OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

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SUSAN M. BROWNELL
VICE PRESIDENT, SUPPLY MANAGEMENT

JORDAN M. SMALL
ACTING VICE PRESIDENT, NETWORK OPERATIONS

LINDA J. WELCH
ACTING VICE PRESIDENT, DELIVERY AND POST OFFICE OPERATIONS

SUBJECT: Management Advisory – Fuel Management Initiatives for Surface Network Operations – Fuel Purchasing Strategy (Report Number NL-MA-09-001)

This report presents the results of our self-initiated review of Fuel Management Initiatives for Surface Network Operations (Project Number 08XG029NL000). The objective was to assess the effectiveness of the U.S. Postal Service's fuel management initiatives in controlling fuel costs. This report focuses on the planning and implementation of the Postal Service's National Fuel Purchasing Strategy (fuel strategy) and addresses strategic, financial, and operational risks. See Appendix A for additional information about this review.

Conclusion

The Postal Service has taken positive steps in developing a fuel strategy to promote efficiencies and realize cost savings in purchasing fuel. However, the Postal Service has not yet fully planned and implemented the fuel strategy to ensure accomplishment of desired outcomes and has recently placed the fuel strategy on hold because of other competing priorities. As a result of this delay, the Postal Service incurred about $20 million in unnecessary fuel acquisition costs[1] since August 2008. Further, the Postal Service is missing an opportunity to save approximately $20 million annually.[2] We also noted a fuel "hedging" strategy should be further considered as part of the Postal Service's fuel purchase risk management plan.

[1] The $20 million in monetary impact represents unrecoverable questioned costs, which are costs that are unnecessary, and covers the period August 2008 through July 2009 for which the Postal Service should have had, at a minimum, a well-developed plan with implementation time frames.
[2] The Postal Service's potential savings are preliminary estimates based primarily on its analysis of transactional data and purchasing patterns. This represents the midpoint of the Postal Service's current potential savings range of $16 to $24 million annually.

Delays in National Fuel Purchasing Strategy Planning and Implementation

In January 2008, the Postal Service began developing a data-driven fuel strategy to promote increased efficiency and cost reduction for the Postal Service. However, the Postal Service has not yet:

- Implemented a rigorous and disciplined project management plan with time certain target dates.
- Considered all operational factors for successful implementation.
- Considered all the relevant organizational components including contracting, operations, and financial personnel at all levels.
- Considered major project risks and concerns.
- Included processes for monitoring compliance with strategy requirements.
- Assigned adequate project accountability and oversight at the appropriate level, with authority over all Postal Service Headquarters' and field components that should be involved in planning and implementation.

The Postal Service has recently suspended work on the fuel strategy to address other priorities where they believe the risks and potential financial benefits are greater. Management stated that in order to address the significant decline in mail volume and related financial losses to the Postal Service, they are undertaking a number of actions across all operations to identify the greatest opportunities to increase efficiency and reduce costs.

The responsibility for the current fuel strategy resides with the Transportation Asset Management office under the general direction of the Vice President of Supply Management. Accordingly, the main focus of the strategy to date has been on supply chain management purchasing analyses and identification of cost savings opportunities. However, collaboration needs to occur at all operational levels to direct operational resources and ensure adequate support to address challenges, obstacles, and concerns.

Although the Postal Service hopes to resume planning and implementation of the fuel strategy in fiscal year (FY) 2009, they advised us that efforts will probably be delayed until FY 2010. As a result, the Postal Service has incurred about $20 million in unnecessary fuel acquisition costs since August 2008. If delays continue and if implementation issues are not addressed, the Postal Service will continue to experience missed opportunities to save as much as $20 million annually. See Appendix B for our detailed analysis of this topic.

We recommend the Vice President, Supply Management, Acting Vice President, Network Operations, and Acting Vice President, Delivery and Post Office Operations, coordinate to:

1. Assign appropriate accountability and cross-functional authority for the planning, implementation, and success of the National Fuel Purchasing Strategy; and provide adequate support from the appropriate headquarters' functional areas and the nine Postal Service geographical areas.

2. Ensure appropriate allocation of contracting, operational, and financial resources at all levels to support the timely implementation of the National Fuel Purchasing Strategy.

3. Ensure adequate consideration of project management principles and best practices outlined in Appendix C in planning and implementing the National Fuel Purchasing Strategy, including development of a project management plan, which includes project goals, performance measures, baselines and target dates, changes to target dates, and documented reasons for changes.

4. Develop a risk mitigation plan to address major project risks to help achieve stated goals of the National Fuel Purchasing Strategy.

5. Develop measurement factors to monitor achievement of the stated goals of the National Fuel Purchasing Strategy, and consider including these factors as part of the National Performance Assessment plan as appropriate.

Other Matters – Fuel Purchasing Risk Management – Hedging

The Postal Service did not include fuel hedging[3] as part of its overall fuel strategy to help control the volatility of fuel costs.[4] Management stated they continue to explore the fuel hedging option and are developing a hedging infrastructure; however, they have not yet decided to actively engage in hedging as part of their overall fuel management strategy.

A review of best practices for managing risks associated with fuel price volatility found that airline and other companies have successfully used hedging to better manage risks by stabilizing fuel costs during a time of fluctuations and uncertainty.[5] There are various

[3] The goal of hedging is to ensure a more stable cost structure of purchasing fuel and to improve financial planning.
[4] Fluctuations in fuel prices impact Postal Service costs in two ways: they directly impact the Postal Service's fuel expenses and indirectly impact labor expenses through the cost-of-living adjustment calculation used in its union contracts, which are based on the Consumer Price Index containing a fuel cost component.
[5] Airlines and other transportation companies spend a far larger percentage of their total expenses on fuel compared to the Postal Service, thereby resulting in more risk associated with fuel prices. Specifically, while the Postal Service's fuel purchases are less than 3 percent of its total expenses, fuel expenses for other companies can make up as much as 10 to 30 percent of their total expenses.

hedging techniques the Postal Service might want to consider to better manage its risk and protect it against these dramatic price fluctuations. For example, the Postal Service can hedge against the risk of potential price increases by locking in a predetermined pricing structure for future fuel purchases. However, hedging can be speculative and costly depending on the hedging strategy adopted. Additionally, certain hedging vehicles can require investment-grade credit and significant transaction costs. Further, a hedged entity could potentially pay more if there is a decrease in fuel prices.

Although hedging involves risks, we agree that the Postal Service should consider incorporating hedging into its comprehensive fuel management framework by:

- Continuing to evaluate the viability of hedging;
- Developing an infrastructure to support the implementation of hedging; and,
- Considering designing and implementing a fuel hedging management program that will manage the risks of hedging against fluctuating fuel costs and improve the Postal Service's financial planning efforts.

Because of the Postal Service's on-going efforts, we are making no recommendation regarding this issue. See Appendix B for more information on this topic.

Management's Comments

Management agreed with our finding and recommendations. Management responded that in view of the Postal Service's current financial situation they have been fully engaged in implementing several other strategies, which were resource intensive and where the financial benefits were greater than those under the National Fuel Purchasing Strategy. As a result, the fuel strategy became a lower priority for the Postal Service. Additionally, management stated they will reconsider these fuel purchasing opportunities and establish priorities as part of their goal setting process for FY 2010. Further, management has set a target date of June 2010 for the establishment of a plan for the implementation of all opportunities or in part, under the fuel strategy, including assessment of risk and development of measurement factors.

Management disagreed with the monetary impact of $20 million in unrecoverable questioned costs. Management stated that the estimated monetary impact of the fuel strategy was just an analysis designed to provide senior management of the financial potential of the strategy. Further, they note that the estimated monetary impact of $16 to $24 million annually would be valid only if all four fuel strategy opportunities are fully implemented and there is full compliance. Finally, management stated that because their strategy impacts were only preliminary estimates of potential savings, this should not be reported as questioned costs or potential missed opportunities. Management's comments, in their entirety, are included in Appendix E.

Management did not comment on fuel hedging, because we did not report it as a recommendation.

Evaluation of Management's Comments

The U.S. Postal Service Office of Inspector General (OIG) considers management's comments responsive to the recommendations in the report, and their corrective actions should resolve the issues identified.

Regarding our monetary impact, we consider the amount appropriate based on the data provided by management and the current conditions in the fuel market. As pointed out by management, the National Fuel Purchasing Strategy was developed to identify and explore opportunities to reduce the Postal Service's cost of purchasing fuel. In April 2008, as fuel prices were dramatically rising to unprecedented levels, Postal Service management presented the fuel strategy to senior leadership as an opportunity to reduce the cost of purchasing fuel. At that time, Postal Service management estimated the total cost avoidance relating to the four purchasing opportunities as $20 to $27 million annually.

As fuel prices continued to rise – peaking at $4.76 a gallon for diesel fuel in July 2008 – Postal Service management actively pursued the fuel strategy and continued its briefing of senior leadership as to the savings opportunities and status. In October 2008, Postal Service management advised that they reduced their estimated savings range to $16 to $24 million due to their continued assessment of the savings opportunities. As late as March 2009, we were advised by Postal Service management that they continued to explore and assess the fuel strategy and were looking at validating opportunities in pilot testing. In our assessment, the projected fuel savings as presented to senior leadership were considered significant to move forward to the pilot phase.

Although we were later advised that the strategy was placed on hold due to other priorities given the Postal Service's financial position, the opportunity to reduce fuel costs remain. Given the actual nature of the fuel strategy, the associated savings identified by the Postal Service, and the extensive resources expended by the Postal Service staff over 15 months, we believe that the reporting of questioned costs is appropriate. We will report $20 million of monetary impact of unrecoverable questioned costs in our *Semiannual Report to Congress*.

The OIG considers all the recommendations significant, and therefore requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective actions are completed. These recommendations should not be closed in the Postal Service's follow-up tracking system until the OIG provides written confirmation that the recommendations can be closed.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Jody Troxclair, Director, Transportation, or me at (703) 248-2100.

E-Signed by Robert Batta
VERIFY authenticity with ApproveIt

Robert J. Batta
Deputy Assistant Inspector General
for Mission Operations

Attachment

cc: Patrick R. Donahoe
Joseph Corbett
Steven J. Forte
Samuel M. Pulcrano
Robert J. Pedersen
Bill Harris

APPENDIX A: ADDITIONAL INFORMATION

BACKGROUND

The Postal Service is one of the largest consumers of fuel in the United States, spending more than $2.3 billion on fuel for its transportation network during FY 2008. This increase is more than $500 million over FY 2007 fuel costs. The Postal Service uses more than 370 million gallons of fuel annually on highway surface transportation. Highway Contract Route (HCR) suppliers used approximately 230 million gallons of diesel fuel. Drivers of Postal Service-owned vehicles, including delivery, transportation, and administrative vehicles, use the remaining 140 million gallons.

The Postal Service has considered many of the industry best practices in the development of its fuel acquisition management program. (See Appendix D for the fuel acquisition best practices considered.) Since 1998, the Postal Service has been working on developing a fuel management framework to reduce the cost of acquiring fuel. For example, the Postal Service conducted a study in 1998 on a number of fuel acquisition and distribution strategies. The study focused on leveraging the Postal Service's market position as one on the nation's largest fuel consumers and achieving economies of scale by allowing the Postal Service to negotiate wholesale or "bulk" fuel purchase prices with the nation's major fuel suppliers.

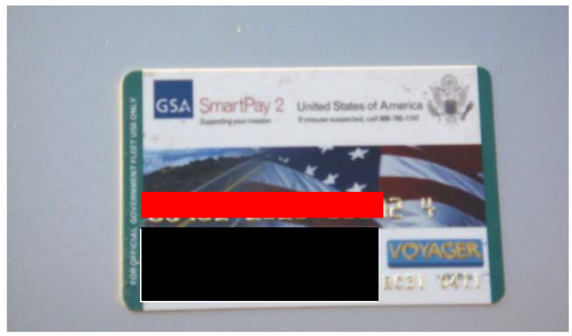
Subsequently, the Postal Service developed the Bulk Fuel Purchase Plan,[6] which they initiated 2 years later in September 2000. The plan included estimated annual savings of more than $18 million; however, only approximately $1 million in annual savings was realized. This was the result of control weaknesses, as reported by the U.S. Postal Service Office of Inspector General (OIG) and Government Accountability Office (GAO),[7] and implementation challenges resulting in limited participation by contractors. Specifically, GAO's May 2004 report concluded that some Postal Service supply chain management data was unreliable and savings calculations from some supply chain management initiatives were inaccurate or unverifiable. Additionally, the Postal Service had been unable to realize millions of dollars in potential savings, because the bulk fuel program experienced implementation problems in that only 600 of more than 17,000 highway routes were involved in the bulk fuel program nearly 4 years after implementation.

In their response to the GAO report, Postal Service management stated that the bulk fuel program presented a significant savings opportunity when compared to the reimbursement of individual contractors for retail purchases; and that they were developing a plan to expedite new wholesale fueling sites for highway contractors. However, less than 1 year later, the Postal Service began moving away from its efforts

[6] Highway transportation contractors, who own large trucking companies and who operated their own fuel storage and pumping facilities, would act as "host fuelers" for smaller contractors.
[7] Refer to the Prior Audits section for a listing and summary of these reports.

to move highway contractor fuel procurement to a wholesale environment because of implementation challenges with its Bulk Fuel Purchase Plan.

In March 2005, the Postal Service expanded its highway contractor retail fuel procurement by issuing Voyager Cards[8] to highway contractors. In its February 2007 report, the GAO concluded that the Postal Service was highly vulnerable to fuel price fluctuations in part because its fuel purchasing process involved buying fuel as needed at retail locations, and the Postal Service had incomplete data on its fuel procurement programs because it did not have effective systems to track or monitor fuel purchases.[9]



New U.S. Postal Service SmartPay2 Voyager Card issued to highway contractors.

The Postal Service's current fuel acquisition program for highway contractors is primarily based on the purchase of fuel at retail locations via the Voyager Card. The Voyager Card program provides more complete fuel spend data for analysis but also makes the Postal Service vulnerable to fuel price fluctuations. Recent efforts by the Postal Service are focused on moving the acquisition of fuel from indiscriminate retail purchasing through the development of a data-driven fuel strategy to promote efficiencies and realize cost savings. In January 2008, as part of its response to GAO's findings, the Postal Service undertook an extensive "spend analysis"[10] focused on analyzing the Voyager fuel data over a 2-year period to identify purchase patterns. The spend analysis resulted in the development of a four-pronged fuel strategy.

The fuel management acquisition strategy, design, development, planning, and policy are the responsibility of the headquarters Vice President, Supply Management. However, the nine Area Vice Presidents; Vice President, Network Operations, and Vice President, Delivery and Post Office Operations, have significant interface with Supply Management, and are responsible for ensuring successful implementation, including compliance and monitoring, of fuel management and acquisition policy. There is no

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[8] The Voyager Card is a financial instrument used like a credit card. It is used to fuel vehicles at more than 200,000 retail locations nationwide, and is administered under the government-wide General Services Administration SmartPay Program.

[9] The GAO audit work started in April 2006, which was the first partial year of the HCR Voyager program. Since that time, the Postal Service has gathered and assessed transactional data for two full fiscal years and has moved the HCR Voyager transactions to its Fuel Asset Management System (FAMS) database.

[10] The spend analysis provides information on who is buying fuel, the locations, and the cost, and it identifies the opportunities to leverage buying power.

single program accountability for overseeing both planning and implementation of the strategy.

In addition to the fuel strategy, the Postal Service took several steps in recent years to strengthen its fuel management framework in an effort to better control fuel costs and integrate its environmental activities. The steps taken include – establishing a centralized fuel management unit at headquarters (Transportation Asset Management) dedicated to fuel management and purchasing, and creating a vice president for Sustainability who oversees energy initiatives. The focus of energy initiatives is to lead the cross-functional efforts of the Postal Service to reduce energy consumption and costs while maintaining continuity of operations as outlined in the Postal Service's National Energy Management Strategy.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to assess the effectiveness of the Postal Service's fuel management initiatives in controlling fuel costs. This report focuses on planning and implementation of the fuel strategy.

To accomplish our objective, we interviewed Postal Service Headquarters' Network Operations, Supply Management, and energy initiatives officials to obtain an understanding of the fuel management program and its history. We reviewed the Postal Service's draft fuel strategy and supporting documentation to determine whether the listed opportunities were adequately developed, based on appropriate assumptions and data, and provided reasonable assurance of reducing fuel acquisition costs. However, we did not comprehensively audit the specific fuel purchasing techniques contained in the fuel strategy and are not reporting on the identified techniques at this time.

We researched best practices for implementing major projects and identified best practices for reducing fuel acquisition costs. We compared the best practices with the Postal Service initiatives to determine whether the Postal Service considered the practices in planning and implementing its fuel strategy and whether the Postal Service considered options, such as hedging, to reduce fuel acquisition costs. See Appendix D for the fuel acquisition best practices reviewed.

We conducted this review from May 2008 through August 2009, in accordance with the President's Council on Integrity and Efficiency, *Quality Standards for Inspections*. We relied on data obtained from Postal Service officials and data systems, including FAMS. We did not test controls over the Postal Service data systems used for the spend analysis. We performed limited data integrity reviews, including discussions with officials to support our reliance on the data. We discussed our observations and conclusions with management on June 5, 2009, and included their comments where appropriate.

PRIOR AUDIT COVERAGE

The OIG and the GAO have issued three reports addressing fuel management data challenges and control weaknesses in fuel program implementation.

Report Title	Report Number	Final Report Date	Report Results
Bulk Fuel Purchase Plan	TR-AR-01-004	July 27, 2001	The Postal Service lacked qualified personnel to manage a fuel purchase program; had an ineffective decentralized system of fuel acquisition, which lacked a centralized fuel management unit; had inadequate analysis of the economic and operational impacts of fuel related decisions; and lacked computer-based fuel tracking and monitoring systems to monitor fuel usage and cost.
Postal Service Progress in Implementing Supply Chain Management Initiatives	GAO-04-540	May 17, 2004	The Postal Service had mixed success in implementing various supply chain management initiatives. Regarding the bulk fuel program initiative, the Postal Service had been unable to realize millions of dollars in potential savings, because the program experienced implementation problems, including resistance from many highway contractors; setbacks in its plans to expand the number of bulk fuel delivery locations; and lack of an automated system to accurately capture fuel prices.
Vulnerability to Fluctuating Fuel Prices Requires Improved Tracking and Monitoring of Consumption Information	GAO-07-244	February 16, 2007	The Postal Service's actions to control fuel costs were generally consistent with industry procurement and consumption practices, but the Postal Service could improve in a couple of areas. First, the Postal Service was highly vulnerable to fuel price volatility, in part because its fuel purchasing process involved buying fuel as needed, particularly at retail locations. In addition, the Postal Service had incomplete data on its fuel procurement programs, because it did not have an effective system to track or monitor fuel use.

APPENDIX B: DETAILED ANALYSIS

Delays in National Fuel Purchasing Strategy Planning and Implementation

In 2008, the Postal Service took positive steps to develop a fuel strategy to promote efficiencies and realize cost savings in purchasing fuel. Postal Service Supply Management conducted comprehensive analyses of "fuel spend"[11] market price data to identifying cost savings opportunities. As a result of their analyses, four opportunities to reduce the cost of purchasing fuel were identified. (See Table 1.) The overall objective of the fuel strategy is to reduce fuel costs by shifting the purchase of fuel from indiscriminate retail locations to either bulk locations or "retail cost leaders."[12]

Table 1: National Fuel Purchasing Strategy Opportunities

Opportunity	Mission	Monetary Impact[13] (in millions)
1	Shift Postal Service retail spend to existing Postal Service bulk fuel sites.	$3 - 5
2	Shift HCR and Postal Service retail spend to existing HCR bulk fuel sites.	$1 - 2
3	Add new bulk tanks at select Postal Service facilities, and collaborate with other bulk providers to extend the bulk network in high consumption areas.	$7 - 10
4	Shift HCR and Postal Service retail spend to retail cost leaders.	$5 - 7

The Postal Service has not yet fully planned and implemented its fuel strategy, and none of the four opportunities have been initiated. The Postal Service has experienced numerous delays in planning and implementation since July 2008, its original target date for developing an implementation plan. As of April 2009, the Postal Service suspended the planning, testing, and implementation of the fuel strategy because of competing priorities and expects to resume their efforts in FY 2010. There are still many unanswered questions and further analysis and work is needed.

[11] "Fuel Spend" is the amount the Postal Service spends annually for diesel fuel and gasoline for its surface transportation as derived by Voyager Card transactions.
[12] Retail cost leaders are the lowest-cost retail merchants in the geographical area based on an analysis of retail petroleum pricing data from the Oil Price Information Service.
[13] Per the *Postal Service's National Fuel Purchasing Implementation Planning Status Update*, October 2008, figures are listed as per annum.

For example:

- Opportunity 1 was originally determined to be the easiest cost-savings option to implement, because the Postal Service believed that directing Postal Service vehicle assets to use Postal Service-owned fueling locations would require less maneuvering and implementation time than the other options. However, the Postal Service has not yet developed an adequate plan to implement this opportunity quickly.

- Opportunity 3 was determined to be the most difficult cost savings option to implement, because it involved installing new bulk tanks at Postal Service facilities. This option has been substantially restructured with a focus on contracting with third-party bulk tanks facilities.

- Opportunity 4 requires the highest level of negotiations and cooperation from all operational groups, and a high-level of continuous monitoring. However, the Postal Service has not yet undertaken the necessary steps required to achieve support for implementation and monitoring at the facility level.

Further, the Postal Service has not yet assigned adequate accountability and oversight with appropriate cross-functional authority over both planning and implementation of its fuel strategy. Additionally, they have not yet allocated adequate resources to the project and are not following a rigorous and disciplined project management and risk mitigation approach to implementation. The Postal Service also has not tied the success of the fuel strategy to performance goals.

A review of best practices found that the success of any strategic project or initiative depends on appropriate planning and implementation. By applying accepted best practices at both stages, the Postal Service will mitigate its risks and increase the likelihood of success. See Appendix C for a summary of major strategy planning and implementation best practices,[14] which should be considered by the Postal Service. Using these best practices, we found that in planning and implementing their fuel strategy, the Postal Service has not yet fully addressed the issues and concerns that follow.

No Implementation Plan – The Postal Service did not have a sound implementation plan with time certain target dates. For example, most of the savings opportunities will involve negotiations and the finalization of agreements and HCR contracts, which will require time for area and headquarters staff to complete. Time-sensitive target dates would assist in ensuring the agreements and HCR contracts are completed on time.

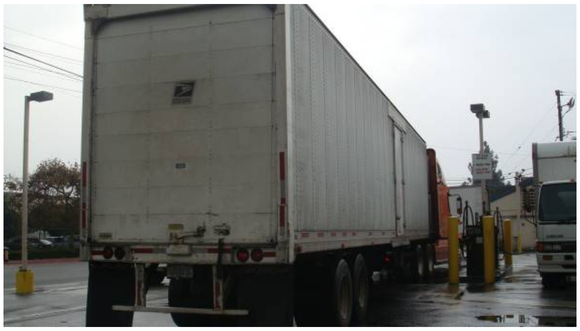
[14] We benchmarked government agencies, private companies, and academic institutions to identify best practices for planning and implementing strategic initiatives. The best practices contained herein were drawn from several audit reports and internal control documents issued by the GAO, as well as documents issued by the Audit Director Roundtable and Postal Service.

Operational Factors and Other Considerations – The fuel strategy is primarily based on the analysis of spending patterns, and the Postal Service has not yet considered all operational factors, requirements, and obstacles. For example,

- The Postal Service has not conducted an operational assessment with regard to shifting retail spends to bulk sites to determine whether Postal Service and HCR bulk fuel sites can accommodate the additional fuel volume and vehicles.

Postal Service highway contractor driver fueling at a retail fuel location located in City of Industry, CA.

December 22, 2008



- The Postal Service has not conducted an assessment of HCR bulk contractors' willingness to be a "host" site and allow other postal HCR contractors to obtain fuel at their sites. Further, controls and contract provisions may be required to ensure participation in the HCR bulk fuel program.

Involvement of Relevant Organizational Components – The Postal Service has not yet identified and fully engaged all appropriate operational personnel at headquarters (Network Operations and Delivery Operations) and at the areas and districts. These resources include Information Technology resources to maintain the various data systems and to run the data and generate scorecards; headquarters and area resources to draft and negotiate the necessary agreements and contracts; and area and local resources to monitor operational and HCR compliance and impact.

Other Major Project Risks and Concerns – We also identified a number of other project risks and concerns that should be addressed in moving forward with the fuel strategy.

- Before retail spend is switched to retail cost leaders, the Postal Service should actively communicate and negotiate additional discounts based on the confirmed increased gallon totals.

- Most of the savings opportunities will involve negotiations and the finalization of agreements and HCR contracts, which will require significant resources and time to complete.

- The installation of additional bulk tanks at selected Postal Service facilities would require the assessment of federal and state environmental and regulatory requirements, as well as a capital investment analysis and approval. This will require close coordination and communication with regulatory agencies.

- The Postal Service's preliminary savings for the four opportunities may include vehicles and/or contractors under more than one opportunity. Precautionary measures should be established to avoid double-counting and duplication of reported savings among the four opportunities.

- Pricing and spend data may become obsolete given the time needed to implement the fuel strategy. As such, any reported savings should be based on timely pricing information and spend data to ensure that dramatic increases/decreases in fuel pricing are not inadvertently captured as strategy-realized savings.

Compliance and Monitoring – We found the Postal Service has not yet developed a plan to establish accountability for headquarters, area, and plant officials, as appropriate. For example, to enhance monitoring, the Postal Service is considering the development of a "scorecard" for contractor and Postal Service vehicles, which would measure actual fuel costs against a geographical mean. Although the scorecards will help ensure "best value" purchases of fuel, they will require significant local resources and will depend heavily on accurate and current cost and pricing data, regular monitoring, the follow-up on identified outliers and timely corrective action. The Postal Service must provide the necessary tools and resources required for the successful deployment of the scorecard program.

As a result, although the planning for the fuel strategy began in January 2008, as of June 2009, the strategy has not yet been implemented and savings have not yet been realized. The Postal Service has incurred about $20 million in unnecessary fuel acquisition costs since June 2008 and is missing an opportunity to save approximately $20 million annually.

Other Matters – Fuel Purchase Risk Management – Hedging

The Postal Service did not include fuel hedging as part of its overall fuel strategy to help control the volatility of fuel costs. Management stated they continue to explore the fuel hedging option and are developing a hedging infrastructure; however, they have not yet decided to actively engage in hedging as part of their overall fuel management strategy.

Before the Postal Service can engage in hedging, it must have a well developed hedging infrastructure in place to support hedging. A hedging infrastructure would include the development of policies and procedures; establishment of financial controls; determination of applicable hedging accounting practices; assessment of required resources and expertise; drafting of agreements; and obtaining the proper delegations and authorizations. An adequate hedging infrastructure will provide the Postal Service with the capability to hedge if they decide to engage in hedging.

The price of petroleum has been extremely volatile recently, and fuel price increases can significantly impact the Postal Service's expenses and financial results. Following is a sampling of the average nationwide fuel prices since January 2007, showing the volatility in the marketplace:

Table 2: Average Monthly Price Per Gallon – Nationwide Retail Cost[15]

Effective Period	Gasoline (Regular)	Diesel Fuel
January 2007	$2.240	$2.485
July 2007	2.965	2.868
January 2008	3.043	3.308
July 2008	4.062	4.703
January 2009	1.788	2.292
March 2009	1.959	2.092

The goal of hedging is to create a more stable cost structure of purchasing fuel and to improve financial planning, and hedging is one tool to help control costs during volatile periods. Hedging has been more prevalent in the airline industry over the last 20 years. However, as the price for petroleum has fluctuated significantly in recent years, trucking companies and other businesses heavily dependent on fuel have developed fuel hedging strategies to improve their financial planning and manage costs and volatility associated with fuel costs. Additionally, the recent increase in fuel costs have brought about significant fuel surcharges from fuel-dependent industries, such as shipping companies like FedEx and United Parcel Service, and commercial airlines and trucking companies, enabling them to mitigate their risks and pass on increased fuel costs to their customers. However, because of the Postal Service's operational environment, it cannot directly pass on these increased fuel costs to its customers. The exception is the Postal Service's shipping services products, which is a small component of its operations.

There are various hedging techniques the Postal Service may want to consider to better manage its risk and protect it against these dramatic price fluctuations. For example, the Postal Service can hedge against the risk of potential price increases by locking in a predetermined pricing structure for future fuel purchases. However, hedging can be very risky, speculative, and costly, and certain hedging vehicles may require investment-grade credit and significant transaction costs.

[15] Retail prices were obtained from the U. S. Department of Energy, Energy Information Administration (EIA). The pricing data represents national monthly retail prices for Number 2 diesel fuel and regular gasoline.

Further, a hedged entity could potentially pay more if fuel prices decrease as was the case within the past 15 months (see preceding table). For example, an entity could have hedged against future price increases in January 2008 when the price of gasoline increased to $3.04 per gallon by locking in future fuel purchases at $3.50 per gallon. However, because the market price of gasoline decreased to $1.79 per gallon in January 2009, the hedging strategy would have proven to be more costly, given the significant drop in price.

Although hedging involves risks, we agree that the Postal Service should consider incorporating hedging into its comprehensive fuel management framework by:

- Continuing to evaluate the viability of hedging;
- Developing an infrastructure to support the implementation of hedging; and
- Considering designing and implementing, a fuel hedging management program that will manage the risks of hedging against fluctuating fuel costs and improve the Postal Service financial planning efforts.

APPENDIX C: STRATEGY PLANNING AND IMPLEMENTATION BEST PRACTICES[16]

Planning Phase
Identify all organizational stakeholders from all levels and locations and include them early in the process to identify all concerns, and adjust strategies based on stakeholder input.
Form cross-functional and cross-organizational teams consisting of people with the required competencies and authority.
Develop a documented project plan to manage and control the project's implementation, including requirements, resources needed, goals, performance measures and baselines, target dates, risks and mitigation measures, and responsibilities.
Provide for the plan to be flexible and dynamic, requiring periodic reviews and revisions based on operational concerns, lessons learned, changes in the marketplace, and so forth.
Assess risks, including organizational-culture risks.
Identify risk mitigation measures regarding the implementation schedule, compliance, and project failure.
Develop cost savings estimates that are comprehensive to all expenses, firm for goal setting, and reasonable.
Use baselines to establish a cost and volume fuel variance reporting system, so results can be compared for performance.
Thoroughly document all elements of the project plan and periodically update and communicate them to all stakeholders.
Conduct an operations test in a geographic area representative of the operational environment expected during roll-out.

Implementation Phase
Encourage continued support from all organizational stakeholders with an emphasis on senior leadership and address resistance to change within the organization and with vendors.
Encourage organizational-wide ownership.
Include training for headquarters, area and plant managers, staff, and HCR contractors.
Establish or revise policies and procedures that support the fuel initiatives.
Implementation status must be monitored regularly and the plan adjusted as needed.
Measure project success through performance goals.
Enforce accountability to goals and timelines, and link project success to personnel performance.
Provide for post-implementation monitoring of results and tracking of results against the plan.
Any reported cost savings through variances must be reasonable, validated, and documented.
Communicate correct detail of results in a timely manner to the proper stakeholders, and address what is working and what is not working as well as was expected.
Provide for the continuous improvement of the strategy.

[16] We benchmarked government agencies, private companies, and academic institutions to identify best practices for planning and implementing strategic initiatives. The best practices contained herein were drawn from several audit reports and internal control documents issued by the GAO, as well as documents issued by the Audit Director Roundtable and Postal Service.

APPENDIX D: FUEL ACQUISITION BEST PRACTICES[17]

FUEL MANAGEMENT TOOLS[18]
Develop and implement a fuel buying plan.
Appoint a fuel manager.
Centralize fuel procurement.
Purchase wholesale (bulk) fuel.
Install on-site fuel tanks.
Implement on-site wet hosing (mobile re-fueling).
Track purchases with a fuel card.
Negotiate discounts and rebates with fuel card companies.
Perform market price analysis using current technology.
Negotiate price with suppliers.
Research and transition to alternative fuels.[19]
Apply customer fuel surcharges.[20]
Develop a hedging (risk management) plan.[21]

[17] We identified the industry best practices to manage fuel acquisition costs based on our extensive research and benchmarking efforts of other government agencies and private companies. All of these industry practices are situational and depend on an organization's operations, structure, and the size and dispersion of its fleet.
[18] An organization should consider all associated risks and impacts of each practice, including environmental, financial, and operational risks, in the development of its overall fuel management plan. The viability of each option or degree to which implemented will change as an organization's risks change, and an organization must continually evaluate the appropriate mix of these tools as part of its comprehensive fuel management framework. Except as noted below, we found that the Postal Service considered these best practices in the development of its fuel acquisition management program.
[19] The Postal Service operates a large alternative fuel-capable fleet and has embarked on a variety of initiatives to further lessen its dependence on fossil fuels.
[20] As discussed in Other Matters above, the Postal Service does not have the authority to impose fuel surcharges on its customers the way private companies directly pass fuel costs on to their customers.
[21] The Postal Service continues to explore the fuel hedging option and is developing a hedging infrastructure but has not yet decided to actively engage in hedging as discussed under Other Matters in this report.

APPENDIX E: MANAGEMENT'S COMMENTS

UNITED STATES POSTAL SERVICE

July 23, 2009

LUCINE M. WILLIS

SUBJECT: Draft Management Advisory – Fuel Management Initiatives for Surface Network Operations – Fuel Purchasing Strategy (Report Number NL-MA-09-DRAFT)

Thank you for the opportunity to review and comment on the subject management advisory report. Management agrees with Recommendations 1 through 5 of the report. As was noted within the report, the Postal Service has been fully engaged in implementing several strategies; such as, carrier route adjustments, vehicle reduction planning, and network consolidation, which were resource intensive and had a significant financial benefit to the Postal Service. Therefore, this fuel management strategy became a lower priority for the organization as a whole. That is not to say there is no opportunity, but the Postal Service must expend its limited resources where the risks are lower and the financial benefit is greater. We will work together to ensure these "last mile" fuel strategies are reconsidered and prioritized. With regards to the impact, we disagree with the monetary impact of $20 million unrecoverable questioned costs, and approximately $20 million annually in missed opportunity. The section on Hedging will not be addressed in this response, since there are no recommendations and it would not fall under the authority of the addressed Vice Presidents.

Monetary Impact: The estimated monetary impact, although based on detailed analysis, was just that, an analysis, designed to provide senior management a sense of the financial potential of further expansion of the Postal Service's Fuel Purchasing/Delivery Strategy. Within the strategy, Supply Management provided a preliminary estimate of a potential savings range of $16 to $24 million annually. The OIG's report stated that this "data-driven fuel strategy to promote increased efficiency and cost reduction for the Postal Service" is lacking when considering "operational factors and all the relevant organization components including contracting, operations, and financial personnel." Nor does the strategy consider "major project risks and concerns." Further, we should note that the $16 to $24 million annually, is only valid if all four opportunities are fully implemented and the end users are fully compliant. It also does not take into account all costs associated in implementing the strategy, and does not define the length of time for fully implementing all the opportunities within the strategy which would potentially change the annual savings ranges. Therefore, since these figures are only preliminary estimates of potential savings, we disagree with the monetary impact associated with this report, and request that the OIG not report this information in the Semi-Annual Report to Congress.

The OIG recommended that the Vice President, Supply Management; Acting Vice President, Network Operations; and Acting Vice President, Delivery and Post Office Operations; coordinate to:

Recommendation 1: Assign appropriate accountability and cross-functional authority for the planning, implementation, and success of the National Fuel Purchasing Strategy; and provide adequate support from the appropriate headquarters' functional areas and the nine Postal Service geographical areas.

475 L'ENFANT PLAZA SW
WASHINGTON DC 20260

Management Response: We agree that the four opportunities under the National Fuel Purchasing Strategy have potential savings for the Postal Service. The Vice President, Supply Management; Acting Vice, President Network Operations; and Acting Vice President, Delivery and Post Office Operations will assume the role of champions for this strategy and agree to meet in order to review the strategy, prioritize the four opportunities, and discuss the issues of accountability and authority. This meeting will be scheduled by the Vice President, Supply Management no later than September 2009.

Recommendation 2: Ensure appropriate allocation of contracting, operational, and financial resources at all levels to support the timely implementation of the National Fuel Purchasing Strategy.

Management Response: Although the Postal Service agrees with this recommendation, the assignment of additional resources must be accomplished consistent with other competing priorities and in the light of our current financial situation. This initiative will be reviewed as part of our goal setting process for fiscal year 2010.

Recommendation 3: Ensure adequate consideration of project management principles and best practices outlined in Appendix C in planning and implementing the National Fuel Purchasing Strategy, including development of project management plan, which includes project goals, performance measures, baselines and target dates, changes to target dates, and documented reasons for changes.

Management Response: We agree that project management principles and the best practices presented in the OIG's report in Appendix C are of value and will be considered for use during the development of the implementation plan(s). In fact, as we reviewed the referenced list of planning and implementation best practices in Appendix C of the report, we were glad to see that we already use many of these best practices as part of our standard business processes. As additional plans are developed for this strategy they will be made available to the OIG as a courtesy. Target date for the establishment of plans for the implementation of any of the opportunities under the strategy is June 2010.

Recommendation 4: Develop a risk mitigation plan to address major project risks to help achieve stated goals of the National Fuel Purchasing Strategy.

Management Response: Risk mitigation plans add value to the overall implementation of the strategy and will be included as the organizations work through the planning efforts. For the purpose of establishing completion times, we believe this recommendation coincides with the efforts in recommendation 3, above. A risk mitigation plan(s) is targeted for completion by June 2010

Recommendation 5: Develop measurement factors to monitor achievement of the stated goals of the National Fuel Purchasing Strategy, and consider including these factors as part of the National Performance Assessment plan as appropriate.

Management Response: As the planning effort evolves with this strategy, measurement factors will be developed to assist in determining whether the estimated savings are achieved. Including the factors in the National Performance Assessment plan will be reviewed as an option to assist with compliance and achieving savings. This will be considered during the planning stages targeted for June 2010.

We believe that this report contains proprietary or business information and may not be disclosed, in its entirety, pursuant to the Freedom of Information Act. Exemption 3 (5 U.S.C. 552(b)(3)) applies to information that is exempt from disclosure under another federal statute. As noted in 39 U.S.C. 410(c)(2), we contend that this strategy (record) is information of a commercial nature, including trade secrets, whether or not obtained from a person outside the Postal Service, which

3

under good business practice would not be disclosed. The release of the record would be of potential benefit to firms in economic competition with the Postal Service and could materially increase procurement costs. Also, Exemption 5 (5 U.S.C 552(b)(5)) applies to interagency or internal information, such as, drafts, internal proposals, estimates, statements of opinion, analysis, etc., where the deliberative process privilege permits withholding of predecisional information. If you have any questions about this response, please contact Susan Witt at (202) 268-4833.

Susan M. Brownell

Susan M. Brownell
Vice President, Supply Management

Jordan M. Small
Acting Vice President, Network Operations

Linda J. Welch

Linda J. Welch
Acting Vice President, Delivery and Post Office Operations

cc: Patrick R. Donahoe
Joseph Corbett
William P. Galligan
Robert J. Pedersen
Samuel M. Pulcrano
Katherine S. Banks