



July 31, 2009

TERRY J. WILSON  
VICE PRESIDENT, SOUTHEAST AREA OPERATIONS

SUBJECT: Audit Report – Air Networks – Federal Express  
Transportation Agreement – Southeast Area  
(Report Number NL-AR-09-007)

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 09XG013NL000). See [Appendix A](#) for additional information about this audit.

### [Conclusion](#)

It was more effective and economical in some cases for the Southeast Area to use ground transportation and domestic air carriers and sort mail at U.S. Postal Service plants than to use FedEx for these functions. Because the area used FedEx, the U.S. Postal Service incurred about \$8.6 million in unnecessary costs. If the Southeast Area implements our recommended changes, we estimate the Postal Service could save \$43.4 million over a 10-year period.

### [Transporting Surface Mail on FedEx Day Turn](#)<sup>1</sup>

We concluded that using ground transportation was more advantageous than using FedEx in some cases. Transporting surface mail by FedEx costs the Postal Service about \$7.5 million more than necessary for October 1, 2006, through September 30, 2008. 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 \$32.1 million over 10 years. See [Appendix B](#) for our detailed analysis of this topic.

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<sup>1</sup> FedEx Day Turn operations are principally for transporting First-Class Mail and Priority Mail during daytime hours.

We recommend the Vice President, Southeast 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 agreed with our finding and recommendation. Management stated that in most cases it is less expensive to transport Periodicals and Standard Mail on surface transportation than on FedEx. Management stated they will continue to follow established Headquarters' Network Operations transportation policy for these mail types and provided a copy of a memorandum sent to the plant managers on May 29, 2009, that reinforces the policy. In addition, management stated that distribution networks' employees will review whether improper mail types are being improperly comingled with First-Class Mail for air transportation when conducting site visits and will instruct their terminal handling service (THS) liaisons to review tub and tray utilization for mail moved on FedEx.

Management did not agree with our questioned costs and projected costs savings over 10 years. While management stated the savings would be much lower, they did not offer a specific figure of what that amount should be. Management stated that Standard and Periodical mail could only be handled or mishandled at the three Southeast Area concentration points – Atlanta, GA, Memphis, TN, and Jacksonville, FL. Management stated that it conducted a limited sampling of mail from one of its three concentration points as evidence to support assertions concerning density and an alternative result. Management also provided other examples of situations where it is more advantageous to use FedEx than surface transportation for these mail types. Management's initial and amended 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 taken should resolve the issues identified in the report. The OIG disagrees with management's reasoning regarding our monetary impact amounts and believe our estimates to be valid based on the data used. While management stated that only three origins in the Southeast Area have an opportunity to put surface mail classes on FedEx, our on-site observations and inspections in FY 2009, as well as the most recently available TRACS data, confirm otherwise. We observed many instances of Standard, Periodical, and/or Package Services mail classes being prepared for and transported by FedEx at other origins. Further, the limited sampling of outgoing mail and related density at only one Southeast Area origin is not sufficient to dispute the overall findings

and monetary impacts. The intent of our recommendation is to reduce overall cubic feet use on FedEx with fewer mail-piece tubs and trays.

### **FedEx Versus Passenger Airlines**

When the Postal Service requires air transportation, we concluded it is more advantageous in some cases to use passenger carriers rather than FedEx. From October 1, 2007, through September 30, 2008, the Postal Service incurred \$283,000 in unnecessary costs to move [REDACTED] cubic feet of First-Class Mail on FedEx from origins in the Southeast Area. The Postal Service incurred the excess costs, because officials did not plan to fully utilize less costly available commercial air transportation. The Southeast Area could save about \$2.5 million over a 10-year period by maximizing the available 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, Southeast 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 agreed with our finding and recommendation. They stated that using domestic air carriers is more cost-effective and economical than using FedEx. Management provided a copy of a memorandum sent to plant managers to reiterate the policy to utilize commercial air to the maximum service responsive capacity. Management also stated that they will monitor weekly Headquarters' Network Operations reports that track commercial air lift and volumes, as well as monitor weekly reports that list all activity of modifications to air routes, in order to ensure maximum use of commercial air.

Management commented that while commercial airlines have provided capacity, they have found in numerous situations that capacity required by the Postal Service and the capacity offered by commercial airlines are not aligned. Management cited challenges with Postal Service data systems; contingency measures placed on them by Headquarters' Network Operations to fill FedEx matrix commitments; inconsistent or nonresponsive service offered by the current commercial air suppliers; the need to reassign mail to FedEx due to inadequate commercial air lift; and other issues. Finally, management stated that they do not agree that local officials were not always following mail assignment priorities or that local managers changed prioritization codes for mail assignment.

Management did not agree with our questioned costs and projected cost savings over 10 years. Management made several attempts to recreate our calculated questioned costs but the attempts resulted in different amounts that were inconclusive.

## Evaluation of Management's Comments

The OIG considers management's comments responsive to the finding and recommendation and the corrective action should resolve the issues identified in the report. We agree that management must consider service, timeframes, and capacities when assigning mail to commercial air transportation, and the Southeast Area should continue to work diligently with Headquarters' Network Operations to address capacity issues with commercial airlines in order to maximize their use.

Regarding management's comment on not following mail assignment procedures, we revised the statement in the report to better clarify our point. The report now states the Postal Service incurred the excess costs because officials did not plan to fully utilize less costly available commercial air transport. We recognize that local officials no longer readily have the ability to change planned routings once established, even though they are able to modify active routings on a daily basis. However, the Postal Service established a system for assigning mail to ensure that it moves on intended routes, based on availability, service and cost. We recognize that issues can occur in the assignment process, but the Postal Service has procedures in place to address and correct the process and address issues. Any routing adjustments to use other, more costly, transportation should be made when it is clearly documented and determined that stated commercial air capacity is not always available or responsive.

Finally, regarding our calculations, we analyzed capacity by lane, considered continued commercial carrier service in projecting our reported savings, and believe our projections are valid based on the data used.

## Mixed Versus Bypass Air Containers

Finally, in some cases it was more advantageous for the Postal Service to sort mail than to have FedEx sort it. During the period October 1, 2007, through September 30, 2008, the Southeast Area unnecessarily spent about \$895,000 to have FedEx sort mail. The Postal Service incurred this expense because the Southeast Area processing plants did not separate mail and distribute it in bypass containers.<sup>2</sup> If the Southeast Area properly sorts and distributes this mail, the Postal Service could avoid about \$8.8 million in unnecessary costs over 10 years. See [Appendix B](#) for our detailed analysis of this topic.

We recommend the Vice President, Southeast Area Operations:

3. Sort mail into bypass containers as appropriate.

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<sup>2</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 agreed with our finding and recommendation. They stated that it is more effective and economical for the Postal Service to perform distribution functions than FedEx. In their response, management provided a copy of a memorandum sent to plant managers to reiterate the policy to utilize by-pass containers, while minimizing the use of mixed containers. Further, management stated that local Postal Service liaisons are working daily with THS suppliers to ensure mail is loaded into appropriate bypass containers wherever possible; that they are monitoring daily reports for any unusual high conversions of bypass to mixed containers; and that they are reviewing upcoming FedEx bypass schedules to ensure the number of bypass containers are warranted.

Management included examples of circumstances that support the use of mixed containers instead of by-pass containers, including insufficient/excessive mail volumes; processing facilities being too small to make planned separations; the exact times that mail must be tendered; and the 6-month FedEx matrix planning cycle. Management stated that they believe this policy is adhered to the highest degree possible, but agreed to continue to monitor the policy for improvement.

Management did not agree with the unnecessary costs and projected cost savings over 10 years, but offered no alternative amounts.

## Evaluation of Management's Comments

The OIG considers management's comments responsive to the finding and recommendation, and the corrective action should resolve the issues identified in the report. Regarding management's comments on circumstances that support the use of mixed versus bypass containers, 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 and enforce established processes to meet plans. 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 THS 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.

Regarding our monetary impact, our analysis of mail pieces took into consideration the conversion criteria and excessive volumes, and we believe our estimates are valid based on the data used.

## Additional Management Comments

Overall, management did not agree with the questioned costs and funds put to better use included in our report and stated the amount in potential savings is too high.

Management stated that the Postal Service is faced with sharply declining volume and the entire transportation network was built over the years based on increased volume. Management further stated the Postal Service is removing pieces of transportation but it must still maintain service. Management stated that since volume plays an important part in the issues identified, it should be noted that as volumes continue to drop, the transportation network and current procedures will change.

In summary, however, management stated their corrective actions should produce positive results by the end of the FY and greatly reduce or eliminate the exposure of the Area to any funds wasted due to non-compliance for the three issue areas identified in the report.

### Evaluation of Management's Additional Comments

Management did not provide supporting documentation for the amounts it disagreed with or for its alternate estimates. We acknowledge management's comments regarding declining mail volume and recognize the corrective actions to reduce or eliminate non-compliance. Our estimates considered volumes, including any declines, during the period audited (October 2006 through September 2008). These estimates are based on the best available data 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 \$52,017,366 in monetary impact for the three findings in our *Semiannual Report to Congress*, including \$8,630,104 in questioned costs and \$43,387,262 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 Michael A. Magalski  
VERIFY authenticity with ApproveIt



**For**  
Robert J. Batta  
Deputy Assistant Inspector General  
for Mission Operations

Attachments

cc: Patrick R. Donahoe  
Steven J. Forte  
Susan Brownell  
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Katherine S. Banks  
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## 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 using 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 reliance on passenger airlines with established records of performance would help the Postal Service achieve on-time delivery and provide higher levels of service with its new contracts.

**Postal Service officials explained that American Airlines is a passenger airline with a reliable, on-time performance record. The agency awarded the airline a contract to continue providing service.**

**American Airlines jet at Tampa International Airport, February 25, 2009.**



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 THS contractors.

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

The air container  
pictured in the  
foreground was  
designed to be loaded  
onto FedEx aircraft.



The Postal Service transportation network currently uses THS contractors to prepare and load mail into containers and onto FedEx planes. The contractors for Southeast Area THS operations are Cargo Force, Inc.; Integrated Airline Services, Inc.; and Quantem Aviation Services, Inc.

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

To conduct our work, we visited various facilities and operations in the Southeast Area, including airport mail centers; THS operations; and mail processing facilities in Atlanta, GA, as well as in Jacksonville, Fort Lauderdale, Miami, Orlando, West Palm Beach, and Tampa, FL.

We interviewed officials from Postal Service Network Operations and the Southeast Area. We also interviewed Postal Service contractors, including officials from FedEx, Cargo Force, Inc., Integrated Airline Services, Inc., and Quantem Aviation Services, Inc. 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 containers loaded by THS operations for tender to FedEx, Orlando, FL.**



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 2006 through September 2008 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; we conducted source document examinations; and we 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 January through May 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 officials on April 28, 2009 and included their comments where appropriate.

### PRIOR AUDIT COVERAGE

Report Title	Report Number	Final Report Date	Monetary Impact
<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
<i>Air Networks – Federal Express Transportation Agreement – Southwest Area</i>	NL-AR-09-002	March 3, 2009	\$53.3 million

The reports listed above identified the same or similar issues identified in this report. We identified FedEx operational efficiency opportunities in the Pacific, Western, and Southwest Areas 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 and Southwest Areas, 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 FedEx 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) 2007 and 2008 cost and revenue analyses and the Transportation Cost System (TRACS) identified large volumes of surface mail<sup>3</sup> transported using the FedEx Daytime Network (Day Turn) from origins in the Southeast 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, Southeast 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 \$7.5 million more than necessary, as shown in Table 1.

**Table 1. Excess Costs of Transporting Surface Mail on FedEx Day Turn during FYs 2007 and 2008**

<i>Fiscal Year</i>	<i>Periodicals</i>	<i>Standard Mail</i>	<i>Package Services</i>	<i>Total Cost in Millions</i>
2007	\$1,254,150	\$1,206,356	\$798,201	\$3,258,706
2008	<u>1,664,543</u>	<u>1,221,170</u>	<u>1,308,420</u>	<u>4,194,133</u>
<b>Total</b>	<b>\$2,918,693</b>	<b>\$2,427,525</b>	<b>\$2,106,621</b>	<b>\$7,452,839</b>

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

The Southeast Area transported surface mail on FedEx and the Postal Service incurred excess costs, in part, because employees at Southeast 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>4</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, employees mixed Periodicals and Standard Mail with First-Class Mail in originating distribution operations. See [Appendix D](#) for more details on the sites we visited.

<sup>3</sup> Surface mail includes magazines, advertising, and merchandise shipped by major mailers such as publishers, catalog companies, or online retail companies

<sup>4</sup> Atlanta, GA P&DC and Logistics and Distribution Center (L&DC); North Metro, GA P&DC; Fort Lauderdale, Jacksonville, South Florida, and West Palm Beach, FL P&DCs; Miami and Orlando, FL P&DC and L&DC



Standard Mail in First-Class Letter Trays and Periodicals in Flat Tubs destined for transportation on FedEx, Atlanta P&DC (February 11, 2009) and Jacksonville P&DC (February 23, 2009).

The Postal Service could lower overall FedEx lift requirements and save about \$32.1 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 in some cases for the Postal Service to use domestic carriers rather than FedEx. From October 1, 2007, through September 30, 2008, the Postal Service incurred almost \$283,000 in unnecessary costs to move █████ cubic feet of First-Class Mail on FedEx from origins in the Southeast Area. The Postal Service incurred the excess costs because officials did not plan to fully utilize less costly available commercial air transport. See Table 2.

Table 2. Available Unused Capacity on Passenger Airlines  
Analysis of the Southeast Area – October 1, 2007 through September 30, 2008

<i>Southeast Area Point of Origin</i>	<i>Unused Passenger Airline Capacity in Cubic Feet</i>	<i>Excess Costs</i>
Atlanta	██████████	\$86,765
Jacksonville	██████████	19,185
Miami	██████████	30,978
Mobile	██████████	13,417
Orlando	██████████	79,974
Tampa	██████████	52,377
<b>Total</b>	<b>153,592</b>	<b>\$282,696</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 five site visits to THS operations at various airports, we observed First-Class Mail arriving from processing plants and 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 Southeast Area transportation managers have an opportunity to meet on-time standards and save about \$2.5 million over 10 years if they maximize the available capacity of selected passenger airlines. See [Appendix C](#) for a breakdown of unnecessary costs and potential cost avoidance.

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

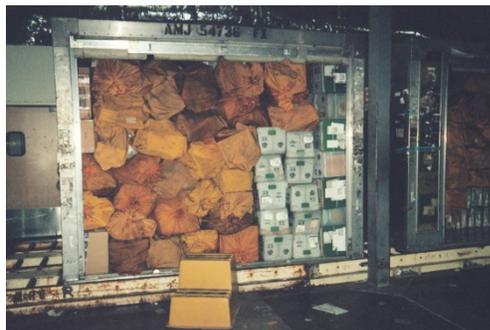
Finally, in some cases it was more advantageous for the Postal Service to sort mail than to have FedEx sort it. During the period October 1, 2007, through September 30, 2008, the Southeast Area unnecessarily spent about \$895,000 to have FedEx sort mail at its Memphis hub. The Postal Service tenders 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] cents 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 ██████ First-Class Mail letter trays.

This picture shows a fully loaded FedEx air container prepared by THS officials in Tampa, FL, February 24, 2009. The container is about to be transported to the FedEx Memphis hub for sorting.



The Postal Service contractors for most THS operations in the Southeast Area — Cargo Force, Inc., Integrated Airline Services, Inc., and Quantem Aviation Services, Inc., — load FedEx air containers for transport on FedEx aircraft. For many valid operational reasons, the contractors 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 Southeast Area for the period October 1, 2007, through September 30, 2008, showed that the Southeast Area achieved an average of 50 percent of planned bypass goals. See Table 3.

**Table 3. Southeast Area – Planned and Actual Bypass Mail Sorted by FedEx  
October 1, 2007 through September 30, 2008**

<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>
Atlanta, GA	1,694,379	800,677	47.25
Jacksonville, FL	1,023,831	132,190	12.91
Knoxville, TN	109,953	76,198	69.30
Miami, FL	2,473,535	1,584,671	64.07
Orlando, FL	1,424,905	928,833	65.19
Tampa, FL	2,168,661	757,358	43.74
<b>Total</b>	<b>8,895,264</b>	<b>4,471,221</b>	<b>50.27</b>

Because Southeast 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 ██████ mail bags, trays, tubs, or other mail handling units that FedEx unnecessarily sorted. As a result, the Postal Service paid FedEx about \$895,000 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 the THS contractors.
- Dispatch mail to airports in time for THS contractors to place it into 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 Southeast Area processing plants properly separate bypass mail and dispatch mail to airports on time, the Postal Service could avoid about \$8.8 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 SOUTHEAST AREA  
FEDEX OPERATIONS**

**Unnecessary Costs<sup>5</sup> – October 2006 through September 2008**

<i>Cost Category</i>	<i>Amount</i>
Cost to transport surface mail on FedEx Day Turn (FYs 2007 & 2008).	\$7,452,839
Excess cost of First-Class Mail that could have been transported on less costly passenger airlines (FY 2008).	282,696
Avoidable sorting costs at the FedEx Memphis hub (FY 2008).	<u>894,569</u>
<b>Total</b>	<b>\$ 8,630,104</b>

**Potential Cost Avoidance (over 10 years)<sup>6</sup>**

<i>Method of Cost Avoidance</i>	<i>Amount</i>
Moving surface mail on less costly surface transportation.	\$32,075,850
Using commercial passenger airlines to move First-Class Mail when capacity exists and FedEx contract minimums have been met.	2,512,856
Avoiding FedEx sorting charges by maximizing plans to avoid charges and pursuing additional opportunities to further reduce charges.	<u>8,798,556</u>
<b>Total</b>	<b>\$ 43,387,262</b>

<sup>5</sup> Unnecessary costs are unrecoverable questioned costs.

<sup>6</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 affect the 10-year projection results.



## APPENDIX E: MANAGEMENT'S COMMENTS

TERRY J. WILSON  
VICE PRESIDENT, AREA OPERATIONS  
SOUTHEAST AREA



May 29, 2009

LUCINE WILLIS  
DIRECTOR, AUDIT OPERATIONS

SUBJECT: Transmittal of Draft Audit Report – Air Networks Federal Express Transportation Agreement – Southeast Area (Report Number NL-AR-09-DRAFT)

The Southeast Area has evaluated the conclusions and recommendations contained in Report Number NL-AR-09-DRAFT. We agree it is more effective and economical for the Southeast Area to use ground transportation, domestic air carriers than to use FedEx, and for us to perform distribution functions other than FedEx. However, the Area is not in agreement with the \$8.6 million in unnecessary costs or the estimated savings of \$43.7 million over a 10-year period. We address each of the three issues below.

**Recommendation #1:**

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

**Management Response:**

The Southeast Area concurs with this recommendation. The Area will continue to follow established HQ Network Operations policies, guidelines and instructions concerning the transport of mail. The attached instructions were sent to the field reiterating this policy on May 29, 2009.

The Southeast Area agrees that in most cases it is less expensive to transport Periodicals and Standard Mail on surface transportation than on FedEx. We do not advocate or instruct our facilities to transport these classes of mail on FedEx or any air transportation. However, we are not in agreement with the \$32.1 million savings over 10 years for the following two reasons:

1. DMM labeling list L201 and DMM labeling list L009 directs mailers to enter only surface destinations at plants (L201) and only enter the mixed states working volume (outgoing piece distribution) to the three concentration centers in the Southeast Area.

This results in only Memphis TN, Jacksonville FL, and Atlanta GA receiving volume that could possibly end up on FedEx. All other facilities in the Southeast Area only receive Periodicals and Standard Mail in which they have surface transportation. The \$32.1 million dollar savings (data from TRACS) was based on 30 Southeast Area facilities transporting Periodicals and Standard Mail on FedEx transportation, while it is only possible for three facilities to have an opportunity to transport these mail classes on FedEx.

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MEMPHIS TN 38108-0100  
901-747-7333  
Fax: 901-747-7444

2. The Postal service pays FedEx by the cube and not by weight as with commercial air carriers. This means that any vacant space in a letter tray or flat tub is already paid. In reality, adding weight to the tub or tray actually helps the Postal Service achieve a higher density. The only way that the Postal Service can incur additional cost by mixing Periodicals and Standard Mail with First Class Mail is when the Periodicals or Standard Mail forced the originating plant to make a second tray or tub.

A sampling of flat tubs ready for dispatch was conducted at the Memphis P&DC in the first week of May 2009. The Memphis P&DC is one of the three concentration centers which would have an opportunity to fly Periodicals and/or Standard Mail on FedEx. We reviewed 105 total number of flat tubs of which only 48 had 45% or more volume in the tub.

Considering that only three facilities even have a chance to transport Periodicals and Standard Mail on FedEx and the Postal Service only incurs a cost when additional trays or tubs are needed, we believe the savings would be much lower than the \$32.1 million stated in the audit report.

***Recommendation #2:***

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

**Management Response:**

The Southeast Area concurs with this recommendation. Although the commercial airlines have provided capacity, we have found in numerous situations the capacity required by USPS versus the capacity offered are not aligned. Therefore we believe we are utilizing the commercial airlines as much as possible in accordance with the national routing policy. We are not in agreement with the \$8.8 million savings over 10 years for the following reasons:

- Capacity offered is often outside the required transportation window to match the dispatch and arrival profile at our processing facilities.
- Capacity offered is often for destinations that are surface, thus USPS is not utilizing any of this offered capacity.
- Toward the end of the FedEx block, when USPS has failed to reach FedEx contractual minimums, HQ requires the Areas to tender mail normally intended to commercial airlines to FedEx to help reach the contractual minimums.
- Mail from smaller processing facilities, located long distances from commercial air operations, often arrives too late to connect to CAIR routings.

We have been unsuccessful in recreating the identified costs savings of \$282,696 regarding the 154,000 cubic feet. Several attempts have resulted in several different amounts:

- 154,000 cubic feet divided by 550 cubic feet for an AMJ = 280 AMJ's.  
280 AMJ's x \$300.00 PER AMJ = \$84,000.
- 154,000 cubic feet divided by 49 cubic feet for GPC = 3,142 GPC's.  
3,142 GPC's x 36 trays per GPC = 113,112 trays  
113,112 trays x \$.615 FedEx cost per handling unit = \$69,563.

We are not in agreement with the comment, "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." Local officials do not change the prioritization codes for mail assignment to air carriers found in the Surface and Air Management System (SAMS).

We are following the established HQ policies regarding mail assignment based on the following prioritization codes:

- UPS: 00
- Commercial Flights: 06, 07 based on on-time performance
- FedEx daytime: 20
- FedEx night turn: 03

Concerning Table 2 page 8 of the report, "Available Unused Capacity on passenger Airlines Analysis of the Southeast Area – October 1, 2007 through September 30, 2008", two of the six origin airports listed, Jacksonville and Mobile, no longer have passenger airline capacity.

Commercial Air suppliers have offered capacity and have been unable to lift the mail tendered to them. USPS is then forced to reassign to FedEx the following day. Service on this mail tendered to the CAIR supplier is compromised.

Also, when computing the savings over 10 years, the data extracted from the Active Dispatch Matrix system must be analyzed lane by lane because the total pounds offered can be misleading. Below is an example of commercial air lift out of Miami FL.

There are 72 destinations listed in the Active Dispatch Matrix for Miami with a total of 98,000 lbs of capacity. However, when you analyze each lane, you find the following:

- Out of the 72 destinations listed, the air carriers have offered lift to only 40.
- Out of the 98,000 lbs. offered, our demand out of MIA is only 48,000 lbs.
- Within the 40 lanes and 48,000 lbs., 4 lanes are under our demand.
- 20 of the 40 lanes are transfer flights. The Southeast Area prefers not to use transfer flights due to the delayed volume and rollover mail at the major commercial air hubs. The transfer flights increase the risk of not meeting service standards.
- Nine of the original 72 destinations are surface lanes.
- Out of the original 72 destinations and 98,000 lbs of capacity, there are really only 28 destinations and about 16,000 lbs. of capacity. Miami does utilize these 28 destinations on commercial air.

**Recommendation #3:**

*Sort mail into bypass containers as appropriate.*

**Management Response:**

The Southeast Area concurs with this recommendation and believes that this policy is adhered to the highest degree possible. It should be noted there are situations that dictate converting by-pass containers to mixed containers. Because of the reasons listed below, the Southeast Area believes the \$895,000 identified as unnecessarily spent is too high.

The following are examples of some of these circumstances supporting the use of mixed containers instead of by-pass containers:

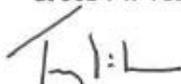
- Insufficient mail volume to make by-pass container: If the Monday night volumes are large enough we usually have no issues meeting the minimum for a by-pass container. On other nights a facility may not have enough volume to reach the minimum and must change the by-pass container to a mixed container.
- More mail for a by-pass destination than will fit into the container: the by-pass container is dispatched 100%; however there is more mail that is then placed into the mixed container.
- USPS is required to tender 75% of the containers to FedEx by 0400. To achieve this 75% goal some by-pass containers are converted to mixed. This is a local decision that must be made just prior to the FedEx cutoff time.
- Small processing facilities do not have sufficient volume to make direct GPC containers for by-pass destinations. If the feeder sites made all of the by-pass separations the number of containers would exceed the capacity of the truck thus incurring additional highway transportation costs from the origin office to the Terminal Handling Services (THS). Consequently feeder sites do not make up all by-pass destinations. Southeast Area has 22 feeder sites.
- FedEx matrix is planned 6 months in advance. With the recent decrease in mail volumes, planning for by-pass destinations change from month to month.
- HQ has mandated by-pass containers that are less than 87% full must be converted to a mixed container and filled.

In addition to all of the issues listed above, the Postal Service finds itself in a situation it has never been before, one of sharply declining volumes. The entire transportation network has been built over the years based on increased volume year to year. We are now finding ourselves in a situation where we are removing pieces of transportation but must still maintain service. Since volume plays an important role in all three of the issues identified by the OIG, it should be noted that as volumes continue to drop, the transportation network and some of the other procedures we have in place today may change. This is another reason we believe the \$43.7 million savings is too high.

**Freedom of Information Act (FOIA)**

The Southeast Area does not believe that this report contains any proprietary or business information and may be disclosed pursuant the Freedom of Information Act.

If you have any questions or need additional information, please contact Mary Mahnke at 901-747-7332.

  
Terry J. Wilson

Attachment

cc: Katherine Banks, Manager, Corporate Audit and Response Management  
Tammy Autenrieth, Manager, Operations Support  
Mary Mahnke, A/Manager, Distribution Networks

OPERATIONS SUPPORT  
SOUTHEAST AREA



May 29, 2009

PLANT MANAGERS

SUBJECT: SEA Air Networks Federal Express Transportation Agreement Audit

A recent audit of the Southeast Area Air Networks Federal Express Transportation agreement revealed deficiencies in adherence to established headquarters policies at some facilities. Please review these policies as outlined below with your staff and ensure they are followed.

- Surface Transportation must be utilized to the maximum extent possible for all mail that does not require air transportation to meet Postal Service on-time standards.
- Transportation with Commercial Airlines under contract with the Postal Service must be utilized up to their maximum service responsive capacity.
- By-pass containers should be utilized whenever possible while minimizing the use of mixed containers.

If you have any questions please contact Mary Mahnke, Acting, Manager, Distribution Networks at 901-747-7332.

A handwritten signature in black ink, appearing to read "Tammy Autenrieth".

Tammy Autenrieth  
Manager, Operations Support (A)

cc: Mary Mahnke, Manager, Distribution Networks (A)  
Kim Mertz, Manager, In Plant Support (A)

TERRY J. WILSON  
VICE PRESIDENT, AREA OPERATIONS  
SOUTHEAST AREA



July 20, 2009

LUCINE WILLIS  
DIRECTOR, AUDIT OPERATIONS

SUBJECT: Transmittal of Draft Audit Report – Air Networks Federal Express Transportation Agreement – Southeast Area (Report Number NL-AR-09-DRAFT)

This is our second revised response to the subject draft audit report. Again, thank you for opportunity to review and comment.

**Recommendation #1:**

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

**Management Amended Response:**

The Southeast Area is in agreement with this recommendation and the supporting finding. On May 29, 2009, instructions were sent to the field reiterating the dispatch policy concerning the utilization of surface transportation for mail that does not require air transportation to meet Postal Service on-time standards. We have added this item to our review process when visiting facilities. DN employees will review flat operations to investigate if Periodicals and Standard Flats are being comingled with First Class Mail for air transportation destinations. Letter mail operations will also be reviewed. We will also instruct the Postal THS Liaisons to review flat tubs and letter trays for full trays of Periodicals and Standard moving on the FedEx network.

**Recommendation 2:**

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

**Management Amended Response:**

The Southeast Area is in agreement with this recommendation and the supporting findings. On May 29, 2009, instructions were issued to the field reiterating the importance of utilizing service-responsive commercial flights to transport mail. The following Southeast Area air stops dispatch to commercial flights: MIA, FLL, TPA, MCO, PBI and ATL.

HQ has created a new report in ADM called "Network Utilization". This report provides information regarding available CAIR lift and volume which should have been transported on and we are monitoring this each week.

We also monitor the ROUTE MODIFICATION REPORT Weekly report in SAMS which lists all activity to modifications to routes.

However, it should be noted that there are numerous times in which we move First Class Mail from commercial air to FedEx at the request of Headquarters to ensure the matrix is met. Also, in some cases, it is less expensive to transport some letter trays on FedEx. For example: American Airlines cost to move 1 pound of First Class Mail is 53 per pound. The FedEx cost is \$6.00 per cubic foot. If I had a FCM that weighed 15 pounds, the cost would be \$7.95 on American. The cost of FedEx would be \$7.00 (\$6.00 per cube and \$1.00 handling charge if the tray was in a mixed container).

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**Recommendation 3:**

*Sort mail into bypass containers as appropriate.*

**Management Amended Response:**

The Southeast Area is in agreement with this recommendation and the supporting finding. May 29, 2009, instructions were issued to the field reiterating the importance of utilizing bypass containers. The local USPS liaison is working daily with the THS supplier to ensure mail is loaded into the appropriate bypass containers wherever possible.

A daily report is issued regarding mail scanned after 0230. We monitor these daily reports for any unusual high conversions of bypass cans to mixed. We then investigate the reason for the conversion. We also review the block changes for bypass can changes to ensure high volume destinations are selected for bypass cans.

The Southeast Area DN is reviewing each upcoming FedEx block for bypass cans in which the volume does not warrant a bypass can anymore. It should be noted that volume is heavier on Tuesday and Wednesday morning and in some cases we have the volume to make the bypass can early in the week but not later in the week.

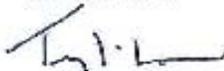
**In Summary:**

We expect these corrective actions to produce positive results by the end of this FY and greatly reduce or eliminate the exposure of the SE Area to any funds wasted due to non-compliance concerning these three issues and associated recommendations. We realize that OIG observations and data support the need for improvement concerning these issues and believe the actions stated above are corrective and will achieve the desired results.

**Freedom of Information Act (FOIA)**

The Southeast Area does not believe that this report contains any proprietary or business information and may be disclosed pursuant the Freedom of Information Act.

If you have any questions or need additional information, please contact Mary Mahnke at 901-747-7332.

  
Terry J. Wilson

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