives to leverage industry best practices within the BMC network and plans to test various network concepts in mid-2009.

### OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of this review were to:

- Determine what actions management took to mitigate previously identified concerns and potential risks associated with BMC outsourcing.
- Determine whether there are any additional concerns and potential risks associated with the TDSN strategy.

To accomplish our objectives, we reviewed:

- Concerns and risks previously identified.
- The revised comparative analysis, the draft request for proposal, and other related documents.
- Government Accountability Office and OIG reports regarding outsourcing.

In addition, we:

- Interviewed Postal Service managers.
- Determined additional risks and concerns related to this initiative.
- Rated the impact and vulnerability of each risk as high, medium, or low based on our audit experience and judgment.

We conducted this review from September 2008 through March 2009 in accordance with the President's Council on Integrity and Efficiency, *Quality Standards for Inspections*. We discussed our observations and conclusions with management on January 21, 2009, and included their comments where appropriate.

### PRIOR AUDIT COVERAGE

Report Title	Report Number	Final Report Date	Report Results
<i>Miami AMC Outsourcing</i>	EN-AR-08-004	July 16, 2008	The Postal Service outsourced some operations at the Miami Airport Mail Center (AMC) and reduced costs with minimal service performance impact. Management generally complied with existing policies and procedures and agreed with the recommendation to conduct a post-implementation review (PIR) after outsourcing the Miami AMC to determine whether the outsourcing was cost-effective.
<i>St. Louis AMC Outsourcing</i>	EN-AR-08-002	February 29, 2008	The Postal Service's decision to outsource some St. Louis AMC operations should reduce costs with minimal impact on service performance. However, management did not develop guidance for measuring results. Management agreed to establish an AMC PIR program and conduct a PIR for the St. Louis AMC.
<i>Bulk Mail Center Outsourcing</i>	EN-WP-07-001	April 25, 2007	This memorandum identified 10 concerns and risks associated with the Postal Service's plan to outsource the processing and distribution operations of the BMC network. The concept of contracting out these operations could have merit and may result in significant savings for the Postal Service. The OIG recommended the Postal Service initiate a rigorous risk management approach as part of the BMC outsourcing effort.

**APPENDIX B: DETAILED ANALYSIS**

**Risks Identified in Prior OIG Reports and Newly Identified Risks**

**Risk Name**

Political Risks

**Risk Description**

Ability to effectively convince legislators of the necessity for specific network realignment strategies and operational efficiency initiatives, including transformation of the BMC network.

**Risk Assessment Summary**

<b>Impact (High – Critical)</b>	<b>Vulnerability (High)</b>
<ul style="list-style-type: none"> <li>Failure to convince and work effectively with Congress and the Postal Regulatory Commission (PRC) could result in undesirable legislation and/or regulatory constraints that could be harmful to the network realignment strategies and operational efficiency.</li> </ul>	<ul style="list-style-type: none"> <li>Resistance to Postal Service efforts.</li> </ul>

**Current Postal Service Risk Mitigation Strategies**

- Proactively communicating with legislators and other major stakeholders.
- Responding to congressional inquiries regarding outsourcing efforts.

**OIG Assessment of Postal Service Risk Mitigation Strategy Progress**

<b>Not Addressed</b>
<ul style="list-style-type: none"> <li>It is imperative that the Postal Service work with key legislators and the PRC to enhance their understanding of the necessity for specific realignment strategies.</li> </ul>

**Risk Name**

Cost Factor Analysis (Business Case/Plan)<sup>4</sup>

**Risk Description**

Consider all cost factors affecting projected cost savings, including transitioning of affected employees, costs associated with transformation of the BMC facilities for future use, and costs associated with revising ground transportation contracts for current BMC transportation routes.

**Risk Assessment Summary**

<b>Impact (High – Critical)</b>	<b>Vulnerability (Medium)</b>
<ul style="list-style-type: none"> <li>Inadequate data may distort results of analysis, possibly leading to incorrect decisions.</li> </ul>	<ul style="list-style-type: none"> <li>Without adequate data, the potential for making a flawed decision increases substantially.</li> </ul>

**Current Postal Service Risk Mitigation Strategies**

- Management indicated it would refine the business case as the initiative progresses.
- The business case will take into account costs to transition employees and transform BMC facilities.
- Transportation
  - Most headquarters-funded and some area-funded transportation contracts contain a 60-day termination clause without payment of any indemnity.
  - The Postal Service should be able to avoid most indemnity costs by timing cancellation of transportation contracts with the TDSN contract ramp-up to minimize indemnity costs.

**OIG Assessment of Postal Service Risk Mitigation Strategy Progress**

<b>Not Addressed</b>
<ul style="list-style-type: none"> <li>Management has not fully developed a business case.</li> <li>Management has provided insufficient documentation to substantiate that indemnity costs would be minimal. But, if management has been diligent when renewing or establishing new transportation contracts, indemnity costs should be minimal as this initiative has been in progress for at least 1.5 years.</li> </ul>

<sup>4</sup> A business case is a structured proposal for Postal Service business process improvement that functions as a decision package for its leadership.

**Risk Name**

Most Efficient Internal Operation Analysis

**Risk Description**

Baseline for comparing an in-house operation with an outsourcing proposal includes the requirement to identify the expected performance of a redesigned operation.

**Risk Assessment Summary**

Impact <i>(High)</i>	Vulnerability <i>(High)</i>
<ul style="list-style-type: none"> <li>Inadequate data for the MEIO may lead to incorrect decisions.</li> </ul>	<ul style="list-style-type: none"> <li>Significantly increases the risk of not selecting the best option between in-house work and outsourcing.</li> </ul>

**Current Postal Service Risk Mitigation Strategies**

- Developed a draft comparative analysis which includes the MEIO.
- Considering opportunities to improve operational efficiencies, such as workhour and facility reductions, through a new attempt to model the BMC network.
- Expected improvements from implementing industry best practices would result in a reduced number of trailers, thus reduced transportation costs.

**OIG Assessment of Postal Service Risk Mitigation Strategy Progress**

Not Addressed
<ul style="list-style-type: none"> <li>Management has provided insufficient documentation to support analysis of workhour and facility reductions.</li> <li>Management has provided insufficient documentation to support improvements expected from implementing industry best practices.</li> <li>Management has not completed an MEIO.</li> </ul>

**Risk Name**

Aggressive Implementation Date

**Risk Description**

Implementation date appeared very optimistic and poorly timed.

**Risk Assessment Summary**

Impact ( <i>Medium</i> )	Vulnerability ( <i>Medium</i> )
<ul style="list-style-type: none"> <li>• Mail may be delayed.</li> <li>• Postal Service brand may be adversely impacted.</li> </ul>	<ul style="list-style-type: none"> <li>• Contractor may have difficulty processing mail while establishing facilities during peak seasons or short implementation periods.</li> </ul>

**Current Postal Service Risk Mitigation Strategies**

- Revised the implementation to start after peak mailing season.
- Revised the request for proposal to state the entire network must be operational within the first 18 months of the contract. Includes a gradual implementation of facilities throughout the 18-month period.

**OIG Assessment of Postal Service Risk Mitigation Strategy Progress**

Addressed
<ul style="list-style-type: none"> <li>• An 18-month implementation period beginning after peak mailing season should mitigate risks associated with the implementation date.</li> </ul>

**Risk Name**

Capacity of the Contractor

**Risk Description**

This outsourcing effort is very large and, as a result, the number of contractors with the capacity to handle such an effort is limited.

**Risk Assessment Summary**

Impact <i>(High – Critical)</i>	Vulnerability <i>(High)</i>
<ul style="list-style-type: none"> <li>Contractor may not be able to cost effectively handle mail volumes during peak mailing seasons and/or consistently meet required service standards.</li> <li>Postal Service brand may be adversely impacted.</li> </ul>	<ul style="list-style-type: none"> <li>Contractor’s own business volumes may increase at the same time the contractor needs to process and transport increased Postal Service volumes.</li> </ul>

**Current Postal Service Risk Mitigation Strategies**

- Contractor is required to provide details about its processing operations including how mail will be distributed, throughput of the equipment, machine productivity, missort rates, downtime percentages and run times.
- Contractor must provide its available capacity and how it will process its own product and postal volume during regular and peak seasons.
- Contractor is also required to conduct a 3-day acceptance test, which tests the complete process with average daily volume for that facility.

**OIG Assessment of Postal Service Risk Mitigation Strategy Progress**

Addressed – OIG Concerns Remain
<ul style="list-style-type: none"> <li>If the Postal Service selects a contractor whose capabilities it has critically assessed, capacity of the contractor may not be an issue.</li> <li>Challenges remain during peak periods.</li> </ul>

**Risk Name**

Scope of Outsourcing Effort

**Risk Description**

Implementing major initiatives using an incremental approach may be warranted in an uncertain environment.

**Risk Assessment Summary**

Impact <i>(High)</i>	Vulnerability <i>(High)</i>
<ul style="list-style-type: none"> <li>Not testing BMC outsourcing initiative in a controlled environment at a reduced number of facilities could increase risk of failure.</li> </ul>	<ul style="list-style-type: none"> <li>Postal Service has not managed a contract of this magnitude before.</li> <li>Contractors may not be able to provide required services within projected costs, which could affect service performance.</li> </ul>

**Current Postal Service Risk Mitigation Strategies**

- Considered outsourcing only a portion of the network, but believes this would result in diseconomies of scale.
- Using both contractor and Postal Service facilities could result in network redundancies and increase transportation and overall network operating costs.
- A phased approach could disrupt plans to use BMC facilities for Flats Sequencing System machines and other operations.

**OIG Assessment of Postal Service Risk Mitigation Strategy Progress**

Addressed – OIG Concerns Remain
<ul style="list-style-type: none"> <li>Although the Postal Service has considered the risks, we believe testing the BMC outsourcing initiative through a pilot program with a reduced number of facilities could further mitigate risks.</li> <li>Management should evaluate its ability to monitor and manage the contractor.</li> </ul>

**Risk Name**

Revenue at Risk

**Risk Description**

Revenue at risk due to large dollar exposure in this initiative.

**Risk Assessment Summary**

Impact <i>(High)</i>	Vulnerability <i>(High)</i>
<ul style="list-style-type: none"> <li>Potential loss of revenue.</li> </ul>	<ul style="list-style-type: none"> <li>Contractor’s system for measuring mail processed and revenue due will be critical to ensuring accurate revenue realization.</li> </ul>

**Current Postal Service Risk Mitigation Strategies**

- Contractor is required to achieve 95 percent service performance (Postal Service’s performance is currently at 60 percent for some classes of mail).
- The Postal Service will use scan data to monitor performance and compensate contractor. Using scans to compensate contractor is an incentive to ensure mail is scanned.
- The Postal Service has implemented disincentives for late deliveries.
- Postal Service employees will monitor contractor application of bar codes on mail without bar codes.

**OIG Assessment of Postal Service Risk Mitigation Strategy Progress**

Addressed – OIG Concerns Remain
<ul style="list-style-type: none"> <li>Large dollar exposure, although initiative does provide increased flexibility by reducing fixed costs and potentially increases service.</li> </ul>

**Risk Name**

Untested Decontainerization Efficiencies

**Risk Description**

Ability to floor load<sup>5</sup> and reduce the number of trailers to improve efficiency and reduce costs.

**Risk Assessment Summary**

Impact ( <i>Medium</i> )	Vulnerability ( <i>Medium</i> )
<ul style="list-style-type: none"> <li>Efficiency may not improve and costs may not decrease if additional workhours are required to decontainerize and recontainerize the mail.</li> <li>Without an adequate floor loading analysis, there may be inaccurate savings assumptions.</li> <li>Without adequate supporting documentation, the Postal Service may be vulnerable to criticism from unions, mailers, and other stakeholders</li> </ul>	<ul style="list-style-type: none"> <li>Without adequate data, the potential for making a flawed decision increases substantially.</li> </ul>

**Current Postal Service Risk Mitigation Strategies**

- Management has already factored additional workhours into the comparative analysis.
- Employees would only floor load inter-BMC transportation.
- Floor loading is a proven technique – a common practice in the transportation industry.
- Floor loading pilot test showed favorable results.

**OIG Assessment of Postal Service Risk Mitigation Strategy Progress**

Partially Addressed
<ul style="list-style-type: none"> <li>Management provided insufficient data. Specifically, management provided an explanation of methodology but did not provide data to support assumptions for the efficiency gains projected from decontainerizing mail, floor loading, and then recontainerizing mail to reduce the number of transportation trips.</li> </ul>

<sup>5</sup> Using a brick-laying or T-stacking technique for loading individual handling units into trailers. Floor loading uses every available cubic foot by loading the trailer from floor to ceiling and from back to front. This method results in the most efficient trailer use and reduces the number of trailer equivalents required to transport a given amount of mail.

**Risk Name**

Stakeholder Interest (Communications)

**Risk Description**

Ensure interests of impacted stakeholders are clearly identified and changes impacting them are effectively communicated.

**Risk Assessment Summary**

<b>Impact (High)</b>	<b>Vulnerability (High)</b>
<ul style="list-style-type: none"> <li>Providing stakeholders with late or inadequate notice of significant changes increases the risk that pressure from them could disrupt the Postal Service’s efforts.</li> </ul>	<ul style="list-style-type: none"> <li>Stakeholders have applied pressure in previous efforts to optimize the mail processing network, which has resulted in cancellation or postponement of those efforts.</li> </ul>

**Current Postal Service Risk Mitigation Strategies**

- Management has corresponded with Congress on the initiative and will brief them when the Postal Service makes a final decision on the initiative.
- Management will brief mailers once they understand the design of the contractor’s network.
- Management has provided unions with a copy of the draft comparative analysis<sup>6</sup> and briefed them.

**OIG Assessment of Postal Service Risk Mitigation Strategy Progress**

<b>Partially Addressed</b>
<ul style="list-style-type: none"> <li>Stakeholder communications have been limited, and some concerns have not been addressed timely.</li> <li>Management has provided insufficient documentation to indicate they have considered employees’ and mailers’ interests adequately.</li> <li>Management has not developed a communications plan.</li> </ul>

<sup>6</sup> An assessment of a product or service in use, compared to available information and forecasts regarding a like (similar) product or service that has been proposed to fulfill a client need. The Postal Service used an in-house option modified to accommodate floor loading inter-BMC trailers.

### NEWLY IDENTIFIED RISKS

Risk Identified <sup>7</sup>	Risk Description	Risk Assessment Summary	
		Impact	Vulnerability
Internal Control and Quality Assurance	Establish controls and a quality assurance process that effectively protects the integrity of the initiative and revenue.	Potential loss of revenue. <b>(High)</b>	If controls are in place and ready to implement prior to contracting out BMC operations, risks should be reduced. <b>(Medium)</b>
Potential Contractor Conflict of Interest or Misconduct	An organizational conflict of interest exists when the nature of the work to be performed under a contract may give a supplier an unfair competitive advantage, or when a supplier has other interests that may impair its objectivity or ability to perform satisfactorily.	Conflict of interest may: <ul style="list-style-type: none"> <li>• Provide the contractor with an unfair competitive advantage.</li> <li>• Impair the contractor’s objectivity or ability to perform satisfactorily. <b>(Medium)</b></li> </ul>	Conflict of interest can be mitigated if management controls are enhanced and the Postal Service diligently monitors the contractor’s performance. Additionally, incentives are included in the contract which should improve contractor performance. <b>(Medium)</b>
Contingency Planning	Ability to recover from disruptions in contractor’s performance requirements.	Without a contingency plan, there is the potential of disruption in service, loss of revenue, and increased costs. <b>(High)</b>	If the Postal Service has critically assessed the contractor, that should minimize the risks of disruptions in service and loss of revenue. <b>(Medium)</b>

<sup>7</sup> We identified four new risks and included three in this table. The fourth is political risk, which we considered critical and, therefore, included it on page 5.

**APPENDIX C: MANAGEMENT'S COMMENTS**

Tony Pajunas  
Vice President, Network Services



March 5, 2009

Lucine Willis  
Director, Audit Operations  
1735 North Lynn Street  
Arlington, VA 22209-2020

SUBJECT: Time-Definite Surface Network Risk Mitigation  
(Report Number EN-MA-09-DRAFT)

Thank you for the opportunity to review and comment on the subject draft audit report.

Since this report was completed by the Office of the Inspector General, the Postal Service has made a determination not to pursue the outsourcing of Bulk Mail Center work at this time. This decision was driven by the accelerating and unprecedented drop in BMC Network product volume which makes it impossible to project future volumes that are required for the Statement of Work.

We have notified major stakeholders of this change. Instead of outsourcing, we have reengineered product flows through our current infrastructure and intend to test our concept shortly. When moving this effort forward, we will take steps to mitigate those factors that you identified that are still relevant given the new direction.

Thank you for bringing your concerns to our attention and the manner in which your audit work was conducted.

A handwritten signature in black ink, appearing to read "Tony Pajunas", written over a printed name.

Tony Pajunas

cc: Mr. Galligan  
Ms. Banks

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