



October 22, 2008

SUSAN BROWNELL
VICE PRESIDENT, SUPPLY MANAGEMENT

ANTHONY M. PAJUNAS
VICE PRESIDENT, NETWORK OPERATIONS MANAGEMENT

SUBJECT: Management Advisory Report – Management Controls at Contractor-Operated Mail Processing Facilities (Report Number MS-MA-09-001)

This report presents the results of our self-initiated review of Management Controls at Contractor-Operated Mail Processing Facilities (Project Number 08RG016MS000). Our objective was to evaluate management controls related to contractor-operated mail processing facilities. See [Appendix A](#) for additional information about this audit.

Conclusion

The U.S. Postal Service can improve management controls by enhancing the contract award process to address potential organizational conflicts of interest and improving surface visibility controls over mail entering and exiting the facilities.

Enhance the Contract Award Process

The Postal Service awarded contracts to vendors without considering potential conflicts of interest. Two major mail presorters/consolidators (Pitney Bowes and United Parcel Service [UPS]) were awarded contracts to process mail for the Postal Service. Moreover, UPS also has a contract to provide air transportation. Awarding mail processing contracts to mail consolidators creates opportunities for the consolidators to introduce mail into the mailstream without the Postal Service verifying postage.

An organizational conflict of interest exists when the nature of the work to be performed under a contract may give an offeror an unfair competitive advantage, or when an offeror has other interests that may impair its objectivity or ability to perform satisfactorily.¹

Contractors' involvement in other mail-related activities, such as presorting and consolidating, was not considered because the Postal Service does not require disclosure of these activities during the solicitation. The Postal Service did not include

¹ *Purchasing Manual*, Issue 3, December 25, 2003 (updated with *Postal Bulletin* revisions through October 1, 2004), Section 1.6.8a, Supplying Principles and Practices (SP&P) (revised July 30, 2007).

the “Organizational Conflict of Interest” clause in the surface transfer center (STC) or the terminal handling services (THS) solicitations; rather, these solicitations only required disclosure of parent companies and business affiliations.² Accordingly, contracting officials did not have sufficient information to adequately assess potential conflicts of interest.

Also, Postal Service purchasing guidelines have become less stringent in recent years. The Postal Service’s *Purchasing Manual*, which had the force and effect of law, required contracting officers to attempt to identify potential conflicts of interest so they may avoid or mitigate them; however, management replaced the *Purchasing Manual* with *Interim Purchasing Guidelines* on May 19, 2005. Then on May 1, 2006, the agency replaced these guidelines with the SP&P. The SP&P, which do not have the force and effect of law, state that the Postal Service will seek to minimize both personal and organizational conflicts of interest and that a purchase plan “should” include possible conflicts of interest. However, the SP&P do not require contracting officers to include the conflict of interest clause in solicitations.

An organizational conflict of interest can cause the public to question the integrity of the Postal Service’s contracting process, give an offeror an unfair competitive advantage, or impair its objectivity or ability to perform satisfactorily. Further, the Postal Service may be at higher risk of losing revenue if mail is entered at contractor-operated facilities without proper verification and acceptance.

We recommend the Vice President, Supply Management:

1. Revise the “Representations and Certifications” section of Requests for Proposals, or include language in the solicitation, to require bidders to disclose any mail-related activities, such as consolidation or presorting operations performed by the offeror, parent companies, and business affiliations, which could lead to a conflict of interest or which appear to constitute a conflict of interest.
2. Incorporate Supplying Principles and Practices Clause 1-7, *Organizational Conflicts of Interest*, in all requests for proposals and contracts for outsourcing mail processing facilities.
3. Develop a conflict of interest mitigation plan for the current affected contracts, and develop a risk mitigation strategy regarding potential conflicts of interest for future mail processing contracts.

² This clause requires the contractor to represent that, to the best of its knowledge, it has no organizational conflicts of interest. In addition, any contractor discovering a conflict of interest after being awarded a contract must disclose the conflict to the contracting officer in writing, along with any corrective action the contractor has taken or proposes to take.

Improve Surface Visibility Controls

Procedures are not in place to confirm that employees have verified and accepted mail arriving at Surface Transfer Centers (STCs) and THS sites and that the customer paid the applicable postage. Specifically, mail barcode scans captured at contractor-operated facilities are not compared to barcode scans captured at mail entry points.³ Enhancing visibility using scanned barcode data would enable the Postal Service to monitor mail and protect revenue by validating that its employees properly verified and accepted all mail tendered to the contractor.

Surface Transfer Centers

Although the capability exists under Surface Visibility⁴ to scan individual mail handling units,⁵ the agency has not fully implemented it. Therefore, not all mail handling units arriving at the STCs have the 24-Digit Enhanced Distribution Label (EDL)⁶ barcode needed to capture detailed data. Accordingly, the STCs are not required to scan individual handling units. Rather, the contractor scans incoming containers to provide data for billing purposes only. Consequently, insufficient scan data is available to uniquely identify each handling unit and enable reconciliation of barcode scans captured at mail entry points to barcode scans captured at STCs.

The 24-digit EDL label format expands the existing 10-digit tray/sack label by adding data elements that will uniquely identify each handling unit and its origin and continue to support sortation and routing. The Postal Service can use this information to validate the receipt of trayed and sacked mail.

The Postal Service currently has ongoing initiatives to enhance visibility over mail through the Intelligent Mail and Surface Visibility programs. On August 21, 2008, the Postal Service promulgated a final rule governing Intelligent Mail barcodes. The 24-digit barcoded label will be available on, but not before, April 6, 2009. Once this barcode is in use, it will be possible to compare unique handling unit scans from mail entry points to scans taken at STCs.

³ Locations where mail is entered into the mailstream, such as business mail entry units, detached mail units, and post offices.

⁴ The goal of Surface Visibility is to collect data at the handling unit (sack, tray, or tub) level in order to track volume throughout the surface transportation network.

⁵ Mail handling units include sacks, trays and tubs.

⁶ The 24-digit EDL barcode includes additional fields to identify the mailer and uniquely number each tray or sack, and will be required for the Intelligent Mail full-service option.

Terminal Handling Services

THS contractors are responsible for scanning the Dispatch and Routing (D&R) Tags⁷ for each handling unit loaded into containers tendered to airlines at origination. Additionally, THS contractors are required to scan D&R Tags for each handling unit unloaded from the containers at destination. This scan data is used as a basis to compensate THS contractors. However, the originating and destinating scan data are not reconciled or used to monitor or account for mail entrusted to these contractors.

Prior to outsourcing mail processing activities, the Postal Service controlled the mail flow from the point of acceptance to delivery. The Postal Service is delegating control of these facilities to contractors without establishing controls to ensure all mail arriving at the facility has been verified and accepted, and the applicable postage has been paid.

Outsourcing mail processing activities to contractors without adequate visibility could increase the risk of revenue loss through transporting mail without proper verification and acceptance.

We recommend the Vice President, Network Operations Management:

4. Establish procedures to ensure the Postal Service reconciles mail scans captured by Surface Transfer Center and Terminal Handling Services contractors with scans at the points of acceptance.

Management's Comments

Management agreed with the intent of recommendation 1 but will not revise the "Representations and Certifications" section of Requests for Proposals. Instead, management will develop, in conjunction with the General Counsel, a tailored version of Clause 1-7, *Organizational Conflicts of Interest*, requiring suppliers to disclose and certify mail-related activities and include this clause in future solicitations. Management agreed with recommendations 2 and 3. To address recommendation 2, management will include the tailored Clause 1-7 in future solicitations for outsourcing of mail processing contracts. To address recommendation 3, management will work with Network Operations to assess the risks for potential conflicts of interest regarding current contracts and consider risk management plans for future mail-related outsourcing activities where the potential for conflicts of interest exist.

Finally, management disagreed with recommendation 4, stating that full adoption of the Intelligent Mail barcode and implementation of Seamless Acceptance will provide a fully

⁷ A barcoded Postal Service label that is attached to a mail handling unit. This tag provides an identification number that is unique for 30 days from generation in human and machine-readable format. It also provides the destination aviation supplier ramp identifier of the handling unit in human readable format.

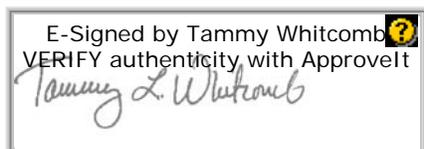
integrated process to capture and track mailpieces and handling units back to the point of acceptance. See [Appendix B](#) for management's comments, in their entirety.

Evaluation of Management's Comments

The U.S. Postal Service Office of Inspector General (OIG) considers management's comments responsive to recommendations 1, 2, and 3 and their corrective actions should resolve the issues identified in the report. However, management's comments are only partially responsive to recommendation 4 and will not fully resolve the issues identified in the report. Adopting the Intelligent Mail barcode and the associated infrastructure will provide the capability to track mailpieces and handling units back to the point of acceptance. However, only the full service option for Intelligent Mail provides some ability to confirm that mail was accepted and postage paid. The Postal Service is not making the full service option for Intelligent Mail or Seamless Acceptance mandatory; therefore, some mailers may not adopt this option. There is also a risk that mail that has not been submitted for verification and acceptance can be delivered to a processing facility. Therefore, reconciliation procedures are still needed to ensure mail arriving at contractor-operated facilities has been properly verified and accepted and the applicable postage paid.

The OIG considers all the recommendations significant, and therefore requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective actions are completed. These recommendations should not be closed in the follow-up tracking system until the OIG provides written confirmation that the recommendations can be closed. We view the disagreement on recommendation 4 as unresolved and plan to pursue it through the formal audit resolution process.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Robert Mitchell, Director, Sales and Service, or me at (703) 248-2100.



E-Signed by Tammy Whitcomb 
VERIFY authenticity with ApproveIt
Tammy L. Whitcomb

Tammy L. Whitcomb
Deputy Assistant Inspector General
for Revenue and Systems

Attachments

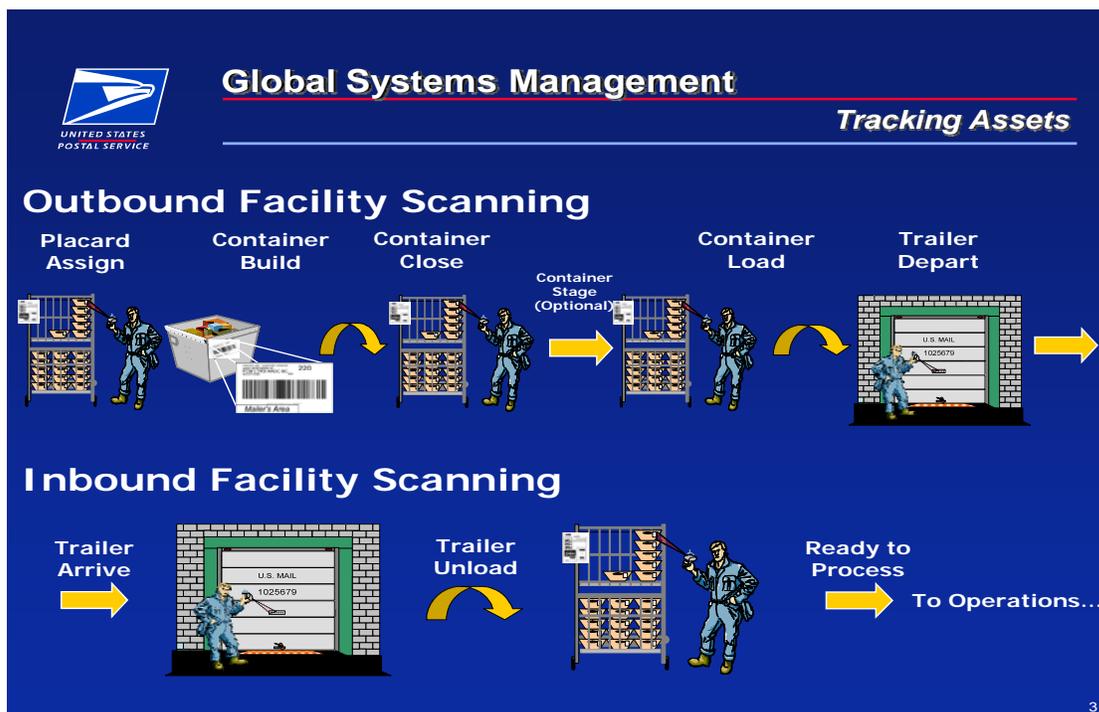
cc: Harold G. Walker
William P. Galligan
Katherine S. Banks

APPENDIX A: ADDITIONAL INFORMATION

BACKGROUND

The Postal Service outsources some of its mail processing facilities to improve operational efficiency and reduce costs. Recent and planned initiatives to outsource mail processing and transportation functions place added significance on the need to avoid, neutralize, or mitigate potential conflicts of interest before it awards contracts.

Surface Visibility provides the real-time decision support capabilities necessary to better manage dock operations. In support of the Surface Visibility implementation strategy for label production, the Postal Service is transitioning from the 10-digit barcode to the 24-digit EDL barcode. The new barcode label provides the capability to uniquely identify handling units in addition to identifying the origin of the handling unit. Real time data is captured by handling unit, container, and trailer using mail processing equipment and wireless handheld scanners. As each uniquely identified handling unit is nested⁸ into a container, it is tracked through the plant and onto and off of trailers. The scanning device notifies employees if they are placing a handling unit into an incorrect container or if the container is loaded onto an incorrect trailer. When a trailer leaves its originating plant, the destinating facility is notified of the expected arrival time and the contents of the trailer.



Source: U. S. Postal Service

⁸ Nesting refers to associating handling units (sacks, trays, and tubs) with containers (rolling stock—general purpose mail containers, universal mail containers, hampers, and pallets), and then containers with trailers.

Contractor-operated mail processing facilities include:

Surface Transfer Centers (STCs), formerly known as Hub and Spoke Programs (HASPs)⁹, are mail consolidation and redistribution facilities intended to efficiently use vehicles. STCs receive mail containerized by product type or by ZIP Code range and sort mixed mail volume to the appropriate facility or transfer direct containers within a specialized surface transportation network. Of 20 STCs, the following seven are contractor-operated.

Contractor-Operated Surface Transfer Centers			
STC Name	Contractor	Period of Contract	Contract Expense*
Atlanta, GA	Pitney-Bowes	9/9/06 – 9/8/10	\$6,959,044
Binghamton, NY	DDL Associates	5/1/06 – 3/31/09	\$1,882,712
Indianapolis, IN	ABX	10/14/06 – 10/13/10	\$5,897,161
Memphis, TN	ABX	9/30/06 - 9/22/10	\$3,792,143
Salt Lake City, UT	New Breed	6/10/06 – 9/30/08	\$4,174,906
Southeast (Clinton, TN)	Pitney-Bowes	7/14/07 – 7/13/08 ¹⁰	\$4,119,736
Southwest (Dallas, TX)	ABX	9/9/06 – 9/8/10	\$5,320,000

Contract expenditures identified above are actual totals for Fiscal Year 2007

Air Mail Centers (AMCs)¹¹ are located at or adjacent to airports. Core operations include assigning mail to flights; receiving and dispatching mail to/from air carriers; accepting and sorting mail to/from plants; measuring performance; overseeing quality control of air carrier operations; and managing functions specific to airport operations. However, due to declining airmail volume, the Postal Service began standardizing AMCs in 2007 by returning non-core AMC operations to processing and distribution centers and bulk mail centers.

Bulk Mail Centers (BMCs) receive and process Periodicals, Standard Mail®, Package Services, and, in some cases, Priority Mail® destinating within their own service area. The BMC network consists of 21 facilities that serve as centralized processing and transfer points for designated geographic areas. The BMC network also includes Auxiliary Service Facilities (ASFs). These ASFs are usually part of a general mail facility that has its own service area and serves as a satellite processing hub for a particular BMC.

⁹ Program for surface mail that includes a central point (“hub”) where mail for a group of offices (“spokes”) can be unloaded from a series of incoming trips, massed according to their intended destination, and then sent on to that destination on another trip.

¹⁰ The Clinton STC is operating under a sole source justification to allow for solicitation of a new contract.

¹¹ Represents both AMCs and Air Mail Facilities (AMFs), which perform essentially the same functions. An AMC is generally larger than an AMF.

In July 2007, the Postal Service issued a Request for Information (RFI) seeking to identify interested organizations with the capability of implementing a time-definite mail distribution and transportation network. In July 2008, the Postal Service issued a draft Request for Proposal (RFP) for a Time-Definite Surface Network, the next step in a process following 2007's RFI on the same subject. The draft RFP provides an opportunity for industry to review and understand the Postal Service's requirements and to provide comments and feedback on the various sections of the solicitation, including the statement of work and provisions and clauses. The Postal Service operates all BMCs and ASFs.

The draft RFP emphasizes the importance of 100 percent visibility of mail processed by potential contractors. Specifically, it states:

. . .visibility data allows the Postal Service to track service, enable payment, protect revenue, and ensure that all mail tendered to the supplier is delivered back to the Postal Service.

The data will be captured through the tracking of unique barcodes on trailers, mail transport equipment, placards, and mail handling units. When a unique barcode is not available, the supplier will produce a barcode for trays, tubs, sacks, pallets, and rolling stock. Each unit is tracked either through direct scanning, nesting/denesting scans, or some other supplier-designed process/system.

Terminal Handling Services (THS) Suppliers are responsible for handing off mail between the Postal Service and air carriers at 65 airports where mail is tendered, received and prepared for dispatch. The primary carrier is FedEx. There are currently nine THS contracted facilities.

Contractor-Operated Terminal Handling Services Sites		
Contractor	Number of Airports Serviced	Estimated Contract Cost
Cargo Force (CFI)	3	\$46,218,927
Global Logistic Service (GLS)	1	\$4,039,403
Metro Air Service (MAS)	5	\$43,617,283
Evergreen-Eagle (EZT)	10	\$131,009,527
Worldwide Flight Services (WFS)	11	\$115,244,049
Integrated Airline Service (IAS)	13	\$79,284,262
Matheson Flight Services (MFE)	16	\$132,945,150
Quantem Airline Service (QAS)	5	\$23,570,399
United Parcel Service (UPS)	1	\$7,175,954

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to evaluate management controls related to contractor-operated mail processing facilities. To accomplish our objective, we:

- Reviewed criteria related to the Postal Service's contracting process.
- Researched best practices pertaining to the bid solicitation/contract award process.
- Interviewed contracting officials to gain an understanding of existing bid solicitation/contract award procedures and related management controls.
- Reviewed contract files for outsourced mail processing facilities to identify potential conflicts of interest and whether key provisions conformed to Postal Service policy and best practices.
- Visited two contractor-operated facilities to observe controls for preventing mail from bypassing the mail acceptance process.
- Interviewed contractor and Postal Service staff at the selected facilities to obtain an understanding of controls in place for detecting mail entering the mailstream without being properly verified and accepted.

- Examined how the Postal Service's Surface Visibility Program operates at contracted facilities.

We conducted this review from April through October 2008 in accordance with the President's Council on Integrity and Efficiency, *Quality Standards for Inspections*. We relied on data obtained from Postal Service officials and data systems, including the Contract Authoring and Management System, PostalOne!, and Transportation Contract Support System. We did not test controls over the Postal Service data systems used. We performed limited data integrity reviews, including source document examination, observations, and discussions with officials to support our reliance on the data. We discussed our observations and conclusions with management officials on September 4, 2008, and included their comments where appropriate.

PRIOR AUDIT COVERAGE

Report Title	Report Number	Final Report Date	Report Results
<i>St. Louis Air Mail Center Outsourcing</i>	EN-AR-08-002	February 29, 2008	The decision to outsource some operations was supported and should reduce costs with minimal impact on service performance; however, management could have improved planning for this new initiative. Opportunities exist to formalize lessons learned and best practices and enhance guidance for measuring results.
<i>Data Needed to Assess the Effectiveness of Outsourcing</i>	GAO-08-787	July 24, 2008	The Government Accountability Office (GAO) reported that the Postal Service has no comprehensive mechanism for measuring results, including any actual savings; therefore, it could not provide information on the effectiveness of its outsourcing. Without cost-savings data, management, stakeholders, and Congress cannot assess the risk and value of outsourcing. Also, accountability for results is limited. GAO recommended that the Postmaster General establish a mechanism to measure the results (including any savings) of outsourcing initiatives that are subject to its collective bargaining agreements and better inform Congress by including these results in its annual operations report. The Postal Service generally agreed with GAO's first recommendation, but did not commit to implementing GAO's recommendation to provide Congress with information about the results of its outsourcing initiatives.

APPENDIX B: MANAGEMENT'S COMMENTS

SUSAN M. BROWNELL
VICE PRESIDENT, SUPPLY MANAGEMENT



October 3, 2008

LUCINE M. WILLIS

SUBJECT: Draft Management Advisory – Management Controls at Contractor-Operated Mail Processing Facilities (Report Number MS-MA-08-DRAFT)

This provides postal management's response to recommendations 1, 2, and 3 of the subject management advisory that were directed to Supply Management. We appreciate the opportunity to review and provide comments. The following addresses the specific recommendations:

Recommendation 1: Revise the "Representations and Certifications" section of Requests for Proposals, or include language in the solicitation, to require bidders to disclose any mail-related activities, such as consolidation or presorting operations performed by the offeror, parent companies, and business affiliations, which could lead to a conflict of interest or which appear to constitute a conflict of interest.

Management Response: We agree with the intent of the recommendation. The "Representations and Certifications" is a standard form that is used by all commodities within Supply Management, and we would prefer not to include specific language associated with mail-related activities within the form located in the Supplying Principles and Practices. However, when considering the outsourcing of mail-related activities, we will develop, in conjunction with General Counsel, a tailored version of Clause 1-7, *Organizational Conflicts of Interest*, requiring supplier(s) to disclose and certify any mail-related activities or operations, and include this clause in future solicitations. Inclusion of this tailored clause for mail-related outsourcing activities will be discussed in a communication developed by the Manager, Transportation Portfolio, and distributed to all transportation contracting officers. This will be completed within 60 days from issuance of the final report.

Recommendation 2: Incorporate Supplying Principles and Practices Clause 1-7, *Organizational Conflicts of Interest*, in all requests for proposals and contracts for outsourcing mail processing facilities.

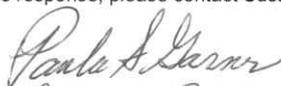
Management Response: We agree with the recommendation and will include the tailored Clause 1-7, *Organizational Conflicts of Interest*, as discussed in Recommendation 1 above, in future solicitations for outsourcing of mail processing activity type contracts. Supply Management will also cascade the Office of Inspector General's final report and emphasize that contracting officers should review and strongly consider using Clause 1-7, and any other available clause, that would be pertinent to the nature of the contract, in order to protect the interests of the Postal Service. The cascade will be issued within 30 days from the final report.

Recommendation 3: Develop a conflict of interest mitigation plan for the current affected contracts, and develop a risk mitigation strategy regarding potential conflicts of interest for future mail processing contracts.

475 L'ENFANT PLAZA SW
WASHINGTON, DC 20260-6200
202-268-4040
FAX: 202-268-2755
WWW.USPS.COM

Management Response: Supply Management generally agrees with this recommendation. Development of risk management plans will be considered for future mail-related outsourcing activities where the potential for a conflict of interest exists. The necessity and formulation of these plans will be discussed in the above communications within 60 days from issuance of the final report. With regard to the current contracts, Supply Management will work in conjunction with Network Operations to assess the potential conflict of interest risks and determine if risk management plans would be beneficial. The assessment will be completed by end of second quarter in fiscal year 2009.

We do believe this report contains proprietary and business information that should not be disclosed pursuant to the Freedom of Information Act. A separate document describing our request for specific exclusions will be provided by October 8. If you have any questions about this response, please contact Susan Witt at (202) 268-4833.


ACTING, VP, SM

cc: William P. Galligan
Katherine S. Banks
Tony Pajunas

TONY PAJUNAS
VICE PRESIDENT, NETWORK OPERATIONS



October 2, 2008

Lucine Willis
Director, Audit Operations
Office of the U.S. Inspector General
1735 North Lynn St.
Arlington, VA 22209-2020

SUBJECT: Draft Management Advisory – Management Controls at Contractor-Operated Mail
Processing Facilities (Report Number MS-MA-08-DRAFT)

Thank you for the opportunity to respond to the findings in your draft Management Controls at
Contractor Operated Mail Processing Facilities (Report Number MS-MA-08-DRAFT). Management
disagrees with your recommendation. Management's response is included below.

Recommendation 4:

Establish procedures to ensure the Postal Service reconciles mail scans captured by Surface
Transfer Center and Terminal Handling Services contractors with scans at the point of acceptance.

Response:

Management does not agree with this recommendation. Full adoption of the Intelligent Mail bar
code by mailers along with implementation of Seamless Acceptance will provide a fully integrated
process capable of tracking mail pieces and handling units back to the point of acceptance. These
actions are currently underway.

If you have any questions or require additional information, please contact Cindy Mallonee,
Manager, Logistics at (202) 268-5450.



Tony Pajunas
Vice President
Network Operations

475 L'ENFANT PLAZA SW
WASHINGTON, DC 20260-7100
202-268-4948
FAX: 202-268-5002
WWW.USPS.COM