May 4, 2001

PAUL E. VOGEL
VICE PRESIDENT, NETWORK OPERATIONS MANAGEMENT

SUBJECT: Audit Report - Mail Transport Equipment Service Center Decision Analysis Report, Performance and Financial Benefits
(Report Number TR-AR-01-003)

This report presents the results of our audit of the Mail Transport Equipment Service Center Network. It is part of a series of reports and focuses on a Postal Service Decision Analysis Report, dated June 30, 1997, recommending implementation of a contractor-operated network in lieu of the Postal Service operated system in place at the time. The analysis forecasted the new network would improve performance and reduce 10-year operating expenses from $3.9 billion to $3.6 billion by achieving operational efficiencies—and as a result, save an average of more than $30 million per year. Our audit responds to a request from the Board of Governors to evaluate whether the new system would achieve the performance and financial benefits anticipated by the Decision Analysis Report.

Our audit revealed the new network was better than the old system, but still needed improvement to achieve Decision Analysis Report standards. Our audit also revealed the network would not achieve anticipated financial benefits. Instead, costs would exceed the 10-year $3.6 billion forecast by more than $1.4 billion, and exceed the old Postal Service operated system by more than $1.1 billion. The Decision Analysis Report was inaccurate because equipment processing and repair volume was significantly higher than expected, forecasted savings from transportation were not realized, and savings associated with the Greensboro, North Carolina, service area were incorrectly calculated. Consequently, the Decision Analysis Report underestimated transportation and facility space requirements—as well as the cost of "start-up" and continuing operations.

We recommended Postal Service management develop and submit a Decision Analysis Report Modification Request to adjust for unanticipated conditions; reduce operating volume by reusing serviceable equipment rather than returning it to service centers for processing; and reduce the cost of dedicated transportation by shipping mail transport equipment on networks that also carry mail. Management agreed with our recommendations regarding the reduction of volume and dedicated transportation. However, they disagreed with our recommendation to submit a Decision Analysis

Report Modification Request because they felt the Mail Transport Equipment Service Center Program was not technically a capital program, and because unanticipated costs were volume driven and as such, were only operating variances.

Management's comments regarding the Decision Analysis Report Modification Request were not responsive. The Mail Transport Equipment Service Center Program does not have to be a capital program to require a Decision Analysis Report Modification Request, and significant cost overruns are not excluded from Decision Analysis Report modification requirements simply because they are volume driven. We believe that Postal Service Handbook F-66, General Investment Policies and Procedures, and Handbook F-66D Other Investment-Related Policies and Procedures, clearly require submission of a Decision Analysis Report Modification Request, and we are concerned that management considers cost overruns of the magnitude forecast in our audit as merely operating variances. We view this recommendation unresolved, and plan to pursue it through the formal audit resolution process. Management's comments and our evaluation of their comments are included in the report.

The Office of Inspector General (OIG) considers recommendation one as significant and, therefore, it requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective action is completed. The recommendation should not be closed in the follow-up tracking system until OIG provides written confirmation that the recommendation can be closed.

We appreciate the cooperation and courtesies provided by your staff during the audit. If you have questions or need additional information, please contact Joe Oliva, director, Transportation, at (703) 248-2317 or me at (703) 248-2300.

Debra S. Ritt
Assistant Inspector General
for Business Operations

Attachment

cc: Anthony M. Pajunas
John R. Gunnels

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EXECUTIVE SUMMARY

Introduction

The Mail Transport Equipment Service Center Network is a centrally managed system of 22 contractor operated equipment service centers designed to supply mail processing facilities with mailbags, trays, sleeves, pallets, hampers, carts, and large rolling containers.

In 1997, Postal Service management prepared a Decision Analysis Report recommending a $1.3 million capital investment to implement the contractor-operated system as a replacement for the Postal Service operated system in place at the time. The report forecasted the new system would improve performance and reduce 10-year operating expenses from $3.9 billion to $3.6 billion by achieving operational efficiencies—and as a result, save an average of more than $30 million per year. On June 30, 1997, the Board of Governors approved the Decision Analysis Report—with project implementation scheduled to begin in November 1997, phased in over 17 months, and completed by April 1999. However, fielding was not complete until January 2000. From the outset, the project was troubled by allegations of poor performance and excessive costs. As a result, the Board of Governors asked the Office of Inspector General to evaluate the program. This is part of a series of reports.

The objective of our audit was to determine whether the Mail Transport Equipment Service Center Network would achieve the performance and financial benefits anticipated by the Decision Analysis Report.

Results in Brief

Based on a survey of 89 Postal Service facilities and follow-up telephone interviews with seven area mail transport equipment specialists, the new contractor operated network is performing better than the old Postal Service operated system, but still needs improvement to achieve performance standards specified in the Decision Analysis Report. Report standards required the network to deliver the right amount of quality equipment to the right place at the right time, improve customer satisfaction, ease employee frustration, and enhance mail operations. Respondents indicated causes of network difficulties included returning usable

equipment to service centers for processing and reissue; hoarding equipment at user facilities because the network was not reliable; and trucks moving empty because the network was suboptimized. Consequently, respondents felt the network was not consistently delivering the right equipment to the right place at the right time, customers were still not satisfied, employees still felt frustrated, and mail operations were still not optimized.

Our audit also revealed that the new system would not achieve anticipated financial benefits. Instead, it would exceed the 10-year $3.6 billion operating expense forecast by more than $1.4 billion. As a result, 10-year forecasts for the new system exceeded the old system by more than $1.1 billion. The Decision Analysis Report was inaccurate because equipment processing and repair volume was significantly higher than expected, anticipated transportation savings were not realized, and savings associated with the Greensboro, North Carolina, service area were incorrectly calculated. Because of unexpected increases in reported volume, unrealized transportation savings, and the calculation error, the Decision Analysis Report understated transportation requirements by $1.0 billion; facility space requirements by $.1 billion; service center "start-up" and continuing operations by $.1 billion; and "other" considerations by $.2 billion.

Postal Service Handbook F-66, General Investment Policies and Procedures, dated April 1999, requires managers to track approved Decision Analysis Report projects, issue compliance reports to ensure the Board of Governors is advised regarding progress toward anticipated goals, and submit modification requests for Board approval when confronted with unforeseen conditions like unanticipated volume and cost overruns. Although managers expressed early concern about volume, and took some action to mitigate impact on operations and cost, their compliance reports did not fully portray the problem, and managers did not submit a modification request to the Governors for approval. Consequently, the Board may not have been fully

cognizant of the magnitude of the problem—or of actions management planned in order to compensate. As a result, costs for transportation, facilities, operations, and other requirements may have increased without sufficient awareness by the Board—or benefit of their emphasis on corrective actions.

Summary of Recommendations

We recommend that the vice president, Network Operations Management:

- Develop a Decision Analysis Report Modification Request to adjust for unanticipated conditions, and submit the request to the Board of Governors for approval.
- Reduce operating volume, consistent with contract volume guarantees, by requiring facilities to reuse serviceable equipment rather than returning it to service centers for processing.
- Improve efficiency and lower cost by reducing the shipment of mail transport equipment on dedicated networks.

Summary of Management's Comments

Management agreed with our recommendations regarding the reduction of operating volume and dedicated transportation. However, they disagreed with our recommendation to develop and submit a Decision Analysis Report Modification Request. They provided the following reasons:

- The Mail Transport Equipment Service Center Program was not technically a capital program.
- Unanticipated costs were volume driven, and as such, were only operating variances not requiring a Decision Analysis Report revision.

Management also made several additional comments regarding differing perspectives, concerns, and questions about the source, interpretation, and accuracy of our data. These additional comments were not necessarily associated with specific recommendations. Management's comments, in their entirety, are included in Appendix C to this report.

Overall Evaluation of Management's Comments

Management's comments regarding the reduction of operating volume and dedicated transportation were responsive. However, management's comments regarding the Decision Analysis Report Modification request, and their additional comments were not. The Mail Transport Equipment Service Center Program does not have to be a capital program to require a Decision Analysis Report Modification Request, and significant cost overruns are not excluded from Decision Analysis Report modification requirements simply because they are volume driven. We believe that published Postal Service investment policies clearly require submission of a Decision Analysis Report Modification Request, and we are concerned that management considers cost overruns of the magnitude forecast in our audit as merely "operating variances." We view the disagreement on this recommendation unresolved, and plan to pursue the formal resolution process.

Although management commented on the details of our work, we noted they did not significantly challenge the magnitude of our results. The Postal Service is facing a potential 10-year cost overrun of more than $1 billion. The Mail Transport Equipment Service Center involves an expenditure of $3.6 billion. Clearly, the Board of Governors has a major interest in being fully informed about the program. The Decision Analysis Report process facilitates the flow of information.

We noted management's additional comments. However, throughout our audit we routinely met with senior managers and officials to update them on the progress and preliminary indications of our work. During those meetings, we routinely sought input and differing perspectives, and we considered that information in our continuing effort. The audit results we presented in our report are consistent with information we exchanged with management during our on-going dialogue. In addition, throughout the course of our audit we consulted with subject matter experts as circumstances may have dictated—and those experts routinely guided and validated our work.

INTRODUCTION

Background

The Mail Transport Equipment Service Center Network is a centrally managed system of 22 "contractor-operated" service centers designed to supply Postal Service mail processing facilities—and certain large customers—with mailbags, trays, sleeves, pallets, hampers, carts, and large rolling containers. The service centers deliver equipment to users with "dedicated" transportation, recover it when equipment is no longer needed or serviceable, and then process it for inventory or redelivery. Processing involves receiving, sorting, and inspecting equipment for repair or disposal.

The network was initiated in 1992 as a pilot, with a prototype center in Greensboro, North Carolina. In 1997, Postal Service management prepared a Decision Analysis Report recommending a $1.3 million capital investment to implement the contractor-operated system as a replacement for the Postal Service operated system in place at the time. The old system had been plagued by problems of poor equipment quality, availability, and delivery delays. The analysis forecasted the new system would:

- Improve performance and customer satisfaction by delivering "the right amount of quality mail transport equipment to the right place at the right time."

- Reduce 10-year operating expenses from $3.9 billion to $3.6 billion by achieving operating efficiencies, and as a result, save an average of more than $30 million per year.

On June 30, 1997, the Board of Governors accepted the recommendation and approved the Decision Analysis Report. Fielding of the network was scheduled to begin in November 1997, phased in over 17 months, and be completed by April 1999. However, fielding was not completed until January 2000. From the outset, the new network was troubled by allegations of poor performance and excessive costs. As a result, the Board of Governors asked the Office of Inspector General to evaluate the program. This report is part of a series of reports.

Objective, Scope, and Methodology

The objective of our report was to determine whether the Mail Transport Equipment Service Center Network would achieve the performance and financial benefits anticipated by the Decision Analysis Report.

During our work we observed operations at Postal Service facilities and 8 of the 22 service centers. We interviewed contractors and Postal Service personnel, including the executive director, Mail Transport Equipment Service Center Program; Area Mail Transport Equipment specialists; Network Transportation specialists; and contracting officers. We analyzed transportation routes, mileage, and costs for all 22 service centers. We evaluated contracts, regulations, and other documents, including the Decision Analysis Report, and Postal Service investment policies and procedures. We analyzed performance and financial records. To determine if anticipated performance improvements were achieved, we conducted a statistical survey of 89 user facilities from December 1999 through January 2000 and projected our results to a national statistical population of 301 facilities. We also conducted follow-up telephone interviews with seven area mail transport equipment specialists during August 2000. Because fielding was not completed until January 2000, we adjusted the Decision Analysis Report planned cash flow to actual cash flows to properly evaluate financial results. A detailed description of our audit and survey methodology is contained in Appendices A and B.

Our audit was conducted from August 1999, through May 2001, in accordance with generally accepted government auditing standards and included such tests of internal controls, as were considered necessary under the circumstances. We discussed our conclusions and observations with appropriate management officials and included their comments where appropriate.

Prior Audit Coverage

Mail and Other Items Missent to Mail Transport Equipment Service Centers (TR-AR-00-007), dated April 5, 2000, concluded that mail erroneously shipped to service centers placed the security and timely delivery of mail at risk. Management agreed with all of our recommendations and actions taken or planned should correct the issues identified in our report.

Extra Trip Expenditures at the Dallas Bulk Mail Center (TR-AR-00-008) dated June 30, 2000, concluded that the Postal Service incurred unnecessary highway transportation costs because mail transport equipment was not available from the Dallas Mail Transport Equipment Service Center. Management agreed with all of our recommendations and actions taken or planned should correct the issues identified in our report.

Extra Trip Expenditures within the Mid Atlantic Area (TR-AR-00-009) dated July 27, 2000, concluded that the Postal Service incurred unnecessary transportation costs in part because three centers in the Mid Atlantic Area were unable to obtain adequate mail transport equipment. Management agreed with all of our recommendations and actions taken or planned should correct the issues identified in our report.

Adequacy of Mail Transport Equipment Center Network Internal Controls (TR-AR-01-001) dated October 31, 2000, concluded that mail transport equipment was invoiced as processed when work was not performed; that containers were reported as repaired when no repairs were made; that serviceable equipment was improperly condemned and discarded; and that deficiencies were caused by inadequate separation of duties, insufficient record keeping, and insufficient quality assurance. Management agreed with all of our recommendations and actions taken or planned should correct the issues identified in our report.

Contracting Practices for the Procurement of Mail Transport Equipment Services (CA-AR-01-001) dated February 27, 2001, concluded that the Postal Service may pay up to $53 million more for services obtained under noncompetitive contracts than it would have for the same or similar services obtained under competitive contracts. The report also concluded that the Postal Service paid a contractor over $1.9 million for work not properly authorized, and is at risk of being charged an additional $11.2 million for other unauthorized work. Management generally agreed with our recommendations but did not agree with all of our findings. Management agreed to work with its noncompetitive contractor to reduce contract costs and to implement improvements in seeking contract competition, issuing letter

contracts, and making unauthorized commitments. However, management questioned our finding that it may pay up to $53 million more to its noncompetitive contractor. Management also disagreed with our conclusions regarding the basis for the noncompetitive awards and that all the contracts could have been awarded competitively, resulting in more fair and reasonable contract prices overall. We maintain that all contracts could have been awarded competitively because the Postal Service had prequalified 17 contractors. Prices offered by these contractors were up to $53 million less than the noncompetitive contractor. Because management's planned or implemented actions are responsive and address the issues identified in this report, no further action is required.

AUDIT RESULTS

Performance Benefits

Based on our survey of 89 Postal Service facilities conducted between December 1999 through January 2000, and our follow-up telephone interviews with seven area mail transport equipment specialists conducted during August 2000, the new Mail Transport Equipment Service Center Network is performing better than the old Postal Service operated system. However, the survey and the interviews also revealed the new system still needed improvement to achieve standards specified by the Decision Analysis Report. Report standards require the new network to deliver "the right amount of quality mail transport equipment to the right place at the right time"—and as a result:

- Improve customer satisfaction and confidence by eliminating the need to order more equipment than necessary—or "hoard" equipment to accommodate broken or incorrect shipments.

- Ease employee frustration.

- Enhance mail operations by reducing the diversion of Postal Service employees and facilities to mail transport equipment requirements.

Our customer satisfaction survey[1] conducted from December 1999 through January 2000 indicated performance during network implementation could have been improved. Specifically, the survey revealed that:

- More than 105 facilities, or more than 35 percent of our total statistical population of 301 user facilities, returned equipment to service centers without using it, and did so because they had not ordered it, did not need it, or found it unacceptable.

- More than 135 facilities, or more than 45 percent of our total statistical population, felt equipment was unavailable.

[1] See Appendix B for a detailed description of our survey design and methodology.

- More than 150 facilities, or more than 50 percent of our total statistical population, felt shortages were caused because the equipment did not exist within the system or the system was improperly managed.

- More than 50 facilities, or more than 18 percent of our total statistical population, had employees searching for equipment more than 6 hours per day.

- More than 45 facilities, or more than 16 percent of our total statistical population, used unscheduled transportation to return equipment, and more than 35 facilities, or more than 13 percent, scheduled extra transportation to obtain equipment.

Telephone interviews with 7 of 11 Area Mail Transport Equipment specialists who responded to our inquiries during August 2000 indicated that although standards still had not been achieved, conditions were slowly improving, and the new system was better than the old. One equipment specialist was "very satisfied," most indicated the new system provided better service, and all expressed some level of satisfaction. But most also cited continuing problems like equipment shortages, system reliability, and trucks moving empty in one direction. Some were concerned about costs.

Respondents indicated the cause of network difficulties included:

- Returning usable equipment to service centers for processing and reissue when the equipment could be used until it was no longer serviceable.

- "Hoarding" equipment at facilities because the network was not reliable.

- Trucks moving empty because the network was "suboptimized."

Although interviews indicated the new system was better than the old, respondents felt it was not delivering the right equipment to the right place at the right time. As a result, customers were still not satisfied, employees still felt frustrated, and mail operations were still not optimized.

Financial Benefits

The service center network will not achieve the financial benefits anticipated by the Decision Analysis Report. Instead, the program will exceed the 10-year $3.6 billion cost forecast by more than $1.4 billion. As a result, 10-year forecasts for the new system now exceed the old system by more than $1.1 billion. See Figures 1 and 2.

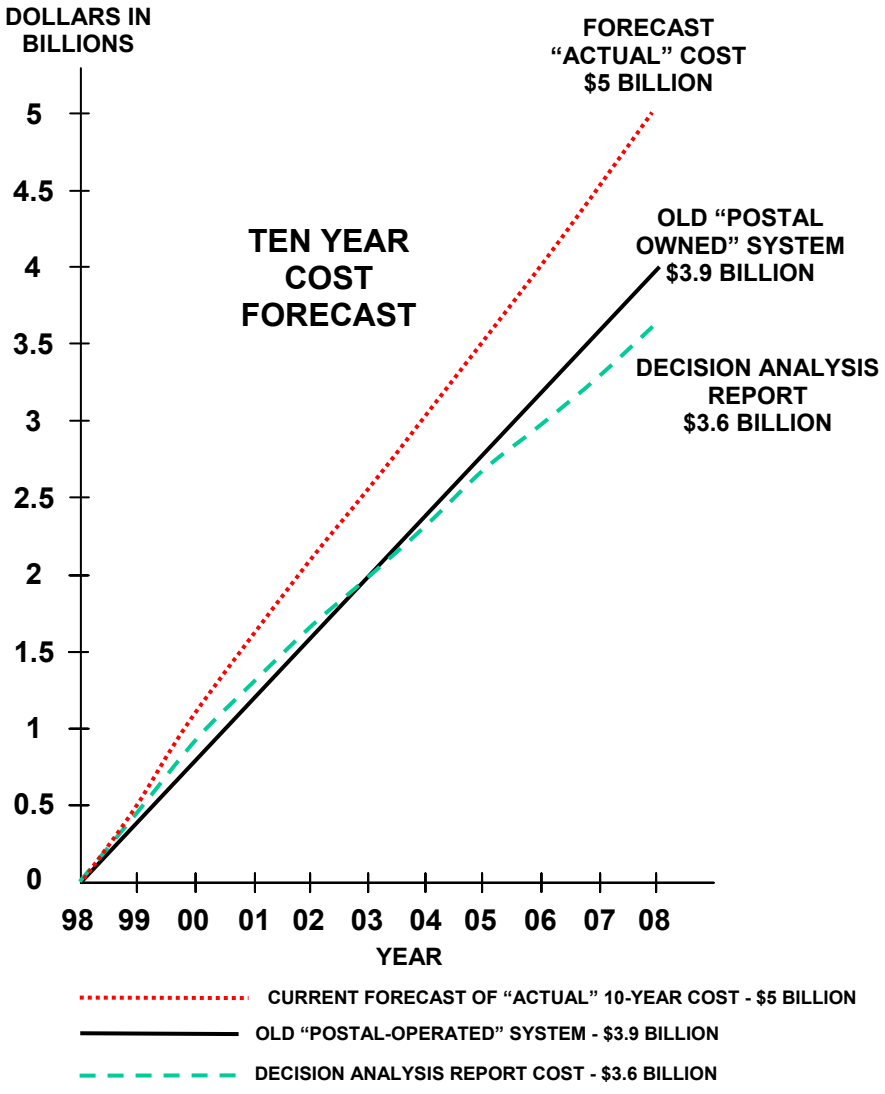

Figure 1

Decision Analysis Report forecasts were inaccurate because:

- Equipment processing and repair volume was significantly higher than expected.

- Forecast savings from transportation were not realized.
- Additional service center space was required.
- Service center "start-up" and continuing operations cost more than anticipated.
- Savings associated with the Greensboro, North Carolina, service area were inaccurately calculated.

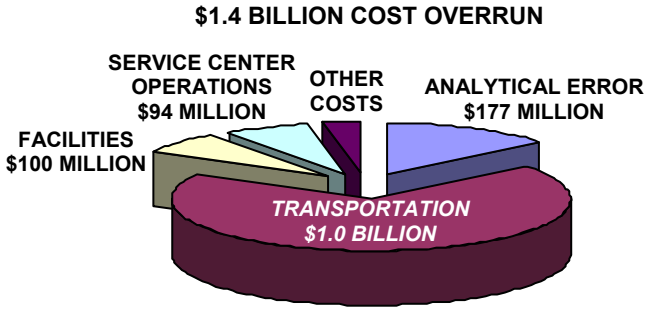

Figure 2

Cost overruns may have been less than apparent because senior management slowed expenditures for all approved Postal Service investment projects. Consequently, the service center network, which was originally scheduled to be fully fielded by April 1999, was not completed until January 2000. As a result, delayed timing of scheduled expenditures may have caused the program to appear within budget.

Postal Service Handbook F-66, General Investment Policies and Procedures, dated April 1999, requires managers to track approved Decision Analysis Report projects, issue compliance reports to ensure the Board of Governors is advised regarding progress toward anticipated goals, and submit modification requests for Board approval when confronted with unforeseen conditions like unanticipated volume and cost overruns. Although managers expressed early concern about volume, and took some action to mitigate impact on operations and cost, their compliance reports did not fully portray the problem—and they did not submit a modification request to the Governors for approval. Consequently, the Board may not have been fully cognizant of the magnitude of the problem or of actions management planned in order to compensate. As a result, costs for transportation, facilities, operations, and other requirements

may have increased without sufficient awareness by the Board—or benefit of their emphasis on corrective action.

Volume

The Decision Analysis Report underestimated repair and processing volume during the first 2 years of operation. Specifically it estimated the network would repair or process 778 million pieces of equipment. However, the Postal Service actually paid for more than a billion pieces. See Figure 3.

PROCESSING VOLUME

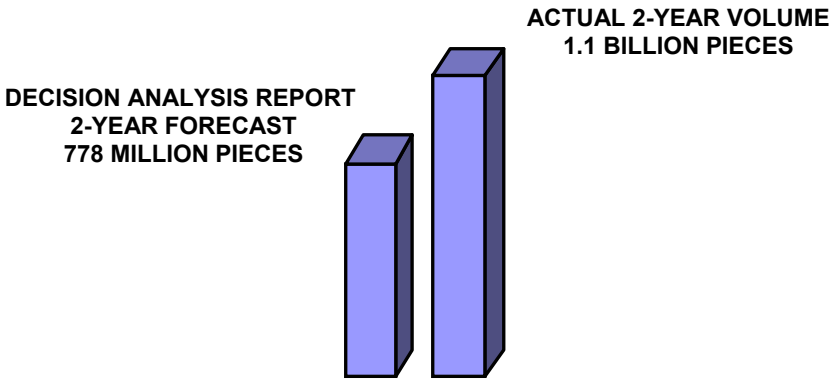

Figure 3

Postal Service managers, including the executive director, Mail Transport Equipment Service Center Program; Network Transportation specialists; and Area Mail Transport Equipment specialists, were unable to completely identify reasons for unanticipated volume. However, they suggested that operational changes, unanticipated inventory, and changes in mail classification may have contributed to the increase. For example, they explained:

- Under the old system, facility staff was encouraged to reuse equipment without processing. Under the new system it is easier to return equipment to service centers for processing and reissue.

- Processing requirements were subject to modification. For example, cardboard trays—discarded under the old system—are now repaired.

- Under the old system, facilities hoarded equipment. When the service center system was implemented more equipment was "turned-in" than anticipated.

- Mail reclassification led to an increase in equipment needs.

In addition to reasons provided by Postal Service managers, volume statistics and associated costs could have been adversely impacted by other factors. For example, when user facilities returned equipment without using it—because they did not order it, because they did not need it, or because they found it unacceptable—the equipment was sometimes improperly recorded and invoiced as processed when work was not actually performed. We identified this situation in our October 31, 2000, report, Adequacy of Mail Transport Equipment Center Network Internal Controls, but because of the identified control weakness, we could not quantify the impact on volume or cost.

Managers did not adequately react to unexpected increases in reported volume, in part, because the Decision Analysis Report did not contain a sensitivity or risk analysis to consider how marginal changes in volume might affect network operations and cost. Consequently, as volume increased, program costs increased.

Dedicated Transportation	The forecast $1 billion dedicated transportation overrun was the most significant affecting the program—more than 70 percent of the total. The Decision Analysis Report forecast 10-year dedicated transportation cost at $118 million—but actual costs could exceed $1.12 billion. Costs will exceed forecasts for two principal reasons: • As previously discussed, the network will transport more volume than forecasted, and as a result, incur extra mileage. Specifically, analysis of mileage for all 22 service centers indicated increases of at least 15 million miles annually. In addition, unanticipated mileage costs could be further exacerbated by unpredictable factors like rising fuel prices. • Dedicated transportation suboptimizes transportation capacity. Specifically, the network does not take full

	advantage of capacity available by rail or trucks moving mail. For example, under the old Postal Service operated system, trucks delivering equipment to user facilities, returned with mail—or vice versa—and trucks frequently moved equipment and mail at the same time. Because the Decision Analysis Report assumed dedicated transportation would replace trips formerly planned for equipment transport, it claimed savings. However, savings were not realized because the requirement to transport mail remained, and the trips were not cancelled. Instead, trucks frequently moved empty in one direction. Suboptimized transportation cost about $310 million because only $444 million of the forecasted $754 million in savings were realized.
Facility Space Requirements	Mail transport equipment service centers will require 1.4 million square feet more space than the Decision Analysis Report specified, and consequently, will cost about $100 million more over the next 10 years than forecasted. The analysis was understated because it did not anticipate the unexpected equipment volume discussed earlier. Specifically, the analysis identified a 3.3 million square foot space requirement, but the Postal Service actually leased about 4.7 million square feet. Consequently, over the next 10 years, the Postal Service will pay $262 million rather than the forecasted $162 million.
Service Center Operations and Start-Up Costs	Service center operations, including costs for processing and repairing mail transport equipment, will exceed the 10-year, $2 billion, Decision Analysis Report forecast by about $100 million. Specifically, the Postal Service will pay almost $2.1 billion, rather than the $2.0 billion forecasted. Although unanticipated volume is the principal cause for the forecast discrepancy, the situation is somewhat unique. About $70 million of the excess costs were “start-up” costs. Project managers explained that under the old system, facilities hoarded equipment. The managers further explained that when the new system was implemented, excess inventory was turned-in, hit the processing and repair cycle, and caused a costly, “one-time,” operating “spike.” Finally managers explained that they took action to normalize the “spike,” and that most service centers were now operating within anticipated parameters.

Greensboro, North Carolina	The Decision Analysis Report understated the 10-year cost of the Greensboro, North Carolina, service area by $177 million because of an analytical error. Had the Postal Service not implemented the new network, the 10-year forecasted cost of servicing the Greensboro area would have been approximately $80 million. When the Postal Service discontinued the old system in Greensboro, the Decision Analysis Report properly registered an $80 million savings. The 10-year forecasted cost of the current Greensboro Service Center is also about $80 million. Consequently, conversion from the old to the new in Greensboro was essentially a "wash." However, the conversion from old to new was not direct. Greensboro was the sight of the "prototype" service center. Had the "prototype" continued to operate as such, its 10-year forecasted cost would have been $177 million. When the Postal Service redesignated the facility as a "service center," the analysis improperly registered an additional $177 million savings. Consequently, the 10-year financial benefit was overstated by that amount.
Recommendation	We recommend that the vice president, Network Operations Management: 1. Develop a Decision Analysis Report Modification Request to adjust for unanticipated conditions, and submit the request to the Board of Governors for approval.
Management's Comments	Management disagreed with our finding and recommendation. They stated that neither the original Decision Analysis Report nor subsequent Decision Analysis Modification Requests were required. They provided the following two reasons. • The Mail Transport Equipment Service Center Program was not technically a capital program. • Unanticipated costs were volume driven, and as such, were only operating variances not requiring a Decision Analysis Report revision.
Evaluation of Management's Comments	Management's comments were not responsive to our recommendation. The Mail Transport Equipment Service Center Program does not have to be a capital program to

require a Decision Analysis Report Modification Request, and significant overruns of financial targets are not excluded from Decision Analysis Report modification requirements simply because they are volume driven. We are concerned that management considers cost overruns of the magnitude forecast in our audit as merely operating variances.

Postal Service Handbook F-66, General Investment Policies and Procedures identifies both "Capital Investments" and "Major Operating Expense Investments" as types of investments subject to Decision Analysis Report provisions, including requirements for a Decision Analysis Report Modification Request. Paragraph 1-4 defines a "Major Operating Expense Investment" as a major operational change that "results in the expenditure of operating funds in excess of $7.5 million over the project period." The Mail Transport Equipment Service Center Program was a major operational change—switching from a Postal Service operated system to a contractor operated system—and it forecast expenditures of $3.6 billion over 10 years. Paragraph 1-4 also specifies that major operating expense investments are subject to requirements identified by Postal Service Handbook F-66D, Other Investment-Related Policies and Procedures. F-66D supplements the policies and procedures specified by F-66. It states:

- Major operating expense investments must be supported by a Decision Analysis Report.

- Major operating expense Decision Analysis Reports must include sufficient data—including data on the impact of volume changes—to allow approving officials to fully evaluate long term financial implications.

- Major operating expense investments must be tracked to ensure they meet targeted results—and in the event they do not—program officials must follow the standard Decision Analysis Report modification requirements that apply to other investments.

We believe that published Postal Service investment policies clearly require submission of a Decision Analysis Report Modification Request. We view these recommendations as unresolved, and plan to pursue it through the formal audit resolution process.

Recommendation	2. Reduce operating volume, consistent with contract volume guarantees, by requiring facilities to reuse serviceable equipment rather than returning it to service centers for processing.
Management's Comments	Management agreed with our finding and recommendation. They stated that requiring facilities to reuse serviceable equipment when economically feasible was current Postal Service policy.
Evaluation of Management's Comments	Management's comments were responsive to our finding and recommendation.
Recommendation	3. Improve efficiency and lower cost by reducing the shipment of Mail Transport Equipment on dedicated networks.
Management's Comments	Management agreed with our finding and recommendation. They stated they would take steps to optimize transportation and reduce costs by incorporating mail on returning trips, and by maximizing the use of one-way highway service and balanced round trip highway transportation.
Evaluation of Management's Comments	Management's comments were responsive to our finding and recommendation. We believe the actions taken and planned should correct the issues identified in our report.
Other Management's Comments	In their response, management made additional comments not necessarily associated with specific recommendations. We will summarize and evaluate those comments here. • Management stated that because surveys and telephone interviews conducted to evaluate network performance were taken during network implementation, they were premature, biased, and inaccurate.
Evaluation of Management's Comments	Network implementation began in November 1997, and from the outset, was troubled by allegations of poor performance. Our audit was initiated at the request of the Board of Governors and was intended, in part, to evaluate those early allegations. Our survey was conducted using valid sampling

methods as described in Appendix B. As a result of our work, we reported that respondents felt the new system was better than the old, but still needed improvement. We noted management's belief that a survey conducted now would be more accurate. We believe our survey was accurate—and accurately reflected perceptions at the time it was taken. However, we agree that a survey taken now might produce different results. Consequently, we are considering such a survey during potential follow-up work.

Management's Comment	Management stated that including prior audit results in our report without including management's responses presented a biased picture.
Evaluation of Management's Comment	We considered management's comment and added management responses to the reports summarized in the prior audit section of this report.
Management's Comments	In general, management made several comments on the source, interpretation, and accuracy of our data, and questioned whether we considered certain principals of transportation and logistics. They also reiterated their belief that on technical grounds they were not required to submit a Decision Analysis Report Modification Request.
Evaluation of Management's Comment	We noted management's additional comments. However, throughout our audit we routinely met with senior managers and officials to update them on the progress and preliminary indications of our work. During those meetings, we routinely sought input and differing perspectives, and we considered that information in our continuing effort. The audit results we presented in our report are consistent with information we exchanged with management during our on-going dialogue. In addition, throughout the course of our audit we consulted with subject matter experts as circumstances may have dictated, and these subject matter experts routinely guided and validated our work. As we stated in the objective, scope, and methodology paragraphs of our report, our audit was conducted in accordance with generally accepted government auditing standards. Consequently, we consider our audit techniques, methods, and results valid. Beyond management's comments concerning the details of our work, we noted that management did not significantly challenge the magnitude of our results. The Postal Service

is facing a potential 10-year cost overrun of more than $1 billion. The Mail Transport Equipment Service Center Program involves an expenditure of $3.6 billion. Clearly, the Board of Governors has a major interest in being fully informed. The Decision Analysis Report process facilitates the flow of information. We reiterate our recommendation that management develop a Decision Analysis Report Modification Report to adjust for the unanticipated conditions, and submit the request to the Board of Governors for approval.

APPENDIX A. AUDIT METHODOLOGY

To evaluate the Decision Analysis Report line items, the OIG reviewed contractor invoices, service center operation reports, transportation, and budget account and general ledger data.

Site Selection

We visited mail transport equipment service centers, bulk mail centers, and processing and distribution centers during January and February 2000. Mail transport equipment service centers were judgmentally selected from a universe of 22 centers operated by 5 separate contractors representing large, medium, small, and half-small size facilities. We also visited Postal Service facilities in close proximity to each service center selected.

At each service center and Postal Service facility visited, we interviewed relevant contractors and Postal Service personnel and observed operations.

MTESC Location	Processing Size	Processing Size (sq. ft.)	Number of Postal Facilities Supported	Supplier	Area
Los Angeles	Large	100k	18	A	Pacific
Cincinnati	Large	100k	16	B	Allegheny
Washington DC	Large	100k	15	C	Capitol Metro
Chicago	Large	110k	25	D	Great Lakes
New Jersey	Medium	80k	16	A	NY Metro
San Francisco	Medium	80k	18	D	Pacific
St. Louis	Small	60k	3	E	Mid-west
Denver	½ Small	40k	13	E	Western

Additionally, during audit survey, we toured the service center and interviewed relevant personnel at the Greensboro, North Carolina, Service Center.

Cash Flow Adjustment – Years 1 and 2

The Postal Service is required to prepare a Decision Analysis Report to enable approving officials to make an informed decision regarding expenditures of Postal Service funds. The Decision Analysis Report Cash Flow Summary for the Mail Transport Equipment Service Center Program documented planned expenditures over a 10-year period assuming all 22 service centers would be operational during the first year. Delays in program implementation resulted in only 9 service centers operating in the first year with the remaining 13 service centers opening in the second year. To effectively compare actual expenditures to planned expenditures the OIG adjusted the Decision Analysis Report cash flow for years 1 and 2 to coincide with actual service center implementation dates.

To adjust the Decision Analysis Report Planned Costs for each category we first calculated the fraction (percent) of the year that each facility was to be in operation, including consideration of the partial capability during the phase in period for the first two years. Then we calculated the corresponding percentage for the adjusted schedule to recalculate the adjusted cost. The adjusted cost is, therefore, the planned cost divided by the planned percentage multiplied by the adjusted percentage. Using the cost for service center operations we illustrate this methodology. Tables 1 and 2 depict the planned cost and percent of the year each service center was to be operational and the actual percentage of the year each center was operational with the adjusted costs. Costs as shown in Tables 1 and 2 are in thousands and the percentages have been rounded to two decimal places.

We used this methodology for all line items except three to which it did not apply--Consulting and Engineering, area and headquarters staffing, and Contract Administration. Tables 1 and 2 show the results of all line items adjusted for schedule delays.

Table 1-Decision Analysis Report Year 1
(Costs in 000's and percentages have been rounded)

Service Center	Planned Cost	Planned Percentage to be Operational	Actual Percentage Operational	Adjusted Cost
Greensboro, NC	$ 10,822	100%	0%	$ -
Newark, NJ	13,237	85%	75%	11,793
Chicago, IL	12,984	62%	83%	17,528
Los Angeles, CA	11,864	62%	68%	13,050
Memphis, TN	4,486	46%	5%	449
Denver, CO	3,514	46%	3%	234
Cincinnati, OH	5,745	38%	0%	-
Minneapolis, MN	3,134	38%	2%	125
Springfield, MA	4,502	31%	0%	-
Dallas, TX	3,400	31%	0%	-
Washingon, DC	5,030	23%	2%	335
Saint Louis, MO	3,167	23%	0%	-
Atlanta, GA	3,436	15%	5%	1,031
Philadelphia, PA	3,601	15%	2%	360
Detroit, MI	2,642	9%	0%	-
San Francisco, CA	3,916	9%	0%	-
Des Moines, IA	2,223	5%	0%	-
Kansas City, MO	2,269	5%	0%	-
Jacksonville, FL	2,308	2%	0%	-
Long Island, NY	3,334	2%	0%	-
Pittsburgh, PA	2,989	0%	0%	-
Seattle, WA	2,538	0%	0%	-
Totals	**$ 111,141**			**$ 44,906**

Table 2 Decision Analysis Report Year 2
(Costs in 000's and percentages have been rounded)

Service Center	Planned Cost	Planned Percentage to be Operational	Actual Percentage Operational	Adjusted Cost
Greensboro, NC	$ 8,440	100%	77%	$ 6,492
Newark, NJ	14,122	100%	100%	14,122
Chicago, IL	19,883	100%	100%	19,883
Los Angeles, CA	14,333	100%	100%	14,333
Memphis, TN	7,983	100%	85%	6,755
Denver, CO	6,105	100%	78%	4,790
Cincinnati, OH	15,392	100%	80%	12,314
Minneapolis, MN	7,277	100%	75%	5,486
Springfield, MA	10,911	100%	72%	7,889
Dallas, TX	9,266	100%	78%	7,270
Washingon, DC	14,308	100%	74%	10,566
Saint Louis, MO	8,688	100%	75%	6,549
Atlanta, GA	10,009	100%	88%	8,777
Philadelphia, PA	10,298	100%	80%	8,238
Detroit, MI	7,399	98%	72%	5,434
San Francisco, CA	11,661	98%	62%	7,288
Des Moines, IA	5,134	95%	63%	3,395
Kansas City, MO	5,270	95%	63%	3,485
Jacksonville, FL	5,289	91%	66%	3,855
Long Island, NY	8,072	91%	60%	5,336
Pittsburgh, PA	6,812	85%	54%	4,335
Seattle, WA	5,896	85%	71%	4,931
Totals	**$ 212,548**			**$ 171,524**

Extrapolating Actual Costs – Years 3 - 10

For the line items reviewed, direct materials, facilities lease cost, transportation cost and savings, current contract savings, service center contract and other costs, we calculated the average cost over the period for which all facilities were fully operational. We first annualized the average accounting period cost, using actual costs for the accounting periods after all facilities were fully operational. Second, to the annual amount thus calculated, we applied Postal Service Decision Analysis Report volume growth factors and economic escalation factors to extrapolate costs for years 3 through 10.

Direct materials, service center contract, and the integration contract costs, under the line item description other contract costs, were annualized using the actual cost averages for accounting periods 10 through 13. Transportation costs were annualized using actual cost averages for accounting periods 5 through 9. We then applied the same Postal Service escalation factors used in calculating the Decision Analysis Report for each Decision Analysis Report year 3 through 10.

We used the contract cost in Decision Analysis Report years 3 through 7 for the Quality Assurance contract because this contract was recently let and those costs we believe best represented the expected program costs for those years. We applied the Postal Service escalation factors to remaining years.

The cost savings claimed from the current contract line item was removed from the Decision Analysis Report Cash Flow Summary completely because these savings were erroneously claimed. See program savings in this report for further explanation.

Performance Survey and Telephone Interviews

To determine if performance improvements specified by the Decision Analysis Report were achieved or if progress toward specified goals was made, we conducted a survey and follow-up telephone interviews.

From December 1999 through January 2000 we conducted a survey of internal customers. To conduct our survey we contacted 89 facilities serviced by the Service Center Network. At each facility contacted, we interviewed the individual responsible for mail transport equipment and asked them to complete a questionnaire. We then tabulated and summarized results. See Appendix B for a detailed description of survey design.

Because the survey was conducted prior to complete network implementation, we felt results might not be representative of long-term performance. Consequently, we conducted a follow-on telephone interview with seven area mail transport equipment specialists during August 2000. Participants responded to predetermined questions and provided additional comments. We then summarized results.

APPENDIX B. STATISTICAL SAMPLING AND PROJECTION FOR MAIL TRANSPORT EQUIPMENT SERVICE CENTER SURVEY

Sample Design And Modifications

We conducted a survey of internal customers from December 1999 through January 2000. Our audit universe consisted of a total of 320 Postal Service facilities like bulk mail centers, processing and distribution centers, processing and distribution facilities, and airmail centers. The list of these facilities was provided by the Mail Transport Equipment Service Center Program Office. The facilities were organized in eight supplier clusters.

To establish our statistical selection, we used a stratified random sample design to allow statistical projection of several measures of satisfaction with the centers. Each supplier cluster was considered a stratum. For all strata, facilities were selected using the dBase random number generator that is incorporated into the Army Audit Agency's Statistical Sampling Software package (SSS), dated 1992. A total sample size of 120 was calculated to provide a two-sided 95 percent confidence interval with approximately 7 percent precision. This total resulted in a planned sample size of 15 facilities per stratum. Because two strata were small, the sample size for those strata was reduced slightly. A total of 113 sites were selected for review.

Both the sample and the audit universe were modified when the response rate for the St. Louis, Kansas City, and Denver cluster was found to be extremely low. Responses were obtained from only 6 of the 11 facilities selected in that cluster. Therefore, that cluster was deleted from the sample and the audit universe, and no projections made here are presumed to apply to the facilities within that cluster. The resulting audit universe consisted of 301 facilities, in seven strata, and the sample contained a total of 102 facilities. Because the program was not fully operational, all 102 sites were not yet serviced by mail transport equipment service centers. Of the 102 sites, we contacted 89. At those facilities we interviewed the individual responsible for mail transport equipment and asked them to complete a questionnaire.

Projections

Methodology

The survey results were analyzed using the attribute equations for a stratified sample, as described in Chapter 5 of Elementary Survey Sampling, Scheaffer, Mendenhall, and Ott, c.1990.

Most strata had one or more nonresponses. Each attribute is analyzed by determining "logical bounds." To generate the logical bounds, the confidence interval is computed for each attribute for each of two scenarios: (1) all nonresponses are assumed to be

"positive" with respect to the subject attribute, and (2) all nonresponses are assumed to be "negative" with respect to the subject attribute.

Results

Attribute 1: Facility returns equipment to the Mail Transport Equipment Service Center Network without using the equipment and does so because they had not ordered it, do not need it, or find it unacceptable.

The logical bounds are that 35 percent to 60 percent of the audit universe return unused equipment.

Scenario 1 - all nonresponses counted as "positive," i.e., the nonresponding facilities do return equipment unused for one of the three reasons stated: based on the sample results, we are 95 percent confident that 151 to 182 facilities, or 50 percent to 60 percent of the audit universe, return unused equipment for one of the three reasons stated. The point estimate for this scenario is that 167 facilities (55 percent) return unused equipment for one of the three reasons stated.

Scenario 2 - all nonresponses counted as "negative," i.e., the nonresponding facilities do not return equipment unused or return it for reasons other than those stated above: based on the sample results, we are 95 percent confident that 106 to 132 facilities, or 35 percent to 44 percent of the audit universe, return unused equipment for one of the three reasons stated. The point estimate for this scenario is that 119 facilities (39.5 percent) return unused equipment for one of the three reasons stated.

Attribute 2: Facility representative feels that needed equipment is unavailable.

The logical bounds are that 45 percent to 70 percent of the audit universe feel needed equipment is unavailable.

Scenario 1 - all nonresponses counted as "positive," i.e., the representatives for the non-responding facilities feel needed equipment is unavailable: based on the sample results, we are 95 percent confident that 177 to 212 facility representatives, or 59 percent to 70 percent of the audit universe, feel needed equipment is unavailable. The point estimate for this scenario is that 195 facility representatives (65 percent) feel needed equipment is unavailable.

Scenario 2 - all nonresponses counted as "negative," i.e., the representatives for the nonresponding facilities feel needed equipment is available: based on the sample results, we are 95 percent confident that 135 to 166 facility representatives, or 45 percent to 55 percent of the audit universe, feel needed equipment is available. The point estimate for this scenario is that 150 facility representatives (50 percent) feel needed equipment is available.

Attribute 3: Facility representative attributes shortages to lack of equipment and/or improper management.

The logical bounds are that 52 percent to 80 percent of the audit universe attribute shortages to lack of equipment and/or improper management.

Scenario 1 - all nonresponses counted as "positive," i.e., the nonresponding facility representatives attribute shortages to lack of equipment and/or improper management: based on the sample results, we are 95 percent confident that 205 to 241 facilities, or 68 percent to 80 percent of the audit universe, attribute shortages to the stated causes. The point estimate for this scenario is that 223 facilities (74 percent) attribute shortages to the stated causes.

Scenario 2 - all nonresponses counted as "negative," i.e., the nonresponding facility representatives do not attribute shortages to lack of equipment and/or improper management: based on the sample results, we are 95 percent confident that 157 to 189 facilities, or 52 percent to 63 percent of the audit universe, do not attribute shortages to the stated causes. The point estimate for this scenario is that 173 facilities (57 percent) do not attribute shortages to the stated causes.

Attribute 4: Facility personnel spend 6 or more hours per day seeking mail transport equipment.

The logical bounds are that 18 percent to 40 percent of the audit universe spend 6 or more hours per day seeking mail transport equipment.

Scenario 1 - all nonresponses counted as "positive," i.e., personnel at the non-responding facilities spend 6 or more hours per day seeking mail transport equipment: based on the sample results, we are 95 percent confident that personnel at 94 to 120 facilities, or 31 percent to 40 percent of the audit universe, spend 6 or more hours per day seeking mail transport equipment. The point estimate for this scenario is that personnel at 107 facilities (36 percent) spend six or more hours per day seeking mail transport equipment.

Scenario 2 - all nonresponses counted as "negative," i.e., personnel at the non-responding facilities spend less than 6 hours per day seeking mail transport equipment: based on the sample results, we are 95 percent confident that personnel at 53 to 72 facilities, or 18 percent to 24 percent of the audit universe, spend less than 6 hours per day seeking mail transport equipment. The point estimate for this scenario is that personnel at 63 facilities (21 percent) spend less than 6 hours per day seeking mail transport equipment.

Attribute 5: Facility uses unscheduled transportation to obtain mail transport equipment.

The logical bounds are that 13 percent to 36 percent of the audit universe use unscheduled transportation to obtain mail transport equipment.

Scenario 1 - all nonresponses counted as "positive," i.e., the nonresponding facilities use unscheduled transportation to obtain mail transport equipment: based on the sample results, we are 95 percent confident that 81 to 107 facilities, or 27 percent to 36 percent of the audit universe, use unscheduled transportation to obtain mail transport equipment. The point estimate for this scenario is that 94 facilities (31 percent) use unscheduled transportation to obtain mail transport equipment.

Scenario 2 - all nonresponses counted as "negative," i.e., the nonresponding facilities do not use unscheduled transportation to obtain mail transport equipment: based on the sample results, we are 95 percent confident that 38 to 59 facilities, or 13 percent to 19 percent of the audit universe, do not use unscheduled transportation to obtain mail transport equipment. The point estimate for this scenario is that 49 facilities (16 percent) do not use unscheduled transportation to obtain mail transport equipment.

Attribute 6: Facility uses unscheduled transportation to return mail transport equipment.

The logical bounds are that 16 percent to 39 percent of the audit universe use unscheduled transportation to return mail transport equipment.

Scenario 1 - all nonresponses counted as "positive," i.e., the nonresponding facilities use unscheduled transportation to return mail transport equipment: based on the sample results, we are 95 percent confident that 89 to 116 facilities, or 30 percent to 39 percent of the audit universe, use unscheduled transportation to return mail transport equipment. The point estimate for this scenario is that 103 facilities (34 percent) use unscheduled transportation to obtain mail transport equipment.

Scenario 2 - all nonresponses counted as "negative," i.e., the nonresponding facilities do not use unscheduled transportation to obtain mail transport equipment: based on the sample results, we are 95 percent confident that 48 to 69 facilities, or 16 percent to 23 percent of the audit universe, do not use unscheduled transportation to obtain mail transport equipment. The point estimate for this scenario is that 58 facilities (19 percent) do not use unscheduled transportation to obtain mail transport equipment.

APPENDIX C. MANAGEMENT'S COMMENTS

PAUL E. VOGEL
VICE PRESIDENT, NETWORK
OPERATIONS MANAGEMENT

UNITED STATES
POSTAL SERVICE

April 24, 2000

DEBRA S. RITT

SUBJECT: Transmittal of Draft Audit Report - Mail Transport Equipment Service Center Decision Analysis Report, Performance and Financial Benefits (Report Number TR–AR–00–DRAFT)

I appreciate the opportunity to work with you and your staff to develop a meaningful report. To that end you will find comments on the text of the draft report indexed by page number where the page number is set out in **bold**. Comments were limited to the body of the report thus no comments were made in response to the executive summary portion of the IG report. Although this is not the usual method of response, we believe that some of the verbiage in your draft requires comment to clarify the issues for future readers and request that our response be included in the final draft in its entirety.

Should you require additional information please contact Tony Pajunas, manager, Logistics at (202) 268-4948.

Paul E. Vogel

Attachment

cc: Mr. Potter
Mr. Donahoe
Mr. Strange
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Page 1
No comments

Page 2
We believe the survey was taken prematurely and therefore the sample was biased. At the time the survey was conducted (December 1999 and January 2000) the network was still completing implementation. Respondents to the survey were responding to their experiences prior to activation of the network or to experiences received during the start-up period. We believe that a survey conducted now would produce a significantly more accurate response.

Page 3
The inclusion of prior audit results without including management's responses, which the Inspector General (IG) agreed to, presents a biased picture that is not reflective of the finished product.

Page 4
Regarding the survey results, the Inspector General's report states that 35 percent of the surveyed population of Postal facilities returned equipment because they "had not ordered it, did not need it or found it unacceptable". We are not surprised at the reasons stated for returning the equipment and frankly can think of no other reasons why a facility would return the equipment. There is, however, a significant difference between returning equipment because it *was not needed* than returning it because *it was unacceptable*. Returning equipment because it is not needed is not a defect in Mail Transport Equipment Service Center (MTESC) operations, since nothing is shipped unless it is ordered. Rather it is a defect in the operation of the Postal facility for having ordered equipment it did not need. At the same time, it is not surprising that facilities over-ordered mail transport equipment (MTE) since, under the old "system", no reliable or consistent ordering process existed. With no empirical data available to help facilities gauge how much MTE they should order, many facilities did, indeed, over-order.

With regard to finding MTE "unacceptable", we wonder if the equipment unacceptable because it was defective or was it unacceptable because the facility preferred cloth sacks to plastic sacks, a common complaint. The MTESC program has quality built into the process. We have a 95 percent confidence interval, 95 percent of the product shipped is at or above standard.

Page 6
We are not entirely surprised at the conclusions stated on this page. At the time the survey was taken the network was a "newborn", only reaching full operations at the end of January, most likely after most of the survey data was collected. We are also not at all surprised that a network comprised of 22 facilities was not "optimized" in its first month of operation.

Page 8 and 9
The manager, Capital Programs confirmed that the additional costs driven by volume are operating variances and no revisions of the Decision Analysis Report (DAR) are required. Further, since the MTESC network program required less that $10 million in capitol, technically, no DAR was required. A DAR was prepared when the program was originally designed which had a capital requirement in excess of $100 million. Changes in the program were made so that the entire cost of the program would be expense money and not capital money. Because the Board of Governors (BOG) had been briefed once on the program when it was a capital program, it was decided to present the DAR to the BOG as information only.

From a practical standpoint, the purpose of the MTESC network is to process and redistribute MTE. It is only reasonable that the network process the equipment available to the full extent practicable. Moreover, if more equipment was presented for processing at the MTESCs, then it follows logically that more equipment would have had to be processed under the old "system." That means that, as the costs for processing in the MTESCs increase because of volume, so would the costs have increased for processing without the network. Since the savings equal the difference in the cost, the net savings will increase proportionately with increased volume. The IG analysis does not include this calculation.

Page 10
This page refers again to increased program costs due to increased volume. Again we make the point that the savings also increase with increased volume.

Regarding transportation expense, we agree that it cost more money to transport more MTE but again make the argument that, even without the program, the additional MTE would have required more transportation as well.

We agree that dedicated transportation sub-optimizes transportation. On the other hand, optimization requires information. During the ramp-up and first year or so of operation, there was insufficient data available to begin the optimization process. To extrapolate the costs experienced during the activation period to the full ten years of the program, as was done in the IG report is inappropriate.

The discussions regarding use of space available transportation to move MTE completely ignore a fundamental principal of physical distribution management, specifically, manage inventory carrying cost. Use of space available transportation will increase the required amount of MTE required to serve the same customer base due to reduced repositioning velocity. If dedicated transportation can reduce the "pipeline time" by a single day, then the total amount of inventory can be reduced by the amount in transit in a given day. At any given time, more than 500 trailers of product are in transit. These savings are considerable and must be included in any informed review of costs.

Page 11
We agree that having more equipment requires more space. On the other hand, we believe that much of the equipment we now store can be disposed of because it is either obsolete or surplus to the known demand. This is an important point, since before the existence of the program, the true demand was not available.

Page 12
Regarding the assertions on this page concerning Greensboro costs, we have no idea of the source of the data leading to these conclusions.

We disagree with the statement, which states "an analysis error was made in claiming $177 million from the end of the contract for the MTESC pilot at Greensboro." (It should be noted that the figure quoted in the audit does not appear anywhere in the DAR or backup, relating to contract costs. The correct figure for the claimed Greensboro contract gross savings is $197 million.)

Claiming a savings for the end of a contract is a standard procedure in the DAR process. Please refer to the following references in the Handbook F66 "General Investment Policies and Procedures":

Para. 7-3.3, states that, "DAR baseline costs – These costs, which reflect the existing situation at the time the DAR was developed, are included in the DAR backup. They are compared to the anticipated costs of each alternative to derive the operating variances for the DAR cash flows."

Para. 5-4.10, "Identifying Operating Variances"...If a current activity is not required in the alternative scenario, the variance is the baseline (current) cost expressed as a savings. If the alternative requires a new activity, the variance is the total cost of that activity."

The DAR backup documentation, Exhibit I, page 39 specifically states that, "Since, we are including Greensboro production and costs in the national MTESC network computation, we must show the current contract as an offsetting savings."

Additionally, the cash flow for the contract costs (attached) shows the ten year savings for the end of the Greensboro pilot, equaling $114.6 million, which is net of the new ten year expected Greensboro MTESC production costs (82.5 million).

Recommendations: We recommend that the vice president, Network Operations Management:

1. **Develop a Decision Analysis Report Modification Request to adjust for unanticipated conditions, and submit the request to the Board of Governors for approval.**

   We do not agree with the finding and recommendation.

   The manager, Capital Programs confirmed that the additional costs driven by volume are operating variances and no revisions of the DAR are required. Further, since the MTESC Network program required less that $10 million in capitol, technically, no DAR was required. A DAR was prepared when the program was originally designed which had a capital requirement in excess of $100 million. Changes in the program were made so that the entire cost of the program would be expense money and not capital money. Because the Board of Governors (BOG) had been briefed once on the program when it was a capital program, it was decided to present the DAR to the BOG as information only.

2. **Reduce operating volume, consistent with contract volume guarantees, by requiring facilities to reuse serviceable equipment rather that returning it to service centers for processing.**

   We agree with the finding and recommendation because it is a restatement of current program policy. Since the programs inception Postal facilities were instructed to reuse MTE internally when doing so would cost no more than returning MTE to the MTESC Network for processing.

3. **Improve efficiency and lower cost by reducing the shipment of Mail Transport Equipment on dedicated networks.**

   We agree with recommendation and will take steps to optimize transportation used for MTE by incorporating mail on returning trips and reduce costs by maximizing the use of one way highway service and balanced round trip highway transportation.

Mail Transport Equipment Service Center
Decision Analysis Report Performance and Financial Benefits

TR-AR-01-003

Greensboro Contract Costs												
PROJECT YEAR		1	2	3	4	5	6	7	8	9	10	total
Current contract savings	-	16,039	16,761	17,515	18,303	19,127	19,988	20,887	21,827	22,809	23,835	197,091
Depreciation & Interest Expense	(831)	(781)	(731)	(681)	(631)	(416)	(388)	(360)	(333)	(305)	-	(5,457)
Direct Labor	(676)	(4,613)	(4,618)	(4,422)	(4,216)	(4,259)	(4,320)	(4,402)	(4,504)	(4,625)	(4,768)	(45,422)
Indirect labor	(169)	(720)	(731)	(729)	(725)	(739)	(754)	(771)	(790)	(811)	(833)	(7,772)
Indirect Non-personnel	(230)	(734)	(747)	(749)	(750)	(765)	(781)	(799)	(819)	(840)	(863)	(8,076)
G&A and Fee	(450)	(1,618)	(1,613)	(1,555)	(1,494)	(1,459)	(1,475)	(1,496)	(1,523)	(1,555)	(1,527)	(15,764)
Subtotal contract cost	(2,356)	(8,466)	(8,440)	(8,136)	(7,816)	(7,638)	(7,718)	(7,828)	(7,969)	(8,136)	(7,991)	(82,491)
Net contract savings	(2,356)	7,573	8,321	9,379	10,487	11,489	12,270	13,059	13,858	14,673	15,844	114,600
Logistics Management		(432)	(443)	(454)	(465)	(477)	(489)	(501)	(513)	(526)	(539)	(4.838)
Contract Quality Control		(38)	(14)	(11)	(11)	(11)	(12)	(12)	(12)	(13)	(13)	(149)
Net contract savingsl(costs)	(2,356)	7,103	7,864	8,914	10,011	11.001	11,769	12,546	13,333	14,134	15,292	109,614
Current contract savings	197,091											
Subtotal contract cost	(82,491)											
net	114,600											