September 29, 1999

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VICE PRESIDENT, NETWORK OPERATIONS MANAGEMENT

SUBJECT: Emergency and Extra Trip Expenditures on Highway Routes
(Report Number TR-AR-99-003)

This report represents the results of our audit of emergency and extra trip expenditures on highway routes. We found that USPS could save $24.7 million in fiscal year (FY) 2000 and avoid $26.7 million annually in subsequent years through better administration of emergency contracts and extra trips.

Management generally agreed with the overall findings and recommendations. They also agreed that savings could be achieved through a reduction in the number of emergency service contracts and more efficient use of extra trips. They plan to validate the actual savings after their July 30, 1999, instruction to convert existing emergency contracts to regular service has been implemented. Management's views are highlighted in the report, and are included in their entirety in Appendix C.

We appreciate the cooperation and courtesies provided by your staff during the audit. If you have any questions or need additional information, please contact Debra Ritt, Director, Transportation at (703) 248-2198 or me at (703) 248-2300.

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EXECUTIVE SUMMARY

Introduction

The Office of Inspector General (OIG) conducted an audit of the United States Postal Service's (USPS) expenditures for emergency contracts and extra trips on highway routes. We conducted the audit in response to issues identified by transportation managers at the end of fiscal year (FY) 1997. USPS expenditures for emergency service and extra trips in FY 1998 totaled about $310 million, or 18 percent of the agency's total expenditures for highway routes.

The objective of the audit was to identify actions USPS can take to reduce emergency service and extra trip costs. To identify these actions, we determined whether USPS (1) limited emergency contracts to valid emergencies, (2) promptly converted emergency contracts to regular service, (3) procured extra trips at the most reasonable rates, and (4) adequately monitored extra trip expenditures.

Results in Brief

We estimate that USPS could save $24.7 million in FY 2000 and avoid $21.2 million annually in subsequent years through better administration of emergency contracts for highway routes. In addition, we estimate USPS can avoid $5.5 million annually by negotiating extra trip rates that exclude fixed costs paid contractors for regular service, and by increasing oversight of extra trip expenditures.

Our audit disclosed that USPS did not limit its use of emergency contracts to valid emergencies. Specifically, 69 percent of the emergency contracts we reviewed did not comply with the emergency criteria set forth in the USPS Purchasing Manual. This occurred because Headquarters and area staff in Facilities and Operations did not notify contracting officials of new transportation requirements in time to award regular service contracts. Also, inconsistencies between the Highway Contracts Support System used in the contracting process and the USPS Purchasing Manual may have contributed to the excessive use of emergency contracts.

In addition, USPS did not take advantage of opportunities to reduce costs by promptly converting emergency contracts to less-costly regular service. Although emergency conditions had ended, 61 percent of the emergency contracts were extended for periods that sometimes exceeded four years. Because contract rates for emergency service averaged 17 percent higher than rates for regular service, USPS incurred additional costs by not converting emergency contracts in a timely manner.

Contracting officials indicated that other workload priorities often interfered with prompt conversions of emergency contracts. Headquarters officials, concerned about the workload of area contracting officials, have initiated several studies to identify ways to streamline the contracting process. In addition to workload issues, we identified several practices of area and Headquarters contracting officials that contributed to routine extensions of emergency contracts. At four of five locations we visited, contracting officials did not investigate the continued need for emergency service and routinely requested extensions from Headquarters. Headquarters approval is required for extensions, but Headquarters officials did not validate the need for the service before granting approval. Area contracting officials also extended emergency service by soliciting follow-on emergency service contracts instead of requesting an extension from Headquarters as required. This practice eliminated management oversight of emergency contract extensions--allowing emergency contracts to run longer than necessary and reducing potential savings.

Regarding extra trips, our audit disclosed that contracting officials did not negotiate special rates for extra trips. Instead, they routinely used the pro rata rate--the rate for regular service--as allowed by contracting guidelines. This practice resulted in excessive expenditures because pro rata rates included fixed costs, such as insurance premiums,[1] for which USPS is already paying contractors as part of regular contract service. Contracting officials indicated the frequency and urgency of extra trip requests made it impractical to negotiate special rates every time a trip was required. We agree that such changes are not practical and therefore recommended that contracts be changed to accommodate this situation. Additionally, our audit revealed that one area paid four contractors a 10 cents per-mile premium above regular contract rates without adequate justification, as required by contracting guidelines.

[1] This is true when premiums are not based on miles driven.

Premiums paid to contractors totaled about $314,000 in FY 1998 alone, and in one instance had been in effect for about 20 years.

Finally, the Distribution Networks Offices (Networks Offices) in the five locations we visited were not monitoring extra trip costs to identify excessive expenditures. By monitoring expenditures, Networks officials could have easily identified extra trip costs that were equal to or more than the cost of regular service on the route. Monitoring could have also led to identifying extra trips that occurred with such frequency that they were "regularly scheduled trips." Networks officials were not monitoring these expenditures because they lacked authority over Operations staff at facilities who authorized the extra trips. Without authority to effect change, Networks officials saw no value in monitoring extra trip costs and had not established a process for tracking these expenditures. Similarly, Headquarters had not emphasized monitoring or established a benchmark for Networks Offices to use in assessing the reasonableness of extra trip costs.

Summary of Recommendations

To ensure that emergency contracts are used judiciously, we recommend the Vice President, Purchasing and Materials, direct contracting officials to review all existing emergency contracts, and as appropriate, convert them to regular service. Contracting officials should also discontinue the practice of extending emergency service by awarding follow-on contracts for the same service. Further, we recommend that the Vice President ensure the Highway Contract Support System is consistent with purchasing criteria for emergency contracts, delegate authority for approving emergency service extensions to local contracting officials, and identify ways to streamline the contracting process. In addition, we recommend that the Chief Operating Officer and Executive Vice President instruct Facilities and Operations managers to promptly notify contracting officials of new service or changes in transportation needs so that adequate time is available to award regular contracts.

To improve oversight of extra trips and reduce expenditures, we recommend the Chief Operating Officer and Executive Vice President in coordination with the Vice Presidents, Purchasing and Materials, and Network

Operations Management require that extra trip rates be established when regular service contracts are negotiated. We also recommend they discontinue paying the 10 cents per-mile premium for extra trips, establish area goals for reducing extra trip expenditures, and charge Networks Offices with monitoring goal achievement.

Summary of Management's Comments

Management generally agreed with our findings, conclusions, and the projected savings resulting from a reduction in the number of emergency contracts and more efficient use of extra trips. However, they indicated the actual savings will have to be determined through careful measurement of changes in the level and cost of emergency service after their corrective actions. They plan to assess the actual savings after their July 30, 1999, instruction is fully implemented. Management also stated that payments above pro rata rates do not constitute premiums, and the examples cited in the report were initially paid to compensate the contractors for extra equipment and employees.

Management agreed to adopt 10 of the 12 report recommendations, deferred its decision to implement one recommendation, and agreed to pilot another. Specifically, USPS will defer its decision to implement recommendation 7 involving delegation of approval authority for emergency service extensions until its July 1999 management instruction has been fully implemented. USPS also plans to pilot recommendation 9 by establishing test sites where negotiated extra trip service will become a part of contract award or renewal. We have summarized management's response in the report and included the full text of their comments in Appendix C.

Evaluation of Management's Comments

Management's comments are generally responsive to our findings and recommendations, and corrective actions taken or planned will meet the intent of the recommendations. Although management concurred with our findings, they did not believe the rates paid above pro rata were premiums. We continue to believe that the payments we observed in excess of pro rata rates constitute premiums because they were incentive-based and not linked to additional contractor costs. Such payments have also been ongoing for many years, and according to local management, are no longer needed to ensure competitive and reliable service.

We agree with management's decision to defer implementation of recommendation 7 until corrective actions have been implemented. If fully implemented, the July 30, 1999 instruction should help to significantly reduce emergency contract extension requests requiring Headquarters' approval. We also agree with management's plan to pilot recommendation 9, and believe that this test will demonstrate that fixed costs can effectively be excluded from extra trip rates.

INTRODUCTION

Background

In FY 1998 USPS managed over 16,000 highway contracts with trucking companies. These contracts establish highway routes to provide regularly scheduled service between facilities. If unforeseen transportation needs arise that cannot be met by established routes or if service is interrupted, USPS can contract for emergency service. USPS can also authorize contractors to perform extra trips on their existing routes when mail volumes exceed regularly scheduled service.

USPS spent about $310 million in FY 1998 for emergency contracts and extra trips, which represented about 18 percent of its total expenditures for highway routes. Of this amount, $161 million was for emergency service and $149 million for extra trips. FY 1998 expenditures for emergency contracts and extra trips represent a 39 percent increase over FY 1997 spending levels.

Responsibility for managing emergency service and extra trips is currently divided between Purchasing and Materials and Operations. Purchasing and Materials staff (or contracting officials) located in 11 area Networks Offices are responsible for contract administration. With respect to emergency service, contracting officials award contracts, determine the need for contract extensions, and convert emergency service to regular contracts. They also negotiate the rates paid for extra trips and are responsible for ensuring that service is procured at the most reasonable rates. Headquarters Purchasing and Materials staff provide additional oversight of contracts through their approval of all emergency contract extensions. Operations staff in the Networks Offices review and validate requirements for highway routes and monitor related expenditures.

Objective, Scope, and Methodology

The objective of the audit was to identify actions USPS could take to reduce emergency service and extra trip costs. To identify these actions, we determined whether USPS (1) limited emergency contracts to emergencies, (2) promptly converted emergency contracts to regular service, (3) procured extra trips at the most reasonable rates, and (4) adequately monitored extra trip expenditures.

To accomplish the audit objectives, we visited five[2] of 11 Networks Offices that were randomly selected for review--Allegheny, Midwest, Southeast, Southwest, and the Seattle Branch of the Western Networks Office. At these sites, we reviewed management controls over highway expenditures and interviewed responsible officials in Operations and Purchasing and Materials. We also statistically sampled 347 contracts that were in effect during September 13, 1997, through January 29, 1999. During our review we:

- determined whether 105 emergency contracts met the established criteria for emergency service and if contract extensions were appropriate,
- estimated the cost savings from converting 117 emergency contracts to regular service, and
- estimated the cost savings from excluding fixed costs from rates paid on 125 extra trip contracts.

In selecting our samples, we used data from the National Transportation Management System and the Highway Contracts Support System. Although we did not perform extensive tests to confirm the reliability of the data, we found the computer-generated data to be consistent with supporting documentation in contract files. Our methods for computing cost savings are summarized in Appendix A.

We expanded our audit at one area to review all premium payments made to contractors during the 18 accounting periods, beginning September 13, 1997, and ending January 29, 1999. Payments were identified by the Networks Office staff and verified against the National Transportation Management System.

We conducted the audit between January and August 1999 in accordance with generally accepted government auditing standards and included tests of internal controls as we considered necessary under the circumstances.

[2] The five sites we visited were comprised of four primary Networks Offices and one branch.

AUDIT RESULTS

Emergency Contracts

We estimated that USPS could save $24.7 million in FY 2000. Additionally, USPS can avoid $21.2 million annually through better administration of emergency contracts. Estimated cost savings are discussed in more detail in Appendices A and B.[3]

Award Criteria

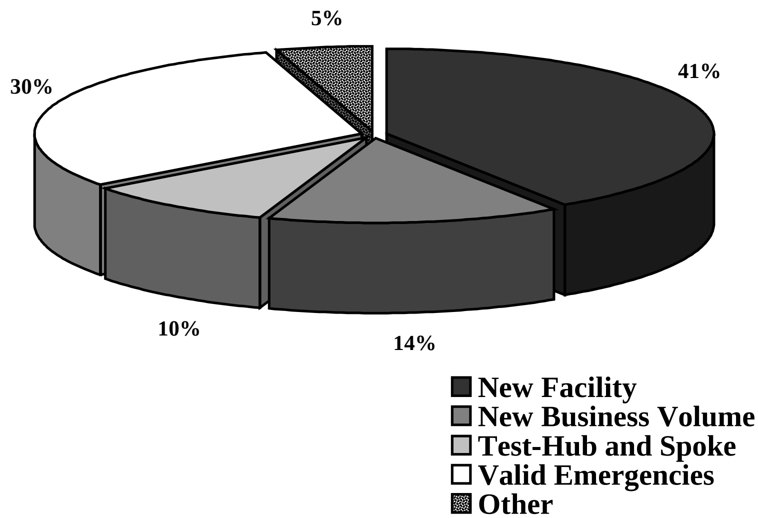
At the five sites we visited USPS did not limit its use of emergency contracts to valid emergencies. Specifically, 69 percent[4] of the contracts we reviewed did not comply with the emergency criteria established by the USPS Purchasing Manual. According to these guidelines, conditions justifying emergency contracts include:

- catastrophic events that interrupt normal transportation operations;
- strikes or other labor disputes that cause service interruptions;
- suspension or termination of a contract with a mail transportation contractor;
- discontinuance of service due to death or incompetence of a sole highway contractor; and
- generation of mail at unanticipated locations or an unexpected increase in mail volume that exceeds the mail hauling capacity of the Postal Service or its regular contractors.

Despite these guidelines, a common justification submitted for emergency contracts was new service as indicated in the following chart:

[3] As discussed in Appendix B, the cost savings reported represent point estimates. For example, based on the results of our sample, we calculate that the actual savings in FY 2000 from converting emergency contracts can range from $18.3 million to $30.7 million.
[4] Sixty-nine percent represents 73 of 105 contracts we sampled.

Reasons for Emergency Contract Award
(Sampled Contracts)



Emergency contracts were not limited to valid emergencies primarily because Headquarters and area staff in Facilities and Operations did not promptly notify contracting officials of new transportation requirements in time to award regular service contracts. For example, contracting officials at one Networks Office were asked to procure transportation service for a new facility three days before the facility was scheduled to open. As a result, an emergency contract was the only option available to meet the transportation need.

We also noted that the Highway Contracts Support System used in the contracting process included criteria for awarding emergency contracts that was inconsistent with the USPS Purchasing Manual. Specifically, this system identifies new service as an acceptable reason for awarding emergency contracts contrary to purchasing guidelines. Further, in a February 26, 1992, decision on two bid protests, USPS determined that the practice of awarding emergency contracts for new service was inappropriate.

Due to the short response time required for emergency service contracts, our audit disclosed that contractors charged an average of 17 percent more for emergency contracts than regular service. Based on this cost difference, we estimate USPS can avoid $15.6 million annually by limiting emergency contracts to valid emergencies.

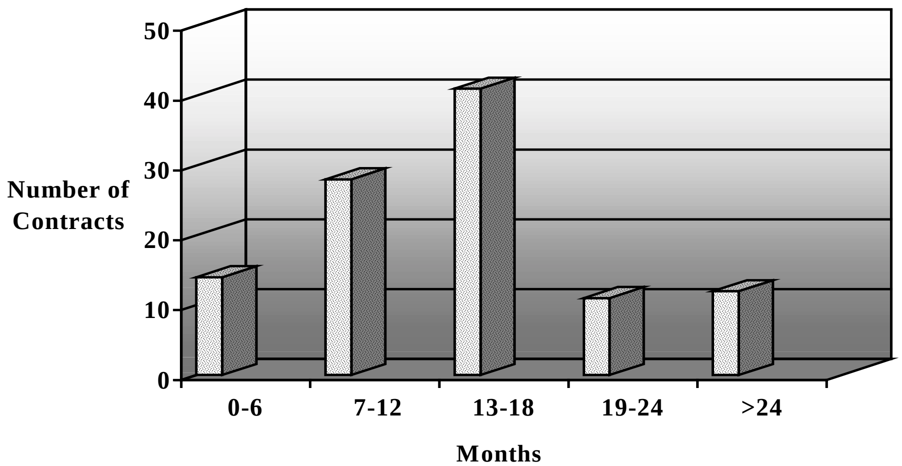
Emergency Contract Conversion

Contracting officials did not take advantage of opportunities to reduce costs by promptly converting emergency contracts to regular service. USPS Purchasing guidelines stipulate that emergency contracts should be converted to regular service when the emergency ends and sufficient time exists to award a regular contract. Emergency contracts are awarded for six months, and any extensions beyond that period require Headquarters approval.

Our audit revealed that contracting officials did not convert emergency contracts when the emergency ended, as required by the guidelines. Specifically, 73 of the 105 contracts we reviewed were extended for periods that sometimes exceeded four years. For example, one Networks Office operated an emergency contract for 4-1/2 years, at a total cost of $7.2 million. Although contracting officials acknowledged they should have converted the contract, they elected not to because they viewed the emergency rate as competitive. During our audit, however, Networks officials solicited the route and received seven bids that were $17,000 to $218,000 lower than the current annual emergency rate. As a result, Networks officials saved about $872,000 over the life of the new contract.

As further illustrated in the following chart, contracting officials frequently extended emergency contracts well beyond the six months stipulated by the USPS Purchasing guidelines.

Emergency Contract Duration
(Sampled Contracts)



Contracting officials at the Networks Offices acknowledged that emergency contracts should have been converted more timely; however, other workload priorities precluded them from doing so. Concerned about the workload of contracting officials, USPS recently reviewed staffing in Networks Offices. A 1998 area workload and staffing study reported that while contract workload had increased by about 20 percent since the 1992 reorganization, staffing had remained constant. Headquarters officials advised us that several initiatives are underway to lessen the workload of contracting officials and streamline the contracting process.

Additionally, our audit identified several practices that caused emergency contracts to be routinely extended. At four of the five locations, contracting officials did not investigate the continued need for emergency service and routinely requested extensions from Headquarters. Although Headquarters approval is required for all such extensions, Headquarters officials did not validate the need for the service before granting approval. In a recent example, one Networks Office submitted over 100 emergency contracts for extension without supporting documentation, which Headquarters approved three days later. Headquarters officials did not always review these requests, because they relied on area contracting officials to validate the need for extensions prior to requesting approval.

At the same four locations we noted that contracting officials also extended emergency service by awarding follow-on emergency contracts, instead of requesting an extension from Headquarters as required. For example, contracting officials in one Networks Office used follow-on emergency contracts to extend 7 of the 25 emergency contracts we reviewed. In one instance, emergency service had been operating for four years. This practice eliminates management oversight of emergency contract extensions, thereby reducing opportunities for potential cost savings.[5]

Because contract rates for emergency service averaged 17 percent higher than rates for regular service, USPS incurred additional costs by not converting emergency contracts in a timely manner. By promptly converting emergency contracts to regular service, we estimate USPS can save $24.7 million in FY 2000 and avoid $21.2 million annually in subsequent years.

In a July 30, 1999, memorandum the Manager, National Mail Transportation Purchasing, directed contracting officials to convert emergency contracts after six months, discontinue changing contract numbers to extend emergency contracts, and award temporary contracts for urgent service needs. These actions are consistent with the recommendations cited below.

Recommendations

We recommend the Chief Operating Officer and Executive Vice President:

1. Instruct managers in Facilities and Network Operations Management to promptly notify contracting officials of new service or changes in transportation requirements so that adequate time is available to award regular contracts.

[5] The Highway Contract Support System changes emergency service contracts numbers when a solicitation for the same service is awarded, reducing visibility of the service.

We recommend that the Vice President, Purchasing and Materials, direct contracting officials in area Networks Offices to:

2. Review all existing emergency contracts, and as appropriate, convert them to regular contracts. Also emphasize prompt conversion of emergency contracts in the future.

3. Discontinue the practice of extending emergency service by awarding follow-on emergency contracts for the same service.

4. Report progress made in responding to recommendations 1 - 3 and related cost savings achieved.

The Vice President, Purchasing and Materials, should also:

5. Monitor actions taken to ensure transportation requirements are received timely enough to limit the need to solicit emergency contracts; promptly convert emergency contracts to regular service; and to the extent possible, not award follow-on contracts to extend emergency service.

6. Work with Information Systems to modify the Highway Contract Support System to reflect the rationale for the emergency and when requirements are received.

7. Delegate authority for approving emergency contract extensions to contracting officials in the Networks Offices and require that they validate the need for extensions.

8. Continue to assess contracting workload issues and identify ways to streamline the contracting process.

Management's Comments

Management generally agreed with our findings, recommendations, and estimated cost savings, but will defer acceptance of recommendation 7 until their July 30, 1999, instruction has been fully implemented. To implement recommendation 1, management will issue a Postal Bulletin article re-emphasizing the need to provide timely information on transportation requirements. They also indicated that the July 30, 1999, management instruction outlining specific guidelines for reducing emergency contracts addresses recommendations 2, 3, and 5. Further, because implementation of this instruction should reduce emergency contract extensions, it may also eliminate the need to adopt recommendation 7. Accordingly, USPS will defer acceptance of this recommendation until after corrective actions have been implemented. Management will also provide periodic updates on their progress in implementing corrective actions, modify the Highway Contract Support System, and continue to streamline contracting workload issues as suggested by recommendations 4, 6, and 8 respectively.

Management agreed that there is an opportunity for savings, possibly in the range outlined in the report. However, they indicated the actual savings will have to be determined through careful measurement of changes in the level and cost of emergency service resulting from corrective actions. Accordingly, they plan to assess the actual savings after their July 30, 1999, instruction is fully implemented.

Evaluation of Management's Comments

The actions management has planned or taken are generally responsive to our findings and recommendations. We continue to believe that authority to approve emergency contract extensions should be delegated to the Networks Offices which have the data needed to validate the appropriateness of such requests. However, we accept management's decision to defer acceptance of recommendation 7 after other corrective actions have been implemented, and will follow-up on this action.

We also concur with management that actual cost savings should be validated after corrective actions have been implemented.

EXTRA TRIPS

Based on a conservative estimate, our audit disclosed that USPS could avoid about $5.5 million annually in extra trip costs -- $5.2 million by negotiating extra trip rates and $0.03 million by eliminating extra trip premiums paid to contractors by one Networks Office. Estimated cost savings are further explained in Appendix A. Additionally, increased oversight of extra trip expenditures by area Networks Offices would help ensure that extra trip costs are reasonable.

Extra Trip Rates

At the five locations we visited USPS did not negotiate rates for extra trips on any of the contracts we reviewed. Contracting guidelines specify that prior to procuring extra trips, contracting officials are to negotiate the rate to be paid for the additional service. If this is not possible, the policy provides for contractors to be paid the pro rata rate for regular service.

Contracting officials acknowledged they should have negotiated extra trip rates. However, the frequency and urgency of extra trip requests made it impractical to negotiate special rates every time a trip was requested. As a result, contracting officials routinely used the pro rata rate, as allowed by the contracting guidelines. The current practice resulted in excessive expenditures for extra trips because pro rata rates included fixed costs for which USPS was already paying as part of regular service. For example, one Networks Office paid a contractor $25,000 in excess of costs for general overhead, insurance, and federal and state unemployment compensation, which did not increase with the additional mileage. By negotiating extra trip rates that exclude contractor fixed costs, we estimate that USPS can avoid $5.2 million annually.

Through discussions with Headquarters Purchasing and Materials staff, we learned that extra trip rates could be established when regular service is negotiated, which would be a more efficient alternative to negotiating rates at the time trips are requested. Purchasing officials also agreed that this approach would help ensure that USPS is procuring extra trips at the most reasonable rates. We agree that negotiating special rates every time trips are requested is not practical; therefore, a negotiated price at the time of contract award is more feasible.

Premium Payments

One Networks Office paid four contractors a 10 cents per mile premium to perform extra trips on 13 contracts. Contracting guidelines preclude Networks officials from paying amounts in excess of pro rata unless such costs are fully documented and supported. In our review of six of the contracts, documentation was not adequate to support payment of the higher rates.

According to contracting officials, the practice of paying premiums began in Florida about 20 years ago to ensure competitive and reliable service. While this may have been necessary in the past, recent awards indicate that a competitive and reliable market now exists that will allow USPS to acquire these services without the premiums. Area contracting officials agreed that the higher rates were no longer needed and planned to discontinue this practice, which will save USPS about $314,000 annually.

Monitoring Extra Trip Costs

Our audit disclosed that Operations staff in the USPS Networks Offices in the five areas we visited were not monitoring extra trip costs, although they were responsible for oversight of highway route expenditures. According to government internal control standards,[6] organizations should engage in monitoring activities to maintain effective controls over its resources and to ensure organizational goals are achieved. Controlling costs by monitoring extra trip expenditures directly impacts USPS achievement of its FY 1999 financial performance goals.[7]

By monitoring extra trips, contracting officials could have easily identified expenditures that were equal to, or more than the cost of regular service on the route. For example, our audit disclosed that one Networks Office paid a contractor about $343,000, of which $279,000[8] was for extra trips. Further, by monitoring expenditures, contracting officials could have identified extra trips that occurred with such frequency, they became regularly scheduled trips.

Networks managers acknowledged they had responsibility for monitoring, but lacked authority over Operations staff at facilities who ordered the extra trips. Extra trips were often

[6] Standards for Internal Control in the Federal Government (GAO/AIMD-98-21.3.1., Dec. 1997).
[7] The USPS FY 1999 Annual Performance Plan outlines goals for improving business unit financial performance and controlling costs.
[8] These expenses were incurred over 18 accounting periods.

necessary to meet service commitments--the operational goals of plants and delivery units--and as a result, took precedence over cost containment.

Without authority to effect change, Networks managers saw no value in monitoring extra trip costs, and had not established a process for tracking these expenditures.[9] Similarly, Headquarters had not emphasized monitoring or established a benchmark for Networks Offices to use in assessing the reasonableness of expenditures.

By not monitoring extra trip costs, USPS did not exercise proper control needed to further reduce highway expenditures. Area Networks officials indicated greater accountability could be achieved by establishing area goals for reducing extra trip expenditures. Establishing financial goals as an area initiative would also ensure a proper balance between service commitments and USPS financial performance goals.

Recommendations

We recommend that the Chief Operating Officer and Executive Vice President work with the Vice Presidents, Purchasing and Materials, and Network Operations Management to:

9. Establish extra trip rates when regular service contracts are negotiated, and ensure rates exclude fixed costs already paid contractors for regular service.

10. Discontinue the practice of paying a 10 cents per mile premium for extra trips in one of the areas.

11. Establish area goals for reducing extra trip expenditures and charge Networks Offices with monitoring goal achievement.

12. Require that Networks Offices establish a tracking system to monitor area goals.

Management's Comments

Management agreed with the findings and recommendations. With respect to recommendation 9, management plans to establish pilot sites as a test to determine whether negotiating extra trip service at contract

[9] One Networks Office had a tracking system, but was not using it to monitor extra trip expenditures.

award results in lower rates. Management will provide feedback on their progress and provide an alternate solution, if necessary. Additionally, management suggests that the payments to contractors above pro rata rates were not premiums, but were payments to compensate the suppliers for extra equipment and employees. They will determine if the operating requirements still justify extra trip rates above pro rata at the one location. Management also agreed to establish goals for reducing extra trips and a tracking system to monitor achievement of area goals.

Evaluation of Management's Comments

Management's planned actions should correct the situations noted in the audit. We agree with management's decision to pilot recommendation 9, and believe that this test will demonstrate fixed costs can effectively be excluded from extra trip rates.

With respect to recommendation 10, we agree that situations may arise where payments above pro rata would be justified. However, we believe those occasions should be rare and for a definite period of time. The examples cited in the report have been ongoing for many years, and according to local management, are no longer needed to ensure competitive and reliable service. Therefore, these payments constitute premiums because they were incentive-based and not linked to additional contractor costs. Management has indicated that it will review the examples cited to determine if continuation of such payments is still justified.

COMPUTATION OF ESTIMATED SAVINGS AND COST AVOIDANCE

	CONTRACT VALUE ($M)	SAVINGS (NOTE 1)	TOTAL ($M)
FY 2000 EMERGENCY CONTRACT CONVERSIONS (NOTE 2)	$145.0	17%	$24.7
ANNUAL COST AVOIDANCE (NOTE 3)			
EMERGENCY SERVICE			
AWARD REGULAR SERVICE CONTRACTS INSTEAD OF EMERGENCIES	$91.8	17%	$15.6
PROMPTLY CONVERT VALID EMERGENCIES	$32.9	17%	$5.6
TOTAL			$21.2
EXTRA TRIPS			
ELIMINATE FIXED COSTS (NOTE 4)	$113.7	4.6%	$5.2
ELIMINATE 10 CENTS EXTRA TRIP PREMIUM (NOTE 5)			$.3
TOTAL			$5.5
TOTAL ANNUAL AVOIDANCE			**$26.7**

NOTE 1. Percentages are based on a statistical projection of actual savings at the five locations visited.

NOTE 2. FY 2000 savings are a one-time savings achieved by converting all existing emergencies to regular service that have been in existence for 90 days or longer (based on data as of February 1999).

NOTE 3. Annual cost avoidance assumes that levels of activity and costs remain constant.

NOTE 4. This is a conservative estimate based on a statistical projection of excess costs that could be avoided by eliminating certain fixed cost elements from extra trips.

NOTE 5. This is an estimated cost avoidance achieved by eliminating the 10 cents extra trip premium paid to four contractors by one Networks Office.

STATISTICAL SAMPLING, PROJECTIONS, AND ANALYSIS MODEL FOR AUDIT OFHIGHWAY TRANSPORTATION COSTS

Purpose of the Sampling

The audit was to assess USPS emergency and extra trip expenditures and potential savings on highway transportation contracts. In support of this objective, the audit team employed multistage variable and attribute samples to allow statistical projection of contract management performance. The resulting projections were then used as inputs to a cost-savings analysis model.

Definition of the Audit Universe

The audit universe consisted of 13 sites that separately manage highway transportation contracts: 11 Distribution Networks Offices and 2 branch offices. The audit period included contracts in effect at some time within the 18 accounting periods ending 12 February 1999. Three separate contract populations were involved in the analysis. For the current emergency service contracts, the contracts subject to selection were those contracts that were greater than $75K. For contracts that were converted from emergency service to regular service, the contracts subject to selection were those contracts that were greater than $25K. For contracts containing extra trip charges, the contracts subject to selection included those contracts that were greater than or equal to $25K and for which extra trip charges constituted at least 10% of the contract value. Data for contract selection came from the National Transportation Management System and the Highway Contracts Support System. The audit team did not independently verify the accuracy and completeness of the universe data.

Sample Design and Modifications

The audit used a two-stage sample design. The same first-stage selection of five highway contract management sites was used for each of three projections. At the first stage, the sites were chosen with their probability of selection proportional to the total number of highway contracts managed. Because the number of elements at the primary stage determines the degrees of freedom and hence the t-value, we could not consider fewer than five sites; audit travel considerations prevented us from including more than five. Expected variability in the data was not known, precluding accurate estimates of sample size requirements; we agreed to take whatever precision and confidence level was achievable from the sample results for a sample size that was largely determined by audit resource considerations. Those considerations (primarily time) limited us to considering only 25 contracts per site for of three contract types: converted emergency contracts; current emergency contracts; and contracts containing extra trip charges.

We note that the Caribbean branch office was subject to selection in the first stage, but later definitions of contract population data did not all include Caribbean information. As a result, the projections are not intended to address contract management of the Caribbean branch.

Statistical Projections of the Sample Data

Savings Attributable to Conversion of Emergency Contracts to Regular Contracts.

Based on projection of the sample results, we are 90 percent confident that between $5.2M and $9.2M of the emergency service contract costs subject to selection could be eliminated by conversion to regular service contracts. For the contracts in the audit period, those values translate into savings of 12.6 percent to 21.2 percent. The unbiased point estimate is $7.2M, or 17 percent.

The point estimate percentage is used by the audit team to calculate the overall savings from all emergency contracts in the audit period minus those contracts that had been in effect less than 90 days as of 12 February 1999: ($145,006,960) * (. 17) = $24.7M. The team also applies the percentage savings range from the sample results to the $145,006,960 to calculate a range of savings: from $18.3M to $30.7M.

Validity of Designation of Contract as Emergency.

Based on projection of the sample results, we are 90 percent confident that at least 210 (38 percent) of emergency service contracts for the audit period are applied to situations that do not comply with valid emergency conditions. The unbiased point estimate is 387 contracts, or 69 percent of the 564 contracts subject to selection.

Excess Charges for Extra Trips.

Based on projection of the sample results, we are 90 percent confident that an annual cost avoidance of at least \$3.9M is achievable (pro-rated from the audit period data by a factor of 1.4 (18 accounting periods at 28 days/period = 504 days; 504/365=1.38)). The unbiased point estimate is \$5.2M annually, or about 4.5% of extra trip charges. As with other annual cost avoidance estimates, this dollar value assumes the number and amounts of non-valid charges would remain the same (ceteris paribus) unless corrective action is implemented.

Calculation of Cost Savings

The point estimate values for savings attributable to conversion from emergency contracts to regular contracts and the fraction of valid emergency contracts were combined with emergency contract duration data (for the population) to calculate an annual cost avoidance for adherence to policy regarding use of emergency contracts. The cost avoidance was divided into two categories, to include the effect of a 90-day "grace period" for conversion of valid emergency contracts into regular contracts. We modeled a steady state condition to compute an expected number of days a given contract exists in a given year, based on the 459-day average contract duration from the data. This was an extremely simplified model, with no attempt to reflect distributions of contract duration or variations in contract activity across the year. All months were considered equally likely to be the starting month for a contract. This steady state model allowed mathematical inclusion of contracts carrying over from prior years as well as contracts starting part way through the "current" year. By examining the steady state condition, we were able to see the effect of allowing the 90-day grace period at the start of new, valid emergency contracts. The grace period multiplier derived from the steady state model is 0.80.

The cost savings model uses as inputs the point estimates of the number of valid (177) and not valid (387) contracts and the percent of contract value "saved" by conversion of emergency service contracts to regular service contracts (17 percent). The audit team provided the total annualized cost for emergency contracts: $133,711,721. The portion of that amount that could be avoided by use of regular service contracts in place of not-valid emergency contracts is (387/(387+177))*($133,711,721)*(0.17)=$15.6M. For the 177 valid emergency contracts, the 90-day grace period multiplier is a factor, and the cost avoidance is (177/564)* ($133,711,721) * (0.80) - (0.17) = $5.7M. Note that none of the cost avoidance calculations address any changes in contract numbers, dollar values, validity of emergency, or average duration of contracts; for, example, an increase in the value of emergency contracts would increase the opportunity for cost avoidance.

NATIONAL MAIL TRANSPORTATION PURCHASING

UNITED STATES
POSTAL SERVICE

September 29, 1999

RICHARD CHAMBERS

THRU: KEITH STRANGE KS 9/29/99

SUBJECT: Draft Report on Emergency and Extra Trip Expenditures on Highway Routes
(Audit Report Number TR-AR-99-draft)

This is written in response to the recommendations contained in the subject report, dated August 16, 1999. The report identifies a series of issues and projected savings that can be achieved through a reduction in the number of emergency contracts and more efficient use of extra trips of service. We agree with the basic thrust of your report that there is an opportunity to achieve some savings, possibly in the range outlined in your report. As we discuss later in this document, the Postal Service's transportation operating system is very large, complex, and subject to the same operating realities of any other very large trucking operation. Among the realities faced by the postal transportation operating system are contractor performance issues that result in an immediate need for replacement service. In some instances, our plans will go astray, requiring emergency replacement service. Although we can reduce the level of emergency contracts, we will have a continuing need for some level of emergency contracts. Therefore, the real savings will have to be determined through a careful measurement of the net difference in the level and cost of emergency contracts referenced in your report and what is in place as we move through FY 2000. Therefore, we will determine the actual savings as we implement the emergency contract reduction instructions issued to the field on July 30, 1999.

The Postal Service has broad authority to award emergency contracts. Therefore, the examples cited in the subject report do not constitute an abuse of the emergency contracting authority. The Postal Service's authority to award emergency contracts is inherent in Title 39 U.S.C. 5001. The policy statement in the Purchasing Manual (Section 4.5.5) is a statement of the Postal Service's authority to solicit and award contracts using expedited procedures in order to ensure that mail continues moving in a timely manner. As stated in Section 4.5.5c.3 of the Purchasing Manual, "Circumstances under which emergency contracts may be appropriate include the following:" This language was purposely broad because we could never develop an exhaustive list of events that would cover all unexpected situations (emergencies) that would require almost immediate contracted transportation services. In the development and writing of the Purchasing Manual (PM), it was not intended to restrict the use of emergency contracts to the examples cited in the Purchasing Manual. Rather, as stated above, the situations listed in the PM are examples and are not intended to restrict the Postal Service's options when it is determined that an emergency exists.

In a system the size and complexity of the Postal Service, there are always going to be emergencies that result from communication problems, unexpected volumes of mail, unexpected changes in operating plans, etc.

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Before we respond to the specific recommendations outlined in the report, let us provide a bit of background information regarding the highway transportation segment of the trucking industry that typically transports mail.

USPS/HCR Business Relationship (History, Service and Cost Model):

During the past 100 plus years, the Postal Service has worked very closely with the highway transportation industry to develop a highly reliable and cost effective transportation and delivery network. During the mid-to late 40's, there was a significant failure in the postal contract transportation operating system. Although we cannot confirm an exact percentage, it is reported that a full 40% (plus) of the postal highway transportation contractors defaulted on their contracts. As a direct response to this failure, the Postal Service worked with Congress to implement Public Law 669. This particular legislation has served as the cornerstone for our current business relationship with highway transportation contractors.

In the years since the implementation of Public Law 669, the Postal Service, working with this industry, developed a purchasing and contract management system that permits the renewal of HCR contracts for an indefinite period of time, typically in increments of four years. The fundamental purpose of this business approach is to develop a reliable contract transportation and delivery network that permits the Postal Service to achieve its mission of delivering mail everywhere everyday. Although this approach has developed an HCR business process that has shifted, the financial risk for the vast majority of the contracts financial risk is to the Postal Service., it It has also achieved its most important mission of providing a dedicated and reliable contract transportation activity. In fact, this network makes it possible for the Postal Service to reach the most distant and remote parts of the United States and its various trust territories.

Based on recent comparisons with rates charged by large trucking companies and the transportation operating approach and resulting cost structure that our competitors use, the Postal Service's unit cost (HCR rate per mile $1.20) seems reasonable. The Postal Service also uses contract delivery services at per delivery cost of $.28 per delivery per day which is well below per delivery cost for rural route carriers ($.42) and postal employees ($.52). As you might benchmark these unit rates with other companies, you will no doubt find them to be very competitive. Although we can incrementally improve certain financial and service aspects, the system yields a reasonable unit rate and is a reliable transportation and delivery provider. It is within this framework that we are working to make incremental improvements in both the service and financial results that the HCR systems produce.

The following information is submitted in response to recommendations outlined in the draft IG audit report (report number TR-AR-99).

Recommendations to the Vice President, Purchasing and Materials

<u>Recommendation Number 1</u>:

Instruct Managers in Facilities and Network Operations Management to promptly notify contracting officials of new transportation requirements in time to reduce the need for awarding emergency contracts to meet transportation needs. This will ensure that service is available when needed.
<u>Management Comments</u>:

We agree with this recommendation and will publish a Postal Bulletin article reemphasizing the need for managers to provide timely information to contracting officers regarding new or changed transportation requirements.

Recommendation Number 2:

Convert all existing emergency contracts to regular contracts as soon as practicable, and, as appropriate, emphasize prompt conversion in the future.

Management Comments:

We agree with the intent of this recommendation. As stated on page 1 in the Introduction section of the report, postal managers indicated that a reduction in the number of emergency contracts would produce some positive financial benefits for the Postal Service. When compared with other transportation cost drivers, we think emergency contract cost reduction is number four or five on our list of cost management initiatives. In our view, 75-80% of the cost of a HCR contract is tied up in contract employee wages/fringe benefits and fuel. Another significant cost driver is leased trailers. During the past few years, the Postal Service has, based on the availability of resources, implemented several initiatives and programs designed to reduce cost, manage cost growth over time, and build infrastructure. A few of the notable examples in this regard include the Fuel Management Program, a contract employee wage and fringe benefit management program, and a national trailer leasing agreement. In our view, these initiatives represent significant cost savings in the short term and, most importantly, build infrastructure to manage cost growth in future years. It is with this long-term business rationale that we have made an effort to go after the high dollar items first.

In that framework, we accept your recommendation to implement a business process to reduce, and to the extent possible, eliminate emergency contracts in the HCR system to which would result in financial benefits for the Postal Service. In fact, as mentioned in your report, instructions implementing this recommendation were issued to all managers of transportation contracting on July 30, 1999. As information, we have attached a copy of these instructions. We think the potential savings will be significantly less than the report projects. (See Comments on Findings).

Recommendation Number 3:

Minimize the practice of extending emergency service through the use of follow-on solicitation for the same service.

Management Comments:

We agree with this recommendation. The instructions issued to field contracting officers on July 30, 1999 will implement this recommendation to the extent possible.

Recommendation Number 4:

Report progress made in responding to recommendations 1-3 and related cost savings achieved.

Management Comments:

We will provide periodic updates on our progress regarding recommendations 1 through 3.

Recommendation Number 5:

Monitor actions taken to ensure transportation requirements are received timely enough to limit the need to award emergency contracts, promptly converted to regular service, and to the extent possible not extend the same service requirement under follow-on emergency contracts.

Management Comments:

We agree with the finding and recommendation. As previously stated, we have issued instructions (July 30, 1999) to the field outlining specific guidelines for reducing the number of emergency contracts and replacing them with temporary or regular contracts. Although these guidelines will not eliminate emergency contracts, they will reduce the number of existing emergency contracts significantly. Emergency contracts (or something similar) are an effective tool for such a large and diverse mail collection, transportation, processing, and delivery system. We will provide information regarding our progress as part of the periodic updates referenced above.

Recommendation Number 6:

Modify system to highlight rationale for the emergency and when requirements have not been received in timely manner.

Management Comments:

We agree with this recommendation. The HCSS and TCSS are currently being upgraded. We will include the requirements to indicated the rationale and when emergency contracts result from a failure to receive timely requirements.

Recommendation Number 7:

Delegate authority for approving emergency contract extensions to contracting officers in the Networks Office's which will require them to validate the need for extensions.

Management Comments:

We agree with the intent of this recommendation. The Postal Service purchases the vast majority of its highway transportation service at the local DN office. A significant number of overall system costs can be most effectively managed from a centralized point. Some examples include the following:

1. System-wide fuel cost
2. Contract employee wages and fringe benefits
3. System-wide emergency contracts
4. Trailer leasing (leverage purchasing power – volume)
5. Holiday Transportation (trailer leasing, national/regional transportation contracts)

The emergency contract instructions submitted to the field on July 30, 1999 have specific instructions regarding the continuation of emergency contracts. Therefore, as an alternate solution, the NMTP group will continue to monitor the number and cost of emergency contracts until our previous instructions have been implemented and the system re-evaluated. At that time, we will determine whether to delegate authority to the Network offices.

Recommendation Number 8:

Continue to assess contracting workload issues and identify ways to streamline the contracting process.

Management Comments:

We agree with the findings and recommendation. The Postal Service will continue to assess workload issues and take proactive steps to streamline the work activities to take non-value-added work out of the process. During FY 99 and 2000, there are four key process improvement initiatives that are in various stages of development. We think these initiatives, when fully developed, will also have a positive impact on the workload issues mentioned in your report.

1. HCR renewal process
2. Service change process
3. Requirements development process
4. Contract payments process

Recommendation Number 9:

Establish extra trip rate when regular service contracts are negotiated, and ensure rates exclude fixed costs already paid contracts for regular service.

Management Comments:

We generally agree with the intent of this finding and offer the following explanation: At the time of contract negotiations, this should be considered by contracting officers. The establishment of negotiated extra trip rates is governed by PM 4.5.8.d, exceptional service. Exceptional service may be required only when an unanticipated increase in mail volume or other conditions arise that require the performance of additional service or equipment. The PM guidelines also state that, whenever feasible, contracting officers should hold discussions with suppliers to establish the rate to be paid for exceptional service before its performance. Whenever possible, all fixed costs that can be excluded during the performance of extra service should be identified and not paid during the performance of extra service. While the practice of pre-negotiating extra trip rates may be an ideal practice no assumption should be made that a pre-negotiated rate for exceptional service will be less than the regular contract rate per mile. In fact, the feedback from some of the contracting officers indicates that the rates could be higher. There are a number of factors that have led to this conclusion. They include:

- Extra trips are usually performed when contracted equipment is busy performing regular route operations.
- Depending on distance, extra trips require housing and other additional costs that may exceed the prorata rate.
- Several of the contractors' costs that ordinarily would be considered fixed can be directly related to and impacted by extra trip operations.

As part of our effort to test this recommendation, we will establish pilot sites where negotiated extra trip service will be a part of the contract award or renewal process. We will provide feedback on our progress during FY 2000.

Recommendation Number 10:

Discontinue the practice of paying a rate (above pro-rata) 10-cents per-mile premium for extra trips in one of the areas.

Management Comments:

We agree with the intent of the finding and offer the following explanation: Improvements can be made in the contract documentation regarding payments to suppliers for above pro rata for extra trips. The examples cited in the report were initially paid in order to provide the supplier compensation for extra equipment and employees to meet the needs of the Postal Service. We are in the process of determining if the operating requirements still justify the continuation of an above pro rate payment for extra trips. However, it should be clearly understood that payment of costs above the rate per mile for extra service is not a premium. Rather, it is for payment for the use of additional equipment and employees needed to complete the required extra service to meet operating standards. As stated, a trip of extra service is normally performed on very short-term notice (standard contractual require-ments are that service begin within four hours of notification) generally requiring that the supplier provide additional equipment or employees on very short notice.

Not all extra trips can be performed using the same equipment and employees, thus saving on fixed costs. For example, extra trips for long haul, high volume routes may involve the use of slip-seat operations as well as team drivers resulting in the need for additional compensation for the performance of the service. Even short haul extra service operated during the same time frame as regularly scheduled service may also require the use of leased equipment and added employees. The decision to pay additional costs must be based on the nature of the extra service that needs to be performed and determined through negotiations with suppliers.

Recommendation Number 11:

Establish area goals for reducing extra trip expenditures and charge Networks Offices with monitoring goal achievement.

Management Comments:

We agree with the finding and recommendation. Extra trip expenditures should be monitored to ensure effective use of this contract feature. It is also important to keep in mind that extra trips serve to enable the Postal Service to mitigate the effects of volume fluctuations, and other factors such as weather delay, that could be considered atypical. It cannot be said that any certain ratio of extra trips to regular trips is "bad". Each area's situation may be unique. For example, extra trips of service are often associated with large mailings that may not occur on a regularly scheduled basis. The extra trip feature of the contract allows the Postal Service to accommodate such fluctuations without committing to a fully funded regular trip. The areas and Headquarters Logistics will jointly establish goals and norms for extra trip utilization. We will provide periodic updates on our progress.

Recommendation Number 12:

Require that Networks Offices establish a tracking system to monitor area goals.

Management Comments:

We agree with the finding and recommendation. The data exists to establish a system and evaluate extra trip utilization and evaluate goal attainment. We will provide periodic updates.

Comments on Findings:

Projected Emergency Contract Savings: The report indicates that up to $24.7 million can be saved in FY 2000 if emergency contracts are eliminated. As mentioned in the body of this response, we will determine the actual savings as we implement the emergency contract reduction plan. As discussed in the report, given the size and complexity of the Postal Service's transportation operating activity, emergencies are a business reality. We will continue to have some number of emergency contracts or some other contract tool that provides similar operating benefits.

Extra Trip Premium: A "10 cents per mile premium" is paid in certain areas for extra trips. In our experience, we would not characterize these payments as premium. Based on our review of the contracts in question, the above pro-rata payment was negotiated with the contractor as compensation for additional equipment needed to support operations. As mentioned in our specific response, we are going to re-evaluate the continuing need for this payment.

Emergency Contract Duration:

As cited in the report, an emergency contract operated 4.5 years. The subject contract was operating at a rate per mile of $.93. This rate is well under the average rate per mile for this type of contract. Based on our knowledge of the current market and a review of the offers received, we have concluded that a small group of our large contractors are making an effort to expand their level of business with the Postal Service and, therefore, in some instances, are offering to provide services at what would normally be considered under market rate. Based on feedback from the suppliers, this assessment of the market is correct.

Summary:

As mentioned initially, we are in agreement with your conclusion and recommendation that a reduction in the number of emergency contracts and more efficient management of extra trips will provide some financial benefits to the Postal Service. We will determine the magnitude of the savings after Networks Offices implement our July 30, 1999 instructions.

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We will provide you with feedback regarding the recommendations that we have agreed to implement and are willing to work with you and share information regarding the other initiatives (service improvement and cost management).

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Manager
National Mail Transportation Purchasing

Major Contributors to This Report

[redacted]