May 14, 2009

JORDAN M. SMALL
ACTING VICE PRESIDENT, NETWORK OPERATIONS

SUSAN BROWNELL,
VICE PRESIDENT, SUPPLY MANAGEMENT

SUBJECT: Audit Report – Boston Airport Mail Center Outsourcing
(Report Number EN-AR-09-003)

This report presents the results of our audit of the Boston Airport Mail Center (AMC) Outsourcing (Project Number 08XG039EN000). Our objectives were to evaluate the operational and monetary impacts of the Boston AMC outsourcing initiative and compliance with outsourcing policies. The U.S. Postal Service requested this audit as part of our Value Proposition Agreement.[1] This is the third in a series of reviews examining outsourcing initiatives.[2] This audit addresses network streamlining in the strategic risk category as well as staffing and process efficiency in the operational risk category. See Appendix A for additional information about this audit.

Conclusion

Service scores improved after the Boston AMC closure[3] and outsourcing. Additionally, the Postal Service saved approximately $8.4 million in costs in the first calendar year following the AMC outsourcing. Postal Service employees complied with outsourcing requirements established in Article 32[4] and followed policies and procedures for the contract award and oversight processes. However, the comparative analysis developed during outsourcing planning was overstated by approximately $3.1 million over the contract period of 11 years. The Postal Service also paid $172,857 in unsupported parking fees and $31,611 for equipment not used to process the mail from May 2006 through January 2009. Eliminating these costs for the remaining term of the contract (4.5 years) could save the Postal Service $318,330. Lastly, the Postal Service paid

[1] A value proposition is a signed agreement between the U.S. Postal Service Office of Inspector General and Postal Service management to perform one or more specific audits in an agreed-upon period.
[2] AMC outsourcing is one of the Postal Service's many outsourcing initiatives. Outsourcing is the use of outside resources to perform activities that internal staff and resources traditionally handle.
[3] The Boston AMC closed on November 18, 2005.
[4] Article 32 of the Collective Bargaining Agreement between the Postal Service and labor unions requires the Postal Service to meet with unions while developing an initial comparative analysis and to consider the unions' views of costs and other factors in discussions of outsourcing.

$296,998 in port fees to the supplier, Worldwide Flight Services; however, the supplier did not pay these fees to the Massachusetts Port Authority (MASSPORT).

Operational Impacts

Impact on Employees – As of July 2006, all employees assigned to the AMC were re-assigned within the Boston District, transferred out of the district or retired. No employees lost their job because of the AMC closure. Most employees were transferred to the Boston Processing and Distribution Center (P&DC) or the Northwest Boston Processing and Distribution Facility (NWB P&DF). This resulted in a temporary increase of employees at these facilities. See Appendix B for our detailed analysis of this topic.

Impact on Service – The supplier, Worldwide Flight Services, met contract performance standards. Compliance is measured by exception reports filed when mail going through the supplier's facility misses a flight. No exception reports were filed between November 2005 and December 2008. Overall, service scores for overnight and 2- and 3-day service have improved since the AMC was closed. See Appendix B for our detailed analysis of this topic.

Monetary Impacts

Costs to outsource the AMC for 2006 and 2007 were less than one-half the 2005 AMC operating costs of $14.7 million. The total contract costs, plus salaries and benefits for Postal Service employees working at the supplier's facility and Boston Logan International Airport (15 ramp clerks, three supervisors, and one Air Transportation supervisor), were approximately $6.3 million in 2006 and $6.5 million in 2007. This resulted in savings of approximately $8.4 million in 2006 and $8.1 million in 2007. See Appendix B for our detailed analysis of this topic.

Compliance with Outsourcing Policies

Management generally complied with outsourcing policies and procedures for the Boston AMC. Specifically, management complied with requirements established in Article 32 of the collective bargaining agreements before outsourcing the Boston AMC functions. However, the price difference[5] reported in the comparative analysis used as one of the factors to justify outsourcing the Boston AMC was overstated by approximately $3.1 million over the contract period of 11 years. This occurred because employees responsible for developing the comparative analysis omitted some port fees. As a result, management relied on incorrect price estimates as a basis for outsourcing the Boston AMC. However, this would not have impacted the decision, because even with the fees included, it was still less expensive to outsource the AMC when compared to the in-house option. See Appendix B for our detailed analysis of this topic.

[5] The price difference represents the difference between the estimated costs for the Postal Service to operate the AMC and the estimated contractor's costs to perform the function.

We recommend the Acting Vice President, Network Operations:

1. Ensure that all suppliers' proposed costs are included in future comparative analyses.

Contract Oversight – Postal Service staff responsible for overseeing the supplier's performance generally complied with applicable policies and procedures; however, improvements could be made. Specifically, the supplier included unsupported parking fees and costs for equipment no longer used when the supplier moved off airport grounds. This occurred because Postal Service employees responsible for providing contract oversight did not question the parking costs included in the variable rates and were unaware that equipment included in the contract was not used to process the mail. As a result, from May 2006 through January 2009, the Postal Service paid $172,857 in additional parking fees and related costs[6] and $31,611 for equipment and related costs not used to process the mail. Eliminating these costs for the remaining term of the contract (4.5 years) could save the Postal Service $318,330. See Appendix B for our detailed analysis of this topic.

We recommend the Vice President, Supply Management:

2. Direct the Postal Service Law Department and the contracting officer to review the contract and identify options to eliminate unnecessary contract costs to the Postal Service.

3. Direct the contracting officer to meet with the supplier and renegotiate contract costs based on options identified with the Postal Service Law Department.

Port Fees – The supplier is holding $296,998 for port fees paid by the Postal Service that have not been paid to MASSPORT. This occurred because the supplier relocated off airport grounds and believed they were no longer required to pay these fees. The supplier should return these fees to the Postal Service. See Appendix B for our detailed analysis of this topic.

We recommend the Vice President, Supply Management:

4. Request a refund of $296,998 from Worldwide Flight Services for port fees not paid to the Massachusetts Port Authority.

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[6] Related costs include general and administrative fees and profit.

Management's Comments

Management generally agreed with recommendation 1, to ensure that all suppliers' costs are included in future comparative analyses. However, management did not agree with our assessment that port fees were omitted from the comparative analysis.

Management agreed with the intent of recommendation 2, to meet with the Postal Service Law Department to review the contract and identify options to eliminate unnecessary contract costs to the Postal Service. However, management does not fully agree that eliminating the OIG's suggested "unnecessary contract costs" is the appropriate action to take. Management stated that taking steps to recover the costs places the Postal Service at risk with respect to the supplier's increased costs of $2.9 million associated with its move off airport grounds. In addition, the Postal Service Law Department advised that the fixed-price nature of the contract precluded any opportunity for the Postal Service to assert entitlement to an adjustment in that regard.

Management generally agreed with recommendation 3, to meet with the supplier and renegotiate contract costs based on options identified with the Postal Service Law Department. Management is currently negotiating the exercise of an unpriced option that will ensure categories of price reflect a more accurate picture of the current off-airport contract.

Management did not agree with recommendation 4, to request a refund of $296,998 from Worldwide Flight Services for port fees not paid to the Massachusetts Port Authority. Management stated it is not in the Postal Service's best interest to request a refund when the supplier will incur an additional $2.9 million in costs associated with its contract performance. See Appendix E for management's comments in their entirety.

Evaluation of Management Comments

The U.S. Postal Service Office of Inspector General (OIG) considers management's comments to recommendation 1 responsive. Management agreed with our recommendation to ensure that all suppliers' proposed costs are included in future comparative analyses. However, management disagreed with our statement that port fees were omitted from the comparative analysis. Our comparison of the supplier's costs submitted in its proposal and the supplier's costs used in the comparative analysis differed because not all port fees were included in the Postal Service's comparative analysis. The contracting officer concluded that an oversight occurred because management did not forward the latest supplier's costs to the team responsible for developing the Postal Service's comparative analysis.

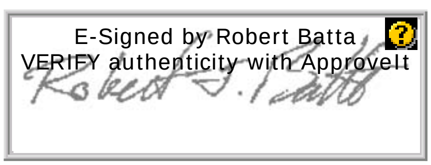
The OIG considers management's comments on recommendation 2 responsive. Management consulted with the Postal Service Law Department and concluded that the fixed-price nature of the contract precluded any opportunity for the Postal Service to assert entitlement to an adjustment. As a result of this OIG audit, the contracting officer requested the supplier to submit its costs incurred to date for this contract. Management stated that the supplier will incur approximately $2.9 million in increased costs over the life of the contract as a result of its move off airport grounds. During the review, the audit team requested documentation supporting the $2.9 million in additional costs, but we were unable to validate the reasonableness of the additional costs.

The OIG considers management's comments on recommendation 3 responsive. Management generally agrees with the concept of renegotiation due to current cost reduction efforts. Although management does not fully agree that renegotiation in this case is the appropriate action, management is currently negotiating the exercise of an unpriced option that will ensure categories of price reflect a more accurate picture of the current off-airport contract.

The OIG considers management's comments on recommendation 4 unresponsive. Management was unable to provide documentation to support the potential $2.9 million in projected additional costs if the supplier is asked to refund the port fees. We still consider the recommendation to be worthwhile, but because we did not designate it as significant, we will not pursue it through the resolution process.

We will report $204,468 in Unrecoverable Questioned Costs, $318,330 in Funds Put to Better Use, and $296,998 in Recoverable Questioned Costs in our *Semiannual Report to Congress*.

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



Robert J. Batta
Deputy Assistant Inspector
for Mission Operations

Attachments

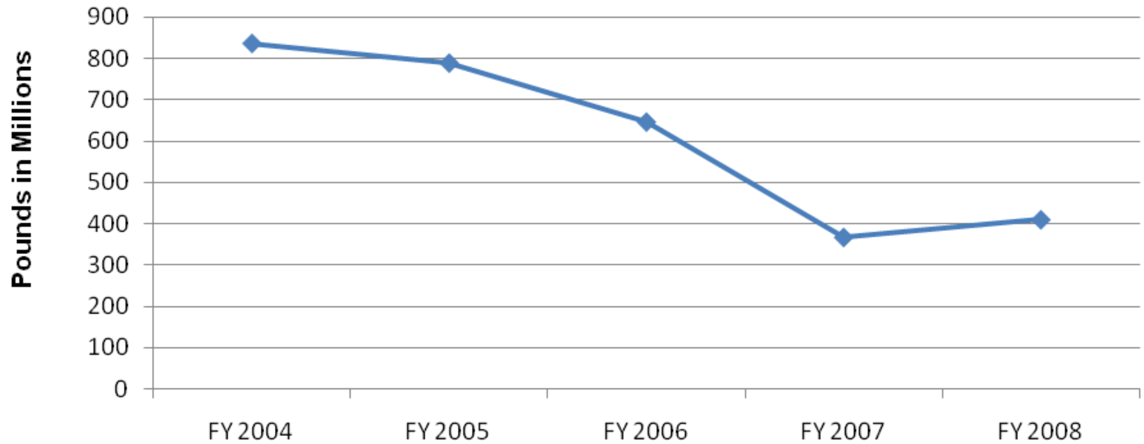
cc: Patrick R. Donahoe
William P. Galligan
Katherine S. Banks

APPENDIX A: ADDITIONAL INFORMATION

BACKGROUND

The Postal Service maintains AMCs and airport mail facilities (AMF)[7] to expedite the transfer of mail to and from commercial air carriers. This transfer is called the tender and receipt of mail. In many cases, these airport facilities have excess capacity as a result of declining volumes of mail tendered to commercial air carriers. Commercial air volume has declined from approximately 837 million pounds of mail in fiscal year (FY) 2004 to 410 million pounds in FY 2008. Figure 1 shows this trend. To address this issue, the Postal Service began standardizing AMCs by returning non-core AMC operations to P&DCs and bulk mail centers. This standardization enabled the Postal Service to improve efficiency and productivity, and reduce costs at the AMCs.

Figure 1. Commercial Air Mail Volume Trend



Optimizing the Network

The Postal Service identified Network Integration and Alignment (NIA) as a strategy in the *Transformation Plan*.[8] NIA's charter was to create a flexible logistics network that would reduce costs for the Postal Service and its customers, increase operational effectiveness, and improve consistency of service. In 2003, the President's Commission[9] found the Postal Service had more facilities than needed and recommended optimizing the facility network.

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[7] We use the term AMC in this report to refer to AMCs and AMFs, which perform essentially the same functions and have the same operations. AMCs are generally larger than AMFs.
[8] *United States Postal Service Transformation Plan,* dated April 2002.
[9] *Report of the President's Commission on the United States Postal Service*, dated July 31, 2003.

The *Strategic Transformation Plan 2006-2010*[10] stated that the efforts to create a flexible network to increase productivity and effectiveness — formerly called NIA — would continue as an evolutionary process called Evolutionary Network Development. One of these efforts was to reexamine the role of AMCs to determine if these facilities could be reduced and better coordinated using third-party facilities (contracting out). The *2006 Annual Progress Report*[11] noted that because of the consolidation of air contractors and expansion of the surface transportation network, the Postal Service was reviewing AMCs. At that time, management was considering contracting out operations at 43 AMCs. The *Strategic Transformation Plan 2006-2010, 2007 Update*[12] noted that some non-core operations were transferred from AMCs to processing plants. More than 40 facilities were standardized, and additional facilities were to be standardized in 2008.

In December 2006, the Postal Accountability and Enhancement Act[13] (Postal Act of 2006) required the Postal Service to provide a facilities plan that would include a strategy for rationalizing the facilities network and removing excess processing capacity and space from the network. This plan was provided to Congress in June 2008.

Operational Impact

Because of security restrictions imposed by the Federal Aviation Administration after September 11, 2001, the Postal Service no longer uses commercial passenger aircraft for Priority Mail®. Consequently, there has been a significant decrease in the volume of mail tendered to commercial passenger carriers. Priority Mail is now tendered to Federal Express and United Parcel Service and containerized by terminal handling services in specially configured facilities. This has contributed to the underutilization of AMC facilities.

Before the initiative to outsource and reduce the number of AMCs, the Postal Service had 80 AMCs — 12 percent of the facilities in the processing network. The Postal Service reduced the number of AMCs by three in FY 2006. Further reductions included 45 facilities in FY 2007 and 12 facilities in FY 2008. As of October 2008, nine additional AMCs were scheduled to close in 2009. Of the remaining 11 AMCs that will stay in operation, seven of these are to be re-classified as P&DCs, and four will remain active AMCs.

In January 2006, management implemented a nationwide integrated air strategy that included reducing reliance on passenger airlines; renegotiating and renewing the Federal Express contract; and where possible, shifting mail moved by air to less costly ground transportation. This strategy would allow the Postal Service to eliminate infrastructure because contractors would perform tender and receipt of mail and other AMC core operations, reducing or eliminating the need for some AMCs.

[10] *Strategic Transformation Plan 2006-2010*, dated September 2005.
[11] *Strategic Transformation Plan 2006-2010, 2006 Annual Progress Report*, dated December 2006.
[12] *Strategic Transformation Plan 2006-2010, 2007 Update*, dated December 2007.
[13] *Postal Accountability and Enhancement Act,* Public Law 109-435, dated December 2006.

In September 2006, the Postal Service entered into a new commercial air contract with seven air carriers: American Airlines, American Trans Air, Continental, Jet Blue, Midwest Express, Sun Country, and US Airways/America West. In April 2007, the Postal Service added on a trial basis an eighth air carrier, United Airlines. The previous commercial air contract used 17 air carriers. At the same time, the Postal Service continued with its air-to-surface initiative, which diverted 3-day First-Class Mail® volume to surface transportation. This reduction of air carriers and increased use of surface transportation provided an opportunity to use direct tender and receipt of mail.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives were to evaluate the operational and monetary impacts of the Boston AMC outsourcing initiative and compliance with outsourcing policies. To accomplish the objectives, we interviewed Postal Service employees, visited the Boston, MA, P&DC and supplier's facilities, and assessed the processes followed to comply with Article 32 requirements and contract oversight. We assessed the processes used by Postal Service employees during the pre-award phase, which included developing the comparative analysis, the solicitation for proposals, evaluating factors, proposal evaluation, price reasonableness certification, and contract award notification. We also reviewed contract files and compared service performance before and after core operations were outsourced. In addition, we reviewed available guidance for outsourcing mail processing operations at AMCs and the implications of the Postal Act of 2006.

We utilized information from two Postal Service data systems: Web Enterprise Information System and the Enterprise Data Warehouse. We did not test the controls over these systems. However, we checked the accuracy and reasonableness of the data by confirming our analysis and results with management and by consulting different data sources. We found no material differences. Because the comparative analysis developed to evaluate AMC outsourcing could not be used to project cost savings, we relied on other sources to complete our analysis. We used the Postal Service's Electronic Data Warehouse Financial Performance Report to determine AMC operating costs and compared that to contract costs.

We conducted this performance audit from July 2008 through May 2009 in accordance with generally accepted government auditing standards and included tests of internal controls that were necessary under the circumstances. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We discussed our observations and conclusions with management officials on February 27, 2009, and included their comments where appropriate.

PRIOR AUDIT COVERAGE

Report Title	Report Number	Final Report Date	Report Results
St. Louis Airport Mail Center Outsourcing	EN-AR-08-002	February 29, 2008	The decision to outsource some operations at the St. Louis AMC was supported and should reduce costs with minimal impact on service performance. However, management did not formalize lessons learned and best practices and develop guidance for measuring results. Management agreed with recommendations to formalize lessons learned, establish a post-implementation review (PIR) program for AMCs, and conduct a PIR for the St. Louis AMC.
Miami Airport Mail Center Outsourcing	EN-AR-08-004	July 16, 2008	The Postal Service's planning for the Miami AMC outsourcing initiative appeared adequate. The Postal Service made the decision to outsource some operations at the Miami AMC and reduce costs with minimal impact on service performance. Management generally complied with existing policies and procedures. Management agreed with the recommendation to conduct a PIR after outsourcing the Miami AMC to determine whether the outsourcing was cost-effective.
Data Needed to Assess the Effectiveness of Outsourcing	GAO-08-787	July 24, 2008	The audit found that the Postal Service has no statutory restrictions on the work it may outsource; however, collective bargaining agreements impose some requirements and limitations. The Government Accountability Office (GAO) recommended the Postmaster General establish a process to measure the results and effectiveness of outsourcing activities subject to collective bargaining, including tracking actual costs and savings, and comparing them with estimated costs and savings. Further, GAO recommended the Postal Service include information on the results and effectiveness of these ongoing outsourcing activities in its annual operations report, *Comprehensive Statement on Postal Operations*, to Congress.

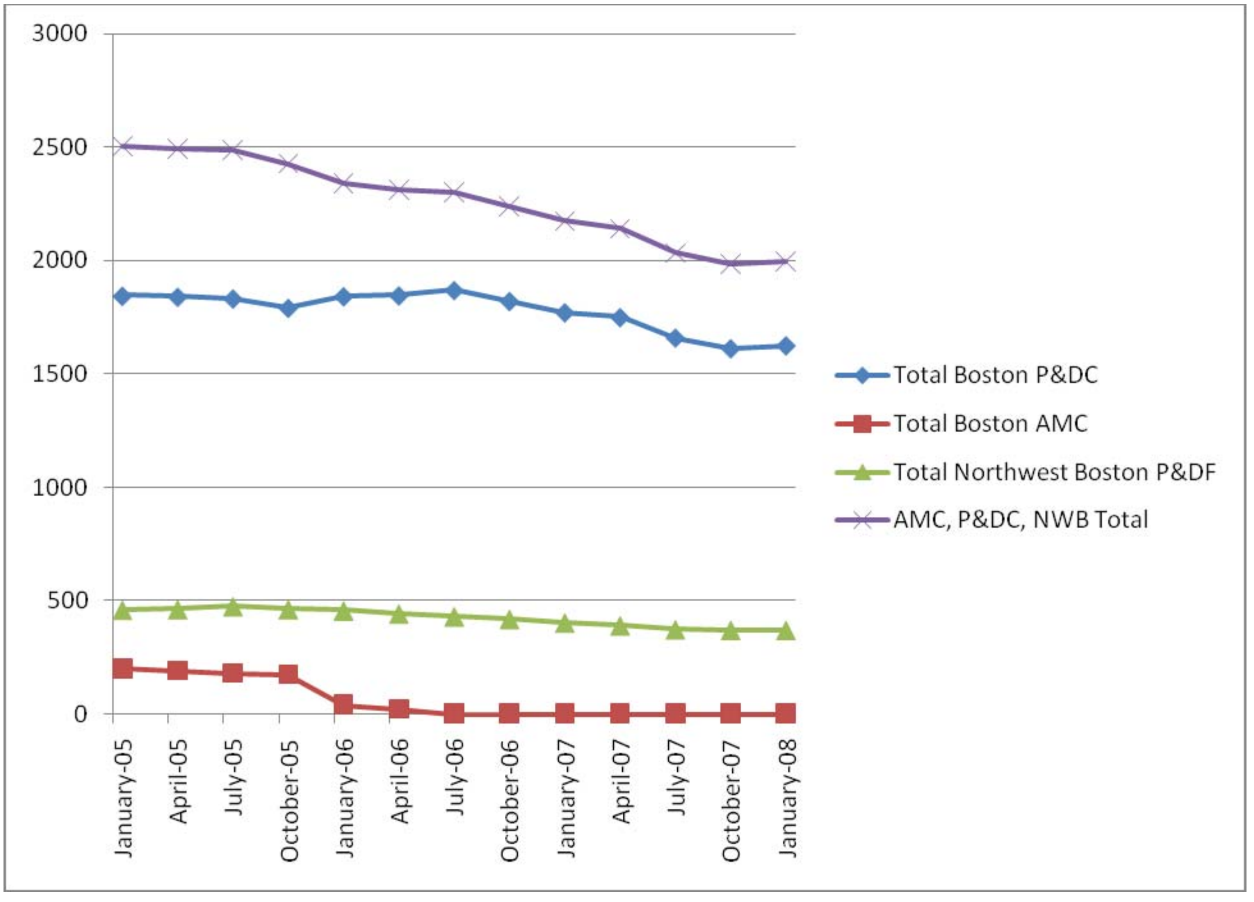
APPENDIX B: DETAILED ANALYSIS

Operational Impacts

The outsourcing of the Boston AMC functions helped the Postal Service realign its network to reduce costs.

- The majority of AMC employees (141 of 185 assigned to the Boston AMC in July of 2005) were transferred to either the Boston P&DC or NWB P&DF. Chart 1 shows the number of employees at all three facilities from January 2005 through January 2008. While there may have been some temporary increases at the Boston P&DC and NWB P&DF to accommodate reassigned employees, there were no permanent increases.

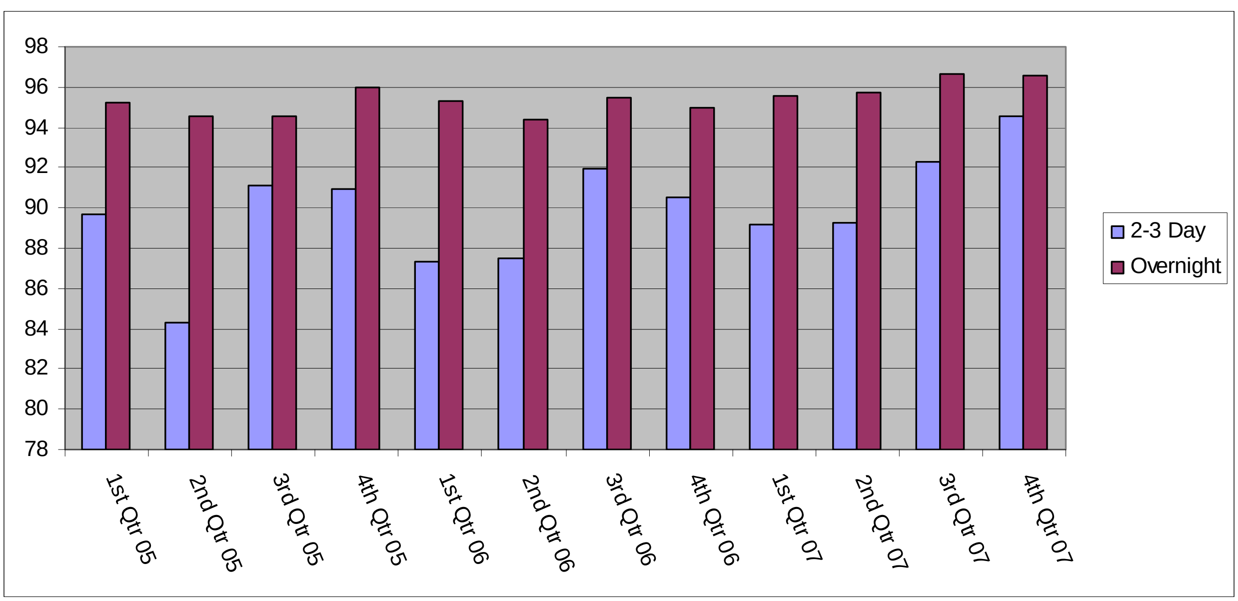
Chart 1: Boston District Employees



- The supplier met contract performance standards. Compliance is measured by exception reports filed by the Postal Service Air Transportation Supervisor and supplier when mail processed does not meet scheduled flights. We requested copies of all exception reports filed between November 2005 when the contract was awarded and December 2008, but none had been filed during this period. Since no reports had been filed, the Postal Service assumed that the supplier achieved the goal of 98 percent of mail processed in time to meet assigned flights. The Postal Service Air Transportation Supervisor confirmed that no exception reports had been filed and stated she was satisfied with the supplier's performance.

- Overall service scores for 2-day, 3-day, and overnight service within the Boston District have improved since the Boston AMC closed. Service performance is the result of many factors and is difficult to establish singular cause and effect. While we could not directly attribute the improved Boston District service performance to the closing and outsourcing of the Boston AMC, we are not aware of any other significant change in district operations that would singularly account for the improvements. We compared the first quarter of FY 2005 mail service scores for the Boston District with the mail service scores through the fourth quarter of FY 2007. We found that in the first quarter of FY 2005, 2- and 3-day mail service scores for originating and destinating mail were 89.67 percent on time. By the fourth quarter of FY 2007, the on-time rate had risen to 94.55 percent. Additionally, on-time overnight performance in the first quarter of FY 2005 was 95.21 percent and increased to 96.53 percent by the fourth quarter of FY 2007. Chart 2 below shows service scores for the Boston District.

Chart 2: Boston District Service Scores FYs 2005 – 2007



Monetary Impact

Our analysis determined that the Postal Service achieved savings by outsourcing the Boston AMC functions. We compared the Postal Service's costs for operating the Boston AMC facility to the supplier's costs for performing the AMC functions. We extracted the Boston AMC Financial Performance Report for calendar year (CY) 2005 and determined that the Postal Service's total costs for operating the Boston AMC functions were $14,686,356. The supplier's total costs to the Postal Service were $6,303,708 in CY 2006 and $6,540,627 in CY 2007. These costs included the amount paid to the supplier and salaries and benefits paid to 19 Postal Service employees located at the supplier's facility and Logan International Airport, but did not include any costs related to contract oversight. We determined the Postal Service saved, exclusive of those contract oversight costs, $8,382,648 in CY 2006 and $8,145,729 in CY 2007 as a result of the Boston AMC outsourcing.

Compliance with Policies and Procedures

Management generally complied with Article 32 of the national agreement with the unions, although compliance may be tested by arbitration. In addition, management generally complied with supply management principles and practices.

Article 32 and Outsourcing Policies

The Postal Service met Article 32 time requirements, provided the unions with the required documentation, and considered the unions' inputs and alternatives to outsourcing. However, the American Postal Workers Union (APWU) and the National Postal Mail Handlers Union (NPMHU) have filed national level disputes alleging violations of Article 32. The disputes have not yet been scheduled for arbitration.

- On August 11 and 15, 2005, the Postal Service notified the NPMHU and APWU representatives that they were considering outsourcing the Boston AMC functions.

- On August 12 and 15, 2005, Postal Service management provided the NPMHU and APWU with an analysis addressing the five factors[14] as established in the national agreement and an initial comparative analysis.

- Postal Service representatives also met and corresponded with union representatives to inform them of their intent to outsource the Boston AMC functions. Union representatives provided Postal Service management with their input on the Postal Service's justification and the initial comparative analysis.

[14] The five factors are public interest, cost, efficiency, availability of equipment, and qualification of employees.

- The Postal Service considered the unions' comments and addressed them, as required by Article 32.

Our assessment of the comparative analysis showed that the price difference was overstated by approximately $3.1 million over 11 years. This occurred because employees responsible for developing the comparative analysis omitted some port fees. The result showed a price difference of approximately $1 million in favor of outsourcing versus the $4.1 million reported by Postal Service officials. As a result, Postal Service management relied on incorrect price estimates as one of the factors used to support the decision to outsource the Boston AMC functions, but this would not have altered the decision.

Contract Oversight

We also assessed the Postal Service's contract oversight. We determined that generally, the contracting officer provided adequate contract oversight. However, additional improvements could be made.

- The supplier included unsupported parking fees in its variable costs covered in its facilities lease, and costs for equipment that was not used for mail processing after the move to the current location off airport grounds in January 2006. This occurred because staff responsible for providing contract oversight did not question the parking costs included in the variable rates and were unaware that some equipment was no longer used to process mail. As a result, the Postal Service paid $172,857 in additional parking fees and related costs[15] and $31,611 for equipment no longer used to process the mail and related costs from May 2006 through January 2009. Eliminating these costs for the remaining term of the contract (4.5 years) could save the Postal Service $318,330.

- In May 2006, the Postal Service issued a modification to the contract, increasing the mail volume to be processed by the supplier. The increase in mail volume required the supplier to provide the Postal Service with a new price sheet, which showed an increase in the price per pound the Postal Service would pay for the additional mail volume processed by the supplier. However, when the supplier updated the price sheet to reflect the new price per pound, it did not eliminate the costs for parking fees and equipment no longer required to process the mail.

- We determined that not eliminating the equipment costs resulted in unrecoverable costs to the Postal Service totaling $31,611. Eliminating these costs could result in $50,996 in funds put to better use during the remaining contract term.

[15] Related costs refer to General and Administrative fees and profit.

- We determined that payments for parking costs resulted in $172,857 of unrecoverable costs to the Postal Service. Eliminating these costs in the future could result in more than $267,334 in funds put to better use during the remaining contract term.

- On February 18, 2009, the Postal Service Chief Financial Officer (CFO) issued a letter to all Postal Service suppliers. The letter noted that the Postal Service is experiencing the largest mail volume decline in its history and suffered a net $2.8 billion loss in 2008. The CFO stated that the Postal Service was taking steps to reduce costs, increase efficiency and optimize its workforce. As a means of cost reduction, the CFO announced an initiative to reduce costs related to products and services provided by suppliers. The goal of this initiative was savings of "well over $1 billion a year." Eliminating payments for equipment not used and unnecessary parking fees will contribute to this savings initiative. See Table 1 below for costs to the Postal Service of parking fees and equipment not used by the supplier.

Table 1: Parking Fees and Equipment Not Used by Supplier

Description	Unrecoverable Costs	Funds Put to Better Use	Total
Equipment	$ 31,611	$ 50,996	$ 82,607
Parking Fees	172,857	267,334	440,191
Total	**$204,468**	**$318,330**	**$522,798**

Port Fees Paid to the Contractor

The supplier is holding $296,998 for access and port fees paid by the Postal Service that have not been paid to MASSPORT. The supplier moved off airport grounds and is currently challenging these charges.

- When the contract for terminal handling services was awarded to the supplier, the supplier intended to operate on airport grounds. Consequently, the supplier expected to pay MASSPORT 5 percent of the total contract cost in port fees. However, when the supplier moved off airport grounds, supplier officials believed they were no longer required to pay the port fees. As a result, the supplier stopped paying port fees to MASSPORT and is currently challenging the charges imposed by MASSPORT.

- Although the supplier was not making the payments to MASSPORT, the Postal Service continued paying the fees to the supplier for 22 months, but stopped paying port fees to the supplier when the Postal Service exercised the contract's first option.

- We calculated the port fees the Postal Service paid to the supplier between May 1, 2006, and August 26, 2007, and determined that the Postal Service should request a refund of $296,998 for fees the supplier has not paid to MASSPORT.

APPENDIX C: SUMMARY OF QUESTIONED COSTS AND FUNDS PUT TO BETTER USE

Description	Unrecoverable Questioned Costs[16]	Funds Put to Better Use[17]	Recoverable Questioned Costs[18]
Parking	$172,857	$267,334	
Equipment	31,611	50,996	
Port Fees			$296,998
Totals	$204,468	$318,330	$296,998

[16] Unrecoverable costs that are unnecessary, unreasonable, or an alleged violation of law or regulation.
[17] Funds that could be used more efficiently by implementing recommended actions.
[18] Recoverable costs that are unnecessary, unreasonable, or an alleged violation of laws or regulations.

APPENDIX D: LETTER TO SUPPLIERS FROM THE POSTAL SERVICE'S CHIEF FINANCIAL OFFICER

JOSEPH CORBETT
CHIEF FINANCIAL OFFICER
EXECUTIVE VICE PRESIDENT

UNITED STATES POSTAL SERVICE

February 18, 2009

[Supplier Name]
[ATTN Senior Business Unit Manager]
[Supplier Address]

Dear [Senior Business Unit Manager]

As the new Chief Financial Officer of the U.S. Postal Service, I am writing to inform you of our current financial condition and to ask for your cooperation in our efforts to reduce our costs significantly. I would much rather have the option to meet you under better circumstances, however, the sharp drop in mail volumes and our weakened financial results require quick and decisive actions.

The Postal Service is experiencing the largest mail volume decline in its history. National mail volume fell by an unprecedented 9.5 billion pieces or 4.5 percent last year, resulting in a greater than expected $2.8 billion net operating loss after making a congressionally mandated payment of $5.6 billion to pre-fund retiree health benefits. With this downward trend expected to continue for both volume and revenue, the Postal Service expects substantial losses by year's end. The Postal Service is self-supporting and funded by the revenue earned through the sale of its products and services, not through tax dollars. To maintain our ability to affordably serve the needs of American families and businesses, we must reduce our cost structures to align with declining mail volume.

This stark reality requires quick and bold action. We are taking steps to reduce costs, increase efficiency, and optimize our workforce. The Postal Service has offered early retirement to tens of thousands of eligible employees. We are reorganizing delivery routes, adjusting Post Office hours, and reducing overtime. We are postponing construction of new facilities, adjusting hours in processing plants, and consolidating mail processing operations. However, these steps are not enough. Additional cost savings actions are necessary to reduce the forecasted substantial losses. This is where you come in.

Nearly 20 percent of the Postal Service's costs are related to products and services provided by suppliers. As an important member of our supplier community, we need your help to reduce these costs so we can maintain affordable service and remain viable to best serve our customers. This initiative targets savings of well over $1 billion per year.

As a valuable customer to your business, we ask you to commit to our mutual success by helping identify possible scope reductions and process improvements and by making significant price reductions on both existing and future work. Your respective contracting officer(s) are ready to discuss our initiative. It is critical that these meetings and conversations occur as soon as possible so that we can understand your commitment levels by March 13. We seek to discuss actions that your company may implement immediately, in the short-term (two to three months), and in 2010 and beyond.

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WASHINGTON, DC 20260-5000
202-268-5272
FAX: 202-268-4364
www.usps.com

Be assured, we appreciate the difficulty in reducing contract amounts for your business. However, the results our teams mutually achieve will directly affect the Postal Service's ability to continue to spend and provide for investments in future years across our supply base.

Thank you very much for your consideration and cooperation.

Joseph Corbett

APPENDIX E: MANAGEMENT'S COMMENTS

UNITED STATES POSTAL SERVICE

May 1, 2009

LUCINE M. WILLIS

SUBJECT: Draft Audit Report – Boston Airport Mail Center (AMC) Outsourcing (Report Number EN-AR-09-DRAFT)

Thank you for the opportunity to review and comment on the subject audit report. Management's responses to Recommendations 1 through 4 are provided below.

Recommendation 1: We recommend that the Vice President, Network Operations: Ensure that all suppliers' proposed costs are included in future comparative analyses.

Management Response: Network Operations agrees that all known costs should be included in the comparative analyses. In fact, the analysis was developed in accordance with Postal Service policy, as well as the process set forth in Article 32 of national agreements with both the National Postal Mail Handlers Union and the American Postal Workers Union, and addresses the comments provided to the Postal Service after their review. However, the OIG stated that the cost difference reported in the final comparative analysis to justify outsourcing the Boston AMC was overstated by approximately $3.1 million over the ten-year-period in the model due to inadvertently omitted port fees.

The port fees were not omitted as reported by the OIG. The total port fees as noted in the J-1-SUM, in solicitation 5AAIMT-05-A-3008, by the offeror Worldwide Flight Services, for the period of 11/01/05 – 08/28/08, were $145,067.90 of which 74 percent ($107,266.28) were for Commercial Air Terminal Handling Services, and the remaining port fees were for the Shared Networks Terminal Handling Services operation. The port fees of $107,266.28 are included under Terminal Handling Services Contractor Other Costs (ground handling equipment, communications, port fees and office supplies) in the Final Cost Comparison Model for the ten-year-period totaling $1,656,061.

Please note that these were costs submitted by the offeror and awarded as such, and are correct as reported in the final financial comparative analysis. All the appropriate fees are included in the Final Cost Comparison Model, and additional fees are not required in the model as suggested. Based on the review, and receipt of the validation of the same from Lynn Malcolm, former Vice President, Controller, the decision to outsource the tender and receipt of mail at the Boston AMC was approved.

In addition, the OIG report, in Appendix B, page 11, states the following: "Postal Service management relied on incorrect price estimates as one of the factors used to support the decision to outsource the Boston AMC functions, but this would not have altered the decision." While we do not agree that Postal Service management relied on incorrect price estimates as noted above, we agree with the OIG that the decision would not have been altered and that the Postal Service made the correct decision based on the comparative analysis.

Recommendation 2: We recommend the Vice President, Supply Management: Direct the Postal Service Law Department and the contracting officer to review the contract and identify options to eliminate unnecessary contract costs to the Postal Service.

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Management Response: While we understand the intent of this recommendation and recommendation 3 below, Supply Management does not fully agree that eliminating the OIG's suggested "unnecessary contract costs" (parking fees, equipment, and port fees) is the appropriate action to take.

The supplier was awarded this work under a competitive process. The contract is a fixed price contract, and the supplier is obligated to deliver the product or service specified by the contract for that fixed price. The supplier assumes the risks associated with that price, and the profit the supplier earns depends upon the accuracy of its pricing calculations. The costs included in the Supplier's proposal represented its best estimates for performing the required work scope. Worldwide was the technically superior, lowest priced offeror and the competitive contract award to the supplier was determined to be the best value for the Postal Service.

Shortly after contract award, but prior to the start of contract performance, the supplier learned that it would not be able to perform in its proposed on-airport building. It, therefore, relocated to an off-airport site. The supplier came to the contracting officer and requested an increase in contract price because it would incur increased costs in equipment maintenance and fuel, increased equipment costs (primarily trucking), and increased facility costs. The contracting officer denied the request for increased costs because it was a fixed price contract and the supplier bore the risks associated with its need to relocate.

Charges and costs were incurred because of the move to an off-airport location. If the change was directed by the Postal Service, the Postal Service would have been responsible for absorbing those increased costs. However, in this case, the costs are born by the supplier as it had to relocate and this change was not caused by the Postal Service. As a result, the supplier had to absorb the increased costs, and assume the full cost responsibility under the fixed price contract. If this was awarded as a cost reimbursable contract, then these categorized unnecessary costs could be disallowed and payments would be adjusted accordingly. However, with a cost reimbursable contract a portion of risk would be placed on the Postal Service to reimburse the supplier for all allowable, reasonable, and allocable costs incurred. So, the Postal Service would be liable to pay for those incurred increases in costs for the move off-airport, in which the contracting officer denied. Of course, to the extent that by reason of its move, the supplier no longer incurred the costs for parking fees and equipment, the savings associated with those costs would offset the additional costs it incurred because of the move.

Contract Modification 002 was the result of a change made by the Postal Service; increased volume outside the scope of what was anticipated by the fixed price contract. The modification allowed an equitable adjustment for incremental transportation, equipment, and facility costs relating only to the increased volume. The parking fees and equipment costs that the OIG identified with respect to this recommendation, as well as the costs identified as to recommendation 4 were not relevant to or impacted by the changes made by the Postal Service in Contract Modification 002

If this were a cost-type contract, and the contracting officer were to take the opportunity to identify options to eliminate unnecessary contract costs, she would also be required to consider the increased costs the supplier incurred when it had to move off-airport. Because the contract is a fixed-cost contract, the Postal Service cannot summarily go back to the supplier and "cherry-pick" to eliminate unnecessary contracts costs. As a result of this OIG audit, the contracting officer requested the supplier to submit its costs incurred to date for this contract. The supplier will incur approximately \$2.9 million in increased costs over the life of the contract as a result of its move off-airport. In summary, undertaking to recover the costs identified by the OIG as "unnecessary" in the amount of \$615,328 (\$318,330 plus \$296,998) in this fixed price contract places the Postal Service at risk with respect to the supplier's increased costs of \$2.9 million associated with the off-airport move, as discussed above.

As was suggested by the OIG, the contracting officer consulted with the Law Department to obtain advice on the risks associated with attempting to eliminate these several identified contract costs. The Law Department advised that the fixed-price nature of the contract precluded any opportunity for the Postal Service to assert entitlement to an adjustment in that regard. Supply Management agrees with this position.

Recommendation 3: We recommend the Vice President, Supply Management: Direct the contracting officer to meet with the supplier and renegotiate contract costs based on options identified with the Postal Service Law Department.

Management Response: Despite the fact that this is a fixed price contract, management generally agrees with the concept of renegotiation due to current cost reduction efforts being employed by the Postal Service. Although, in this case, Supply Management does not fully agree that a renegotiation is the appropriate action to take with the supplier. However, we are currently negotiating the exercise of an unpriced option that will ensure categories of price reflect a more accurate picture of the current off-airport contract.

Recommendation 4: We recommend the Vice President, Supply Management: Request a refund of $296,998 from Worldwide Flight Services for port fees not paid to the Massachusetts Port Authority.

Management Response: Reference responses to Recommendations 2 and 3 above. It is not in the Postal Service's best interest to request a refund of $296,998 when the supplier will incur additional $2.9 million in costs associated with its contract performance.

We do not believe that this report contains any proprietary or business information and may be disclosed pursuant to the Freedom of Information Act. If you have any questions about this response, please contact Susan Witt at (202) 268-4833.

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