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PATRICK R. DONAHOE
CHIEF OPERATING OFFICER
AND EXECUTIVE VICE PRESIDENT

SUBJECT: Audit Report – Transition Planning for the Priority Mail Processing Center Network (Report Number MK-AR-01-003)

This report presents the results of our audit of the Priority Mail Processing Center Network transition planning conducted at the request of the Board of Governors (Project Number C0NA016MK000). The original audit objectives were to review the planning process for network transition and to assess the operational impact of the transition. During the course of the audit, we refined the objectives to determine whether planning was adequate to successfully transition network operations from the contractor to the Postal Service, and assess the reasonableness of projected savings.

The audit revealed transition planning for the Priority Mail Processing Center Network was generally adequate. However, opportunities to improve the transition planning process were identified in the areas of facilities, processing equipment, staffing, transportation, and cost reporting. Recommendations were provided to Postal Service officials during the course of the audit. Postal Service management generally agreed with our recommendations and took corrective actions during the audit.

This report does not contain recommendations and management was given the opportunity to comment but no comments were received. We appreciate the cooperation and courtesies provided by your staff during the review. If you have any questions or need additional information, please contact Larry Chisley, director, at (703) 248-2100, or me at (703) 248-2300.

Robert L. Emmons
Assistant Inspector General
for eBusiness

Attachment

cc: John R. Gunnels

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EXECUTIVE SUMMARY

Introduction

In response to a request from the Board of Governors, the Office of Inspector General (OIG) initiated an audit of the Priority Mail Processing Center Network transition planning. We conducted the audit to determine if the planning process ensured the network transition protected the interests of the Postal Service. In addition, we evaluated the potential impact of the transition plan on Postal Service operations. During the course of the audit, we refined the objectives to determine whether planning was adequate to successfully transition network operations from the contractor to the Postal Service, and assess the reasonableness of projected savings.

In addressing our first objective we focused on facilities, processing equipment, staffing, and transportation plans. In the second objective, the impact of the plan was determined by the adequacy of management's planning and the cost of the transition.

Results in Brief

Transition planning for the Priority Mail Processing Center Network was generally adequate. Plans for leased facilities, processing equipment, proposed staffing, and transportation were generally sufficient to continue operations. However, we noted the following improvements were needed in transition planning and provided our recommendations to the Postal Service:

- Environmental transaction screenings for leased commercial real estate had not been performed, placing Postal Service employees in potentially unsafe working conditions carrying legal, financial, and operational consequences.
- The Postal Service's test evaluation and quality staff was not included in plans for testing the integration of equipment used by the Postal Service and the contractor to manifest Priority Mail to the airlines, a potential for service disruption existed if the contractor's equipment did not effectively interface with Postal Service systems.
- Security screenings performed by the contractor were not adequate. A postal Inspection Service audit

report issued in October 1999, determined the contractor's preemployment screenings did not meet contract requirements, causing a potential security risk to Postal Service operations.

- Existing resources at airport mail centers were potentially inadequate to effectively process Priority Mail Processing Center Network mail along with the existing mail volume.

Postal Service management generally agreed with our recommendations and took corrective actions during the audit.

- Environmental transaction screenings for the leased commercial real estate were performed.
- The Postal Service's test evaluation and quality staff was included in testing the integration of equipment used to manifest Priority Mail to the airlines.
- Postal Service management modified the security screening process to ensure the problems identified in the Inspection Service's report were corrected.
- The Postal Service agreed and indicated that the Priority Mail would be tendered directly to the airlines.

Our audit also disclosed that projected savings were not adequately disclosed. The inclusion of anticipated contractor payments, as savings in the draft Decision Analysis Report did not clearly state the cost of assuming network operations to the Postal Service. Postal Service management agreed and added narrative information to clarify the inclusion of contractor payments in the Decision Analysis Report.

INTRODUCTION

Background

In March 1996, the Board of Governors approved a pilot project for the implementation of a network of ten Priority Mail Processing Centers. Under the terms of the contract, the contractor was responsible for providing a time definite 2 day Priority Mail Processing Center Network within the Northeastern and Southeastern portions of the United States. The contractor began network operations in August 1997, with the opening of the first Priority Mail Processing Center in Miami, Florida.

Differences arose between the contractor and the Postal Service over compensation under the contract. The contractor's proposed rate was 40 percent higher than the Postal Service's estimate, potentially impacting the Priority Mail rate structure. Differences continued despite numerous attempts to negotiate adjustments in contract prices.

As a result, management believed an early end to the contract would limit the Postal Service's financial exposure and decided to negotiate a termination agreement to end the contract. The Board of Governors subsequently approved the settlement and contract termination costs. The negotiated termination agreement was reached on November 3, 2000. Costs related to the termination of the existing contract and provisions covering the Postal Service's assumption of portions of the Priority Mail Processing Center Network infrastructure were defined in the agreement.

Objectives, Scope, and Methodology

The original audit objectives were to (1) determine if the planning process protected the interest of the Postal Service, and (2) evaluate the potential impact of the transition plan on Postal Service operations. During the course of the audit, we refined them to (1) determine whether planning was adequate to successfully transition network operations from the contractor to the Postal Service, and (2) assess the reasonableness of projected savings. In addressing the first objective, we focused on management's plans for facilities, equipment, staffing, and transportation. To address the second objective, we

evaluated the impact of the plan by determining the adequacy of management's planning and the cost of the transition.

We reviewed numerous internal documents and reports relating to the Priority Mail Processing Center Network. We interviewed Postal Service officials at headquarters, area offices, and each of the ten Priority Mail Processing Center locations. In addition, we reviewed the Priority Mail Processing Center Network – Transition from Contractor to Postal Service Decision Analysis Report and its supporting documentation.

The audit was conducted from September 2000 through September 2001 in accordance with generally accepted government auditing standards and included such tests of internal controls, as were considered necessary under the circumstances. We discussed our conclusions and observations with appropriate management officials and included their comments, where appropriate.

Prior Audit Coverage

In our September 1999, Office of Inspector General report, Priority Mail Processing Center Network, (Report Number DA-AR-99-001), we concluded that Priority Mail processed through the network cost 23 percent more than Priority Mail processed by the Postal Service without a network and that the Priority Mail Processing Center Network was not meeting overall delivery rate goals. We also found that neither network personnel nor the contractor were responding in a timely and substantive manner to repetitive operational problems. In addition, there were opportunities to reduce network cost for commercial air transportation and fuel procurement.

Management generally agreed with our recommendations. However, management pointed out that differences of opinion remain on some of the findings in the report. In addition, officials pointed out that the Priority Mail Processing Center Network was audited during its pilot

phase, and that many of the findings and recommendations in the report may be premature.

In October 1999, the Postal Inspection Service completed a personnel security review of the Priority Mail Processing Center Networks, (Case Number 952-291970-PS(1)). The review found problems with the scope of background checks and that prior employment checks were not always done. The Postal Inspection Service believed the contracting officer would work with the contractor to resolve the identified problems.

AUDIT RESULTS

Transition Planning was Generally Adequate

We concluded transition planning for leased facilities, processing equipment, staffing, and transportation was generally adequate. However, we identified several improvements that were needed, which have subsequently been addressed by Postal Service management.

Plans for Leased Facilities Adequate but Environmental Screening Not Performed

The Postal Service planned to assume leases for the ten facilities used by the contractor.¹ Our review indicated the facilities generally provided adequate space to meet the current needs of the transition. Area personnel had considered the incorporation of complementary workflow and the introduction of additional mail processing equipment in some facilities. In addition, Postal Service officials considered the relocation of some facilities due to location, cost, or volume considerations. Planning in this area was generally adequate.

However, there was an opportunity to protect the interest of the Postal Service through the completion of facility environmental assessments. We determined that required environmental transaction screening for leased commercial real estate had not been performed. An environmental screening is designed to assess environmental conditions associated with a property. Failure to perform these screenings could potentially place Postal Service employees in unsafe working conditions and could have legal, financial, and operational consequences.

Facilities Environmental Guide Handbook RE-6 and National Environmental Policy Act Operational Guidance Management Instruction AS-550-96-4 provides policy and guidance for facilities-related activities. They include guidance for environmental screenings and provide an environmental checklist that must be completed for the "creation, relocation or increase of 100 or more employees at any one Postal Service facility." In addition, the guidance suggests certain headquarters actions such as the "implementation of a new network of mail processing or sorting centers" may require an environmental assessment.

¹ The Priority Mail Processing Centers are located in Bethpage, New York; Jacksonville, Florida; Kearny, New Jersey; Miami, Florida; Nashua, New Hampshire; Orlando, Florida; Rochester, New York; Springfield, Massachusetts; Swedesboro, New Jersey; and Warrendale, Pennsylvania.

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During the audit, the environmental screening process had not been completed. We recommended that Facilities personnel ensure the Postal Service complete the required environmental transaction screening for each leased facility before assuming control. Management agreed and conducted environmental transaction screenings before assuming control of the facilities.

Processing Equipment Plans Adequate but Not Tested

Transition plans included the retention of sortation equipment, the installation of new equipment, equipment maintenance, and the development of contingency plans. Plans also included integration testing of the contractor's Commercial Air Routing and Tagging System and Postal Service equipment used to manifest mail to commercial airlines.

However, equipment integration test plans did not include participation by the Postal Service's Test Evaluation and Quality staff that manages testing and evaluation for the Postal Service. A key component of their mission is equipment testing and failure analysis. The Test Evaluation and Quality staff were not included because the transition team intended to conduct and evaluate the integration test.

We recommended that the Test Evaluation and Quality group be assigned the responsibility for testing and evaluation of the integration of the contractor's Commercial Air Routing and Tagging System. Postal Service management agreed and the Test Evaluation and Quality group was included in the integration testing.

Staffing Plans Complete but Security Screening Inadequate

Staffing plans for the network transition were generally adequate. The transition team sought input and concurrence from each of the Postal Service areas and functional experts within Postal Service Headquarters to ensure that staffing levels at the Priority Mail Processing Centers were sufficient and did not adversely impact the transition.

Staffing plans also included cost data associated with the hiring and training of contractor employees and the placing of Postal Service Human Resources staff members at each processing center to assist in employee transition.

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However, staffing plans relied on personnel security screenings performed by the contractor and the successful recruitment of contractor employees. Contractor security screenings would be used during the hiring process in lieu of the Postal Service conducting new background investigations. The Postal Inspection Service's October 1999 audit report disclosed that the contractor's preemployment screenings of applicants did not meet contract requirements. The contractor's security screening problems included problems with the scope of criminal checks, incomplete reviews of criminal information, missing employee files, incomplete documentation, and screenings required for rehires. Therefore, the Postal Service could not rely on security screenings by the contractor to determine whether an applicant posed a potential security risk to Postal Service operations.

We recommended that Human Resources take the necessary action to ensure the security screening problems identified in the Inspection Service's report were corrected. Postal Service management agreed and modified the screening process during the course of the audit.

**Transportation
Adequate but
Insufficient Capacity at
Airport Mail Centers**

Transportation planning for the Priority Mail Processing Center Network was generally adequate. The transition team generally sought to duplicate the contractor's existing transportation network in an attempt to avoid service delays and minimize the impact on the Postal Service. In addition, the Postal Service identified costs for air and surface transportation.

The audit also determined the tendering of Priority Mail Processing Center Network mail for commercial air transportation through Postal Service airport mail centers could impact delivery service. Mail volume estimates prepared by the Postal Service showed that mail volume from the Priority Mail Processing Center Network exceeded 216 million pounds in fiscal year 2000. As a result, airport mail centers might not have the space necessary to service this volume along with existing workload. Postal Service officials at the headquarters, area, and local levels agreed Postal Service airport mail centers were potentially space deficient.

In the past, the contractor tendered mail from the Priority Mail Processing Center Network directly to commercial airline freight houses for transportation. As a result, we recommended the senior vice president Operations, should ensure Postal Service Headquarters Transportation, coordinates with the impacted national areas to resolve the direct tendering of Priority Mail from network operations to commercial airlines. Postal Service management agreed and indicated that headquarters and area personnel would work with the airlines to have network mail sent directly to the airlines.

**Projected Savings
were Overstated**

The draft Decision Analysis Report for the network transition contained a cash flow statement that included an estimate for investment costs and operating variances. The cash flow presented anticipated contractor payments in the operating variances portion of the Decision Analysis Report as program related savings.

Although the anticipated contractor costs are included in the Decision Analysis Report cash flow, the Postal Service will not truly realize payment savings from the network transition because the Postal Service assumes the cost of operating the entire network.

The inclusion of anticipated contractor payments as savings in the draft Decision Analysis Report did not clearly identify the cost of network operations. The net present value of the Postal Service network was a negative \$623 million if anticipated contractor payments were included as savings. However, if anticipated contractor payments were excluded, the net present value of the network transition would be a negative \$4.4 billion.

Therefore, we recommended the manager, Capital Program and Evaluation, include additional language in the Decision Analysis Report narrative to clarify the financial impact of the network transition to the Postal Service. Postal Service management agreed and added narrative information to clarify the inclusion of contractor payments in the Decision Analysis Report.

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