OFFICE OF
INSPECTOR
GENERAL
UNITED STATES POSTAL SERVICE

Military Mail Reimbursements

Audit Report

March 21, 2013

Report Number MS-AR-13-006

OFFICE OF
INSPECTOR
GENERAL
UNITED STATES POSTAL SERVICE

HIGHLIGHTS

March 21, 2013

Military Mail Reimbursements

Report Number MS-AR-13-006

BACKGROUND:

The U.S. Postal Service partners with the U.S. Departments of Defense and State to deliver mail to military and diplomatic facilities within and outside of the continental U.S. Responsibilities and accountability for transporting and processing military mail are outlined in agreements between the Postal Service and the Departments of Defense and State. These departments reimbursed the Postal Service about $644 million in fiscal year (FY) 2011 and $465 million in FY 2012 for airline carrier transportation costs incurred to transport mail for their departments.

Our objective was to determine whether the payment and billing processes for transporting military mail were efficient and effective.

WHAT THE OIG FOUND:

The Postal Service pays air carriers for transportation costs incurred to transport Department of Defense and Department of State mail to foreign destinations in advance and later obtains reimbursement from the departments. By instituting processes that require these departments to pay for mail transportation costs directly, the Postal Service can eliminate about $149,000 per year — the cost of borrowing funds to pay the airline carriers directly — and $17,000 in labor costs associated with the billing process. We also determined that the Postal Service does not have a process to identify and seek reimbursement for customer claims that can be traced to delayed or damaged mail caused by the Departments of Defense or State. We estimate the Postal Service's liability for these claims is at least $440,000 per year.

Finally, we noted that the agreement between the Postal Service and the Department of Defense is 33 years old and does not reflect current processes, including the method for reimbursing transportation costs.

WHAT THE OIG RECOMMENDED:

We recommended the Postal Service institute a payment process for interagency agreements that eliminates upfront payment of costs by the Postal Service. We also recommended the Postal Service establish a process to identify and receive reimbursement for customer indemnity claims and update agreements with the Departments of Defense and State accordingly to reflect these new processes.

Link to review the entire report

OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

March 21, 2013

MEMORANDUM FOR: TIM0THY F. O'REILLY
VICE PRESIDENT, CONTROLLER

DAVID E. WILLIAMS, JR.
VICE PRESIDENT, NETWORK OPERATIONS

E-Signed by Sean Balduff
ERIFY authenticity with eSign Deskto

for

FROM: Darrell E. Benjamin, Jr.
Deputy Assistant Inspector General
for Revenue and Performance

SUBJECT: Audit Report – Military Mail Reimbursements
(Report Number MS-AR-13-006)

This report presents the results of our audit of Military Mail Reimbursements (Project Number 12RD001EN000).

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Janet Sorensen, director, Sales and Marketing, or me at 703-248-2100.

Attachments

cc: Megan J. Brennan
Joseph Corbett
Giselle E. Valera
Brent A. Raney
George S. Rudy
Corporate Audit and Response Management

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Introduction

This report presents the results of our audit of Military Mail Reimbursements (Project Number 12RD001EN000). Our objective was to determine whether the payment and billing processes for transporting military mail are efficient and effective. This self-initiated audit addresses financial and operational risk. See Appendix A for additional information about this audit.

The U.S. Postal Service partners with the U.S. Department of Defense (DoD) and the U.S. Department of State (DoS) to deliver mail to military facilities in the Continental U.S. (CONUS) and military and State Department personnel and their families outside the CONUS. The Postal Service has agreements with the DoD and DoS that prescribe procedures related to moving DoD and DoS mail.[1] Currently, the Postal Service pays air transportation costs incurred to transport DoD and DoS mail to foreign destinations in advance and obtains reimbursement from the DoD and DoS. Although this process is outlined in the DoS agreement, it is not currently included in the DoD agreement. The DoD and DoS reimbursed the Postal Service about $644 million and $465 million for airline carrier transportation costs in fiscal years (FYs) 2011 and 2012, respectively. The DoD accounts for about 98 percent of annual reimbursed costs.

Conclusion

Currently, the Postal Service pays air carriers for costs incurred to transport DoD and DoS mail to foreign destinations in advance and later obtains reimbursement from the departments. By instituting processes that require the DoD and DoS to pay mail transportation costs directly, the Postal Service can eliminate about $149,000 per year — the cost of borrowing funds to pay the airline carriers directly — and $17,000 in labor costs associated with the billing process. We also determined that the Postal Service does not have a process to identify and seek reimbursement for customer claims that can be traced to mail the DoS or DoD delayed or damaged. We estimate the Postal Service's liability for these claims is at least $440,000 per year. Finally, we noted that the agreement between the Postal Service and the DoD is 33 years old and does not reflect current processes, including the method for reimbursing transportation costs. Updating this agreement and the agreement with the DoS every 5 years, as required, would reduce the risk of noncompliance with applicable laws and regulations. See Appendix B regarding the monetary impacts.

Reimbursement Process

Procedures related to the payment and subsequent reimbursement of transportation costs for DoD and DoS mail could be improved. Currently, the Postal Service pays

[1] Although this agreement is between the DoS and the Postal Service, the DoD facilitates some movement of mail for the DoS.

commercial air carriers for transporting DoD and DoS mail and then invoices these federal agencies for reimbursement. This process requires Postal Service personnel to review, document, invoice, and reconcile reimbursement transactions — a process that can take up to 60 days after the Postal Service has already paid the commercial air carriers. Streamlining these procedures by using more effective payment methods could result in the avoidance of about $149,000 in borrowing costs and $17,000 in labor costs per year for an annual savings of $166,000.

Payment Process Alternatives

We identified two alternative payment mechanisms that would reduce or eliminate reimbursement costs currently incurred by the Postal Service. One mechanism available is known as 'direct cite' billing, which requires contractor services to be billed directly to the DoD and DoS. This process would terminate the Postal Service's 'middleman' function in the bill payment process and subsequently eliminate the associated labor costs currently expended by the Postal Service to provide invoicing, posting, and reconciliation services. Both the DoD and DoS expressed interest in this option.

A second mechanism consists of using either the Intra-Governmental Payment and Collection (IPAC) system, which government agencies use to transfer appropriations[2] from one agency to another, or electronic funds transfers (EFT), which transfers actual dollars from one entity to another. Either process would reduce the capital costs incurred by the Postal Service by reducing the delay between invoicing and reimbursement. However, it would not eliminate the need for the Postal Service to act as the 'middleman' or reduce the associated labor costs.

We believe the 'direct cite' option provides the greater opportunity for increased efficiency and effectiveness. This process eliminates capital costs and labor costs for the Postal Service. The IPAC or EFT options only reduce the capital costs and the Postal Service would still incur labor costs to manage the process.

Tracking Process

The Postal Service does not have a process in place to gather or monitor reimbursable claims paid to customers for delay, loss, or damage caused by the DoD or DoS. For example, Express Mail® failure[3] rates to U.S. Army and Air Force post offices (APO), U.S. Navy and Marine Corps post offices (FPO), and diplomatic post offices (DPO) were 83 percent and 75 percent in FYs 2011 and 2012, respectively. According to existing agreements with the DoD and DoS, Postal Service payments made to customers for claims related to lost, damaged, stolen, or wrongly delivered mail while in the possession of the military are subject to reimbursement by the DoD and DoS. However, the Postal Service did not track these types of claims and were not reimbursed by the DoD or DoS. This occurred because there was no clear assignment of responsibility for

[2] Funds provided to government agencies for specified purposes.
[3] An Express Mail failure exists when delivery of the mailpiece occurs after the guaranteed delivery time.

ensuring compliance with the terms of these current agreements. We estimate the Postal Service's liability is at least $440,000[4] in potential claims per year.

Agreement With the Department of Defense

Although updates to the agreement between the Postal Service and the DoD should occur every 5 years,[5] we determined this agreement has not been updated since 1980. During the audit, Postal Service management advised they have held several meetings to initiate the update process with the DoD; however, any written updates to the agreement may not be incorporated into a draft document for over 1 year. The Postal Service recently completed a 9-year process to update the agreement with the DoS, which became effective October 25, 2011; however, this updated agreement does not contain criteria identifying update frequency. Postal Service management cited higher priority commitments as the leading cause for delays in updating these agreements.

Because the DoD agreement is not current, the Postal Service may have lost opportunities for efficiency and increased revenue. For example, it has not sought reimbursement from the DoD for lost, damaged, or delayed Express Mail claims because this product was not offered in 1980 when the agreement was created. Had the Postal Service made updates at appropriate intervals, it may have identified ways to collect data and established a process to monitor these types of claims, which would have enabled the agency to effectively request reimbursement.

Recommendations

We recommend the vice president, Controller:

1. Implement an alternative payment process for interagency agreements that eliminates advance payment of costs and associated labor expenses.

We recommend the vice president, Controller, in coordination with the vice president, Network Operations:

2. Develop a process to identify and receive reimbursement for customer claims that can be traced to delayed or damaged mail caused by the U.S. Department of Defense or the U.S. Department of State.

3. Update the interagency agreements between the U.S. Postal Service, the U.S. Department of Defense, and the U.S. Department of State to include the use of effective payment methods associated with the reimbursement of mail transportation costs and establish criteria for periodic updates of these agreements.

[4] The liability identified is based on Express Mail failure rates derived from the Postal Service's *On Time Performance* and *Rate, Pieces, and Weights* reports. We could not calculate the Postal Service's total liability of potential claims because data for other types of claims was not available.
[5] Publication 38, *Postal Agreement with the Department of Defense,* dated February 1980.

Management's Comments

Management generally agreed with our findings and recommendations. Regarding recommendation 1, management stated in a subsequent conversation that their disagreement with our finding and recommendation is based on their assertion that the use of IPAC for payments had already been initiated at the start of our audit. They also stated they will continue to explore the feasibility of other payment methods such as pre-payment and direct cite while proceeding with the IPAC solution. Management did not agree with the estimated $149,000 per year savings in advance payment costs citing our calculations did not consider the benefits of quarterly prepayments from the Navy, which began in FY 2013. Management's target implementation date to adopt the IPAC payment process is September 30, 2013.

Regarding recommendation 2, management stated they are taking steps to increase tracking of mail items sent for APO, FPO, and DPO destinations. Improvements for parcel products to enhance visibility are planned to help determine the last possession (Postal Service, DoS, DoD, or air carrier). Management's target implementation date is December 31, 2013.

Regarding recommendation 3, management stated the present agreement does not reflect current Postal Service processing and system operations, and has formed a committee to renegotiate terms under current requirements. Management's target implementation date to update the status of negotiations is September 31, 2014.

See Appendix C for management's comments, in their entirety.

Evaluation of Management's Comments

The OIG considers management's comments responsive to the recommendations and corrective actions should resolve the issues identified in the report. The Postal Service disagreed with recommendation 1 stating they were already pursuing the use of IPAC before the start of our audit. Although we were aware the Postal Service had initiated discussions regarding the use of IPAC, we considered this to be a preliminary initiative, because the DoD and DoS have not agreed to this solution and no definitive plans have been made. Management disagreed with the monetary impact stating the benefits received in the form of advance quarterly prepayments from the Navy, starting in FY 2013, were not considered in our calculations. We did not include these payments in our future monetary impact calculations because these payments are currently being made at the discretion of the Navy and could be discontinued at any time.

Appendix A: Additional Information

Background

Military mail is comprised of domestic mail delivered to or on military bases within the CONUS and international mail delivered to APOs, FPOs, and DPOs. According to a 33-year old agreement between the Postal Service and the DoD and a 2-year old agreement between the Postal Service and the DoS, the Postal Service is responsible for transportating mail:

- From Postal Service facilities to overseas military facilities.

- Between domestic Postal Service facilities and air or surface carriers.

- Between civilian post offices on military installations and the receiving or dispatching Postal Service facility.

The DoD is responsible for transporting mail from overseas military facilities to Postal Service facilities and between Postal Service facilities within overseas areas. Transportation fees for mail delivered within the CONUS are included in the customer's postage price. The Postal Service pays fees for transporting mail between CONUS gateways and overseas locations upfront and is reimbursed by the DoD and DoS.

Data such as weight, contract, and airline are recorded for each shipment of mail and reconciled to the carrier invoices received by the St. Louis Accounts Payable Branch (APB). The APB then prepares weekly invoices and forwards them to the DoD or DoS, depending on which agency received mail. These agencies then approve the invoices and reimburse the Postal Service. The Postal Service maintains the contract for air carrier services and has no authority to pay the carrier directly with DoD or DoS funds. As a result, this reimbursement arrangement has developed over the years, is not specified in the agreement with the DoD, and only recently was included in the recently revised agreement with the DoS. The DoD and DoS reimbursed to the Postal Service about $644 million and $465 million for airline carrier transportation costs in FYs 2011 and 2012, respectively.

Objective, Scope, and Methodology

Our objective was to determine whether the payment and billing processes for transporting military mail are efficient and effective.

We reviewed agreements between the Postal Service, DoD, and DoS and interviewed officials from each organization. In addition, we obtained and reviewed military mail transportation reimbursement data and assessed the reliability of this data by interviewing Postal Service, DoD, and DoS personnel knowledgeable about the data. We determined the data were sufficiently reliable for the purposes of this report.

We conducted this performance audit from August 2012 through March 2013 in accordance with generally accepted government auditing standards and included such tests of internal controls as we considered necessary under the circumstances. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. We discussed our observations and conclusions with management on February 6, 2013, and included their comments where appropriate.

Prior Audit Coverage

The OIG report titled *International Transportation Payments* (Report Number CA-AR-12-007, dated February 28, 2010) found that the Postal Service generally provided sufficient oversight of the international air transportation contract. The audit was unable to determine the accuracy of about $46 million per year surface air support system initiated payments made between June 2009 and June 2011 that were ultimately processed through Global Business System (6 percent of the total payments). In addition, the Postal Service could not provide evidence of prior certification, nor was supporting data maintained that could be readily reviewed. Postal Service management disagreed with the basis of our finding, recommendation, and monetary impact. The OIG considered management's comments unresponsive but did not pursue formal audit resolution.

Appendix B: Monetary and Other Impacts

Monetary Impacts

Recommendation	Impact Category	Amount
1	Questioned Costs[6] (FYs 2011 and 2012)	$261,944
1	Questioned Costs (about $149,000 per year)	297,518
1	Questioned Costs (Labor)	34,000
1	Funds Put To Better Use[7]	34,000
Total		**$627,462**

Other Impacts

Recommendation	Impact Category	Amount
3	Revenue at Risk[8]	$879,692

We calculated questioned costs during FYs 2011 and 2012 by first identifying the amount of funds the Postal Service paid to air carriers for military mail transportation and the elapsed time between payment and reimbursement. We then multiplied the daily amount of funds in use by a daily cost of capital rate[9] for the appropriate period as provided to us by the Postal Service's Financial Planning Office.

Questioned costs for FYs 2013 and 2014 were calculated using FYs 2011 and 2012 data for proxy, applying the current 0.247 percent cost of capital rate, and then calculating the annual average of about $149,000 and multiplying that figure by 2.

Questioned costs (labor) ($17,000 per year for FYs 2011 and 2012) and funds put to better use ($17,000 per year for FYs 2013 and 2014) represent the annual salary plus benefits of one St. Louis Accounting Service Center full-time employee devoted to the military mail transportation invoicing and reconciliation process.

Revenue at risk reflects an estimated dollar value of postage anticipated in FYs 2013 and 2014 for failed Express Mail pieces destined for DoD and DoS facilities. We based this figure on the actual dollar value of similar items from FYs 2011 and 2012. Currently no process exists to identify the portion of Express Mail failures attributable to the DoD and DoS that would identify actual revenue lost. Without such a process in place, the entirety of future amounts are at risk.

[6] Unnecessary, unreasonable, unsupported, or an alleged violation of law, regulation, contract, etcetera. May be recoverable or unrecoverable. Usually a result of historical events.
[7] Funds that could be used more efficiently by implementing recommended actions.
[8] Revenue that the Postal Service is at risk of losing (for example, when a mailer seeks alternative solutions for services currently provided by the Postal Service).
[9] Actual cost of capital rates used: October 2010–June 2011: 0.267 percent, June–November 2011: 0.187 percent, and November 2011–September 2012: 0.145 percent.

Appendix C: Management's Comments

UNITED STATES
POSTAL SERVICE

March 14, 2013

JUDITH LEONHARDT
DIRECTOR, AUDIT OPERATIONS

SUBJECT: Response to Military Mail Reimbursements] (Report Number [MS-AR-13-DRAFT]

Management does not agree with the findings and recommendations in this audit report prepared by the U.S. Postal Service Office of Inspector General's (OIG) regarding recommendation 1.

Recommendation [1]:
Implement an alternative payment process for interagency agreements that eliminates advance payment of costs and associated labor expenses.

Management Response/Action Plan:
Management does not agree with the findings and recommendations in this report that an alternative payment process should be determined to eliminate the advance payment costs and associated labor expenses with the current prepayment process. Prior to the start of the OIG Audit, the Postal Service was already pursuing the Intra-Governmental Payment and Collection (IPAC) solution to facilitate payment processing with the Department of Defense (DoD) and Department of State (DoS). Furthermore, the OIG calculations stating that the Postal Service can eliminate $149,000 per year to pay for transportation and associated labor cost, do not appear to consider the benefits to the Postal Service for receiving quarterly prepayments, which began in FY 2013, from the U.S. Navy (USN) to transport their mail to foreign destinations. With regard to recommendation 1, the IPAC system is already in place and determined to be the more expedient payment process for the Postal Service to pursue at this time. The IPAC process would allow the Postal Service to directly debit the agencies for funds paid to carriers by the Postal Service for transporting mail. This solution will require the DoD and DoS to agree to allow the Postal Service to directly access their funds. The risk involved with this solution is that the agencies will disallow direct debiting of their funds and take the funds back. The alternative solutions; the

pre-payment method and the "direct cite" billing are more preferable solutions. The pre-payment method is the process currently in place with the USN, and the direct cite billing method would require the carriers to agree to bill the agencies directly for payments. The feasibility of using one of these methods will continue to be explored while proceeding with the IPAC solution.

Target Implementation Date:
The U. S. Postal Service proposal to adopt the IPAC payment process will be implemented by the end of FY 2013.

Responsible Official:
Scott G. Davis
Manager, Corporate Accounting

Recommendation [2]:
Develop a process to identify and receive reimbursement for customer claims that can be traced to delayed or damaged mail caused by the U.S. Department of Defense or the U.S. Department of State.

Management Response/Action Plan:
Management agreed with the findings and recommendations with regard to recommendation 2. The current agreement between the U. S. Postal Service and the Department of Defense (DoD) is dated February 1980. Section V is the section which references Claims. In Section V.1.A, the DoD agrees to assume financial liability "...for the loss, damage, theft, wrong delivery or rifling of accountable mail after receipt from or prior to delivery to a civilian or military post office by a mail clerk employed by the Department of Defense...". In 1980, when the agreement was written there was not a way to determine when a mail piece entered the DoD mail stream.

In September 24, 2012, the Postal Service instituted piece-to-bag nesting for Express Mail products destined to Army Post Office-Fleet Post Office-Diplomatic Post Office (APO-FPO-DPO) destinations. These piece level articles can be tracked for each air carrier possession or handoff. Although air carrier possessions for Express Mail products originating at an APO-FPO-DPO cannot be tracked at this time, another initiative is under review to create a Global Business Systems (GBS) lite version for deployment on the military's Automated Military Postal System to provide large volume overseas originations the capability to nest retrograde inbound Express Mail and parcel items.

For parcel products, planned improvements to tracking include Outside Piece (OSP), positive piece-to-bag nesting for both Mail Processing Equipment (MPE) and manual sort operations for GBS air carrier possession, and handoff tracking updates. The improved visibility will help to determine the last possession (USPS, DoS, DoD, or air carrier) in cases of mail completely lost, but will not be beneficial in cases of rifled or damaged mail in substantiating who had possession of the article when the damage or rifling occurred. For this reason, the Postal Service will negotiate to split responsibility for claims due to damage or rifling 50% with the DoD or DoS. If it is determined that the DoD or DoS had last possession when a loss is claimed, then reimbursement for the loss can be arranged utilizing the payment system described in Recommendation 1.

The military re-evaluated their logistics network in relationship to the Military Express Mail product and provided an updated transit table to and from the serving gateways. This table was married to the domestic Express Mail expected delivery days to and from the gateways to determine a new delivery expectation by destination zip code. This new transit table was included in the Service Delivery Calculator (SDC) and deployed nationally September 7, 2012. However, the USPS-DoD agreement, Publication 38, does not address DoD paying claims for service performance failures. Paying claims for causing service failures will be included in discussions to establish a new agreement.

Target Implementation Date:
System requirements are being identified to implement the piece-to-bag nesting for parcel products at the end of Quarter 1 FY 2014.

Responsible Official:
Brent A. Raney
Executive Director, International Operations

Recommendation [3]:
Update the interagency agreements between the U.S. Postal Service, the U.S. Department of Defense, and the U.S. Department of State to include the use of effective payment methods associated with the reimbursement of mail transportation costs and establish criteria for periodic updates of these agreements.

Management Response/Action Plan:
Management agrees with the findings and recommendations with regard to recommendation 3. The current agreement between the U. S. Postal Service and the DoD is dated February 1980. The current agreement addresses several categories applicable to the Postal Service: 1. Transportation, 2. Personnel, 3. Equipment, 4. Delivery, 5. Claims, 6. Logistical and Administrative Support, 7. Audits and Inspections, 8. Mail Sortation, 9. Mail Forwarding, 10. SAM/PAL, and 11. Review and Amendment. The Postal Service has also undergone system changes that influence the military payment process including the GBS and the Accounts Payable System (APEX). With the changes the Postal Service has undergone, Handbooks and Postal Manuals have been created and revised, and training has been conducted to ensure employees know how to process military payments. Since the current agreement does not reflect any Postal processing or system changes that have transpired over the past 30 years, it is recommended to update the current agreement with the DoD.

A USPS-DoD committee was formed to renegotiate terms under current requirements and renew the Publication 38 agreement. The first monthly meeting was held August 9, 2012. Stakeholders from USPS and DoD are included in the ongoing discussions.

Target Implementation Date:
Publication 38 renewal: Status update in FY14

Responsible Official:
Brent A. Raney
Executive Director, International Operations

This report and management's response do not contain information that may be exempt from disclosure under the Freedom of Information Act (FOIA).

David E. Williams
VP, Network Operations

Timothy O'Reilly
VP, Controller

cc: Megan J. Brennan
Stephen J. Masse
Giselle E. Valera
Brent A. Raney
George S. Rudy
Corporate Audit and Response Management