September 27, 2001

DONNA M. PEAK
VICE PRESIDENT, FINANCE, CONTROLLER

SUBJECT: Audit Report – Decision Analysis Report Process
(Report Number DA-AR-01-005)

This report presents the results of our self-initiated audit of the Decision Analysis Report Process (Project Number 00BA001DA000). The overall objective of our audit was to determine whether major capital investments made by the Postal Service are properly supported, documented, approved, and controlled.

We determined that the Postal Service generally followed the established capital project approval process for the major projects reviewed in this audit. However, the audit revealed that several projects were not adequately validated and were approved without consideration of all test results, adequate support for savings and costs methodology, or complete spares cost estimates. In addition, we noted limitations in the mechanisms for reporting project performance to Postal Service management.

We made 12 recommendations to improve accountability for the Postal Service's capital investments. We recommend revising the policy to require more complete documentation and analysis for validating and monitoring project performance. We also recommend selecting effective performance measures to report project performance in the Investment Highlights. Finally, we recommend developing policies and procedures for selecting and monitoring projects for cost studies and reassessing the procedures to perform cost studies. Management generally agreed with all of our recommendations. However, management did not agree with some of the findings. Specifically, they commented on the individual projects we cite in the report. Management's comments and our evaluation of these comments are included in the report.

The Office of Inspector General (OIG) considers recommendations 1 – 10 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 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 during the audit. If you have any questions, or need additional information please contact Tracy LaPoint, director, Developmental, at (703) 248-2100, or me at (703) 248-2300.

Robert L. Emmons
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EXECUTIVE SUMMARY

Introduction

Since 1997, we have reviewed Postal Service major developmental projects with investments totaling over $1.9 billion.[1] Our reviews have revealed trends such as project delays, cost overruns, and inaccurate performance projections.

As a result of these recurring issues, we initiated an audit of the Decision Analysis Report process to determine whether major capital investments made by the Postal Service were properly supported, documented, approved, and controlled. The objectives of the audit were to determine whether (1) Decision Analysis Reports were adequately validated, and (2) the performance of approved projects was measured and reported. This report addresses key controls for validating and monitoring Decision Analysis Report projects and focuses on major Decision Analysis Reports for seven projects. These included five equipment projects and two projects for replacing Postal Service operations with contractor-operated centers. We plan to conduct additional audits on other aspects of the Decision Analysis Report process.

Results in Brief

We determined that the Postal Service generally followed the established capital project approval process for the major projects that were reviewed in this audit. However, our audit and several prior Office of Inspector General (OIG) audits have indicated that seven projects in excess of $800 million in approved capital investments[2] were validated without fully documented consideration of all test results, adequate support for savings and costs methodology, or complete spares cost estimates. Since the Board of Governors relies on the validation process to ensure projects are adequately justified before approval, the Postal Service Finance department must thoroughly review

[1] **Project name and approved capital and expense amount:** Point of Service ONE, $899 million; Tray Management System, $558 million; Priority Mail Processing Center Network, $19 million; Robotics Containerization System, $81 million; Delivery Operations Information System, $120 million; Singulate, Scan, Induction Unit, $103 million; Automatic Airline Assignment/Semi-Automatic Scan Where You Band, $112 million; Mail Transport Equipment Service Center, $1.3 million.

[2] **Project name and approved capital amount:** Automatic Airline Assignment/Semi-Automatic Scan Where You Band, $109 million; Delivery Operations Information System, $120 million; Mail Transport Equipment Service Center Network, $1.3 million; Priority Mail Processing Center Network, $1.4 million; Robotics Containerization System, $80 million; Singulate, Scan, Induction Unit, $102 million; Tray Management System-Phase III, $396 million.

and validate all major projects.[3] This is particularly important because the Postal Service projects a $1.65 billion loss in fiscal year (FY) 2001, which significantly reduces the availability of funding for capital investments and warrants more stringent validation requirements for future Decision Analysis Reports.

Although Finance communicates the cost and schedule status of capital investment projects to the Board of Governors, we noted limitations in the mechanisms for reporting project performance to Postal Service management. While compliance reports were performed regularly, they did not provide adequate project information to reevaluate investment decisions. On the other hand, cost studies that provided more information were neither timely nor frequent. Together, these weaknesses in the reporting processes did not ensure projects achieved financial and operational Decision Analysis Report projections. Effective monitoring and reporting of project performance is critical given the $17.5 billion in planned capital investments for FYs 2001 to 2005 and because the Board of Governors has directed the Postal Service to defer $1 billion of the $3.6 billion in FY 2001 planned capital investments.

Summary of Recommendations

We made 12 recommendations to improve accountability for the Postal Service's capital investments. We recommended revising the policy to require more complete documentation and analysis for validating and monitoring project performance. We also recommended selecting effective performance measures to report project performance in the Investment Highlights. Finally, we recommended developing policies and procedures for selecting and monitoring projects for cost studies and reassessing the procedures to perform cost studies.

Summary of Management's Comments

Management agreed with all 12 recommendations in the report. However, they did not agree with many of the findings related to the individual projects we cite in the report. Specifically, management made several additional comments regarding differing perspectives and concerns related to the individual projects. These additional comments were not necessarily related to the recommendations. Management's comments, in their entirety, are included in the appendix of this report.

[3] The Board of Governors approved $1.6 billion in FY 2000 for 20 new major capital investment projects.

Overall Evaluation of Management's Comments

Management's comments are fully responsive to our recommendations. However, management disagreed with many of the details pertaining to the projects and OIG reports that we reviewed and referenced. Management repeatedly states that the impact of the report's findings will not have any negative effect on an individual project's ability to achieve its projected financial results.

However, we believe that there has been a significant financial impact related to at least two of the projects, Tray Management System and the Mail Transport Equipment Service Center. The Mail Transport Equipment Service Center project, is being pursued through the audit resolution process. For the Tray Management System project, the OIG and Finance concluded that the project would not achieve intended results.

Many of the other projects referenced in the report are still either in the deployment phase, or only recently fully deployed. As a result, we believe that Finance cannot determine if these projects are achieving expected results because of the limited deployment and the lack of an adequate project performance reporting system.

Nevertheless, the purpose of this audit was to determine if (1) Decision Analysis Reports were adequately validated, and (2) the performance of approved projects was measured and reported. We found that Finance could improve their processes for validating and monitoring Decision Analysis Report projects. Overall, Finance agreed that Handbook F-66 could be strengthened to improve controls over validating and monitoring Decision Analysis Report projects.

INTRODUCTION

Background

The Postal Service's F-66 Handbook, Investment Policies and Procedures [4] (investment policy), establishes the approval process, procedures, and responsibilities for investments made by the Postal Service. Major capital investments, generally defined as exceeding $5 million, require a Decision Analysis Report, which is a justification to recommend an investment for approval. (Table 1 below outlines approval authority for capital investment levels.)

Table 1: Approval Levels for Capital Investments

Approval Authority	Amount
Board of Governors	Over $10 Million
Postmaster General/Chief Executive Officer	Up to $10 Million
Senior Vice Presidents/Others*	Up to $7.5 Million
Vice Presidents	Up to $5 Million

*Others include General Counsel, Chief Postal Inspector, and Inspector General.

As shown in Table 2, the Decision Analysis Report is prepared by the sponsoring organization and sent to Finance for validation. Headquarters Finance is responsible for independently validating all Decision Analysis Reports for major investments to provide assurances to approving officials. Specifically, the Finance department provides assurance that supporting documentation complies with the policy and is reasonable, accurate, logical, valid, and auditable.

The vice president Finance, controller, issues a validation letter after issues arising from the review are resolved. After validation, the appropriate authorities identified in Table 1 and 2 review and approve the Decision Analysis Report.

[4] The Handbook F-66 Series includes five modules, F-66, F-66A, F-66B, F-66C, and F-66D for investment policies and procedures. We reviewed the F-66, General Investment Policies and Procedures and F-66B, Investment Policies and Procedures--Major Equipment.

Table 2: Decision Analysis Report Process[5]

Review and Approval Process

Decision Analysis Report Prepared	Decision Analysis Report to Finance for Validation; Senior Vice Presidents for Review	Headquarters Vice Presidents & Area Concur with Decision Analysis Report (as applicable)	Final Decision Analysis Report Prepared and Distributed
Validation Complete	Controller Issues Validation Letter	Vice President Review & Approval	Capital Investment Committee Review & Approval
Postmaster General/Chief Executive Officer Review & Approval	Board of Governors Capital Projects Committee Review	Board of Governors Review & Approval	

Post-Approval

Contract Award	First Article Test	Deployment	Benefits

After approval, the project sponsor[6] is responsible for ensuring that costs are tracked and reported using the appropriate compliance report format. In addition, Finance monitors and reports the status of projects requiring Board of Governors' approval quarterly in the Investment Highlights report. This report was initiated in 1996 at the request of the Board of Governors.

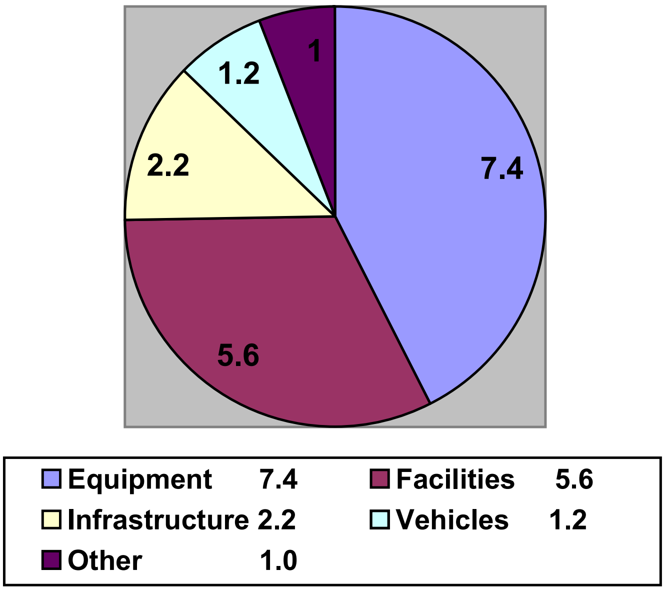
As shown on the next page, the fiscal year (FY) 2001-2005 Capital Investment Plan reported $17.5 billion in anticipated capital investments. The table illustrates major investment categories and 5-year estimates.

[5] Approving officials may vary depending on the investment amount. See Table 1, page 1 for capital investment approval levels.

[6] The project sponsor is the Postal Service organization that requests and justifies the investment project.

Table 3: Postal Service 5-Year Plan

FY 2001-2005 Capital Investment Plan Categories ($ billions)



The Postal Service's 5-Year Plan dedicates $7.4 billion or 43 percent of capital resources to developing equipment technology. Most equipment investments consist of automation and mechanization projects, which are based on economic considerations such as return on investment.

Objectives, Scope, and Methodology

The purpose of our audit was to determine whether major capital investments made by the Postal Service are properly supported, documented, approved, and controlled. The objectives of the audit were to determine whether (1) Decision Analysis Reports were adequately validated, and (2) the performance of approved projects were measured and reported.

Our audit focused on seven major Decision Analysis Reports. Five projects involved major capital investments in equipment and two were major projects for replacing Postal Service operations with contractor-operated centers. All seven projects required the Board of Governors' approval.

Although the two projects for replacing Postal Service operations did not require a significant capital investment, they represented considerable changes in organizational strategy and involved billions of dollars in contracts and operating expenses. We also interviewed headquarters officials in Engineering, Information Technology, and Facilities, to determine their roles in the Decision Analysis Report process.

For our review, we selected three approved Postal Service equipment projects, which are being audited or were audited by the Office of Inspector General (OIG) this year:

- Singulate, Scan, Induction Unit

- Automatic Airline Assignment/Semi-Automatic Scan Where You Band

- Delivery Operation Information System

In addition, we relied on prior OIG audit reports that identified internal control weaknesses with the Decision Analysis Report process. Two of the prior audits were major equipment projects and two were major projects that replaced Postal Service operations with contractor-operated centers; all required the Board of Governors' approval. These audit reports and Postal Service management responses are summarized in the Prior Audit Coverage section:

- Priority Mail Processing Center Network
- Tray Management System
- Robotics Containerization System
- Mail Transport Equipment Service Center

The OIG has also issued reports that identified internal control issues regarding the Decision Analysis Report process for two other major projects:

- Point of Service ONE
- International Mail

Although these reports are listed in the Prior Audit Coverage section, we have not included their findings as examples in this report. The issues reported on these two projects did not pertain directly to this phase of the Decision Analysis Report audit.

To address the first objective we determined whether major Decision Analysis Reports had (1) adequate supporting documentation and analysis, and (2) were sufficiently validated to ensure costs and benefits were accurately represented. To address the second objective, we reviewed the adequacy and completeness of the processes in place to monitor and report the actual project performance of approved major capital projects.

In planning our audit we used the General Accounting Office's (GAO) Executive Guide for Leading Practices in Capital Decision-Making, Exposure Draft, April 1998. This guide summarizes the fundamental practices that have been successfully implemented in governmental and private sector organizations recognized for their outstanding capital decision-making practices.

This audit was conducted between July 2000 and 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 findings and recommendations with appropriate management officials and included their comments where appropriate.

Prior Audit Coverage

Previous audit reports concluded that management presented projects to the Board of Governors for approval without adequate documentation and analyses, or that the projects may not achieve anticipated performance and financial results.

- Point of Service ONE (DA-AR-99-002), dated September 20, 1999, disclosed that during development and deployment, the system was not achieving the results outlined in the Decision Analysis Report. We recommended that management improve the monitoring of controls to ensure project accountability. Management agreed with our recommendations.

- Priority Mail Processing Center Network (DA-AR-99-001), dated September 24,1999, revealed that the project did not report all costs and did not meet service improvement goals. Management generally agreed with our recommendations; however, they did not agree with all of our findings, and claimed the project was prematurely evaluated.

- Tray Management System (DA-AR-00-002), dated March 31, 2000, disclosed that the Tray Management System was experiencing a negative return on investment because anticipated savings were overstated in three areas by $462 million. Management did not initially agree to reevaluate savings and reassess continued deployment, stating the methodologies they used in validation were sufficiently accurate and fully achievable. However, management subsequently agreed to reevaluate savings projections. In May 2001, at the request of the Board of Governors, the OIG reassessed the actual return on investment of the project. We determined that the project was still experiencing a negative return on investment. The Postal Service also recomputed the return on investment for the system and concluded the project was achieving about a 1 percent return.

- International Mail (AC-AR-00-005), dated September 29, 2000, disclosed project changes were made that altered the overall concept and increased costs without submitting Decision Analysis Report modifications. Management agreed with the report recommendation to modify the Decision Analysis Report and to report the actual use of funds, but disagreed with the finding.

- Robotics Containerization System (DA-AR-01-002), dated February 26, 2001, concluded that work hour savings projected at $347 million in the Decision Analysis Report would not be realized unless planned staffing levels were achieved. The report also stated that the cost of spare parts was understated in the Decision Analysis Report. Management generally agreed with our recommendations. However, Engineering officials indicated current operations are achieving planned staffing levels and they expect to realize the savings projected in the Decision Analysis Report.

- Delivery Operations Information System (DA-AR-01-003), dated March 29, 2001, disclosed weaknesses in the methods and assumptions used to derive productivity savings and the related return on investment. Management agreed to incorporate lessons learned into future Information Platform projects.

- Mail Transport Equipment Service Center Decision Analysis Report, Performance, and Financial Benefits (TR-AR-01-003), dated May 4, 2001, concluded that the Decision Analysis Report was inaccurate and a significant portion of the savings was incorrectly calculated. As a result, the network would not achieve anticipated savings and the costs would exceed forecasts by more than $1.4 billion. Management did not agree to prepare a Decision Analysis Report modification. This recommendation is being pursued through the audit resolution process.

AUDIT RESULTS

Decision Analysis Reports Were Not Adequately Validated

Our audit and several prior OIG reviews indicated that seven projects in excess of $800 million in approved capital investments were not adequately validated before approval. Specifically, Finance's documentation did not always completely support or fully disclose various elements of the validation process. For example, Finance validated these projects without documented consideration of all test results, adequate support for savings and costs methodology, or complete spare parts cost estimates. Three of the projects we reviewed were major equipment projects. Two of the prior audits were major equipment projects and two were major projects involving replacing Postal Service operations with contractor-operated centers; all required the Board of Governors' approval. The two projects for contractor-operated centers did not require a significant capital investment, but involved considerable changes in organizational strategy and involved billions of dollars in contracts and operating expenses. As shown in Table 4, major projects totaling $809 million in approved capital were reviewed by Finance and submitted to the Board of Governors with inadequate documentation and analysis.

Table 4: Projects with Inadequate Documentation and Analysis			
Project Approved[7] Capital (millions)	**Test Results and Analysis**	**Cost and Savings Methodology**	**Inventory Specialists' Review of Spare Parts Estimates**
AAA/SASWYB **$109**	X	X	X
DOIS **$120**		X	
RCS **$80**	X		X
SSIU **$102**	X	X	X
TMS Phase III **$396**		X	
PMPC **$1**		X	
MTESC **$1**		X	
Total $809			

*Note: X denotes areas with inadequate information.

The GAO's Executive Guide for Leading Practices in Capital Decision-Making states that leading organizations have capital review processes in place that determine the level of analysis and review based on the size, complexity, and cost of the project. Projects that are expensive and are crucial to an organization's strategy usually require more analysis, support, and review than projects that cost less or have less organization-wide impact.

Since the Board of Governors relies on the validation process to ensure that projects are sufficiently justified before approval, Finance must thoroughly review all major projects.[8] This is particularly important because the Postal Service projects a $1.65 billion loss in FY 2001, which significantly reduces the availability of funding for capital investments and warrants more stringent validation requirements for future projects.

[7] **AAA/SASWYB**: Automatic Airline Assignment/Semi-Automatic Scan Where You Band; **DOIS**: Delivery Operations Information System; **RCS**: Robotics Containerization System; **SSIU**: Singulate, Scan, Induction Unit; **TMS**: Tray Management System-Phase III; **PMPC**: Priority Mail Processing Center; **MTESC**: Mail Transport Equipment Service Center.

[8] The Board of Governors approved $1.6 billion in FY 2000 for 20 new major capital investment projects.

Test Results and Analysis Not Considered

Our audit showed that in three major equipment projects with total approved capital investments of $291 million, project sponsors did not submit adequate supporting documentation for analyses of test results. This condition existed although Handbook F-66B requires the use of detailed information, such as machine performance, to support assumptions in the Decision Analysis Report. For example:

- Singulate, Scan, Induction Unit – Prototype results were included in the supporting documentation; however, competitive test results and analysis were not included although the test had been performed before final validation.

- Automatic Airline Assignment/Semi-Automatic Scan Where You Band – Finance validated the Decision Analysis Report with unsubstantiated results from prequalification tests. In addition, the Decision Analysis Report indicated that competitive testing was scheduled before approval by the Board of Governors; however, competitive tests were completed after approval, and Finance's documentation did not include competitive testing results and analysis.

- Robotics Containerization System – Finance validated the Decision Analysis Report, although test results consistently failed to meet system performance targets.

Our audit highlighted the following weaknesses in Postal Service policy and procedures that if corrected could provide improvements to the validation process:

- Although the investment policy states that detailed supplemental information is required to support assumptions in a Decision Analysis Report, it does not provide specific guidelines for sponsors to document project tests and analysis for validation.

- Investment policy does not require Finance to monitor equipment performance assumptions by documenting summary competitive test results and analyses when validation is performed prior to the completion of competitive testing. Finance relies on sponsors' assurances that test results and analyses met projections in Decision Analysis Reports.

- Investment policy does not require Finance to assure equipment performance tests are completed before Decision Analysis Reports are validated and approved. Equipment performance testing was not always completed before validation and approval of Decision Analysis Reports.

- Finance's internal procedures do not require independent reviews of conditionally accepted projects. Engineering stated that many systems were released for deployment after the First Article Test[9] under a conditional acceptance, and in some instances, the acceptance criteria were revised when original parameters seemed unreasonable or unattainable. Project sponsors were responsible for ensuring that conditionally accepted equipment was consistent with performance projections in Decision Analysis Reports.

As a result, the Postal Service approved investments in projects, such as the Tray Management System, when expected cost and benefit projections in the Decision Analysis Report were not supported. It is imperative that projects submitted to the Board of Governors demonstrate a high probability of meeting operational and financial projections through independently validated test results.

Recommendation

We recommend the vice president, Finance, controller, revise Handbook F-66, Investment Policies and Procedures, to require that:

1. Project sponsors provide Finance with test plans, summary data, and an analysis of available test results to ensure projections in Decision Analysis Reports are reasonable.

[9] After funding is approved and the contract is awarded, the project sponsor conducts the First Article Test to evaluate equipment for functionality, quality, and compliance with contract specifications.

Management's Comments	Management agreed with the recommendation, but not with the findings. They agreed that Handbook F-66 requires verification of operating costs variances and the review of assumptions. As such, management will prepare a memorandum by the end of quarter II, FY 2002, to remind the sponsors and Program Evaluation staff of this requirement. Lastly, management will strengthen the appropriate Handbook F-66 areas as identified in their response. Management also included comments on our discussion of the Singulate Scan Induction Unit projects' lack of documentation for the competitive test results. They indicated that they do not believe this finding has any negative effect on the project's ability to achieve its projected financial results.
Evaluation of Management's Comments	Management's comments are responsive to our recommendation. Management agreed to notify sponsors and Finance staff of this requirement. Management also agreed to strengthen the Handbook F-66 by requiring sponsors to include a summary of any available test results. We believe the actions planned, if implemented, should correct the issues identified in our report. We do not agree with management's comments regarding the Singulate Scan Induction Unit project. Management states they believe their lack of documented competitive test results and analysis for this project has no negative effect on the project's ability to achieve its projected financial results. However, we question how Finance can reach this conclusion without validating the summary competitive test results and analysis, or having an adequate performance measurement system.
Recommendation	2. If validation is performed prior to the completion of competitive testing, Finance will obtain the summaries of competitive test results and analyses, and compare them to the Decision Analysis Report assumptions, taking the appropriate notification action if the performance significantly varies from the Decision Analysis Report assumptions.

Management's Comments	Management agreed with this recommendation and will obtain the summaries of competitive test results and analyses, and compare them to the Decision Analysis Report assumptions. Management will also take the appropriate notification action and follow up if performance significantly varies from Decision Analysis Report assumptions. Management agreed to strengthen the Handbook F-66 to include reviews of completed test results after validation. Management also included comments on our discussion of the Automated Airline Assignment projects' competitive tests results. They stated that competitive test results exceeded prequalification test results in the trays per minute measure. Management also indicated that the impact of unsubstantiated test results and analysis for the project has no negative effect on its ability to achieve projected financial results.
Evaluation of Management's Comments	Management's comments are responsive to our recommendation. Management agreed to change the Handbook F-66 and perform reviews of competitive test results and analysis to ensure Decision Analysis Report assumptions are still valid. We believe the actions planned, if implemented, should correct the issues identified in our report. We do not agree with management's comments on the Automated Airline Assignment program tests results. We found that the tray per minute measure is only one of many performance measures for this program. Furthermore, we determined that the competitive test indicated qualified vendors did not meet several other performance measures in the competitive test. Without assessing the impact of the other performance measures, we question how management can definitively state the lack of competitive test results has no negative effect on the project's ability to achieve its projected financial results. Further, we question how Finance can reach their conclusion without having an adequate performance measurement system.
Recommendation	3. The test status is fully disclosed in the validation letter when submitting equipment projects for approval.

Management's Comments	Management agreed with this recommendation. However, management stated that since full disclosure is part of the validation process and included in the Handbook F-66B, Section 5, changes are not needed. Management also included comments on several projects we reviewed, stating specific examples of full disclosure for those projects referenced in the report.
Evaluation of Management's Comments	Management's comments are responsive to our recommendation. Management agreed that full disclosure is necessary and a part of the validation process. Although the policy does not clearly state that the test status should be disclosed, we believe that management's actions for recommendations 1 and 2, if implemented, will meet our overall intent of improving the controls for validating and disclosing test results. We consider including the test status in the validation letter as an additional level of disclosure of testing accomplished. We do not agree with management's comments that the Robotics Containerization System test status was fully disclosed to the Board of Governors. Management stated that the Board of Governors was advised that each vendor's design was tested at their respective plants, and that they were successfully meeting the requirements defined in the Statement of Work. However, the OIG reported that the documentation related to the initial testing indicated vendors were not meeting many of the performance goals. Furthermore, the competitive test indicated that the contractor that received the award did not meet several Statement of Work criteria.
Recommendation	4. Sponsors notify Finance of conditionally accepted projects and apprise Finance of actions taken to improve performance prior to final acceptance. If deployment continues, Finance will monitor these projects using the performance measures and leading indicators process identified in recommendations eight and nine.
Management's Comments	Management agreed with the recommendation and will prepare a memorandum by the end of quarter II, FY 2002 to notify the sponsors and Program Evaluation staff of this

requirement. Also, management agreed to change the Handbook F-66 section for compliance reporting to strengthen controls for project monitoring.

Evaluation of Management's Comments

Management's comments are responsive to our recommendation. Management agreed to strengthen the policy and to notify sponsors and Finance staff of the processes for monitoring conditionally accepted projects. We believe the actions planned, if implemented, should correct the issues identified in our report.

Savings and Cost Methodology Not Adequately Supported

Postal Service policy requires detailed information to support assumptions in Decision Analysis Reports. Our review showed that in six projects with total approved capital of $729 million, sponsors did not submit sufficient supporting documentation to justify the methodologies used.

Specifically, project sponsors' documentation did not support or fully disclose:

- How hardware costs that comprised 45 percent of the Singulate, Scan, Induction Unit investment were computed.

- Their justification for including 20 unassigned machines in the savings calculation, which represented approximately 5 percent of savings for the Automated Airline Assignment/Semi-Automatic Scan Where You Band systems. The Decision Analysis Report disclosed that these 20 additional machines would only be purchased and deployed to economically justified sites.

- How including savings for three nonconcurring areas would impact total Decision Analysis Report savings for the Delivery Operations Information System. Although Finance's validation letter stated 3 of 11 areas did not concur with savings methodologies, it did not disclose that savings were included in the Decision Analysis Report for these 3 areas.

Furthermore, the three nonconcurring areas also identified weaknesses in the testing and savings methodologies.[10]

- The inconsistency in the Tray Management System Decision Analysis Report, which based the return on investment computation on work hour savings estimates from equipment deployment sites only, while Postal Service management allocated the project savings nationally. As a result, the audit revealed the return on investment was overstated.

- Why savings for the discontinued Greensboro, North Carolina, prototype service center were double counted in the Mail Transport Equipment Service Center Decision Analysis Report. As a result of this analytical error, the audit determined that savings for the Greensboro service area were overstated by $177 million.

Their justification for not including acceptance and delivery costs in total network service costs for the Priority Mail Processing Center Network. The methodology was not an accurate comparison because these costs are needed along with contract volume variable costs, which are included, to accurately reflect total end-to-end service costs. As a result of this omission, the audit concluded Priority Mail processed through the Priority Mail Processing Center Network in FY 1998 cost $101 million or 23 percent more than the same volume processed in-house by the Postal Service.

Supporting documentation was inadequate because Postal Service policy required detailed supplemental information for methodologies, but did not require sponsors to submit specific supporting documentation for cost and savings methodologies. Without strengthening the policy, there is an increased risk that future projects may be validated based on unattainable financial expectations.

Recommendation

We recommend the vice president, Finance, controller, revise Handbook F-66, Investment Policies and Procedures, to require that:

[10] Delivery Operations Information System (DA-AR-01-003) identified several weaknesses in testing methodology and related savings. Postal Service management agreed with our recommendation to incorporate lessons learned from the financial justification of the project in future initiatives.

5. Sponsors provide detailed analyses to support the adequacy and reasonableness of savings and cost methodologies in Decision Analysis Reports.

Management's Comments

Management agreed with our recommendation; however, they did not agree with most examples supporting our findings. Management agreed to strengthen the policy sections for operating variances and Decision Analysis Report assumptions.

Management included comments on many of the projects we referenced as examples where documentation did not support or fully disclose savings and cost methodologies. Management disagreed with many of the references from the OIG reports and discussions of projects we reviewed in the section entitled, "Savings and Cost Methodology Not Adequately Supported."

Management states that for the Mail Transport Equipment Service Center report the OIG finding is incorrect regarding savings being overstated by $177 million for the Greensboro service area.

Management states the inconsistencies in the methodology used in the Tray Management System savings calculation was a management decision fully endorsed by the Board of Governors. Further, senior management has the authority to determine how budget savings are allocated as long as the project meets or exceeds the return on investment. Therefore, management believes our finding is irrelevant to this audit of the Decision Analysis Report process.

Management commented that the Decision Analysis Report for the Delivery Operations Information System included savings for three areas that nonconcurred, and that this had no impact on the project's financial results. Management notes that it is always senior management's prerogative to increase or decrease budgeted hours as long as the Decision Analysis Reports economics have not changed.

Management also did not agree with our conclusion that the supporting documentation for the Singulate, Scan, Induction Unit hardware costs was not complete.

Evaluation of Management's Comments

Management's comments are responsive to our recommendation. Management agreed to strengthen Handbook F-66, as necessary, for the verification of assumptions and operating cost variances, which directly relate to project savings. We believe the actions planned, if implemented, should begin correcting the issues identified in our report.

Regarding management's disagreements with the examples we cited of inadequate support for savings and cost methodology, management has yet to provide the OIG with evidence to support its position. Specifically, while the OIG audit report on the Mail Transport Equipment Service Center Decision Analysis Report, Performance and Financial Benefits (Report Number TR-AR-01-003, dated May 4, 2001) is being pursued through the audit resolution process, the Postal Service has not been able to explain why the $177 million savings for the Greensboro area was double counted. Further, this double counting was not detected in Finance's validation of the projected savings for this project.

We strongly disagree with management's assertion regarding the relevancy of the Tray Management System findings to this audit. We believe this example provides a good illustration of how the Postal Service's methodology was inadequate in supporting projected savings. The OIG determined that savings were applied to sites that did not have Tray Management Systems, which inflated the savings projection in the Decision Analysis Report. A follow up OIG audit of the project confirmed the return on investment was significantly overstated, and that the actual return on investment was a negative 5 percent instead of the 4.9 percent originally projected. Management also reevaluated the return on investment and reached similar conclusions, although their cost study showed a 1 percent return on investment.

With respect to management's comments on the Delivery Operations Information System, we believe when three areas challenged the validity of the savings, Finance should have reassessed the savings methodology. While management stated they have the prerogative to increase or decrease budgeted hours, this does not absolve Finance from its obligation to ensure all projected savings and cost analyses presented to the Board of Governors are reliable and adequately supported. Lastly, the OIG audit report for the Delivery Operations Information System (Report Number DA-AR-003 dated March 29, 2001) projects disclosed weaknesses in the methods and assumptions used to derive productivity savings. Management agreed to incorporate lessons learned from this project into future efforts.

Management also disagreed with our conclusion that the supporting documentation for the Singulate, Scan, Induction Unit hardware costs was not complete. We found that although the subject matter expert prepared an estimate for hardware costs, they did not provide Finance sufficient detail to support the per site hardware costs. There was no methodology explaining how the per site equipment cost of $2.2 million was determined. The total hardware estimate of $42 million appears to be based on the minimum amount of machines needed (2 per site times 21 sites). The Decision Analysis Report equipment requirements ranged from 42-58 machines based upon estimated volume and throughput. Finally, the hardware cost represented about 45 percent of the total investment, which will significantly affect the project's return on investment if mistakenly calculated.

Furthermore, most of the other projects discussed in the report are either still being deployed or only recently fully deployed. As such, Finance cannot definitively determine the impact on the projects ability to achieve expected results. Finally, the lack of an adequate project performance reporting system limits Finance's assurance the projects are achieving the intended productivity savings.

Recommendation

6. Finance fully discloses savings in the validation letter, including factors that may affect return on investment.

Management's Comments

Management agreed with this recommendation and stated that it is currently part of the Decision Analysis Report process.

Management included comments on the projects, Automated Airline Assignment, Semi-Automatic Scan Where You Band, and Delivery Operations Information System, referenced as examples where factors that may affect savings were not fully disclosed. Management commented that all but four of the Automated Airline Assignment machines remain unassigned.

Evaluation of Management's Comments

Management's comments are responsive to our recommendation. Management agreed that full disclosure is necessary and a part of the validation process. We still believe including risk factors that could negatively impact return on investment in the validation letter may provide some additional assurance of disclosure. However, management's overall actions for recommendations one through five, if implemented, will improve the controls for validating project test results and savings.

Also, management agreed that in the future they would perform a sensitivity analysis of the savings without the unassigned machines for projects where additional units are purchased and not yet assigned to a specific site. Management agreed to prepare a memorandum by the end of quarter II, FY 2002, to notify the Finance staff of this requirement.

We disagree with management's comments on the Automated Airline Assignment System. Currently, there are six unassigned Automated Airline Assignment machines and ten unassigned Semi-Automatic Scan Where You Band machines.

We also disagree with management's comments on the Delivery Operations Information System project regarding the three areas nonconcurrence with Decision Analysis Report savings estimates. Finance states they do not believe this will have any negative impact on the project's ability to achieve its projected financial results. However, without an adequate system to monitor project performance, we do not agree with Finance's assertion that no financial impacts may result.

Review of Spare Parts Estimates Not Complete

Although inventory specialists within the Purchasing and Materials group provided input on the cost of spare parts, they did not have the opportunity to review final estimates in Decision Analysis Reports. In three major equipment projects that we reviewed with total approved capital of $291 million, spare parts estimates were understated by millions of dollars.

- For the Robotics Containerization System, the project manager reduced spare parts estimates without concurrence from the inventory specialist.

- For two separate Decisions Analysis Reports, (1) Automated Airline Assignment/Semi-Automatic Scan Where You Band, and (2) Singulate, Scan, Induction Unit, initial assumptions used to calculate spare parts estimates were incorrect. There was no indication that an inventory specialist had reviewed the estimates for the final Decision Analysis Reports.

These conditions existed because project sponsors were not required to consult inventory specialists to confirm final cost estimates for spare parts. Without such feedback, there is an increased risk of understated projections, which could result in spare parts funded outside of the approved Decision Analysis Report. More importantly, understated projections may result in an overstated return on investment.

Ultimately, the sponsor and project manager are responsible for a Decision Analysis Report's spare parts cost estimates. However, Finance should evaluate any differences between the inventory specialist's and project official's estimates. If a resolution is not reached, then the Decision Analysis Report should fully disclose the disagreements in spare parts cost estimates.

Recommendation

We recommend the vice president, Finance, controller:

7. Revise Handbook F-66, Investment Policies and Procedures, to require Finance to ensure inventory

specialists review spare parts estimates in the final Decision Analysis Report and provide written analysis.

Management's Comments

Management agreed with this recommendation and will prepare a memorandum by the end of quarter II, FY 2002 to notify the sponsors and Program Evaluation staff of this requirement. Also, management stated that this requirement is addressed in the Handbook F-66, but that they will add more specific instructions to provide for further reviews of spare parts cost estimates.

Evaluation of Management's Comments

Management's comments are responsive to our recommendation. Management agreed with the intent of the recommendation and will also communicate this requirement in a memorandum. Also, management agreed to change the Handbook F-66 to strengthen controls for project monitoring. We believe the actions planned, if implemented, should correct the issue identified in our report.

Inadequate and Untimely Performance Reporting	The audit disclosed that the cost and performance of approved projects was not adequately reported to the Board of Governors. Although Finance communicates cost and schedule status of major capital investment projects to the Board of Governors, we noted the Investment Highlights,[11] compliance reports, and cost studies did not adequately report project performance results and costs to Postal Service management. While compliance reports were performed regularly, they did not provide adequate project information. On the other hand, cost studies that provided more information were neither timely nor frequent. As a result, projects exceeding cost projections and failing to perform were not brought to the attention of the Governors. Consequently, the Board of Governors did not have the information they needed to reevaluate current and future investments.
Investment Highlights and Compliance Reports Lacked Performance Measures	Our audit revealed that compliance reports and Investment Highlights did not contain key performance measures for evaluating economically justified projects.[12] The GAO's Executive Guide for Leading Practices in Capital Decision-Making states that leading organizations generally hold project managers accountable for meeting performance goals. Also, the guide indicates that regular reviews of project performance status by individuals outside of the project team allows for an independent assessment of project success. Although the Postal Service's Investment Highlights report communicated the status of capital project costs and whether a project was on schedule, it did not provide sufficient information to measure the project's effectiveness in meeting performance and operating cost projections. Compliance reports are intended to provide assurances that projects are implemented and savings materialize as stated in the approved Decision Analysis Report. Compliance reports must be submitted quarterly from the time of Decision Analysis Report approval until 18 months after deployment. The project sponsor has responsibility for

[11] Finance's quarterly report tracking all investment projects approved by the Board of Governors; primarily generated from compliance reports and project sponsors.

[12] Projects justified by economic considerations provide a measurable improvement to operations, produce economic benefits, and meet a target hurdle rate.

ensuring that costs for all projects are tracked and reported using the appropriate Decision Analysis Report compliance report format.

Compliance reports also provide information for key measures included in the Investment Highlights reports, such as approved capital investment, committed capital investment, estimated capital investment at completion, capital cash outlays, on-time status and percentage complete. Finance routinely validates the committed capital and cash outlays through reconciliation with accounting systems. However, we determined that while compliance reports were performed regularly, they did not provide adequate project performance information for actual operating costs, work hours, and volume.

The audit revealed that the accounting system used to validate compliance reports did not track operating expenditures or actual savings for projects. As a result, Finance cannot report the actual return on investment for projects in the Investment Highlights.

Our audit also disclosed that significant operating cost overruns might be incurred and not reported. For example, the Audit of the Mail Transport Equipment Service Center Decision Analysis Report, Performance and Financial Benefits, concluded the projects' operating expenses would exceed estimates by about $1.4 billion. The report states that the project's compliance reports did not fully portray the problem, and consequently the Board of Governors may not have been fully aware of the situation. The report recommended that Postal Service management develop a Decision Analysis Report modification to adjust for the unanticipated conditions. Postal Service management did not concur, stating that operating variances, even of that magnitude, did not require a revision.

A minimum return on investment is required to approve economic projects; however, actual project savings were not tracked and return on investment was not reported in the Investment Highlights report. Project savings are the key component of return on investment, which is one of the primary factors the Board of Governors considers for economic projects.

In previous audits of equipment projects, we identified significant differences between actual and projected labor savings. The following examples illustrate overstated savings that could result in inflated returns on investment.

- For the Robotics Containerization System, the Decision Analysis Report projected $347 million in labor savings that may not be attainable unless the staffing levels meet projections in the Decision Analysis Report.

- For the Tray Management System, labor savings were overstated by $442 million because officials did not exclude savings that were projected to be achieved at sites not receiving the system.

According to the Postal Service, operating costs and other performance measures that determine project savings are difficult to isolate in overlapping equipment projects and interrelated operations. However, Finance and Operations stated they are exploring ways to identify meaningful performance measures such as equipment utilization, throughput, and integration with other systems. In addition, Finance and Operations suggested a need for sponsors to identify leading indicators that support performance measures for each Decision Analysis Report. Similarly, the GAO's Executive Guide for Leading Practices in Capital Decision-Making discusses the practice and benefit of evaluating project results through setting overall performance measures and assessing these with specific performance indicators.

Postal Service management attributed some of the prior reported findings to challenges they faced in the early project stages. Nevertheless, without performance measures, management cannot easily identify when continued deployment of a project is in the best operating and financial interest of the Postal Service.

Recommendation

We recommend the vice president, Finance, controller:

8. Identify effective performance measures to be used in assessing economic projects during deployment.

Management's Comments	Management agreed with this recommendation. Finance stated that they would require the sponsor of new Decision Analysis Reports to include the specific performance measures and methodology to be used in assessing economic projects during deployment. This effort will be coordinated with Engineering and Operations and begin with new projects initiated in quarter II, FY 2002.
Evaluation of Management's Comments	Management's comments are responsive to our recommendation.
Recommendation	9. Revise Handbook F-66, <u>Investment Policies and Procedures</u>, to require project sponsors to identify leading indicators that support performance measures for each Decision Analysis Report and include methodologies in supporting documentation.
Management's Comments	Management agreed with this recommendation. In conjunction with recommendation 8, the Handbook F-66 will be revised to require project sponsors to include specific leading indicators and methodologies for measuring project success. This change will be effective with new projects beginning in quarter II, FY 2002.
Evaluation of Management's Comments	Management's comments are responsive to our recommendation.
Recommendation	10. Ensure compliance reports include leading indicators to support performance measures, which will be reported in the <u>Investment Highlights</u> report.
Management's Comments	Management agreed with this recommendation. In conjunction with recommendations 8 and 9, the policy will be strengthened to require that the measures of success be addressed in the compliance report.
Evaluation of Management's Comments	Management's comments are responsive to our recommendation. If policy changes are implemented with new projects beginning in quarter II, FY 2002, changes in compliance reporting will be reflective in the subsequent issue of the <u>Investment Highlights</u>.

Cost Studies Were Not Timely and Frequent

According to the investment policy, cost studies are intended to provide assurances that projects are implemented and savings materialize as stated in the approved Decision Analysis Report. However, only three cost studies were completed for projects approved in the past 10 years limiting their usefulness. In addition cost studies did not provide Postal Service management with timely assurance because they are performed at least 18 months after final deployment. The audit revealed that policies did not exist for selecting projects for cost studies. Similarly, there were no procedures for monitoring cost studies.

Finance performs cost studies and also interim studies and ad hoc analyses of project performance. We determined that cost studies are an effective tool to compare project performance to projections in the Decision Analysis Report after the project is completed. Unlike compliance reports that did not report operating costs and savings, cost studies did report these key performance measures. In addition, cost studies compared all actual costs and savings to the projections in the Decision Analysis Report in determining the projects actual return on investment.

Taken collectively, cost studies and compliance reports did not assure projects met financial and operational projections in Decision Analysis Reports. While compliance reports were performed routinely, they did not provide adequate project performance information for the Investment Highlights, or report projects' actual operating costs. Cost studies reported actual operating costs, however, they were neither timely nor frequently prepared.

Since project savings are a key factor the Board of Governors considers in approving most major projects, it is critical that they receive actual performance results indicating whether savings are materializing. Effective monitoring and reporting of project performance is critical given the $17.5 billion in planned capital investments for FY 2001 to 2005. Furthermore, since the Board of Governors deferred $1 billion of the $3.6 billion in capital investments planned for FY 2001, it is critical for the Postal Service to effectively monitor and report program performance.

Recommendation	In conjunction with the recommendation to identify performance measures, we recommend the vice president, Finance, controller: 11. Develop policies and procedures for selecting and monitoring projects for cost studies.
Management's Comments	Management agreed with this recommendation and plans to put in place a decision matrix to help prioritize projects for review in quarter I, FY 2002. However, due to the amount of resources involved, they will pursue cost studies that focus on high risk/high profile projects such as the Tray Management System and the 34 letter mail automation projects, which are assessed annually.
Evaluation of Management's Comments	Management's comments are responsive to our recommendation.
Recommendation	12. Reassess the procedures to perform cost studies before final deployment to improve their timeliness and benefit.
Management's Comments	Management agreed with this recommendation. Management stated that if efforts addressed in recommendations 8, 9, and 10 are successful, the reliance on cost studies should be significantly reduced.
Evaluation of Management's Comments	Management's comments are responsive to our recommendation.

APPENDIX. MANAGEMENT'S COMMENTS

DONNA M. PEAK
VICE PRESIDENT
FINANCE, CONTROLLER

UNITED STATES
POSTAL SERVICE

September 18, 2001

ROBERT L. EMMONS

SUBJECT: Response to Draft Audit Report on Decision Analysis Report Process (Report Number DA-AR-01-DRAFT)

We have completed our review of your draft audit report on the decision analysis report (DAR) process. We agree with all 12 of the recommendations contained in the report. However, we have disagreement with some of the findings. We are also concerned that other audits and their corresponding findings are referenced in this audit when these audits are still being reviewed, are in the audit resolution process, or management is not in agreement with them. Our detailed response to the specific findings and recommendations is outlined in the attachment.

We agree with the recommendations that focus on implementing ongoing performance measures to strengthen our ability to assess the success of Board-approved capital investments. That process will be implemented with new DARs as soon as the necessary policy changes are developed and promulgated.

The F-66B enhancements to strengthen policies referenced in this response will be completed in the usual three-step process:

1. A memorandum will be issued describing the enhancements to strengthen the policy.

2. Pen and ink (markup) changes will be made with notification through the Postal Bulletin.

3. The updated F-66B will be issued via the postal Intranet followed by hard copy issuance when cost effective.

Donna M Peak

Donna M. Peak

Attachment

cc: Mr. Donahoe
Mr. Day
Mr. Johnstone
Mr. Strasser
Mr. Gunnels

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Detailed Response to Office of Inspector General (OIG)
Draft Audit Report – Decision Analysis Report (DAR) Process
(Report Number DA-AR-01-DRAFT)

AUDIT RESULTS: Decision Analysis Reports Not Adequately Validated
-- Test Results and Analysis Not Considered

Comments on findings:
Finding: Singulate, Scan, Induction Unit (SSIU) – Prototype results were included in the supporting documentation; however, competitive test results and analysis were not included although the test had been performed before final validation.

Response: We concur that we can improve on the documentation of the tests results for this project, however, we do not believe the impact of this finding will have any negative effect on the project's ability to achieve its projected financial results. The complete tests results and analyses are maintained by Engineering who are accountable for their accuracy. Although not part of the validation process, as a follow-up activity, Engineering will provide competitive results if done after the validation. If the test results differ significantly from the DAR assumptions, appropriate action will be taken.

Finding: Automatic Airline Assignment (AAA) and Semi-Automatic Scan Where You Band (SASWYB) – Finance validated the decision analysis report with unsubstantiated results from pre-qualification test. The decision analysis report indicated that competitive testing was scheduled before approval by the Board of Governors; however, competitive tests were completed after approval, and the results were not validated by Finance.

Response: While the backup documentation contained a summary of the pre-qualification test results for the equipment, we do concur that we can improve on the documentation of the tests results for this project. However, we do not believe the impact of this finding will have any negative effect on the project's ability to achieve its projected financial results.

In actuality, the later competitive tests exceeded per-qualification tests and the assumptions used in the DAR. The average trays per minute from the pre-qualification test that were used in the DAR analysis ranged from a low of 12.19 trays per minute to a high of 21.42 trays per minute. The competitive tests results ranged from a low of 15.6 trays per minute to a high of 23.9 trays per minute. Since the competitive test results exceeded the pre-qualification test, this would not have impacted the decision to move forward with this DAR. Although not part of the validation process, as a follow-up activity, Engineering will provide competitive results if done after the validation. If the test results differ significantly from the DAR assumptions appropriate notification and follow-up action will be taken.

Finding: Robotics Containerization System (RCS) – Finance validated the decision analysis report, although test results, including the first article test, consistently failed to meet system performance target. Engineering stated that many systems were released for deployment after first article test under conditional acceptance, and in some instances, the acceptance criteria were revised when original parameters seemed unreasonable or unattainable.

Response: Validation by Finance must always be completed prior to the first article acceptance since first article acceptance is a deployment activity that is always conducted subsequent to project approval and contract award. It is the first sample of purchased equipment that is placed and tested for functionality, quality, and compliance

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with contract specifications. After first article acceptance, the supplier begins deployment as scheduled to other sites. Engineering, in conjunction with Operations, is responsible and accountable for accepting machines. When a project is conditionally accepted, it typically means that the performance has not met the contract specifications, but the contractor and Engineering expect that it will meet the specifications. A decision is then made to conditionally accept beneficial use of the equipment with the agreement that final acceptance and final payment will be made once all steps outlined in the conditional acceptance are met. The equipment will be re-tested when the specifications are met. Full payment is sometimes withheld until the conditions are met.

There are situations when the contractor cannot meet the specifications and the performance parameters are changed. It should be noted that when this is done, the contract is typically also modified in terms of cost to account for the impact that the revised performance parameters will have upon the Postal Service.

Recommendations:
Vice President, Finance, Controller revise Handbook F-66, Investment Policies and Procedures, to require that:

1. Project sponsors provide Finance with test plans, summary data, and an analysis of available test results to ensure projections in decision analysis reports are reasonable.

Response: Management agrees with the recommendation, but not with the findings. All available test results should be included in the DAR and must be reviewed by Finance to ensure reasonableness. The F-66 requires verification of operating costs variances and the review of assumptions. We will prepare a memorandum by the end of quarter II, fiscal year 2002 to remind sponsors and Program Evaluation staff of this requirement, and strengthen the appropriate policy areas as necessary (F-66B, section 3-4.1.2 and 3-4.2.1). We will add the following to section 3-4.1.2 "...Summary of any available equipment test results"; and add to section 3-4.2.1 "...As well as a summary of any available equipment and test data and results."

2. If validation is performed prior to the completion of competitive testing, Finance will obtain the summaries of competitive test results and analyses, and compare them to the DAR assumptions, taking the appropriate notification action if the performance significantly varies from the DAR assumptions.

Response: Management agrees with this recommendation and will obtain the summaries of competitive test results and analyses, and compare them to the DAR assumptions. There will be appropriate notification action and follow-up if the performance significantly varies from the DAR assumptions. The F-66B will be strengthened in section 6-9.2, Status Report, 2. ... "This includes items such as tests results completed after validation and spare parts cost to determine if they significantly vary from the DAR projections."

3. The test status is fully disclosed in the validation letter when submitting equipment projects for approval.

Response: Management agrees with this recommendation. However, since full disclosure is part of the validation process and included in the F-66B, section 5, exhibit 5-1, changes in policy are not needed. Specific examples of full disclosure of test status for equipment projects referenced in the audit findings include:

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a) AAA/SASWYB - The Board of Governors was advised of the status of the prototype systems and that the system was being tested at the Dulles Air Mail Facility.

b) SSIU - The Board of Governors was advised of the proof of concept that was conducted at the Springfield BMC and that two different vendors were tested in Dallas and Pittsburgh, and that the results of the tests supported the DAR assumptions.

c) RCS - The Board of Governors was advised that each vendor's design was tested at their respective plants, and that they were successfully meeting the requirements defined in the statement of work.

4. Sponsors notify Finance of conditionally accepted projects and apprise Finance of actions taken to improve performance prior to final acceptance. If deployment continues, Finance will monitor these projects using the performance measures and leading indicators process identified in recommendations eight and nine

Response: Management agrees with this recommendation. We will prepare a memorandum by the end of quarter II, fiscal year 2002 to notify the sponsors and Program Evaluation staff of this requirement. We will also strengthen the F-66B, section 6-9.2, Status Report, 2 as follows: "...This includes items such as tests results completed after validation and spare parts cost to determine if they significantly vary from the DAR projections."

-- Savings and Cost Methodology Not Adequately Supported

Comments on findings:
Finding: Project sponsors' documentation did not support or fully disclose how per site hardware costs that comprised 45 percent of the Singulate, Scan, Induction Unit investment were computed.

Response: We do not agree. The SME appropriately provided the capital investment estimates (including hardware) in the backup documentation in a letter dated September 24, 1999. We do not believe the impact of this finding will have any negative effect on the project's ability to achieve its projected financial results.

Finding: Project sponsor's justification for including 20 unassigned machines in the savings calculations, which represented approximately 5 percent of savings for the Automated Airline Assignment/Semi-Automatic Scan Where You Band. The decision analysis report disclosed that these 20 additional machines would only be purchased and deployed to economically justified sites.

Response: The DAR states that the "...additional units of each type of equipment would only be purchased and deployed to sites that could economically justify the equipment." The savings anticipated, if the equipment should be purchased, were based on average savings of the total site-specific data. This allows management to purchase and deploy additional equipment, if the economic justification is present. This was fully disclosed to the Board of Governors. All but four of the unassigned machines have been assigned. All of the assigned equipment has had the appropriate budget impact associated with it. We do not believe the impact of this finding will have any negative effect on the project's ability to achieve its projected financial results. Historically, all machines have been assigned; however, in the future we will perform a sensitivity analysis on the savings

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without the unassigned machines. We will prepare a memorandum by the end of quarter II, fiscal year 2002 to notify the Program Evaluation staff of this requirement.

Finding: Delivery Operations Information System (DOIS) DAR included savings for three areas that did not concur with the savings.

Response: While three Vice Presidents, Area Operations (AVPs) did not concur with the savings, Operations included these savings in all area budgets. While the AVPs' concurrence is part of the DAR process, it is always senior management's prerogative (Chief Operating Officer or headquarters Capital Investment Committee) to increase or decrease budgeted hours as long as the DAR economics remain unchanged. The fact that three areas did not concur with the workhour savings was disclosed in the validation letter. We do not believe the impact
of this finding will have any negative effect on the project's ability to achieve its projected financial results. In similar cases, we are now noting in validation letters that all area budgets will be assessed based upon the analysis.

Finding: The inconsistency in the Tray Management System (TMS) DAR, which based the return on investment (ROI) computation on workhour savings estimates from equipment deployment sites only, while Postal Service management allocated the project savings nationally. As a result, the audit revealed the return on investment was overstated.

Response: There is no inconsistency in the TMS DAR since the ROI was estimated based on site-specific workhour savings which were applied in total to the USPS Operating Budget. The fact that a portion of the savings was allocated to non-TMS sites for budgetary reasons has no bearing on the estimated or actual ROI. It should be noted that this savings allocation methodology was fully disclosed to the Board of Governors both in writing and verbally at committee discussions. This finding was disputed by management in the original TMS audit and in follow-up discussions with the OIG. Senior management has the authority to determine how budget savings are allocated as long as the project meets or exceeds the ROI approved in the DAR. Thus, the finding is irrelevant to this audit.

Finding: Savings for the discontinued Greensboro, North Carolina, prototype service center were double counted in the Material Transportation Equipment Service Center (MTESC) DAR.

Response: No such analytical error could be found. The dollar amount sited in the May 4, 2001, audit does not appear anywhere in the DAR or the backup documentation. The Greensboro Equipment Processing Center was in operation several years before MTESC was brought on line and would have continued operations regardless of the MTESC national deployment decision. This finding was also disputed by management in the original MTESC audit and in follow-up discussions with the OIG. We are in the process of conducting a review of MTESC financial performance relative to the original DAR projections. It is difficult to grasp the relevancy of the finding to this audit.

Finding: Sponsor's documentation did not support or fully disclose justification for not including acceptance and delivery costs in total network service costs for the Priority Mail Processing Center (PMPC) Network.

Response: We do not understand why the finding is in this audit. In discussions with the Board and OIG, we fully explained why it was not necessary to include acceptance and delivery costs in the decision to outsource the PMPC network. Acceptance and delivery costs would not change from the baseline in either scenario. Thus, the finding is not germane.

Recommendations:
Vice President, Finance, Controller revise Handbook F-66, Investment Policies and Procedures, to require that:

5. Sponsors provide detailed analyses to support the adequacy and reasonableness of savings and cost methodologies in decision analysis reports.

Response: Management agrees with this recommendation. The F-66 requires verification of operating costs variances and the review of assumptions. We will strengthen the appropriate policy areas as necessary (F-66B, section 3-4.1.2 and 3-4.2.1). However, management disagrees with many of the findings. As mentioned earlier,

TMS savings allocation was a management decision that was fully endorsed by the Board of Governors. The MTESC finding with regards to Greensboro is not correct. PMPC findings are irrelevant and proceeding with the DOIS project without the concurrence of three areas was a management decision that did not impact the results of the investment.

6. Finance fully discloses savings in the validation letter, including factors that may affect return on investment.

Response: Management agrees with this recommendation which is currently part of the DAR process (reference F-66B, Chapter 5, Validation, section 5-6, exhibits 5-1 and 5-2). Economic information such as net present value, annual savings, return on investment, full-time equivalent complement impacts, sensitivity analyses, net financial impact upon profit and loss, economic value added impact, potential revenue, and budget impacts are some of the many factors that are part of the validation and disclosed to the Capital Investment Committee, the Capital Projects Committee, and the Board of Governors.

-- Review of Spare Parts Estimates Not Complete

Finding: In three major equipment projects, spare parts estimates were understated by millions of dollars. Project sponsors were not required to consult inventory specialists to confirm final cost estimates for spare parts.

Response: Management agrees with this recommendation, however we do not believe that the findings will have any impact on these projects' projected results.

Recommendation:
The Vice President, Finance, Controller,

7. Revise Handbook F-66, Investment Policies and Procedures, to require Finance to ensure inventory specialists review spare parts estimates in the final decision analysis report and provide written analysis.

Response: Management agrees with this recommendation and will prepare a memorandum by the end of quarter II, fiscal year 2002 to notify the sponsors and Program Evaluation staff of this requirement. This is addressed in the F-66B, section 3-4.1.2. We will add the following to section 6-9.2, Compliance, # 3 "...This includes items such as test results received after validation, and spare parts cost to determine if they significantly vary from the DAR projections."

AUDIT RESULTS: Inadequate and Untimely Performance Reporting
-- Investment Highlights and Compliance Reports Lacked Performance Measures

Recommendations:
The Vice President, Finance, Controller,

8. Identify effective performance measures to be used in assessing economic projects during deployment.

Response: Management agrees with this recommendation. Finance will require the sponsor of new DARs to include the specific performance measures and methodology to be used in assessing economic projects during deployment. This effort will be coordinated with Engineering and Operations and begin with new projects initiated in quarter II, fiscal year 2002.

9. Revise Handbook F-66, Investment Policies and Procedures, to require project sponsors to identify leading indicators that support performance measures for each decision analysis report and include methodologies in supporting documentation.

Response: Management agrees with this recommendation. In conjunction with recommendation #8, the F-66 will be revised to require project sponsors to include specific leading indicators and methodologies for measuring project success. This change will be effective with new projects beginning in quarter II, fiscal year 2002.

10. Ensure compliance reports include leading indicators to support performance measures, which will be reported in the Investment Highlights report.

Response: Management agrees with this recommendation. In conjunction with recommendations 8 and 9, policy will be strengthened to require that the measures of success be addressed in the Compliance Report. If the policy changes are implemented with new projects beginning quarter II, fiscal year 2002, the compliance reporting will be reflected in the subsequent issue of the Investment Highlights. Management is also looking at alternative methods for reporting on projects. One vehicle being considered is the Bold Actions Program Management Support effort.

-- Cost Studies were not timely and frequent.

Recommendations:
In conjunction with the recommendation to identify performance measures, we recommend the Vice President, Finance, Controller:

11. Develop policies and procedure for selecting and monitoring projects for cost studies.

Response: Management agrees with this recommendation. We will put in place a decision matrix to help prioritize projects for review in quarter I, fiscal year 2002. The characteristics that are assessed in this process will be all facets of the broader notion of risk. The characteristics assessed are: size of capital investment; size of deployment;

number of phases; length of deployment; dependence on multiple technologies; "soft" technology/savings; low ROI; new technology; multiple vendors; Article 32 involvement; and, the degree of cross functional cooperation. Cost studies are also a function of resources. As agreed to in Recommendation #12, we weigh the benefits and timeliness of cost studies and available resources. We pursue interim cost studies and analyses that focus on high risk/high profile projects such as TMS and the 34 letter mail automation projects which are assessed annually.

12. Reassess the procedures to perform cost studies before final deployment to improve their timeliness and benefit.

Response: Management agrees with this recommendation. Given that after cost studies, by definition, are after the fact, their utility is limited. Our desire is to facilitate the use of the Investment Highlights and the Compliance Reporting (as well as judicious selection of Interim Cost Study candidate projects) to provide a more meaningful and timely approach to evaluating program performance. If our efforts to address Recommendations 8, 9, and 10 are successful, we see reliance on costly cost studies significantly reduced.