October 31, 2000

PAUL E. VOGEL, JR.
VICE PRESIDENT, NETWORK OPERATIONS MANAGEMENT

J. PAUL SEEHAVER
EXECUTIVE DIRECTOR, MAIL TRANSPORT EQUIPMENT
SERVICE CENTER PROGRAM

SUBJECT: Audit Report - Adequacy of Mail Transport Equipment Center Network Internal Controls (Report Number TR-AR-01-001)

This report presents results from our audit of the Mail Transport Equipment Service Center Network. This is the second in a series of reports and focuses on network internal controls. The audit responds to a request from the Board of Governors.

Our audit revealed that equipment was invoiced as processed when work was not performed; that containers were reported as repaired when no repairs were made; that serviceable equipment was improperly condemned and discarded; and that these deficiencies were caused by inadequate separation of duties, insufficient record keeping, and insufficient quality assurance. The report provided four recommendations to correct deficiencies. Management agreed with all our findings and recommendations, and we believe their actions, taken or planned, should correct the issues identified. Management's comments and our evaluation of their comments are included in the report.

We appreciate the cooperation and courtesies provided by your staff during the audit. If you have any questions or need additional information, please contact Joseph Oliva, director, Transportation, at (703) 248-2317 or me at (703) 248-2300.

Debra S. Ritt
Assistant Inspector General
for Business Operations

Attachment

cc: Anthony M. Pajunas
John R. Gunnels

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EXECUTIVE SUMMARY

Introduction

The mail transport equipment service center network is a centrally managed logistical system of 22 contractor operated equipment service centers with dedicated transportation. It is designed to supply Postal Service mail processing facilities—and certain large customers—with mailbags, sacks, pouches, trays, sleeves, pallets, hampers, carts, and large rolling containers.

In 1997, the Board of Governors approved fielding of this centralized "outsourced" network to replace decentralized, internally operated systems. Initial requirements indicated a $1.3 million capital investment and $3.6 billion in expense funding over a ten-year period. Initial projections indicated that the initiative would reduce costs by about $376 million over the ten-year period. In 1999 the chairman of the Board of Governors requested that we examine service center operations. This is the second in a series of reports and focuses on internal controls.

Results in Brief

Our audit revealed that controls were insufficient to detect or prevent overstated or unsupported invoices. Specifically:

- Equipment was recorded or invoiced as processed when work was not accomplished.
- Containers were reported as repaired when no repairs were made.
- Serviceable equipment was improperly turned in for disposal.

Controls were also not sufficient to prevent the operating contractor from improperly condemning and discarding serviceable equipment, or to properly account for equipment removed from inventory.

Most issues identified in this report occurred due to inadequate separation of duties, insufficient record keeping, and insufficient quality assurance. The Postal Service could reduce the risk of paying for work that was not accomplished by strengthening controls over recording, documenting, and verifying contractor work.

Summary of Recommendations	We recommend that the vice president of Network Operations Management segregate network oversight from service center operations; require quality auditors to test and verify the serviceability of equipment before it is discarded; require individual rolling stock repair and servicing histories to be documented; and to fully staff the quality assurance function.
Summary of Management's Comments	Management agreed with all our findings and recommendations. They acknowledged that it was desirable to separate quality audit and production functions, and stated that they would evaluate such separation prior to renewing the current integration contract. They acknowledged that serviceable equipment could be erroneously discarded because there were insufficient quality assurance personnel to properly monitor the function, and agreed to fully staff the independent quality assurance function. Finally, management agreed to examine procedures for recording individual rolling stock repair and servicing histories, and to reinforce those procedures with operating contractors. Management's comments in their entirety, are included in the Appendix.
Overall Evaluation of Management's Comments	Management's comments were responsive to our findings and recommendations, and actions taken or planned should correct the issues identified in this report.

INTRODUCTION

Background

The mail transport equipment service center network is a logistical system of 22 contractor-operated equipment service centers with dedicated “over the road” transportation. It is designed to supply Postal Service mail processing facilities—and certain large customers—with mail transport equipment. Mail transport equipment includes items such as mailbags, sacks, pouches, trays, sleeves, pallets, hampers, and carts. It also includes large rolling containers, referred to as “rolling stock,” used to move mail “over the road.”

The geographically dispersed service centers recover used equipment from user facilities, evaluate serviceability, dispose of non-serviceable equipment, restore serviceable equipment, and return restored equipment to inventory for use. The centers also receive, store, and distribute equipment that has been newly purchased by the Postal Service or restored at other network locations.

In addition to operating the 22 centers, contractors provide:

- Centralized information management to allow Postal Service managers to control the network at the national level.

- Quality assurance at the service center level.

The "outsourced" concept was initiated in 1992 as a pilot, with a prototype in Greensboro, North Carolina. The prototype was intended to test and evaluate a contractor-operated centralized network as a replacement for the multiple, internally operated, and decentralized systems in place at the time. The pilot contract was renewed in 1995. In 1997, the Board of Governors approved fielding of the full network. The approved program required four independent levels of contractor activity:

- A network “integration” contractor was to provide centralized coordination, system-wide information management, and inventory control, which would allow Postal Service managers to provide program oversight at the national level.

- A “research and development” contractor was to continue to operate the Greensboro prototype as a laboratory for testing new equipment processing procedures, in addition to operating the plant as a mail transport equipment service center.

- “Operating” contractors were to manage 21 service centers.

- A “quality assurance” contractor was to ensure compliance with operating contractors' statements of work at the service center level and audit the accuracy of production reporting.

Initial requirements indicated a $1.3 million capital investment and $3.6 billion in expense funding over a ten-year period. Initial projections indicated that the “outsourcing” initiative would reduce labor, transportation, and other costs by about $376 million over the ten-year period.

Objective, Scope, and Methodology

The objective of our audit was to assess the effectiveness of the internal controls protecting the service center network.

During our work, we visited 8 of the 22 service centers; observed operations; interviewed contractors and Postal Service personnel; evaluated Postal Service contracts, regulations, and other documents; and analyzed federal law and policy.

Our audit was conducted from August 1999 through October 2000 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

Our April 5, 2000, report, Mail and Other Items Missent to Mail Transport Equipment Service Centers (TR-AR-00-007), concluded that mail and other items erroneously shipped to service centers placed the security and timely delivery of mail at risk.

AUDIT RESULTS

Production Reporting and Invoicing

Controls over contractor work were not sufficient to detect or prevent overstated or unsupported invoices. For example:

- At four of the eight service centers we visited, equipment was invoiced as processed when work was not actually performed. For example: the Cincinnati Service Center billed the Postal Service for processing trailers of inventory; however, the trailers were never unloaded and processed as required. Subsequently the contractor had to reimburse the Postal Service about $6,000. The Los Angeles center received pallets of new products that did not require processing. The pallets of products were reported as if they had been processed. The Washington Service Center replaced placards on processed products which can cause additional charges. In addition, the Washington service center also inducted rolling stock into repair stations that were not in need of repair.

- During a ten-day period at the Los Angeles Service Center, the weight of processed mailbags may have been overstated by about 20 percent; and the weight of processed trays, sleeves, and lids overstated by more than 30 percent. Processing discrepancies of this magnitude could have resulted in a daily average of about $13,000 in overcharges for the ten-day period.

- During a five-day period at the Chicago Service Center, the quality assurance auditor reported that rolling stock invoiced for payment was overstated by at least 1,223 containers. As a result, the Postal Service required the operating contractor to reimburse approximately $26,000.

Overstated and unsupported invoices result in contractor overpayments that increase operating costs and expose the Postal Service to potential embarrassment.

Equipment Disposal and Inventory Management

Controls were also not sufficient to prevent operating contractors from improperly condemning and discarding serviceable equipment, or to properly account for equipment removed from inventory.

The Postal Service spends about $91 million annually to replace mailbags, trays, and sleeves. At the Los Angeles Service Center, we observed service center personnel condemning large quantities of serviceable pouches. One hamper of pouches was condemned because service center personnel considered them unserviceable. We requested the contents of the hamper be inventoried which revealed 321 pouches scheduled for disposal. However, the accompanying documentation reported only 128. After we discussed the matter with a quality auditor, pouches identified as new or serviceable were returned to inventory. However, our discussion with the quality auditor revealed independent verification and testing by quality assurance personnel was not required for this type of equipment.

SERVICEABLE EQUIPMENT CONDEMNED FOR DISPOSAL

Since program inception, service centers have condemned and discarded approximately 205,000 rolling stock containers. Contract provisions require operating contractors to obtain quality assurance verification and approval before condemning and discarding rolling stock—and there was no contract provision that permitted delegation of authority to operating contractors. However, at three service centers we visited, quality assurance auditors delegated such authority. A Postal Service official we interviewed explained that the contract deviation was necessary to prevent warehouse congestion when the quality auditor was not on site.

Controls Over Contractor Work	Most of the issues identified in this report occurred due to inadequate separation of duties, insufficient record keeping, and insufficient quality assurance. The General Accounting Office's Standards for Internal Control in the Federal Government require program managers to segregate independent functions, like program operations and information management; accurately document records readily available for examination; and support critical internal control functions, like independent quality assurance.
Separation of Duties	The Postal Service did not provide sufficient segregation of contractor responsibilities. In many cases, the same contractor performing work was responsible for developing the data the Postal Service used to oversee that work. The Postal Service relied on operating contractors to accurately report production and invoicing data, and relied on the integration contractor to independently develop production and invoicing data. However, the same contractor who provided network integration also operated four network service centers. This was the same contractor who may have overstated the weight of mailbags by more than 20 percent and the weight of trays, sleeves, and lids by more than 30 percent. The same contractor discarded serviceable equipment and had to reimburse the Postal Service $26,000 for overstating "rolling stock" production.
Documentation	Operating contractors did not maintain adequate rolling stock repair histories. During each of our service center visits, we observed multiple repair stickers affixed to rolling stock containers indicating chargeable work had been accomplished. The containers were uniquely identified and bar coded, but recording procedures did not always ensure individual repair histories were maintained. Consequently, it was not possible to identify what work each repair sticker represented—or independently verify whether such work was necessary, duplicated or performed.
Quality Assurance Staffing	The independent quality assurance function was not staffed sufficiently. Most service centers operated at least two shifts. However, Postal Service contracting officer representatives were not on site—domiciled at Postal Service Headquarters, and the independent quality assurance contract provided only one quality auditor for an eight-hour day. Consequently, the quality auditor was

not routinely available to perform necessary verification or tests.

Recommendations	We recommend that the vice president of Network Operations Management: 1. Segregate network integration from service center operations by requiring those independent functions to be performed by different and unrelated contractors.
Management's Comments	Management agreed with our recommendation and stated that it was desirable to separate functions. They also stated that prior to the conclusion of the current integration contract, they would evaluate the advantages and disadvantages of separating those functions.
Recommendation	2. Require that quality assurance auditors test and verify the serviceability of equipment before it is discarded.
Management's Comments	Management agreed with our recommendation. They stated that due to insufficient quality assurance staffing, it was possible for equipment to be discarded without being reviewed by a quality assurance auditor. Management agreed to fully staff the quality assurance function.
Recommendation	3. Revise or reinforce procedures for recording individual rolling stock repair and servicing histories and make such maintenance records readily available to quality assurance auditors.
Management's Comments	Management agreed with our recommendation. They stated that they would examine procedures for recording individual rolling stock repair and servicing histories, and reinforce the procedures with operating contractors.
Recommendation	4. Fully staff the independent quality assurance function by expanding the quality assurance contract or assigning Postal Service quality assurance personnel.
Management's Comments	Management agreed with our recommendation. They stated that they would fully staff the independent quality assurance function in order to provide full operations coverage.
Evaluation of Management's Comments	Management's comments are responsive to our findings and recommendations. We believe that the actions taken and planned should correct the issues identified in our report.

APPENDIX. MANAGEMENT'S COMMENTS

PAUL E. VOGEL
A/VICE PRESIDENT,
NETWORK OPERATIONS MANAGEMENT

UNITED STATES POSTAL SERVICE

September 29, 2000

DEBRA S. RITT

SUBJECT: Audit – Adequacy of Mail Transport Equipment Service Center Network Internal Controls (Report Number TR-AR-00)

Please find attached a response to the subject audit report. I appreciate the opportunity to work with you and your staff to develop a meaningful report. I would like to commend your staff on the professional manner in which this audit was conducted and the manner in which the issues have been worked out.

We generally concur with the findings and recommendations enumerated in the report. We further agree that it is desirable to separate the audit function from the production function in the mail transport equipment service centers, and have it performed by an independent contractor under a separate contract.

Should you require additional information, please contact Tony Pajunas, manager, Logistics at (202) 268-4948.

FOR Paul E. Vogel

Attachment

cc: Mr. Potter
Mr. Strange
Mr. O'Reilly
Mr. Pajunas
Mr. Seehaver

1. **Recommendation**

We recommend that the vice president, Network Operations Management segregate network integration from service center operations by requiring those independent functions to be performed by different and unrelated contractors.

We agree with the finding and recommendation.

Prior to the conclusion of the current integration contract, the Postal Service will evaluate the advantages and disadvantages of having the integration work performed by a supplier that is also an operating contractor.

2. **Recommendation**

Require that quality assurance auditors test and verify the serviceability of equipment before it is discarded.

We agree with the finding and the recommendation.

Quality Assurance Auditors are currently required to verify the serviceability of the equipment before it is discarded. However, due to less than sufficient staffing to cover all hours of service center operations, it is possible for equipment to be discarded without being reviewed by the Quality Assurance Auditors. Our response to recommendation number four should resolve this issue.

3. **Recommendation**

Revise or reinforce procedures for recording individual rolling stock repair and servicing histories and make such maintenance records readily available to Quality Assurance Auditors.

We agree with the finding and the recommendation.

Under the current contracts, contractors are required to record individual rolling stock repair and servicing histories. We will examine these procedures to ensure that they provide for individual rolling stock accountability and then reinforce the procedures with the operating contractors.

4. **Recommendation**

Fully staff the independent quality assurance function by expanding the quality assurance contract or assigning Postal Service quality assurance personnel.

We agree with the finding and the recommendation.

It is the intention of program management to remove quality-monitoring activities from the current operations contracts. We agree that it is more desirable to have all of the quality work performed by an independent contractor who reports directly to the program manager. Furthermore, we agree that the staffing required under this contract should provide for full operations coverage.