

November 6, 2009

JORDAN M. SMALL  
VICE PRESIDENT, NETWORK OPERATIONS

SUBJECT: Management Advisory Report – Network Distribution Center Phase 1  
Activation (Report Number EN-MA-10-001)

This report presents the results of our review of the Network Distribution Center (NDC) Phase 1 activation (Project Number 09XG022EN000). This review responds to a request from the vice president, Network Operations, and is the first in a series of reviews planned to evaluate the NDC activation. Our objectives were to assess the planning, execution, and impacts associated with Phase 1 of the NDC activation and identify key issues and risks. This review addresses strategic and operational risks. See [Appendix A](#) for additional information about this audit.

## **Conclusion**

The NDC Phase 1 activation planning process appeared adequate, the execution of the plan generally went well, and the impact on operations were mostly positive. However, management could enhance the planning process by completing customer supplier agreements<sup>1</sup> (CSA) and the Article 12 employee excessing process earlier in the activation and including specific milestones in the Readiness Assessment Checklist. In addition, we identified key issues and risks associated with the activation that the U.S. Postal Service should address during activation of Phases 2 through 4.

## **Planning for NDC Phase 1 Activation**

The NDC Phase 1 planning process appeared adequate; however, management should have completed CSAs and the Article 12 process earlier in the activation. In addition, the Readiness Assessment Checklists provided to each site before activation could have incorporated specific milestones to ensure items on the checklist were completed and reviewed timely. There was no established guidance for this initiative, as it was a unique project the Postal Service implemented quickly. In addition, management acknowledged they relied on the Business Service Network (BSN) group to coordinate CSAs with mailers. During our review, management took action to address the CSA issues and involve the mailers in the solution process by establishing a Mailer Technical Advisory Committee (MTAC) workgroup.<sup>2</sup> Timely implementation of the CSAs is important in achieving projected savings through workhour and transportation reductions. See [Appendix B](#) for our detailed analysis of this topic.

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<sup>1</sup> CSA is an agreement between the Postal Service and the mailer for developing customer requirements that meet service and quality expectations

<sup>2</sup> MTAC Workgroup #131, *Communicating Network Distribution Center (NDC) Origin Separation Requirements*.

We recommend the vice president, Network Operations:

1. Identify and apply best practice for encouraging mailer participation in customer supplier agreements and reducing the duration of the Article 12 process.
2. Require field management to develop and submit specific milestones in the Readiness Assessment Checklist to the network distribution center activation team for validation before the scheduled activation date.

### Execution of NDC Phase 1 Activation

Execution of the NDC Phase 1 activation went well with only minor issues. Activation of Phase 1 began on May 18, 2009, rather than the initially planned mid-April date. In mid-June, management accelerated the activation and completed it on July 17, 2009, rather than the original completion date of August 7, 2009. Management used an incremental approach<sup>3</sup> with leadership at all levels engaged in the activation. Management exercised agility when addressing issues and was effective in making required changes. See [Appendix B](#) for our detailed analysis of this topic.

### Impacts Associated with NDC Phase 1 Activation

Management generally complied with instructions for the Phase 1 activation and as a result, operational impacts were mostly positive. Specifically, management implemented live loads and unloads of all trailers, increased trailer utilization, streamlined transportation trips, reduced some mail processing workhours, and improved Package Service performance. However, as of July 31, 2009, standby hours<sup>4</sup> as a percentage of mail processing workhours remained high at one Phase 1 NDC. Costs also exceeded savings for highway contract route (HCR) adjustments; however, projected annualized cost avoidance from cancelling rail contracts offset the additional HCR costs. Additionally, management stated they would not fully realize anticipated benefits from workhour savings and transportation trip cancellations for Phase 1 until about 2 months after completing Phase 1. As a result, we plan to evaluate transportation and workhour costs and savings for Phase 1 NDCs in a subsequent review. See [Appendix B](#) for our detailed analysis of this topic.

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<sup>3</sup> Incremental approach represents optimizing the performance of the mail processing and transportation infrastructure in phases rather than in its entirety. For example, the long-term vision includes relocating Surface Transfer Centers (STC) operations to NDC operations.

<sup>4</sup> Handbook M-32, *Management Operating Data System*, March 2009, Chapter 4-4.4.4, states that standby time records employee paid hours that cannot be used for productive work activity.

The Postal Accountability and Enhancement Act (The Postal Act of 2006), P.L. 109-435, Title II dated December 20, 2006, requires the Postal Service to report to Congress annually

. . . actions taken to identify any excess capacity within its processing, transportation, and distribution networks and implement savings through realignment or consolidation of facilities including overall estimated costs and cost savings.

### Issues and Risks Associated with NDC Phase 1 Activation

Management noted that six of the 12 risks identified in the U.S. Postal Service Office of Inspector General (OIG) Time-Definite Surface Network (TDSN) Risk Mitigation report<sup>5</sup> are relevant to the NDC initiative and should be considered during activation of Phases 2 through 4. These risks are as follows: political risks, cost factor analysis, aggressive implementation date, revenue at risk, stakeholder interest (communications), and internal control and quality assurance. We identified four additional risks during NDC Phase 1 activation that management should also consider during subsequent activations. These risks are as follows: delays in obtaining CSAs, this network streamlining initiative may not provide the savings anticipated, the loss of goodwill, and coordination with other initiatives. See [Appendix B](#) for our detailed analysis of this topic.

Postal Service Actions – Management initiated action to mitigate some risks identified in the TDSN report which apply to the NDC initiative. These include:

- Aggressive Implementation Date – Mitigating actions included activating the NDC in phases, keeping the activation schedule flexible, and applying significant resources to planning and oversight during activation.
- Stakeholder Interest – Mitigating actions included encouraging mailer participation in the solution process and maintaining transparency in the NDC activation process.

In addition, as part of lessons learned from Phase 1, management is emphasizing at Phases 2 through 4 kickoff meetings the need to initiate CSAs as soon as possible in the activation process.

We recommend the vice president, Network Operations:

3. Develop a written plan to address identified risks during implementation of Network Distribution Center Phases 2 through 4 activation.

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<sup>5</sup> Report Number EN-MA-09-001, March 20, 2009. Six of the 12 risks apply to any network realignment initiative.

## Management's Comments

Management agreed with the first part of recommendation 1, to identify and apply best practice for encouraging mailer participation in customer supplier agreements. Management took action during the audit to establish an MTAC workgroup to communicate with mailers origin separation requirements to support network reengineering. The workgroup is scheduled for completion in February 2010.

Management agreed in principle with the second part of recommendation 1, to apply best practices for reducing the duration of the Article 12 process. Management acknowledged inefficiencies in the Article 12 process and stated a Lean Six Sigma project has been initiated to identify opportunities to improve the process. Management stated that the Article 12 process is part of the collective bargaining agreements, and therefore, Article 12 recommendations should be directed to the Vice president, Labor Relations.

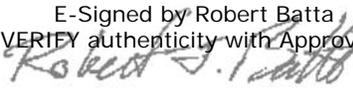
Management agreed with recommendation 2 and stated that for Phase 4, they conducted preactivation meetings with lessons learned and best practices, and set milestones for specific items related to the checklist.

Management agreed with recommendation 3 and developed strategies during the Phase 1 NDC Activation to mitigate identified risks in the remaining phases. Management's comments, in their entirety, are included in [Appendix G](#).

## Evaluation of Management's Comments

The OIG considers management's comments responsive to the recommendations in the report. The OIG considers recommendations 1 and 3 significant. Recommendation 1, as it relates to CSAs, requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective action has been completed. This recommendation should not be closed in the Postal Service's follow-up tracking system until the OIG provides written confirmation that the recommendation can be closed. The OIG will address the Article 12 part of recommendation 1 with Labor Relations in a future audit specifically on this subject. Recommendation 3 will be closed in the follow-up tracking system with the issuance of this report.

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  
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## APPENDIX A: ADDITIONAL INFORMATION

### BACKGROUND

A key Postal Service strategic objective is to optimize its processing and transportation networks. The Postal Service's *2009-2013 Vision 2013 Strategic Plan* provides the roadmap to create a flexible network that promises new gains in service, efficiency, and customer value in the years ahead. 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 network plan that addresses the establishment of performance goals;
- Describe changes needed to its processing, transportation, and retail networks in order to meet those performance goals;
- Summarize its vision for rationalizing its infrastructure and workforce;
- Discuss policies governing re-employment within the agency and early retirement for employees who might be displaced as a result of network rationalization; and,
- Explain the future role of various alternative postal retail access channels.

In the 1970s, the Postal Service developed a bulk mail network of 21 bulk mail centers (BMC) to support mail distribution and transportation for surface Parcel Post<sup>6</sup>, Standard Mail<sup>7</sup>, and Periodicals.<sup>8</sup> With mailers entering more mail near final destination, mail volume declining, and a changing mail mix, much of the mail the BMCs previously processed has gone away. Over the past few years, the Postal Service has evaluated various network design alternatives to streamline the BMC network:

- In 2006, the Postal Service introduced a plan to redesign its network around approximately 70 regional distribution centers (RDCs) that would perform bulk processing operations for all classes of mail, act as surface transfer centers (STCs), and become mailer entry points. However, because of the impact of the Postal Act of 2006, the approval of Phase 1 of the Flat Sequencing Systems (FSS) deployment, the 2007 rate change that introduced shape-based pricing, and the significant amount of capital investment required to implement the network, the Postal Service determined the RDC concept would not result in the planned benefits and halted the program.

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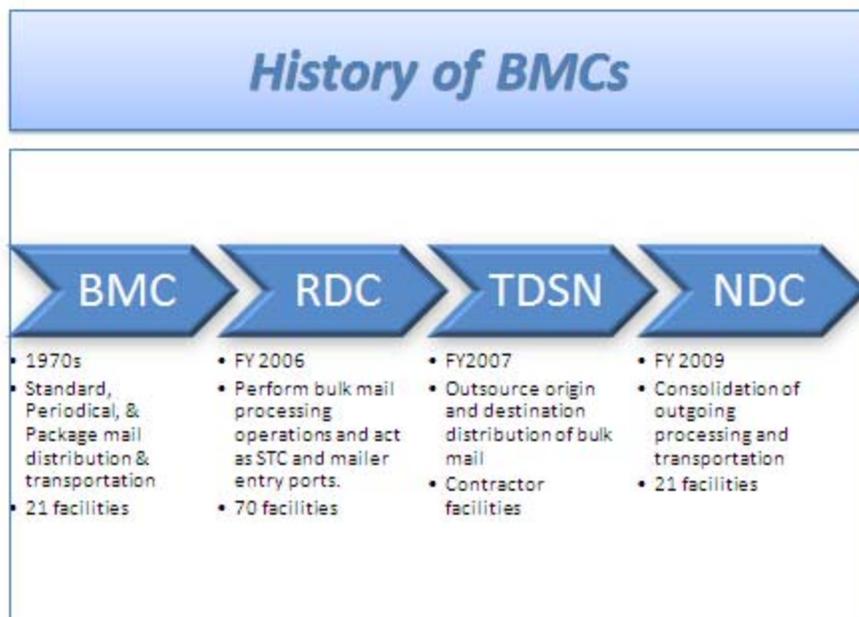
<sup>6</sup> Parcel Post is mail that does not meet the mail processing category of letter-size mail or flat-size mail. It is usually enclosed in a mailing container such as a carton.

<sup>7</sup> Standard Mail is a mail class that is not sent as First-Class Mail® or entered as Periodicals.

<sup>8</sup> Periodicals consist of magazines, newspapers, or other publications formed from printed sheets that are issued at least four times a year from a known office of publication.

- In early 2007, the Postal Service began to evaluate another alternative and by mid 2007, the concept of an outsourced TDSN emerged. With this initiative, the Postal Service considered outsourcing some operations currently performed in BMCs and back filling BMCs with new FSS and other operations consolidated from nearby facilities. The Postal Service issued both a Request for Information and a draft Request for Proposal and received significant interest from the industry. However, because of the unprecedented decline in mail volume, which began in 2008 and the current economic environment, future volumes became nearly impossible to forecast. By late 2008, the Postal Service determined it was not the right time to outsource the BMC network.
- As it became evident the TDSN concept would not be feasible and still facing significant cost reduction targets and excess capacity, the Postal Service began developing an internal re-engineering effort focused on transforming BMCs into NDCs. NDCs would consolidate the processing and dispatching of mail to achieve economies of scale and greater operational efficiency and reduce workhours and transportation. In May 2009, the Postal Service began Phase 1 activation of the NDC concept.<sup>9</sup>

**Chart 1. History of BMC Initiatives**



The core principle of the NDC concept is to fill containers and trucks early in the network and to dispatch them as deep into the network as possible. The Postal Service

<sup>9</sup> On July 21, 2009, the Deputy Postmaster General announced the Postal Service would rename all BMCs as NDCs, effective August 1, 2009.

can achieve this objective by using three tiers of consolidation opportunity. The NDC's level of responsibility depends on its network tier.

The new network, when fully implemented, will include the following:

- Eleven Tier 1 Sites – Will only process destinating and originating turn-around Standard Mail, Periodicals, and Package Services for the Tier 1 service area. In the longer term, Tier 1 sites may also have STC containerization and dispatch functions. All mail for destinations outside of the Tier 1 service area will be sent to Tier 2 sites for processing and dispatch.
- Six Tier 2 Sites – Will include Tier 1 responsibilities and also process all of the outgoing mail from Tier 1 sites. Tier 2 sites may also perform single piece distribution of letters and flats and containerize and dispatch First-Class Mail and Priority Mail.
- Four Tier 3 Sites – Will include Tier 1 and Tier 2 responsibilities and be the gateway sites for cross docking mail from Tier 2 sites when the NDC is unable to send full truckloads to the network.

[Appendix C](#) provides a diagram of the NDC network flow and a description of each tier's responsibilities.

NDC Phase 1 activation took place in the northeast region and included the Northeast, New York Metro, and Eastern Areas. Three BMCs were impacted. The Philadelphia and Springfield BMCs became Tier 1 NDCs while the New Jersey BMC became a Tier 2 NDC. Forty-two processing and distribution centers/facilities (P&DC/P&DF) that transport mail to these three NDCs were impacted in the Phase 1 activation.

[Appendix D](#) shows the location of the three NDCs and lists the P&DCs that transport mail to each under the NDC concept.

## **OBJECTIVES, SCOPE, AND METHODOLOGY**

Our objectives were to—

- Assess the planning, execution, and impacts associated with Phase 1 of the NDC activation.
- Identify key issues and risks.

To accomplish this review, we:

- Identified concerns and risks from previous network realignment initiatives.
- Reviewed Government Accountability Office and OIG reports regarding network realignment initiatives.

- Reviewed NDC planning and communication documentations.
- Interviewed Postal Service Headquarters and field office officials.
- Observed NDC operations at selected Phase 1 facilities.
- Participated in selected daily NDC Phase 1 activation team meetings.
- Participated in selected MTAC meetings.
- Determined risks and concerns related to this initiative.

We conducted this review from June through November 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 September 15, 2009, and included their comments where appropriate.

**PRIOR AUDIT COVERAGE**

Report Title	Report Number	Final Report Date	Report Results
<i>Time-Definite Surface Network Risk Mitigation</i>	EN-MA-09-001	March 20, 2009	The report acknowledged that the concept of contracting out BMC operations may have merit; however, we identified 12 risks associated with the BMC outsourcing initiative. We recommended the Postal Service develop a written plan to address risks and concerns before moving forward with the TDSN initiative. Management explained they were no longer pursuing the outsourcing of BMC work. Instead of outsourcing, management would look at re-engineering product flows through their current infrastructure. Management agreed to take steps to mitigate those risks that are relevant to the new direction.

Report Title	Report Number	Final Report Date	Report Results
<i>Bulk Mail Center Outsourcing</i>	EN-WP-07-001	April 25, 2007	This report 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.
<i>Status Report on the Evolutionary Network Development Initiative</i>	NO-MA-06-001	March 20, 2006	The Postal Service took an incremental approach to network changes and made some progress in their ongoing effort to streamline the mail processing and transportation networks. The report disclosed major challenges management needs to address. We made no recommendations in this report. Management generally agreed with the issues discussed.

## APPENDIX B: DETAILED ANALYSIS

### Planning for NDC Phase 1 Activation

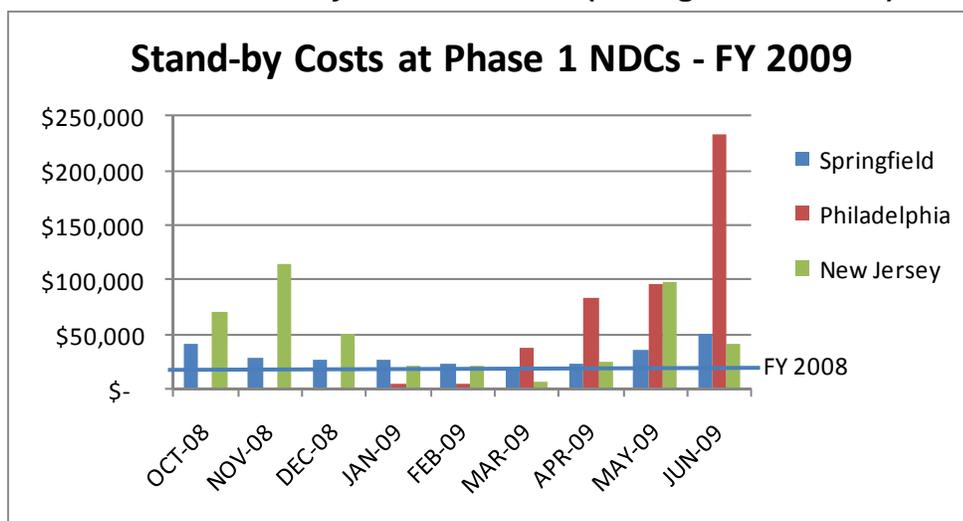
Planning for activation of the NDC initiative generally appeared adequate; however, opportunities exist for improvement. Early in 2008, management began to consider various internal options to re-engineer the BMC network. In Fall 2008, management began planning how they could accomplish these operations internally, if outsourcing was not feasible. In early February 2009, management developed a plan to implement the NDC concept and canceled the TDSN concept. [Appendix E](#) is a timeline showing NDC from concept development to scheduled completion of all four phases.

Management created an NDC implementation resource book to provide guidance for headquarters and local activation teams; and employees at BMCs, P&DCs, and retail units.

We found that management should have completed some actions in support of NDC activation earlier in the NDC activation process.

- Management did not establish CSAs before activating Phase 1 of NDC. This was partially because the activation of Phase 1 progressed quickly and did not provide ample time to work with mailers before startup. CSAs are essential for a positive outcome in the NDC activation. CSAs require mail to be broken down by class, mail type, and destination. The use of CSAs should facilitate a more efficient movement of mail to downstream processing facilities and improve service.
- Management did not adequately plan for the reduction in workhours NDC activation caused. The NDC implementation resource book indicates that workhour savings were to be captured through overtime reductions and attrition. However, during the first three quarters of fiscal year (FY) 2009, standby costs increased significantly over the previous year at the three Phase 1 NDCs. During the NDC Phase 1 activation standby costs at the—
  - Springfield NDC increased from \$18,000 in March 2009 to \$50,000 in June 2009.
  - Philadelphia NDC increased from \$38,000 in March 2009 to \$234,000 in June 2009.
  - New Jersey NDC spiked in May 2009 to \$97,000 and then dropped to \$42,000 in June 2009, as noted in chart 2.

**Chart 2. Standby Costs FY 2009 (through 3<sup>rd</sup> Quarter)**



Source: Postal Service Activity-Based Costing System

Note: The vertical line indicates the average monthly standby cost during same period FY 2008 for Springfield. Standby costs at Philadelphia and New Jersey were minor during that period.

Article 12 of the national agreement with the labor unions addresses excessing of impacted employees. Article 12 is a time-consuming process that usually takes between 4 and 11 months to finalize. At the Philadelphia NDC, Article 12 actions will be effective in early September 2009, when approximately 50 employees are to be excessed.<sup>10</sup> If local management had started the Article 12 process earlier in the activation process, they may have avoided excessive standby time. Management acknowledged there was some delay in initiating the Article 12 process at the Philadelphia NDC. Management also stated, in general, because of the short timeframe between planning and execution of the Phase 1 activation, management would not have been able to initiate the Article 12 process earlier. However, for Phases 2 through 4, management are encouraging earlier implementation of the Article 12 process to avoid unnecessary standby time.

- As part of the NDC implementation resource book, management included a Readiness Assessment Checklist for each type of facility (for example, P&DC, NDC, and retail unit). Currently the checklist only requires a “yes,” “no,” or “N/A” response for each statement. Requiring field management to develop and submit specific milestones to NDC activation teams for validation before the scheduled activation date would provide more assurance that items are completed and reviewed timely.

<sup>10</sup> The Postal Service issued a moratorium on excessing employees until October 9, 2009, under the terms of the August 2009 buyout agreement between the Postal Service, the American Postal Workers Union, and the National Postal Mail Handlers Union.

There was an absence of established guidance because of the uniqueness of this project and the accelerated rate at which it was being implemented. More specific milestones in the planning document and earlier completion of CSAs and Article 12 would help reduce the possibility of missed or delayed savings.

### Execution of NDC Phase 1 Activation

The execution of Phase 1 of the NDC activation went well and appeared to have had only minor problems. Therefore, management accelerated the activation.

Implementation of the NDC concept began in mid-May 2009. The original startup was scheduled for mid-April but was delayed because program changes to retail system labels were needed.<sup>11</sup> On June 19, 2009, after the first 5 weeks of the scheduled 12-week activation, management expedited the remainder of Phase 1 and completed the activation in 9 weeks. Phase 1 was completed on July 17, 2009, rather than on the original planned date of August 7, 2009.<sup>12</sup> Management based this acceleration on the success of the first 5 weeks of activation and the opportunity to capture additional savings more quickly.

NDC activation teams consisted of headquarters and local team members. Team members were assigned to each P&DC and NDC. Teams were not assigned to retail units or mailers' facilities although employees at retail units were to receive training on their responsibilities in relation to NDC activation.

Activation teams documented issues and problems noted at each activation site and recorded the data daily in a web-based NDC Activation Daily Reporting Log. Management conducted a daily teleconference with Phase 1 participants to resolve the issues noted the previous day. The log for Phase 1 activation (May 18 through July 17, 2009) indicated there were 901 issues. Table 1 shows the issues broken down by area.

**Table 1. NDC Phase 1 Activation Issues**

<b>Area</b>	<b>Number of Logged Issues</b>
Eastern Area	257
New York Metro Area	217
Northeast Area	427
<b>Total</b>	<b>901</b>

Source: NDC Activation Daily Reporting Log

<sup>11</sup> New retail distribution codes will be printed on Postal Service owned retail system labels to assist in separating mail received over the retail counter into containers for dispatch to plants and NDCs. Level 18 and above post offices, stations, and branches will use the retail distribution codes to separate the mail.

<sup>12</sup> Phases 2 through 4 of the NDC activation were scheduled for implementation from August 10 through November 20, 2009.

The major issues fell into three categories: mail processing, platform operations, and retail. Some of the major issues included:

- Separations were not performed.
- Mail transport equipment (MTE) labeler placards were not attached to containers or placards were modified.
- Mailers were not making separations because CSAs had not been established.
- During the final week of activation, New Jersey NDC management advised they did not have enough drivers. During the last 2 days, there was a backlog of 80 to 100 trucks. The lack of drivers was due to retirements, unexpected personnel changes, and administrative delays. Management advised later they had hired casual drivers to drive the trucks during this transition period.

Management used an incremental approach to activating NDCs and engaged leadership at all levels in the process. There was no specific guidance for changes that might be needed as the activation moved forward, but we noted the following:

- Activation teams were in place to resolve issues as they occurred.
- Findings and observations were to be communicated to facility coordinators daily so management could identify best practices and potential difficulties for other sites to consider during activation.

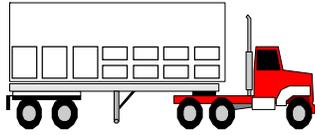
During Phase 1 of NDC activation, management exercised agility to address issues as they occurred and was effective in making required changes.

### **Impacts Associated with NDC Phase I Activation**

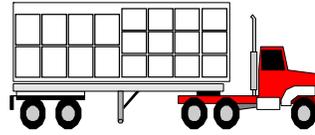
The Postal Service took positive steps to re-engineer and transform BMCs into NDCs. Management developed and implemented strategies that helped the Postal Service achieve some operational improvements during Phase 1 activation. New operational instructions designed to increase operational efficiency and reduce costs include, but are not limited to—

- Improving Dock Operations and Yard Management – All vehicles go directly to the dock door for live loads and unloads of mail to meet distribution and dispatch plans. The new standard cycle time to load or unload is 30 minutes or less, which is a significant departure from past practice.
- Increasing Utilization of Trailers – Currently, more than 50 percent of trailer space is unused, resulting in inefficient cube utilization. The Postal Service recognized that it needed to change the way it transports mail. As a result, management is testing new commercially available MTE alternatives. In addition, new trailer load plan directives to maximize space utilization were

issued to NDC Phase 1 activation facilities. Further, mail handlers and clerks are required to use a hand-held device to scan trailer and container information during live loads and unloads to capture real-time data into the Surface Visibility (SV) system. Management uses SV data to track trailer utilization and contents and provide information on trailers entering or leaving a facility.



Today's NDC – utilization of floor space

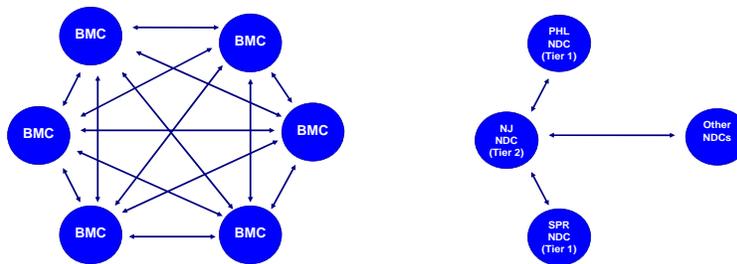


Future NDC – maximize cube space

- Streamlining Network Transportation – The New Jersey NDC, a Tier 2 site, is now the consolidation point for the Philadelphia and Springfield NDCs (Tier 1 sites) for transporting mail to other NDCs in the network.
  - Before Phase 1 activation, the New Jersey, Springfield, and Philadelphia BMCs each had their own contracted transportation to all of the other 20 BMCs in the network.
  - Under Phase 1 of the NDC activation, the Springfield and Philadelphia NDCs transport mail to one facility, the New Jersey NDC. This eliminates trips to and from 19 facilities for the Springfield and Philadelphia NDCs.

Chart 3 shows how transportation flowed under the BMC network and how it flows between NDC Tier 1 and Tier 2 sites.<sup>13</sup>

**Chart 3. BMC Network and NDC Network after Phase 1 Activation**



- Realigning Mail Processing Workhours – Because of the NDC activation, Phase 1 management was required to adjust staffing requirements. At Tier 1 NDCs, there was a need to reduce staff and corresponding workhours because of network mail volume moving to the Tier 2 NDC. The Tier 2 NDC may require an increase in staff and workhours to accommodate the new network volume from

<sup>13</sup> Implementation of the Tier 3 sites was not scheduled to occur until Phase 2 of the activation.

Tier 1 NDCs. Table 2 shows that although mail processing (Function 1) workhours fluctuated, workhours generally decreased at the three NDCs since the beginning of calendar year 2009.

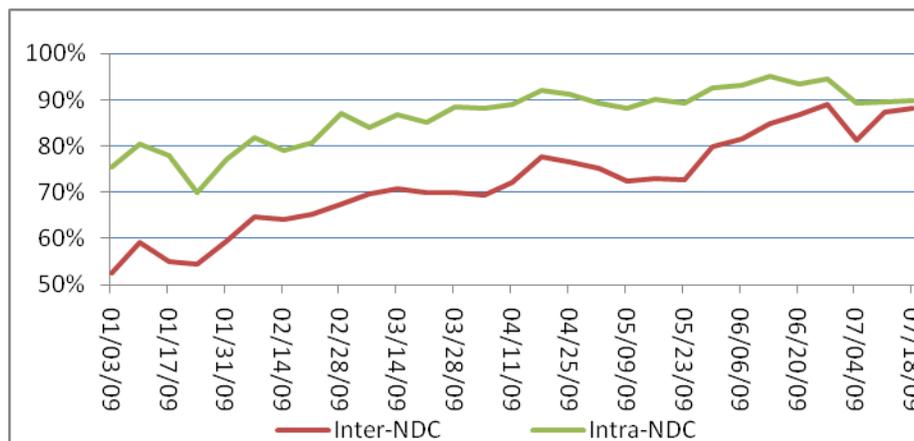
**Table 2. Mail Processing (Function 1) Workhours**

PAYROLL MONTH	NEW JERSEYNDC		PHILADELPHIA NDC		SPRINGFIELDNDC	
	Function 1 Workhours	Percent Change	Function 1 Workhours	Percent Change	Function 1 Workhours	Percent Change
04 - ended 01/16/2009	214,872.91	-17	78,401.36	-13	93,780.22	-19
05 - ended 02/13/2009	222,131.41	3	81,085.56	3	94,584.05	1
06 - ended 03/13/2009	213,768.48	-4	76,474.67	-6	92,356.76	-2
07 - ended 04/10/2009	221,878.52	4	77,316.82	1	92,051.89	0
08 - ended 05/08/2009	213,188.92	-4	74,982.06	-3	87,544.48	-5
09 - ended 06/05/2009	210,568.68	-1	69,459.19	-7	81,570.42	-7
10 - ended 07/03/2009	223,973.68	6	71,372.21	3	76,844.16	-6
11 - ended 07/31/2009	226,503.59	1	69,106.58	-3	69,727.41	-9
<b>Cumulative Change</b>		<b>-12</b>		<b>-23</b>		<b>-40</b>

Source: Postal Service Operations Complement Management

- Improving Package Service Performance –Package Service scores are improving, but we were unable to assess service impacts for other classes of mail processed through NDC sites. Although we could not directly attribute the improved Package Service performance to NDC activation, Table 3 shows the Package Service performance trend.

**Table 3. Package Service Performance Scores for Phase 1 NDCs**



Source: Postal Service Network Development and Support

We also compared the May 9, 2009, average composite Package Service performance scores (1 week before the Phase 1 activation) through the week of July 18, 2009. We found that the average composite scores<sup>14</sup> for the Phase 1 NDCs improved by 20.91 percent. Management stated they were unable to provide service scores for other classes of mail supported by NDCs, because until Intelligent Mail barcoding is fully implemented, there are no good data measurement systems for Standard Mail and Periodicals.

Although operational impacts were mostly positive, we found that as of July 31, 2009—

- The Philadelphia NDC standby hours as a percentage of function 1 workhours were significantly higher than other Phase 1 NDCs and the nationwide NDC average. (See table 4.) As the activation of Phase 1 advanced, standby hours at the Philadelphia NDC increased.

**Table 4. Standby Hours as a Percentage of Function 1 Workhours**

PAYROLL MONTH	NEW JERSEY NDC (Percentage)	PHILADELPHIA NDC (Percentage)	SPRINGFIELD NDC (Percentage)	NATIONWIDE NDCs (Percentage)
04 - ended 01/16/2009	0	0	1	0.2
05 - ended 02/13/2009	0	0	1	0.1
06 - ended 03/13/2009	0	1	1	0.4
07 - ended 04/10/2009	0	2	1	0.7
08 - ended 05/08/2009	1	3	1	1.0
09 - ended 06/05/2009	1	5	2	1.3
10 - ended 07/03/2009	0	10	2	1.4
11 - ended 07/31/2009	0	14	1	1.6

Source: Postal Service Operations Complement Management

- As shown in table 5, the annualized costs of additional HCR exceeded reductions of the same by \$12.9 million. On September 15, 2009, management provided documentation to show that the projected annualized cost avoidance from cancelling rail contracts as of July 31, 2009, was \$13.7 million; thereby, netting a projected transportation savings of \$800,000 annually.

**Table 5. Projected Annualized HCR Costs as of July 31, 2009**

	HCR	ESTIMATED FUEL	TOTAL
Reductions	(\$30,859,113)	(\$11,358,004)	(\$42,217,117)
Additions	40,695,965	14,472,966	55,169,931
Net Change	9,837,852	3,114,963	12,952,815

Source: Postal Service Finance and Business Analysis

<sup>14</sup> The combined originating and destinating service score.

- In addition, management stated that establishing CSAs with mailers continues to be a challenge. As illustrated in Table 6, of the 250 mailers identified, 43 mailers (17 percent) have signed CSAs as of July 8, 2009. Management added that mailers are resistant to CSAs, because they are waiting for the *Domestic Mail Manual* (DMM) to direct business mailing standard changes. However, there is a moratorium on any changes to the DMM. Faced with these challenges, management has formed MTAC workgroup #131 to evaluate issues regarding communicating what separations are necessary and why, as well as industry capabilities.

**Table 6. CSA Results for Phase 1 NDCs as of July 8, 2009**

NDC	Mailers Identified	CSA In Progress	CSA Separations Made	CSA Signed	Expected CSA by July	Expected CSA by August	Expected CSA by September
Springfield	116	19	16	16	19	25	25
Philadelphia	53	47	35	23	13	11	0
New Jersey	81	25	15	4	9	2	10
<b>Total</b>	<b>250</b>	<b>91</b>	<b>66</b>	<b>43</b>	<b>41</b>	<b>38</b>	<b>35</b>

Source: Postal Service Area Offices through the Network Development and Support Team

### Issues and Risks Associated with NDC Phase I Activation

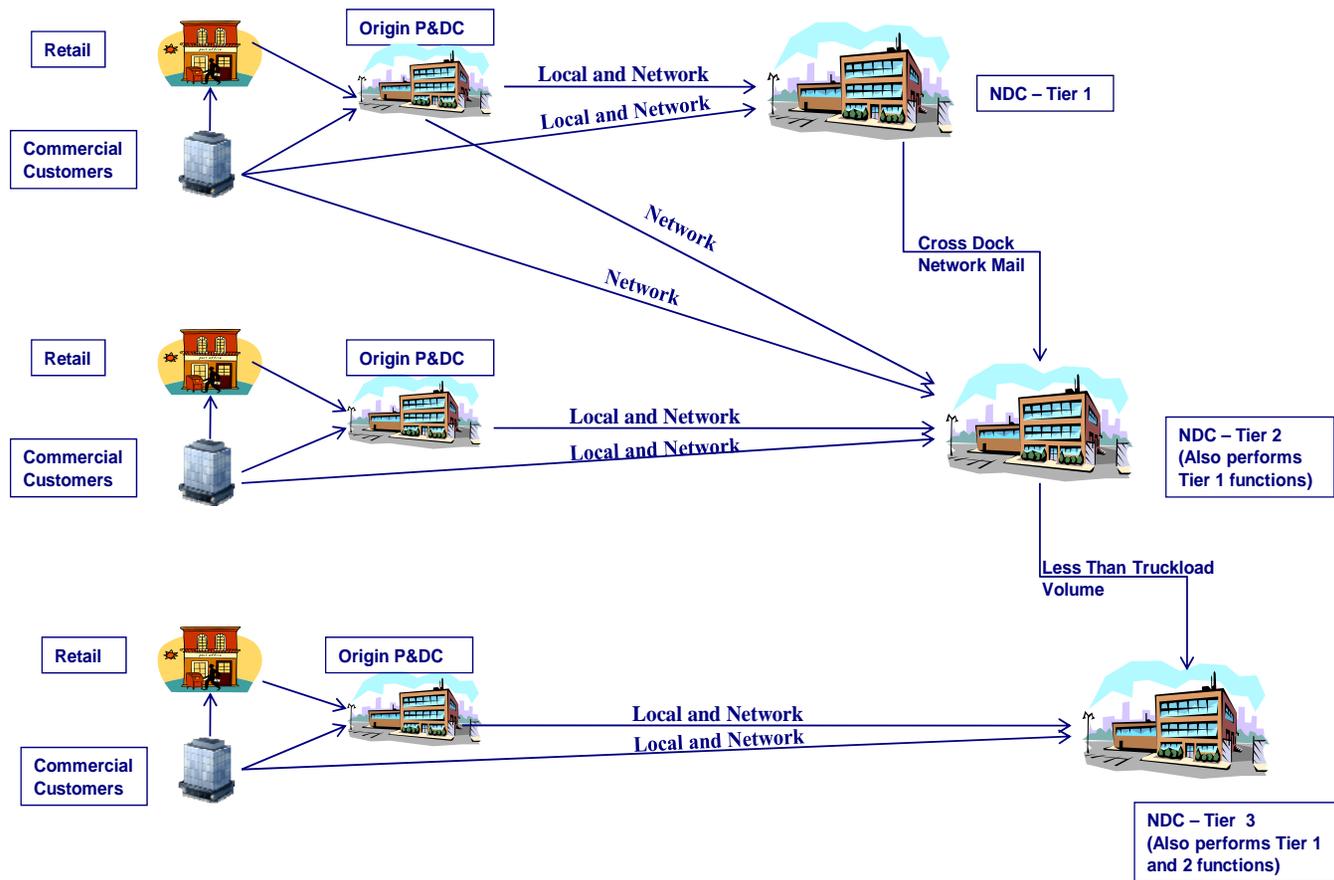
During our review of TDSN Risk Mitigation, we identified 12 risks associated with the Postal Service’s BMC outsourcing initiative. Six of the identified risks also apply to the NDC initiative, and management has taken action to mitigate these risks. These risks are as follows: political risks, cost factor analysis, aggressive implementation date, revenue at risk, stakeholder interest (communications), and internal control and quality assurance.

During our review of NDC activation, we identified an additional four risks associated with the NDC initiative. These four risks are as follows: customer service agreements, goodwill/branding, network streamlining, and coordination with other initiatives.

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 F](#) for details of the 10 risks.

APPENDIX C: NDC NETWORK FLOW AND DESCRIPTION OF RESPONSIBILITIES

# Network Flow

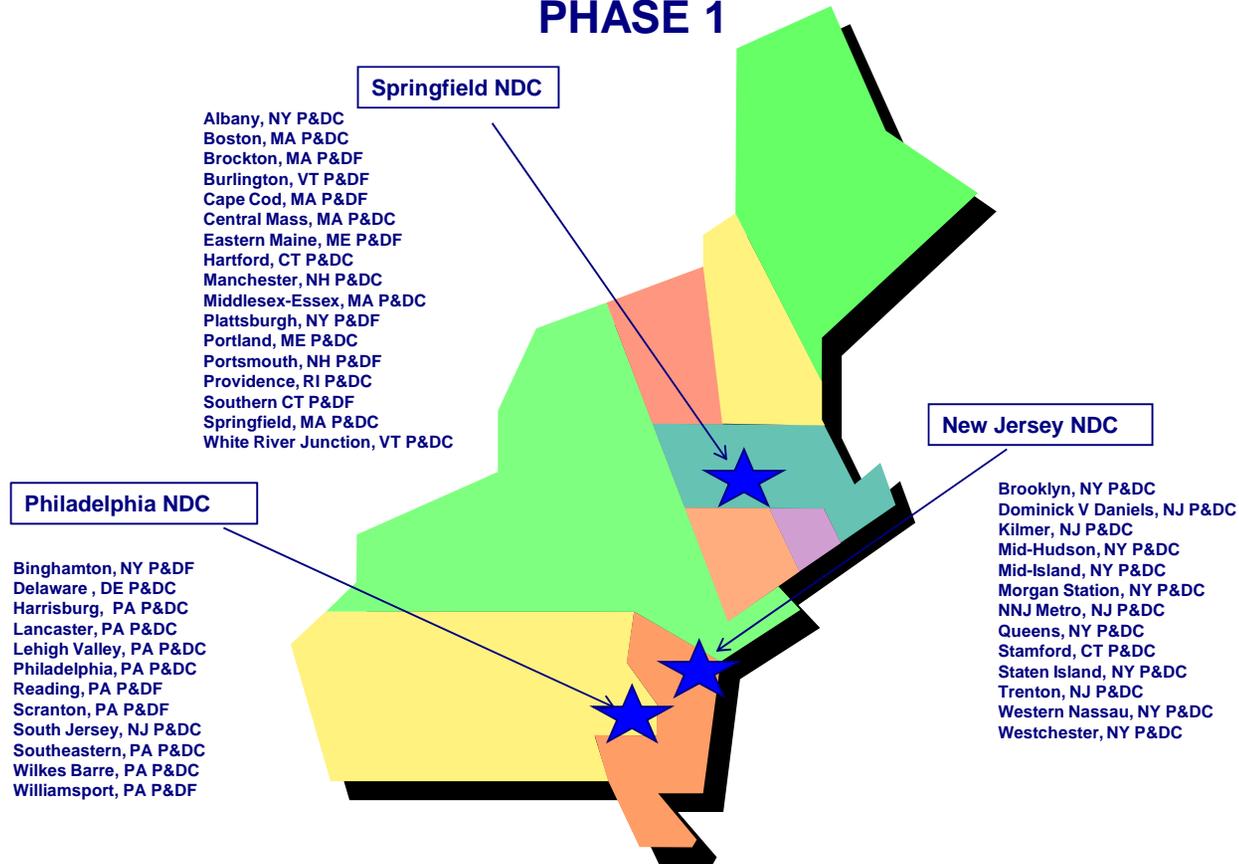


## Description of Responsibilities

<p><b>Tier 1 NDC</b></p>	<p><b>Tier 2 NDC</b></p>	<p><b>Tier 3 NDC</b></p>
<p>Distribution of local and destination Standard Mail, Periodicals, and Package Services</p>	<p>Distribution of local and destination Standard Mail, Periodicals, and Package Services</p>	<p>Distribution of local and destination Standard Mail, Periodicals, and Package Services</p>

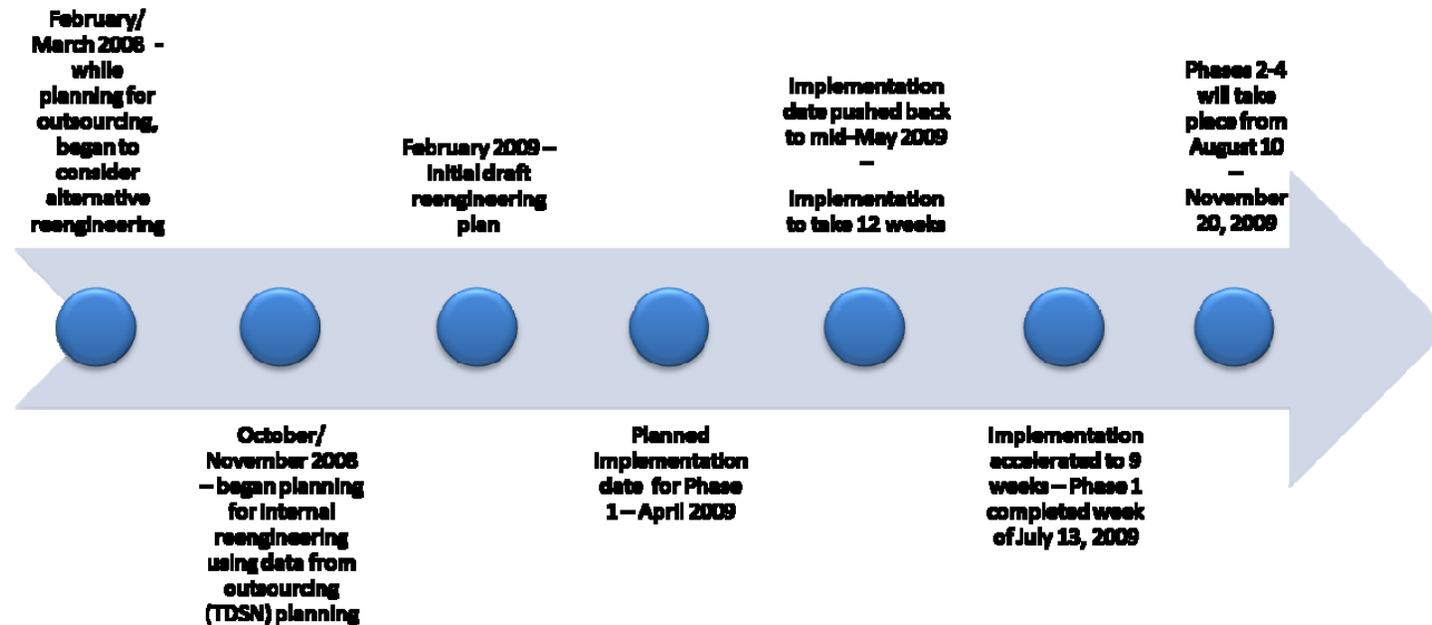
APPENDIX D: NDC PHASE 1 ACTIVATION

**NETWORK DISTRIBUTION CENTER ACTIVATION  
PHASE 1**



APPENDIX E  
NDC TIMELINE (FROM CONCEPT DEVELOPMENT TO COMPLETION)

# NDC Timeline



**APPENDIX F: TEN IDENTIFIED RISKS**

	Risk Identified	Risk Description	Risk Assessment Summary	
			Impact	Vulnerability
<b>Four Newly Identified Risks</b>	Customer Supplier Agreements	Delays in obtaining agreements with mailers to separate mail for routing to appropriate facility.	<ul style="list-style-type: none"> <li>• Potential loss of revenue.</li> <li>• Potential service delays.</li> <li>• Could result in additional work at processing facilities or mail being sent to wrong tier facility.</li> <li>• Potential unrealized transportation savings. <b>(High)</b></li> </ul>	<ul style="list-style-type: none"> <li>• Mailers could decide implementing CSAs is too costly.</li> <li>• Mailers may not agree to this arrangement. <b>(Medium)</b></li> </ul>
	Network Streamlining	Initiative may not provide the savings anticipated or needed.	<ul style="list-style-type: none"> <li>• Lower productivity rates.</li> <li>• Higher standby time and costs. <b>(High)</b></li> </ul>	<ul style="list-style-type: none"> <li>• Facilities may be unable to reduce workhours expeditiously because of the Article 12 process.</li> <li>• Transportation efficiencies may be negatively affected if CSAs are not implemented quickly. <b>(High)</b></li> </ul>
	Goodwill	Customers may perceive the Postal Service as being inept at operating the organization if this initiative falters.	<ul style="list-style-type: none"> <li>• Loss of goodwill.</li> <li>• Loss of loyalty. <b>(Medium)</b></li> </ul>	<ul style="list-style-type: none"> <li>• The Postal Service could be open to negative stakeholder perceptions and destroy trust. <b>(Medium)</b></li> </ul>
	Coordination with Other Initiatives	<p>Too many initiatives ongoing to adequately coordinate and measure results. These initiatives include:</p> <ul style="list-style-type: none"> <li>• New MTE being tested.</li> <li>• Use of SV.</li> <li>• Merging STCs with NDCs.</li> <li>• Movement of mail from Logistics &amp; Distribution Center (Philadelphia) to NDC.</li> <li>• Installation and activation of FSS.</li> </ul>	<ul style="list-style-type: none"> <li>• Higher costs.</li> <li>• Lower productivity.</li> <li>• Potential loss of goodwill.</li> <li>• May cause delays in service.</li> <li>• Difficulty in accurately tracking costs and savings. <b>(Medium)</b></li> </ul>	<ul style="list-style-type: none"> <li>• Stakeholder resistance to a large number of changes at one time. <b>(Medium)</b></li> </ul>

Risk Identified		Risk Description	Risk Assessment Summary	
			Impact	Vulnerability
Six Previously Identified Risks	Political Risks	Ability to effectively convince legislators of the necessity for specific network realignment strategies and operational efficiency initiatives, including transformation of the NDC network.	<ul style="list-style-type: none"> <li>Failure to convince and work effectively with Congress and the Postal Regulatory Commission could result in undesirable legislation and/or regulatory constraints that could be harmful to the network realignment strategies and operational efficiency. <b>(High-Critical)</b></li> </ul>	<ul style="list-style-type: none"> <li>Resistance to Postal Service efforts. <b>(High)</b></li> </ul>
	Cost Factor Analysis	Consider all cost factors affecting projected cost savings, including transitioning of affected employees, costs associated with transformation of the NDC facilities for future use, and costs associated with revising ground transportation contracts for current NDC transportation routes.	<ul style="list-style-type: none"> <li>Inadequate data may distort results of analysis, possibly leading to incorrect decisions. <b>(High-Critical)</b></li> </ul>	<ul style="list-style-type: none"> <li>Without adequate data, the potential for making a flawed decision increases substantially. <b>(Medium)</b></li> </ul>
	Aggressive Implementation Date	Ability to implement concept at a large number of facilities in a shortened timeframe without adversely affecting service and operations when some benefits associated with the project have not yet been demonstrated.	<ul style="list-style-type: none"> <li>May cause delays in service</li> <li>May result in higher standby time and lower productivity rates. <b>(High)</b></li> </ul>	<ul style="list-style-type: none"> <li>Facilities may be unable to handle increases in mail volume.</li> <li>Facilities may be unable to reduce the number of employees at some sites quickly. <b>(High)</b></li> </ul>
	Revenue at Risk	Revenue at risk due to large dollar exposure in this initiative.	<ul style="list-style-type: none"> <li>Potential loss of revenue. <b>(High)</b></li> </ul>	<ul style="list-style-type: none"> <li>Mail flow to customers could be interrupted. <b>(High)</b></li> </ul>
	Stakeholder Interest (Communications)	Ensure interests of impacted stakeholders are identified clearly and changes impacting them are communicated effectively.	<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. <b>(High)</b></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. <b>(High)</b></li> </ul>
	Internal Control and Quality Assurance	Establish controls and a quality assurance process that effectively protects the integrity of the initiative and revenue.	<ul style="list-style-type: none"> <li>Potential loss of revenue. <b>(High)</b></li> </ul>	<ul style="list-style-type: none"> <li>If controls are in place and ready to implement before activating NDCs, risks should be reduced. <b>(Medium)</b></li> </ul>

## APPENDIX G: MANAGEMENT'S COMMENTS

JORDAN M. SMALL  
VICE PRESIDENT, NETWORK OPERATIONS



October 29, 2009

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

SUBJECT: Transmittal of Draft Management Advisory Report – Network Distribution  
Center Phase 1 Activation (Report Number EN-MA-09-DRAFT)

Thank you for the opportunity to review and comment on the subject draft report. As the OIG stated in its report, the scale and timeline made this a unique project. We agree that there are items we could improve upon in future phases of activation, but also recognize significant efforts by Headquarters and Area personnel in implementing this network reengineering within a short timeframe. We are beginning to capture savings for the project and have experienced breakthroughs in service performance since the start of implementation.

Management agrees with the recommendations 2 and 3. In recommendation 1, the report states that Management should identify and apply best practices to reduce the duration of the Article 12 process. Recommendations on Article 12 should be provided to the VP, Labor Relations, as this is not an area of responsibility for Network Operations.

Management offers the responses for the recommendations listed below.

**Recommendation 1:**

Identify and apply best practice for encouraging mailer participation in customer supplier agreements and reducing the duration of the Article 12 process.

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**Response:**

Since the completion of Phase 1, Network Operations has taken further steps regarding the creation of Customer Supplier Agreements (CSAs). As noted in the report, Network Operations has created a Mailers Technical Advisory Committee (MTAC) workgroup in order to communicate with the mailers. The purpose of this workgroup is to discuss origin separation requirements to support the network reengineering of the Bulk Mail Centers (BMCs).<sup>1</sup> Targeted completion date for workgroup is February 18, 2010.

Network Operations has and will continue to work with Business Services Network and Customer Relations to complete CSAs. Within field operations, we are taking a more proactive role in following up on CSAs. We have instructed the managers and supervisors at the Network Distribution Centers (NDCs) and Processing and Distribution Centers (P&DCs) to discuss the status of CSAs with Bulk Mail Entry Unit (BMEU) personnel when presented with mailings that do not have the origin separations in support of the network. We are also evaluating the option to pursue mailing standard changes. If mailing standards are adjusted for the new network, then mailer agreements on the origin separations will no longer be necessary.

As noted in the report, the Article 12 process is time-consuming, and we did not have the opportunity to begin the process earlier. We acknowledged that stand-by hours would increase in Tier 1 NDCs as a result of Phase 1 implementation, and chose to proceed with activation despite this. There was a greater opportunity to gain transportation savings by beginning implementation as soon as the planning phase was complete, and we have saved in excess of \$40 million to date in annual transportation costs as a result of Phase 1 activation. Even though employees are on standby time, we are not incurring additional costs of this time at the Tier 1 NDCs; instead workhours have begun to decline, even with standby time, but we have not yet fully capitalized on the potential labor savings.

The Article 12 process is part of the collective bargaining agreements with Postal Service employees. It exists throughout the organization and is not unique to the NDC Activation project. We acknowledge that there are inefficiencies in the process, and as such, a Lean Six Sigma (LSS) project on the process has begun. The Article 12 process does not fall under the responsibilities of Network Operations, and recommendations for it should be made to the VP, Labor Relations.

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<sup>1</sup> The MTAC Workgroup #131's charter is: A core component of the Postal Service's new Network Distribution Center (NDC) concept is to improve the induction of origin entry mail into the network. The Postal Service completed Phase I NDC activation on July 17, 2009 in Springfield, Philadelphia, and New Jersey NDCs. As a result of the dramatic service improvement and the early cost savings, the national NDC activation schedule has been accelerated and is scheduled to be complete by the end of November 2009. During Phase I activation USPS used Customer Supplier Agreements (CSA), with limited success, to help facilitate the origin separations. Given the importance of this issue collaboration is necessary between the Postal Service and the mailing industry, to bring this to resolution. This workgroup will focus on the issues regarding communicating what separations are necessary and why, and industry capabilities.

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**Recommendation 2:**

Require field management to develop and submit specific milestones in the Readiness Assessment Checklist to the network distribution center activation team for validation before the scheduled activation date.

**Response:**

The Readiness Assessment Checklists were developed for NDCs, P&DCs, and retail units. Each checklist is intended to serve as a basis of major items that must be completed prior to a site's activation. It is not intended to serve as a project plan with milestones. All items on the checklist are due during the advance week.

While the checklist must be completed during the advance week (one week prior to activation), we acknowledge that some items on the checklist are ongoing. One example of this is "Updated surface routings have been entered into NASS". Since transportation changes occur throughout the NDC's activation period, routings will change. During the advance week, the site must acknowledge that the routings for the first week of activation have been entered.

After the completion of Phase 1, we immediately determined that it was in our best interest to accelerate the implementation of the entire network. At the time of this response, Phases 2 and 3 have completed, and Phase 4, the final phase, is underway. To monitor that P&DCs and retail units are ready for activation, we required that District Managers certify readiness through an online tool at the mid-point of the advance week. If they choose, District Managers can collect the P&DC and retail unit checklists to aid in their assessments of the readiness state of their facilities; these checklists are not collected by Network Operations. At the NDCs, the checklist is reviewed and discussed with the NDC Manager and staff, and the results of the checklist are entered into an online tool during the advance week.

Additionally, for Phase 4, we conducted pre-activation meetings with lessons learned and best practices from the first three phases. In those meetings, we set milestones (deadlines) for some specific items related to the checklists.

**Recommendation 3:**

Develop a written plan to address identified risks during implementation of Network Distribution Center Phases 2 through 4 activation.

**Response:**

Prior to implementing this network reengineering, we assessed each risk and determined that the risks could be mitigated to ensure successful network implementation. During the course of the audit, the mitigating strategies, listed below, were implemented.

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Identified Risk	Mitigation
Political Risks	<p>Network reengineering for the NDCs was briefed to Congress and the Postal Regulatory Commission (PRC) on several occasions and was included as one of the main points in our Network Transformation Plan. Additionally, NDC Activation is discussed regularly in the same communication committee formed around AMPs and Stations and Branches consolidation. Government Relations is part of that committee.</p> <p>Through three phases of activation, we have not received resistance from Congress or the PRC.</p>
Cost Factor Analysis	<p>The model for the cost factor analysis was based upon conservative assumptions. As an example, the model used pre-NDC activation productivities, and did not assume any productivity gains. In actuality, productivity in Phase 1 sites increased by nearly 40 percent.</p> <p>Conservative assumptions allowed management to make the decisions to proceed with confidence.</p>
Aggressive Implementation Date	<p>To meet the aggressive implementation schedule, we put more resources on the ground for Phases 2 through 4, developed a communication plan that escalated issues more quickly than in Phase 1, created additional or refined online reporting tools, and conducted additional pre-activation meetings with the field.</p> <p>Despite the accelerated schedule, we continue to approach implementation incrementally and make adjustments to the schedule as needed. For example, Greensboro identified a tray sorting capacity issue. As a result, we moved an additional tray sorter to Greensboro and delayed Greensboro's activation until the equipment could be moved into place.</p>
Revenue at Risk	<p>This network reengineering has caused up to 20 percent increases in service scores for Package Services. Service is monitored every day throughout implementation. Issues are discussed through weekly national telecons for implementation.</p> <p>Mail flow to customers is not interrupted, but instead is improving. This may aid in our ability to grow the volume of this type of mail and create additional revenue streams.</p>

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Identified Risk	Mitigation
Stakeholder Interest (Communications)	For our customers, we minimized the impact. We did not alter the locations or number of entry points, did not change the service standards, and have not made mandatory mail make-up changes. We have increased our communications with the mailing community, including the creation of a MTAC workgroup.
Internal Control and Quality Assurance	We have quality processes in place. Those include on-site monitoring during site activation with corresponding daily teleconferences on issues; reports on missent mail each day; transportation changes tracking; and service reports. A weekly summary report is distributed to all Area Vice Presidents, the Senior Vice President of Operations, and the Deputy Postmaster General.
Customer Supplier Agreements	As discussed in the response to recommendation #1, we are continuing to work on obtaining CSAs. We are approaching this from a Marketing and Operations viewpoint. We are also exploring all our options.
Network Streamlining	The projected savings is based upon conservative assumptions, and we expect to exceed the projections. The impact of lower productivity rates is not expected in future phases and was not seen in Phase 1; rather productivity increased because of the consolidation of the volume in 10 NDCs rather than 21 BMCs.
Goodwill	Our communication strategies to combat inaccurate perceptions regarding this network change include: MTAC workgroup, Periodicals focus groups, and Red Tag meetings. We continue to monitor the network and its results to ensure the initiative will not fail. As necessary, we make adjustments to the plan (e.g., Greensboro's implementation).
Coordination with Other Initiatives	<p>The Phases 1 through 4 activation schedule separates these initiatives so that they are not occurring simultaneously.</p> <ul style="list-style-type: none"> <li>• New Mail Transport Equipment being tested: we removed the test equipment at the end of Phase 1, and Engineering is evaluating a new piece of test equipment. This is separate from the activation.</li> <li>• Use of Surface Visibility: this is an ongoing program, not a new initiative or a change to an old initiative.</li> <li>• Merging Surface Transfer Centers (STCs) with NDCs: STC movements do not occur during the phases. A separate timeline is being developed for each site.</li> </ul>

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- Movement of mail from Logistics and Distribution Centers to NDC: this move in Philadelphia was not begun until after Philadelphia NDC was fully activated.
- Installation and activation of Flat Sequencing System (FSS): this is completely separate from NDCs. The Phase 1 locations and timelines for FSS were chosen prior to the NDC activation, and have not disrupted any NDC activities. For example, set up of FSS in New Jersey NDC did not begin until after activation was complete.

By keeping these initiatives on separate timelines, we are able to better track costs and savings associated with each and not make a large number of changes at one time.

In closing, we have reviewed the audit report and do not believe that any portion of the document requires exemption from disclosure under the Freedom of Information Act.



Jordan M. Small  
Vice President, Network Operations

cc: Mr. Forte  
Mr. Neri  
Mr. Alexander  
Mr. Grossmann  
Ms. Hagaman  
Mr. Harris  
Mr. Batta