



March 3, 2009

ELLIS A. BURGOYNE  
VICE PRESIDENT, SOUTHWEST AREA OPERATIONS

SUBJECT: Audit Report – Air Networks – Federal Express Transportation  
Agreement – Southwest Area (Report Number NL-AR-09-002)

This report presents the results of our self-initiated audit of the Federal Express (FedEx) transportation agreement. The objectives of our audit were to determine whether selected transportation operations were effective and economical (Project Number 08XG027NL000).<sup>1</sup> See [Appendix A](#) for additional information about this audit.

### [Conclusion](#)

It was more effective and economical for the Southwest Area to use ground transportation and domestic air carriers, and to sort mail at U.S. Postal Service plants in some cases, than to use FedEx to perform these functions. Because the Southwest Area used FedEx, the Postal Service incurred about \$9 million in unnecessary costs. If the Southwest Area implements our recommended changes, we estimate the Postal Service could save \$44.3 million over a 10-year period.

### [Transporting Surface Mail on FedEx Day Turn](#)<sup>2</sup>

We concluded that using ground transportation was more advantageous than using FedEx in some cases. Transporting surface mail by FedEx cost the Postal Service about \$8.2 million more than necessary. This occurred because plant employees did not properly segregate surface mail classes (Periodicals, Standard Mail, and Package Services) from First-Class Mail® and Priority Mail®. By using ground transportation, the Postal Service could lower overall FedEx lift requirements and save about \$34.7 million over 10 years. See [Appendix B](#) for our detailed analysis of this topic.

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<sup>1</sup> We changed the wording of the audit objectives slightly from the original announcement letter. The initial objectives were to determine whether operations were effective and to identify opportunities to save money.

<sup>2</sup> FedEx Day Turn operations are principally for transporting First-Class Mail and Priority Mail during daytime hours.

We recommend the Vice President, Southwest Area Operations:

1. Use surface transportation to the extent possible for mail that does not require air transportation to meet Postal Service on-time standards.

### **Management's Comments**

Management generally agreed with our finding and recommendation. Management responded that in many cases, using ground transportation can be more cost-effective than FedEx, when ground transportation is service-responsive. However, they stated that other impacts are associated with separating these mail types, including the additional costs of sweeping and resetting machines and lower container density. Management also stated that they sometimes include surface mail on FedEx to avoid mismatched FedEx contract requirements, claiming this is more cost-effective. They provided other examples of situations where it is more advantageous to use FedEx than surface transportation.

Management also expressed concerns over the amounts of our questioned costs and projected savings. Management disputed the use of the extrapolated volume data from the Postal Service's Transportation Cost System (TRACS), stating that the system is designed to give estimates at the national level and not at the facility or area level. Management further stated that our estimates lacked the offsetting costs of ground transportation and associated labor costs. However, management did state they would follow Postal Service Headquarters policy of providing quality service at the lowest cost to the organization and would issue instructions to plant managers reinforcing the policy. Management's comments, in their entirety, are included in [Appendix E](#).

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

The U.S. Postal Service Office of Inspector General (OIG) considers management's comments responsive to the finding and recommendation, and the corrective actions should resolve the issues identified in the report. The OIG disagrees with management's reasons for transporting some surface mail on FedEx and their rationale for the associated cost impacts. Postal Service policy is to use surface transportation for moving Standard, Periodical, and Package Services mail types. Surface transportation is the most economical method for moving most of these mail types while meeting established standards. We believe that not using this method should be the exception, not the rule. In addition, using the more costly FedEx network to unnecessarily advance mail to avoid on-hand volume reporting is not economically sound and passes local costs on to a national transportation network.

Further, the costs of using established procedures to process and move the mail on prescribed methods of transportation are normal costs of doing business. The normal costs of doing business should not be considered as offsetting costs when determining questioned and projected savings for moving mail on its proper transportation mode. Our monetary impacts are based on the use of existing surface transportation with

available space to accommodate the additional surface mail volume if that volume is removed from FedEx.

Regarding management's comments on the use of TRACS data to apply dollar impacts to the findings and projections, we believe our methodology is sound. Management stated that the system was designed to give estimates at the national level. However, we thoroughly analyzed the test data and associated the data with specific facilities in the Southwest Area. We used the Southwest Area's percentage of the total surface mail types across all areas and applied the applicable costs to the Southwest Area. Although we did not replicate the testing process, our observations verified the existence of surface mail types on FedEx and identified surface mail volumes in containers destined for FedEx at all the locations we visited. In addition, before we issued our draft report, the Postal Service Headquarters Statistical Programs Group reviewed our analysis and found no issues with our methodology and use of TRACS sample data for calculating the cost impacts at the area level. Therefore, we believe the use of the TRACS data gives a fair approximation of the dollar impacts on the Southwest Area.

### **FedEx Versus Passenger Airlines**

When the Postal Service requires air transportation, we concluded it is more advantageous to use passenger carriers than FedEx in some cases. From January 1 through December 31, 2007, the Postal Service incurred \$218,000 in unnecessary costs to move [REDACTED] cubic feet of First-Class Mail on FedEx from origins in the Southwest Area. The excess costs were incurred because local officials did not prioritize mail by assigning it to less costly available commercial air transport. The Southwest Area could save about \$4.2 million over a 10-year period by using the maximum capacity of passenger airlines under Postal Service domestic air transportation contracts. See [Appendix B](#) for our detailed analysis of this topic.

We recommend the Vice President, Southwest Area Operations:

2. Transport mail to the maximum extent possible using the service-responsive capacity of passenger airlines under contract with the Postal Service.

### **Management's Comments**

Management generally agreed with our finding and recommendation. They stated that in many cases, using domestic air carriers has the potential to be more cost-effective and economical than using FedEx. Management stated they have made considerable progress toward maximizing the use of commercial carriers; they continue to regularly review Air Mail Condition Reports from headquarters and seldom dispatch any known surface or commercial air volume on FedEx.

Management also stated that while the per-pound rate of commercial air is less than FedEx, the on-time performance of commercial air carriers on contract with the Postal

Service has not risen above 75 percent, as measured by the Department of Transportation. Management stated that the 2006 commercial air agreement placed considerable limitations on the transportation network. They outlined several reasons for their decisions concerning which mode of transportation to use, which could impact the data used to arrive at the OIG's conclusions. Management explained the Southwest Area's efforts to properly use commercial air routings and challenges with the Postal Service data systems, contingency measures placed on them by Postal Service Headquarters Logistics to fill FedEx matrix commitments, inconsistent or nonresponsive service offered by the 2006 commercial air agreement suppliers, and other issues.

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

The OIG considers management's comments responsive to the finding and recommendation and recognizes management's ongoing efforts to reduce the volumes of First-Class Mail on FedEx. The corrective actions management has already taken and plans to continue will help resolve the issues identified and realize the savings projected in the report.

We agree that management must consider service, timeframes, and capacities when assigning mail to commercial air transportation. The Postal Service established a system for assigning mail to ensure that it moves on intended routes, based on service and cost. Issues can occur in the assignment process; carriers are sometimes not able to carry mail; and carriers are sometimes late in arriving at destinations. However, the Postal Service has procedures in place to address and correct the process when these issues occur. These processes should ensure on-time performance and minimize the need to use FedEx when commercial air capacity is available.

### **Mixed Versus Bypass Air Containers**

Finally, in some cases, it was more advantageous for the Postal Service to sort mail than FedEx. During the period January 1 through December 31, 2007, the Southwest Area unnecessarily spent about \$548,000 to have FedEx sort mail. The Postal Service incurred this expense because the Southwest Area processing plants did not separate mail and distribute it in bypass containers.<sup>3</sup> If the Southwest Area properly sorts and distributes this mail, the Postal Service could avoid about \$5.4 million in unnecessary costs over 10 years. See [Appendix B](#) for our detailed analysis of this topic.

We recommend the Vice President, Southwest Area Operations:

3. Sort mail into bypass containers as appropriate.

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<sup>3</sup> Bypass containers contain mail for specific destinations that do not need to be sorted by FedEx in Memphis, TN, for onward transportation.

## Management's Comments

Management generally agreed with our finding and recommendation. Management stated the area conducts weekly teleconferences and reviews operating plan compliance, which partially drives the utilization of bypass containers. They stated that adherence to operating plans and discussion of the results maximizes the number of bypass containers generated. Management also gave a number of reasons for not sorting mail in bypass containers, including a minimum planning weight requirement, excessive volumes, and the exact times that mail must be tendered. However, management stated that the Area Manager, Distribution Networks, will ensure that plants make the best use of bypass container allocation through established teleconferences and through other regular communication.

## Evaluation of Management's Comments

The OIG considers management's comments responsive to the finding and recommendation, and the corrective actions should address the issues identified in the report. The planned FedEx matrix sets goals for bypass containers tendered to FedEx in order to avoid added sorting costs. To accommodate the plans, local officials should have established processes in place to meet plans as part of their normal method of doing business. In addition, our review determined that the established process was not always followed and resulted in unnecessary sorting. We observed many instances where mail did not arrive at the terminal handling services sites at scheduled times, resulting in conversions from bypass to mixed containers. In addition, we observed mail destined for locations where containers were in place for bypass mail, but the mail arrived in mixed containers. Further, our analysis of mailpieces took into consideration the conversion criteria and excessive volumes.

## Additional Management Comments

Management did not agree that the questioned costs and funds put to better use included in our report were valid. Management commented that, as a whole, mail volume is falling and the FedEx network is continually being shrunk, yet the projected savings assumes that volumes remain constant. Therefore, management did not agree with the 10-year future savings of \$44.3 million projected in the report. Management estimated the 10-year savings at \$10 million to \$14 million. Management stated that they based their estimates on typical methodologies used to determine the return on investments from process changes, and the ongoing decrease in volumes being experienced by the Postal Service. Management did not provide supporting documentation for the amounts it disagreed with or for its alternate estimates.

## Evaluation of Management's Additional Comments

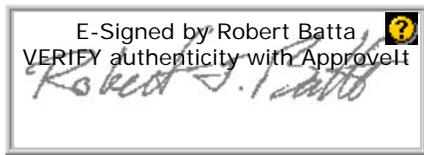
We acknowledge management's comments regarding declining mail volume. Our estimates considered volumes, including any declines, during the period audited (October 2005 through December 2007). These estimates are based on the best

available information and assume continued average volume levels for the period audited. We will continue working with management to reach agreement on projected monetary impacts and close the significant recommendations.

We will report a total of \$53,304,996 in monetary impact for the three findings in our *Semiannual Report to Congress*, including \$8,995,521 in questioned costs and \$44,309,475 in funds put to better use.

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 Postal Service follow-up tracking system until the OIG provides written confirmation that they can be closed.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Jody Troxclair, Director, Transportation, 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

#### Attachments

cc: Patrick R. Donahoe  
William P. Galligan  
Susan Brownell  
Anthony M. Pajunas  
Cynthia F. Mallonee  
Katherine S. Banks

## APPENDIX A: ADDITIONAL INFORMATION

### BACKGROUND

In January 2006, the Postal Service formalized a nationwide integrated air strategy and briefed the Board of Governors. Management explained that passenger airlines were less costly, but also less reliable than other air transportation contractors such as FedEx. Under the strategy, the Postal Service intended to reduce reliance on passenger airlines; expand existing air transportation with FedEx and other air cargo carriers; and, where possible, shift mail moved by air to less costly ground transportation. Officials emphasized that the integrated air strategy would increase air carriers' on-time performance, create air network redundancy, improve flexibility, enhance security, and reduce costs by making contracting more competitive and allowing the Postal Service to eliminate infrastructure.

Passenger Airlines – On June 30, 2006, when the Postal Service's transportation contracts with passenger airlines expired, they discontinued most passenger airlines as domestic air transportation contractors. On September 29, 2006, the Postal Service announced new air transportation contracts with select passenger airlines. The Vice President, Network Operations, explained that by relying on passenger airlines with established records of performance, the new contracts would help achieve on-time delivery and provide higher levels of service.

Postal Service officials explained that American Airlines was a passenger airline with reliable, on-time performance, and was awarded a contract to continue providing service.

Mail being loaded onto an American Airlines jet at Dallas Fort Worth International Airport, November 25, 2008.



The FedEx Contract – On August 2, 2006, the Postal Service announced it had truncated the original 2001 contract with FedEx and signed a new 7-year agreement. The new agreement specified an immediate price reduction in all contract categories and allowed the Postal Service to continue to outsource Terminal Handling Service (THS) contractors.

On July 31, 2006,  
the Postal Service  
signed a new  
7-year agreement  
with FedEx.

The air containers  
pictured in the  
foreground were  
designed to be  
loaded onto FedEx  
aircraft.



The Postal Service transportation network currently uses THS contractors to prepare and load mail in containers onto FedEx planes. The contractors for Southwest Area THS operations are Matheson Flight Extenders, Inc. (Matheson) and Integrated Airline Services, Inc. (IAS).

Under the FedEx contract, the Postal Service periodically negotiates with FedEx for mail transport capacity. As a contract minimum, the Postal Service must use 95 percent of the contracted capacity or pay for it regardless.

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

This is the fourth in a series of reports on the FedEx transportation agreement. The objectives of our audit were to determine whether selected transportation operations in the Southwest Area were effective and economical.

To conduct our work, we visited various facilities and operations in the Southwest Area, including airport mail centers (AMCs), THS operations, and mail processing facilities in Albuquerque, NM; Austin, TX; Baton Rouge, LA; Dallas, TX; Houston, TX; Oklahoma City, OK; and San Antonio, TX.

We interviewed officials from Postal Service Network Operations and the Southwest Area. We also interviewed Postal Service contractors, including officials from FedEx, IAS, and Matheson. We evaluated the types of mail transported, considered on-time service standards, analyzed alternate solutions for making the best use of surface and air networks, and observed and photographed operations.

**The Postal Service outsources THS operations to contractors, who build and tender air containers to FedEx for transportation.**

**FedEx container loaded by THS operations for tender to FedEx, Baton Rouge, LA.**



We also examined relevant documents, including:

- The Postal Service Integrated Air Strategy, dated January 9, 2006.
- The FedEx contract, dated January 10, 2001, and the extended FedEx contract, dated July 31, 2006.
- Postal Service contracts with various passenger airlines.
- Contracts with THS providers.
- Postal Service policies that govern network routing and on-time standards.

We examined computer-generated data from October 2005 through December 2007 to analyze mail volume, operational efficiency, and costs. We did not audit or comprehensively validate the data; however, the large amounts of data and its inaccessibility significantly constrained our work. Extracting more current data during the audit would have delayed our work.

To address these data limitations, we applied alternate audit procedures. We discussed the data with Postal Service officials, managers, supervisors, employees, and contractors; conducted source document examinations; and observed and conducted physical inspections. We also discussed our initial findings and recommendations with senior Postal Service officials, considered their perspective, and included their comments where appropriate.

We conducted this performance audit from April 2008 through March 2009 in accordance with generally accepted government auditing standards and included such tests of internal controls as we considered necessary under the circumstances. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our

audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We discussed our observations and conclusions with management on November 25, 2008, and included their comments where appropriate.

**PRIOR AUDIT COVERAGE**

<b>Report Title</b>	<b>Report Number</b>	<b>Final Report Date</b>	<b>Monetary Impact</b>
<i>Air Networks – Issues In the Pacific Area Associated with a Major Postal Service Customer</i>	NL-AR-08-001	November 23, 2007	\$80.4 million
<i>Air Networks – Federal Express Transportation Agreement – Pacific Area</i>	NL-AR-08-002	February 19, 2008	\$62.8 million
<i>Air Networks – Federal Express Transportation Agreement – Western Area</i>	NL-AR-08-008	September 29, 2008	\$141.3 million

The reports listed above identified the same or similar issues identified in this report. We identified FedEx operational efficiency opportunities in the Pacific Area and the Western Area related to surface mail flown on FedEx, First-Class Mail flown on FedEx, FedEx container capacity, and bypass container use. Management agreed with our findings and recommendations in the Pacific Area, but had not validated all monetary impact at the time of report issuance. In the Western Area, management generally agreed with our findings and recommendations; however, management did not agree with the total monetary impact savings.

**APPENDIX B: DETAILED ANALYSIS**

**Transporting Surface Mail on Federal Express Day Turn**

We concluded that using ground transportation was more advantageous for the Postal Service than using FedEx in some cases. Data from the Postal Service’s fiscal years (FY) 2006 and 2007 cost and revenue analyses and the TRACS identified large volumes of surface mail<sup>4</sup> transported using the FedEx Daytime Network (Day Turn) from origins in the Southwest Area to destinations across the country. Postal Service policy requires transportation managers to balance service and cost. Because surface mail is not as time-sensitive as Express®, Priority, or First-Class Mail, Southwest Area transportation managers could have met the Postal Service’s on-time standards by using highway or rail transportation. By transporting surface mail on FedEx the Postal Service spent about \$8.2 million more than necessary, as shown in Table 1.

**Table 1. Excess Costs of Transporting Surface Mail on FedEx Day Turn during FYs 2006 and 2007**

<i>Fiscal Year</i>	<i>Periodicals</i>	<i>Standard Mail</i>	<i>Package Services</i>	<i>Total Cost in Millions</i>
2006	\$685,631	\$1,140,268	\$2,068,732	\$3,894,630
2007	<u>1,099,879</u>	<u>1,666,611</u>	<u>1,568,509</u>	<u>4,335,000</u>
<b>Total</b>	<b>\$1,785,510</b>	<b>\$2,806,879</b>	<b>\$3,637,241</b>	<b>\$8,229,630</b>

**Note:** We extracted information from Postal Service cost and revenue analysis data. All numbers are rounded. For more details, see [Appendix D](#).

The Southwest Area transported surface mail on FedEx and the Postal Service incurred excess costs, in part, because employees at Southwest Area processing plants did not properly segregate surface mail classes (Periodicals, Standard Mail, and Package Services) from First-Class and Priority Mail during distribution operations. Specifically, during our site visits to processing plants<sup>5</sup> we observed plant employees placing surface mail into First-Class and Priority Mail containers or sacks for transport by FedEx using the Day Turn network. For example, at the [REDACTED] Processing and Distribution Centers (P&DC), we observed that during processing, Periodicals and Standard Mail were mixed with First-Class Mail in originating distribution operations. See [Appendix D](#) for more details on the sites we visited.

<sup>4</sup> Surface mail includes magazines, advertising, and merchandise shipped by major mailers such as publishers, catalog companies, or online retail companies.

<sup>5</sup> Albuquerque, NM; Austin, TX; Baton Rouge, LA; Dallas, TX; Houston, TX; Oklahoma City, OK; and San Antonio, TX.

Redacted

Periodicals in flat tubs and Priority Mail sacks destined for transportation on FedEx,  
 Oklahoma City P&DC and North Houston P&DC.

The Postal Service could lower overall FedEx lift requirements and save about \$34.7 million over 10 years. See [Appendix C](#) for a breakdown of unnecessary costs and potential cost avoidance.

### FedEx Versus Passenger Airlines

It was more advantageous for the Postal Service to use domestic carriers than FedEx in some cases. From January 1 through December 31, 2007, the Postal Service incurred almost \$218,000 in unnecessary costs to move ██████ cubic feet of First-Class Mail on FedEx from origins in the Southwest Area. The Postal Service incurred the excess costs because local officials did not follow mail assignment priorities by assigning mail to less costly available commercial air transport. See Table 2.

**Table 2. Available Unused Capacity on Passenger Airlines  
 Analysis of the Southwest Area – January 1 through December 31, 2007**

<i>Southwest Area Point of Origin</i>	<i>Unused Passenger Airline Capacity in Cubic Feet</i>	<i>Excess Costs</i>
Albuquerque	██████	\$5,698
Austin	██████	12,133
Dallas	██████	81,521
Houston	██████	89,025
San Antonio	██████	28,687
All Other	██████	921
<b>Total</b>	████████	<b>\$217,985</b>

Postal Service transportation managers told us that transportation on FedEx was the most costly transportation mode, passenger airlines were less costly, and surface was the least costly.

Management generally assigns First-Class Mail according to these priorities:

- The Postal Service uses surface transportation when distances allow that mode to meet on-time standards.
- The Postal Service uses passenger airlines because these carriers provide the least costly air transportation.
- The Postal Service uses FedEx when air transportation is required and capacity on passenger airlines or other commercial carriers is not available.

For First-Class Mail that requires air transportation, Postal Service processing plants assign the mail to air carriers before dispatching it to airports. During seven site visits to THS operations at various airports, we observed First-Class Mail arriving from processing plants was being routinely assigned to FedEx when FedEx contract minimums had already been met and there was availability on less costly passenger airlines.

We concluded that Southwest Area transportation managers have an opportunity to meet on-time standards and save about \$4.2 million over 10 years if they maximize the capacity of selected passenger airlines. See [Appendix C](#) for a breakdown of unnecessary costs and potential cost avoidance.

### **Mixed Versus Bypass Air Containers**

Finally, in some cases, it was more advantageous for the Postal Service to sort mail than FedEx. During the period January 1 through December 31, 2007, the Southwest Area unnecessarily spent about \$548,000 to have FedEx sort mail at the FedEx Memphis hub. The Postal Service tenders mail to FedEx in both bypass and mixed containers.

- Bypass containers hold mail bound for the same destination airport. Consequently, when they arrive at the FedEx Memphis hub, the containers can bypass the FedEx sort operation and be transferred directly to planes departing the hub for final destination airports. Bypass containers move through the FedEx Memphis hub at no additional cost to the Postal Service.
- Mixed containers hold mail bound for various destination airports. Consequently, when they arrive at the FedEx Memphis hub, they must open the containers, remove the mail, and sort it before loading it onto departing planes. The Postal Service is required to pay FedEx for sorting mail at the hub.

The Postal Service's contract with FedEx establishes mail sorting fees charged to the Postal Service. During the analysis period, FedEx charged between [REDACTED] for sorting each sack, tub, tray, or similar mail handling unit. Sorting mail for one of the

largest FedEx air containers could cost more than \$300 because those containers hold up to [REDACTED] First-Class Mail letter trays.

This picture shows a fully loaded FedEx container (Ayy) loaded by THS officials in Houston, TX. The container is about to be transported to the FedEx Memphis hub sort operation.



IAS, the Postal Service contractor for most THS operations in the Southwest Area, loads FedEx air containers for transport on FedEx aircraft. For many valid operational reasons, IAS cannot always load mail into bypass containers and, instead, must load it in mixed containers. To balance service and cost, the Postal Service establishes goals for bypass versus mixed containers. Our analysis of the Southwest Area for the period January 1 through December 31, 2007, showed that the Southwest Area achieved an average of 57 percent of planned bypass goals. See Table 3.

**Table 3. Southwest Area – Planned and Actual Bypass Mail Sorted by FedEx  
 January 1 through December 31, 2007**

<i>Point of Origin</i>	<i>Planned Bypass Cubic Feet</i>	<i>Actual Bypass Cubic Feet</i>	<i>Planned Bypass Cubic Feet Achieved (Percent)</i>
Albuquerque, NM	466,501	142,851	30.62
Austin, TX	472,189	387,513	82.07
Baton Rouge, LA	264,451	50,983	19.28
Dallas, TX	3,711,202	2,234,540	60.21
El Paso, TX	40,548	19,584	48.30
Houston, TX	1,336,705	757,358	56.66
Lubbock, TX	67,450	10,069	14.93
Oklahoma City, OK	91,233	64,185	70.35
San Antonio, TX	859,959	550,804	64.05
Tulsa, OK	105,273	43,284	41.12
<b>Total</b>	<b>7,415,511</b>	<b>4,261,171</b>	<b>57.46</b>

Because Southwest Area operations did not meet planned container bypass cubic feet, the Postal Service spent more than necessary to sort mail using FedEx. Our analysis of FedEx scan data for the period identified more than [REDACTED] mail bags, trays, tubs, or other mail handling units that FedEx unnecessarily sorted. As a result, the Postal Service paid FedEx about \$548,000 more than needed.

**FedEx freight and U.S. mail conveyed through the FedEx Memphis hub sort operation, April 20, 2005.**

**FedEx charges the Postal Service for every sack, tub, tray, or other mail handling unit.**

**Note that U.S. mail packages, Priority Mail sacks, and an overturned tub are being conveyed through the sort operation commingled with FedEx freight.**



This condition occurred because Postal Service mail processing plants did not:

- Adequately separate and identify bypass mail before sending it to airports.
- Dispatch mail to airports in time for THS contractors to place the mail in bypass containers. Officials at some THS sites we visited stated that mail routinely arrived late from local facilities and, as a result, containers were converted from bypass to mixed so they could be tendered on-time to FedEx.

If Southwest Area processing plants properly separate bypass mail and dispatch mail to airports on time, the Postal Service could avoid about \$5.4 million in unnecessary sorting costs over the next 10 years. See [Appendix C](#) for details of unnecessary costs and potential cost avoidance.

**APPENDIX C: SUMMARY OF UNNECESSARY COSTS AND  
 POTENTIAL COST AVOIDANCE IN SOUTHWEST AREA FEDEX OPERATIONS**

**Unnecessary Costs<sup>6</sup> – October 2005 through December 2007**

<i>Cost Category</i>	<i>Amount</i>
Cost to transport surface mail on FedEx Day Turn (FYs 2006 & 2007).	\$8,229,630
Excess cost of First-Class Mail that could have been transported on less costly passenger airlines (calendar year 2007).	217,985
Avoidable sorting costs at the FedEx Memphis hub (calendar year 2007).	<u>547,906</u>
<b>Total</b>	<b>\$ 8,995,521</b>

**Potential Cost Avoidance<sup>7</sup>**

<i>Method of Cost Avoidance</i>	<i>Amount</i>
Moving surface mail on less costly surface transportation.	\$34,709,829
Using commercial passenger airlines to move First-Class Mail when capacity exists and FedEx contract minimums have been met.	4,245,237
Avoiding FedEx sorting charges by maximizing plans to avoid charges and pursuing additional opportunities to further reduce charges.	<u>5,354,409</u>
<b>Total</b>	<b>\$ 44,309,475</b>

<sup>6</sup> Unnecessary costs are unrecoverable questioned costs.

<sup>7</sup> Potential cost avoidance is funds put to better use. The standard OIG practice for calculations of this type employs a 10-year cash flow methodology, discounted to present value by applying factors published by Postal Service Headquarters Finance. Fluctuations in mail volume over time may impact the 10-year projection results.

**APPENDIX D: SOUTHWEST AREA**

**"SURFACE" MAIL CLASSES ON FEDEX DAY TURN FYs 2006 & 2007**

Postal Facility	From TRACS Sampling			OIG Observed FY 2008*	TRACS data by quarter									
	Periodicals	Standard Mail	Package Services		FY 2006				FY 2007					
					Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		
X	X													
			X											
X	X	X												
X	X	X	X	X										
X	X	X												
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X	X	X		X										
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**LEGEND:** shaded blocks – each quarter in FYs 2006 & 2007 that "Surface" Mail Classes were sampled by TRACS data collectors at that plant  
 AMC - Airport Mail Center; AMF - Airport Mail Facility; ASF - Auxiliary Service Facility; PMA - Priority Mail Annex; P&DC - Processing and Distribution Center; P&DF - Processing and Distribution Facility; RDC - Regional Distribution Center  
 \* During OIG on-site observations at these plants, "Surface" Mail Classes were found in the mail dispatched for transport via FedEx.  
 \*\* Facility not identified in a TRACS sample, but found by OIG team during facility observations.  
 We did not attempt to visit all of the postal facilities in this list.

## APPENDIX E: MANAGEMENT'S COMMENTS

ELLIS A. BURGOYNE  
VICE PRESIDENT, SOUTHWEST AREA OPERATIONS



February 13, 2009

LUCINE WILLIS  
DIRECTOR, AUDIT OPERATIONS

SUBJECT: Response to Draft Audit Report – Air Networks  
Federal Express Transportation Agreement – Southwest Area  
(Report Number NL-AR-09-DRAFT)

The Southwest Area has evaluated the conclusions and recommendations contained in Report Number NL-AR-09-DRAFT. The Audit, conducted between April 2008 and January 2009, reviewed Southwest Area origins tendering mail to FedEx.

The Southwest Area agrees that where ground transportation is service responsive, it can be cost effective to use that mode of transportation in lieu of the FedEx network. We also agree that the commercial air network has the potential to be more cost effective than the FedEx network.

However, while the commercial air carriers network per pound rate is less than the FedEx network, the on-time performance of the commercial carriers under contract to the USPS has not risen above 75%, since July of 2006 (*Bureau of Transportation Statistics*). National service targets for 3 day First Class Mail is 91%. Our operational mandate is to provide our customers the expected service performance for all classes of mail.

The Area does not agree that the dollar cost estimates of \$9 million in unnecessary costs, and \$44.3 million over a 10 year period are valid.

The \$9 million in unnecessary costs is based on national data obtained from the Transportation Cost System (TRACS), purporting to measure the volume of non-preferential mail (Periodicals, Standard Mail and Package Services) that was transported via FedEx. TRACS data is obtained by randomly sampling the contents of handling units at randomly selected sites around the country. This data sampling is not specific to an Area, nor statistically valid for assigning cost at an Area level. The data assumes that there has been no improvement in our processes over the last three years, which discounts the significant improvement in our processes over the last three years. For instance, in FY 2008, the Southwest Area spent \$17.8 million dollars less in transportation costs than in 2007 by diverting mail from air to surface transportation.

Regardless of the actual cost of transporting non-preferential mail on the FedEx network, the methodology used only identifies the gross cost, not the net. It fails to take into account the offsetting labor and transportation cost that we would have incurred to sort, process, and transport this mail in a separate mail flow and transportation network.

In addition, volume as a whole is falling, and the FedEx network capacity is continually being shrunk, yet the projected savings assumes volume remains constant. Given the ongoing volume reductions, process improvements implemented over the last three years, and lack of accounting for the offsetting labor costs, we cannot agree that the 10-year future savings will be \$44.3 million as shown in the audit report. Our best estimate for potential 10 year net savings is approximately \$10 – 14 million. This estimate is based on typical methodologies used to determine return on investments in process changes, and the ongoing decrease in volumes being experienced by the Postal Service.

PO Box 224748  
DALLAS TX 75222-4748  
214-819-8650  
FAX: 214-905-9227

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**Recommendation 1:** Use surface transportation to the extent possible for mail that does not require air transportation to meet Postal Service on-time standards.

In general, we concur with this recommendation. The Area will follow established HQ Network Operations policies, guidelines and instructions to ensure that the FedEx network is used to transport preferential mail. We will issue appropriate instructions to Southwest Area plant managers by February 28, 2009, that reinforces Headquarters policies to provide quality service at the lowest net cost to the organization.

Area policy is to use the most cost efficient means of processing and transportation, that provides service performance to exceed the national targets. In October 2007, we increased the capacity of our Surface Transfer Center (STC) network to accommodate the mail formerly transported via air transportation. As volume across the Postal Service falls during this economic downturn, we continually evaluate transportation methods. At times, when minimum weight requirements have not matched contract requirements, moving mail onto the FedEx network is the most cost effective for the organization.

The Southwest Area believes there are exceptions where it is fiscally advantageous to transport these surface mail classes on FedEx or on commercial air, rather than ground transportation as shown below

- Periodicals, Standard and Package Services products can be processed in the same mail stream as First Class Mail to gain operational efficiencies. The expense associated with pulling down a Flat Sorter or an APPS that is engaged in sorting First Class Mail or Priority, and resetting that machine to process a small amount of Periodicals and Standard mail to avoid the per pound cost of transportation is contrary to good fiscal responsibility.
  - Machine utilization would be reduced. Machines would sit idle while being pulled down, and set up for small separate non-preferential runs.
  - Additional trays and tubs would be generated, with minimal volumes in each, adding additional allied work hours to handle at origin and destination.
  - The Postal Service would pay additional costs to transport these additional, mostly empty trays and tubs. Essentially paying to move "air" from one location to the other.
  - Poor density. We pay FedEx to transport cubic footage of mail. A full tray or an empty tray costs the Postal Service the same on the FedEx network. The goal, from a cost perspective, is to ensure that containers are as densely packed as possible.

**Recommendation 2:** Transport mail to the maximum extent possible using the service-responsive capacity of passenger airlines under contract to the Postal Service.

We agree in general with this recommendation. We have made considerable progress toward achieving this goal. According to the Air Mail Condition Reports generated by Commercial Air Operations at Headquarters, the Southwest Area seldom dispatches any known surface or known commercial air destinations via FedEx. Area office Distribution Networks staff regularly reviews these reports, and other data, to ensure this policy is followed by our processing plants.

We note that the on time performance of the commercial airlines is sorely lacking, and is frequently not service responsive. We also note the following exceptions and challenges that influence the decision on what mode of transportation is used to transport mail.

The planning of and execution of dispatches via commercial air transportation has changed considerably since the beginning of the CAIR- 2006 contract. Considerable limitations have been placed on the transportation network by this agreement. Outlined below are some of those changes, which impacted our decisions on which mode of transportation to use, and would impact the data used to arrive at your conclusions.

- Under the previous agreement (CAIR-03) any mail that rode on a transfer dispatch was not service responsive. There were no national processes in place with the commercial air lines to determine if the transfer was made in the allotted time or not. Testing performed at that time showed that mail transported on commercial air, with transfers, was not service

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responsive. CAIR-06 has provided for scanning methods to measure whether airlines are providing the expected service levels. Where commercial service provided acceptable performance levels, the Southwest Area has made every effort to use this mode of transportation.

- Headquarters Logistics requires the Area to tender network volume that would normally flow to commercial air transportation to FedEx, when the USPS is not meeting the contractual minimums outlined in the agreement with FedEx.
- The Active Dispatch Matrix (ADM). ADM tells the CAIR supplier how much volume is available in an Origin & Destination pair. However, one supplier is not required to take all volume for that pair. If a commercial air partner does not take all volume for a pair, the remaining volume will be routed on the FedEx network.
- The CAIR supplier is not required to use non-stop or direct service. Mail transported on direct flights versus transfer flights has higher service levels.
- Capacity offered by the CAIR suppliers is often outside of the preferable transportation window, to match the dispatch and arrival profile at our processing facilities.
- CAIR suppliers often overstate the capacity of the aircraft in their fleet. This causes the USPS to reprocess the volume tendered to that carrier which often results in a service failure.
- Must fly requirements are outlined in the Logistics Orders. If a CAIR supplier does not operate in a "must fly" lane, then we are required to use FedEx.
- Mail from small plants, located long distances from commercial air operations, arrives too late to be serviced by CAIR suppliers.
- Some First Class Mail must fly on the FedEx network due to service and security requirements. Examples include remittance mail with 2 day service standards and Treasury checks.

**Recommendation 3:** Sort mail into by-pass containers as appropriate.

In general, we agree with this recommendation. The Area conducts weekly telecons, and reviews operating plan compliance, which in part drives our bypass container utilization. Our plants are to clear outgoing operations by 2400, and have all mail assigned and scanned to transportation by 0230, with transportation to THS operations according to the contract matrix. Adherence to the operating plan, with discussion of the results, maximizes the number of by-pass containers generated by our processing facilities. The Area Manager, Distribution Networks, will ensure that our plants are making the best use of our by-pass container allocation through these telecons, and other regular communication.

However, there are extenuating circumstances that dictate using mixed containers rather than by-pass containers in certain situations. We list some of those circumstances in support of instances where mixed containers were used.

- The minimum requirement for a bypass container is 7,000 pounds. As an example, on a Monday night, from New Orleans to JFK, we usually have no issues meeting the minimum, and make-up the bypass container. On any other night, we may not have enough volume to meet the minimum standard, and must revert to a mixed container.
- Bypass containers can be bulked out on some days, with the remaining volume for that "bypass" destination being sorted to a mixed container.
- We are required to tender 75% of the containers to FedEx by 0400. Mail processing operations on a specific day may dictate closure of the bypass containers, with the remainder dispatched in mixed containers.

No Freedom of Information Act exempt information is contained in either the report or our response. Please contact Cliff Rucker at (214) 819-8600, if there are any questions.

  
Ellis A. Burgoyne