August 8, 2001

PAUL E. VOGEL
VICE PRESIDENT, NETWORK OPERATIONS MANAGEMENT

SUBJECT: Management Advisory Report – Interim Audit Results on [redacted] FedEx Transportation Agreement (Report Number TR-MA-01-002)

This management advisory is the second interim report on the preliminary results of our ongoing audit of the FedEx transportation agreement (Project Number 01NR008TR000). The report responds to a request from you as the vice president, Network Operations Management, and addresses the reasonableness of anticipated cost savings. The Office of Inspector General (OIG) is continuing to independently test the reasonableness of Postal Service assumptions underlying the projected costs and savings that will be incurred under the FedEx transportation agreement. As we previously indicated at the Board of Governors' meetings on May 7, and 15, 2001, and in our May 14, 2001, draft letter advisory report (TR-LA-01-001), we would advise Postal Service management and the Board of Governors of significant issues and findings as they developed.

Results in Brief

We believe the projected savings of $1.3 billion over 7 years [redacted]

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new information from the Postal Service on offsetting savings, which we plan to analyze in completing our audit. Management's comments in their entirety are included in the appendix of this report.

Background

On January 10, 2001, the Postal Service signed a 7-year transportation agreement with FedEx for $6.3 billion to provide integrated, nationwide air delivery of Priority Mail, Express Mail, and First-Class Mail. This transportation agreement anticipates that FedEx will provide approximately 3.5 million pounds of air delivery capacity every day starting in late August 2001. The Postal Service states the transportation agreement will provide solid service, delivery predictability, and achieve cost reductions with a stable and strong financial service provider.

The Postal Service currently uses five separate dedicated networks operated by a number of air cargo service providers and the Air Systems Contract with commercial airlines to provide air delivery for mail. Based on existing provider financial stability, aircraft fleet profile, and historical service, the Postal Service has concluded that continuing with the existing air delivery arrangements may lead to difficulty in meeting service objectives and unacceptable future cost risk.

Either party can terminate the transportation agreement for convenience with predetermined termination fees. [redacted]

Objectives, Scope, and Methodology

The audit objectives were to assess (1) the reasonableness of anticipated costs savings, (2) the reasonableness of anticipated service improvement, and (3) the risks associated with the agreement. This report addresses the reasonableness of anticipated cost savings. In determining the reasonableness of cost savings we have reviewed the cost and savings model and its associated assumptions.

This audit is ongoing and is conducted 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.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]	[redacted]
Recommendation	The vice president, Network Operations Management, should request that the vice president, Finance, controller: 1. [redacted]
Management's Comments	Management agreed [redacted] However, management indicated that [redacted] Management also disagreed that [redacted] Despite their disagreements with our findings, management concurred with the recommendation and agreed [redacted]
Evaluation of Management's Comments	Management's concurrence with the recommendation is responsive. However, their disagreement [redacted] made subsequent to our review, which cannot be substantiated. Further, management has not provided information to support their [redacted] In fact, during this phase of the audit, management indicated [redacted]

[redacted] Management has also not provided support for its assertion [redacted]

If you have any questions, please contact me at (703) 248-2300.

Debra S. Ritt
Assistant Inspector General for
Business Operations

cc: [redacted]

APPENDIX. MANAGEMENT'S COMMENTS

PAUL E. VOGEL
VICE PRESIDENT, NETWORK OPERATIONS MANAGEMENT

UNITED STATES POSTAL SERVICE

July 20, 2001

DEBRA RITT

SUBJECT: Draft Management Advisory
Interim Audit Results of FedEx Transportation Agreement (June 20, 2001)
(Report Number TR-MA-01-DRAFT)

Thank you for the above-referenced interim audit. We concur with your assessment that the report's contents are "preliminary," and therefore, are subject to change as additional data is provided to the OIG. We also concur in your preliminary conclusion [redacted] We will continue our review of this data and work with the OIG to resolve any differences. We plan to share our updated savings analysis with the OIG and BOG as soon as it is finalized.

[redacted] We anticipate that additional operational changes may occur as we learn from our experience in implementing the transportation agreement.

The draft OIG report concludes with the following recommendation:

> *"The vice president, Network Operations Management should request the vice president, Finance, controller, to:*
>
> 1. [redacted]

I concur with this recommendation. [redacted]

Paul E. Vogel

cc: [redacted]

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