



September 28, 2005

PAUL E. VOGEL  
VICE PRESIDENT, NETWORK OPERATIONS MANAGEMENT

SUBJECT: Audit Report – Commercial Air Network Operations  
(Report Number NL-AR-05-015)

This report presents results from our self-initiated audit of Air Network Operations (Project Number 04YG023NL002) and focuses on the Commercial Air 2003 (CAIR-03) Contract. We evaluated whether air network operations were effective and identified opportunities to save money.

On June 28, 2003, the Postal Service signed the CAIR-03 Contract with 18 commercial airlines. The contract replaced the Air Systems Contract in place at the time, and was intended to improve service by measuring performance, reducing costs, and improving operations. It anticipated that the airlines would have 92 percent on-time performance for First-Class Mail.

However, according to the airlines' data for the period October 2003 through May 2005, their overall on-time performance for First-Class Mail averaged between 39 and 67 percent. In addition, according to Postal Service data, during the period June 28, 2003, through May 30, 2005, the Postal Service may have:

- Missed an opportunity to assess as much as \$700,000 in damages attributable to airline contract irregularities.
- Missed an opportunity to assess as much as \$2.2 million in damages attributable to transportation failures caused by the airlines.
- Inadvertently incurred about \$4.4 million in costs from Postal Service caused transportation failures.

Potential damage assessments were missed and additional costs were incurred because management controls needed improvement.

By improving controls, the Postal Service can recover as much as \$3.2 million in damages over the next 2 years and save as much as \$3.5 million in operating efficiencies.

Management has taken some action to address control issues; however, we remain concerned about the control environment. We recommended management aggressively pursue damage penalties where possible; ensure that systems are operating as intended; and strengthen management controls as required.

Management agreed with all our recommendations. They stated they would pursue damages where it made financial sense and would ensure all systems were functioning as intended. They concurred that delays in system implementation and training had prevented the Postal Service from collecting monies that were due and stated that, by implementing our audit recommendations, the Postal Service would be able to properly administer that process. Management's comments and our evaluation of these comments are included in the report.

The Office of Inspector General (OIG) considers recommendations 1, 2, and 3 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 the recommendations can be closed.

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

/s/ Mary W. Demory

Mary W. Demory  
Deputy Assistant Inspector General  
for Core Operations

Attachment

cc: Patrick R. Donahoe  
William P. Galligan  
Anthony M. Pajunas  
Steven R. Phelps

## INTRODUCTION

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### Background

The Postal Service contracts with commercial airlines to transport mail. When mail is to be moved by air, Postal Service air mail centers receive it from mail processing facilities, and distribute or “tender” it to the various airlines.

**United States Postal Service  
Air Mail Center  
at the  
Hartsfield-Jackson  
Atlanta International Airport  
December 2004.**



On June 28, 2003, the Postal Service signed the Commercial Air 2003 (CAIR-03) Contract with 18 commercial airlines. The new contract replaced the

**Delta Airlines loading mail  
at the  
Hartsfield-Jackson  
Atlanta International Airport  
December 2004.**



Air Systems (ASYS) Contract in place at the time, and was intended to improve service by measuring performance, reducing costs, and improving operations. It anticipated that the airlines would have 92 percent on-time performance for First-Class Mail.

The new contract required airlines to accept mail at the point of origin, load it on airplanes, transfer it at any intermediate points, and return it to Postal Service control at the point of final air destination. The contract also required airlines to electronically scan mail in order to document acceptance, loading, transfer, and return.

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**Irregularities**

The contract defined irregularities as instances when the airlines fail to meet their contractual obligations. Irregularities include the airlines' failure to do the following:

- Load and transport mail.
- Protect mail in airline possession.
- Notify the Postal Service of any flight delays, cancellations, or other changes in expected service.

When such contract violations or irregularities occur, the Postal Service is entitled to reimbursement for damages in accordance with the contract penalty schedule.

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**Repossession**

Sometimes mail tendered to airlines cannot be transported to the final air destination on time. When mail cannot be transported on time, the Postal Service may be required to repossess it and reassign it to alternate transportation. Whenever the Postal Service must repossess and reassign mail, delivery to Postal Service customers can be delayed, and the Postal Service incurs unnecessary costs. Transportation failure can be:

- The fault of the airline.
- The result of unanticipated events such as severe weather.
- The fault of the Postal Service for operational inefficiencies such as tendering mail late or assigning too much mail to an airline.

If transportation failure is the fault of the airline, the Postal Service is again entitled to receive monetary reimbursement for damages to recover the costs of rehandling mail.

## Electronic Scanning Systems

Electronic scanning systems are important tools that both the Postal Service and airlines use to properly administer the CAIR-03 Contract. The scanning systems are used to

**The CAIR-03 Contract requires the Postal Service to put dispatch and routing (D&R) tags on all mail handling units.**

**The photograph shows D&R tags being applied to mail trays at the Atlanta Air Mail Center in August 2004.**



track mail and document circumstances associated with potential transportation failures. The contract requires the Postal Service to put D&R tags on all mail trays, sacks, and

**Airline personnel accepting mail for transport by scanning D&R tags at the Atlanta Air Mail Center in August 2004.**



packages. Collectively, individual packages or containers, like mail trays or sacks, are referred to as mail handling units. The Postal Service places D&R tags on all mail



handling units so airline personnel can electronically scan mail at prescribed points while it is in the airlines' possession. The electronic scanning system relies on handheld scanners, specifically designed software and hardware, other electronic equipment, detailed published procedures, and properly trained personnel.

By effectively employing electronic scanning systems, the Postal Service can:

- Properly account for all mail in airline possession.
- Document responsibility for irregularities or repossessions, assess appropriate damages, and hold airlines accountable.
- Pay airlines only for mail they actually transport.
- Assess and improve both airline and Postal Service performance.

The photographs show an electronic scanner (left) and printer (right) used by Postal Service personnel to scan mail.



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### Objectives, Scope, and Methodology

This report presents results from our self-initiated audit of air network operations. The objectives of our audit were to evaluate whether air network operations were effective, and identify opportunities to save money.

During our audit work, we interviewed officials at headquarters and in the Southeast Area. We visited the Atlanta Air Mail Center; interviewed supervisors, employees, and airline personnel; and observed and photographed operations. We examined relevant Postal Service policies and procedures, the expired Air Systems Contract, the current CAIR-03 Contract, and other appropriate documents or records. We consulted financial analysts, computer analysts, and other subject matter experts. We analyzed nationwide Postal Service data, airline data, mail volume, performance standards, and actual airline performance.

To evaluate monetary impact, we used the damage schedule in the CAIR-03 Contract. We also discussed our observations and conclusions with appropriate management officials and included their comments where appropriate.

This audit was conducted from May 2004 through September 2005 in accordance with generally accepted government auditing standards, and included such tests of internal controls as were considered necessary under the circumstances.

During our audit, we examined computer data in management's "Surface – Air Support System" and other electronic data management systems. We did not comprehensively audit or validate the data; however, several control weaknesses delayed and constrained our work. For example, electronic records and data were incomplete because at the time of our work, necessary hardware, software, or other electronic equipment was not fully deployed; Postal Service employees were not properly recording repossessed mail; and the policies required to evaluate Postal Service or airline performance were incomplete or needed clarification.

Although data and other internal control limitations constrained our work, we partially compensated by applying alternate audit procedures, including examination of source documents, observation, approximation, physical inspection, and discussion with responsible officials. For example, because accurate data was not readily available to help us evaluate the monetary impact of repossessions caused by the Postal Service, we used the damage schedule in the CAIR-03 to approximate monetary impact.

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**Prior Audit Coverage**

Our audit report, Mail Backlogs at the Hartsfield-Jackson Atlanta International Airport (Report Number NL-AR-05-002, dated March 8, 2005), described significant mail delays during the 2004 - 2005 Christmas holiday season. On-site Postal Service employees explained that the delayed mail had been tendered to Delta Airlines and was in Delta's possession; the Postal Service was repossessing the mail and assigning it to alternate transportation; scanning

Hartsfield-Jackson  
Atlanta International Airport  
December 2004.

Mail staged on the airport  
tarmac awaiting  
transportation by Delta  
Airlines.



equipment was not adequate for the amount of mail they were required to repossess; and they were probably rehandling the same mail several times. We recommended that the Postal Service inquire into the conditions involving Delta Airlines and take appropriate corrective action.



## RESULTS

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### Commercial Air Operations

Commercial airlines did not always meet their contractual obligations and did not meet the 92 percent on-time performance anticipated for First-Class Mail. In addition, the Postal Service incurred unnecessary costs because Postal Service employees tendered mail to airlines that should not have been tendered, and as a result, mail had to be repossessed.

According to airline data, during the period October 2003 through May 2005, overall airline on-time performance for First-Class Mail averaged between 39 and 67 percent.

According to Postal Service data, during the period June 28, 2003, through May 31, 2005, the Postal Service may have:

- Missed an opportunity to assess as much as \$700,000 in damages attributable to airline irregularities.
- Missed an opportunity to assess as much as \$2.2 million in damages attributable to transportation failures caused by the airlines.
- Inadvertently incurred about \$4.4 million in costs from transportation failures caused by the Postal Service.

The Postal Service missed opportunities to improve efficiency, recover penalties, and reduce inadvertent cost because officials needed to improve the control environment. By correcting the control environment, the Postal Service can recover as much as \$3.2 million in damages over the next 2 years and save as much as \$3.5 million in operating efficiencies.

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### Airline Contract Irregularities

Nationwide Postal Service data for the period June 28, 2003, through May 31, 2005, identified more than 157,500 potential contract irregularities resulting from airline contract violations such as failure to load, transport, or protect mail. However, the Postal Service did not properly document these incidents. As a result, the Postal Service could not verify or refute the facts surrounding the irregularities, including mitigating circumstances; could not

always establish monetary damages; and could not hold the airlines accountable. Consequently, the Postal Service did not recover penalties associated with any of the 157,500 potential contract irregularities. Because data or records were unreliable or unavailable, we could not precisely establish the monetary impact of airline contract violations. However, we conservatively estimated that unrecoverable damages were as much as \$700,000.

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#### Mail Repossession and Reassignment

During the analysis period June 28, 2003, through May 31, 2005, the Postal Service repossessed more than 1.2 million air mail handling units nationwide.

- More than 465,000 units, accounting for about 39 percent of the total units, were repossessed because of airline failure.
- More than 690,000 units were repossessed because of Postal Service caused problems such as assigning too much mail to an airline or assigning the mail too late for it to be transported on time. Problems caused by the Postal Service accounted for about 57 percent of the total.

The Postal Service recovered minimal damages for the repossessions identified. Because Postal Service data or records were unreliable or unavailable, we could not precisely establish the monetary impact of repossessing mail and reassigning it to other transportation. However, using the contract penalty schedule as an approximate surrogate for cost, we estimated monetary impact as follows.

#### Monetary Impact of Repossessing and Reassigning Mail

At Fault	Units*	Percentage	Potential Monetary Impact
Airline	465,768	39	\$2.2 million
Postal Service	690,921	57	\$4.4 million
No-fault	<u>56,557</u>	<u>4</u>	<u>Not applicable</u>
Total	1,213,246	100	\$6.6 million

\*Source: Surface - Air Support System

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System of Control	<p>The Postal Service lost potential damage recoveries and incurred unnecessary costs because when the CAIR-03 Contract was signed in June 2003, the system of management control supporting the contract was not fully in place. For example:</p> <ul style="list-style-type: none"><li>• Handheld devices for recording irregularities and repossessions were not deployed until March 2004.</li><li>• Software updates to accommodate the new contract were not completed until June 2004.</li><li>• Software did not properly interface with the systems needed to properly record or adjudicate incidents.</li><li>• Policies and procedures associated with the new contract were not updated and contained provisions associated with the previous Air Systems Contract that no longer applied. Consequently, employees were not properly trained.</li><li>• Terms for categorizing repossessions were vague or unclear. For example, Postal Service employees could not define or explain the categories “other” or “job action,” and as a result, their use of these undefined categories was inconsistent.</li></ul> <p>Because controls were not fully in place, did not apply, or were inconsistently applied, circumstances associated with contract irregularities and mail repossessions were not properly documented, and the Postal Service could not pursue recoveries, take needed corrective action, hold airlines accountable, or improve performance.</p>
Management Action	<p>After the CAIR-03 Contract was signed, Postal Service officials recognized that controls needed improvement and explained that they took action to improve controls and recover damages where possible. However, officials acknowledged that because weak controls existed, recoveries were minimal. Although management has responded to the control weaknesses, we remain concerned about the control environment. For example:</p>

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- As of the issue date of this report, the policies and procedures that Postal Service officials need to properly administer the CAIR-03 Contract still require development, update, or clarification.
- System deficiencies continue to prevent assessment of damages for irregularities.
- Our subsequent on-site inspections of the Atlanta Air Mail Center suggest that employees are still not properly using the electronic scanning equipment issued to them, or properly recording irregularities or repossessions.
- Our nationwide analysis of data suggests continuing data integrity problems, and that because of inadequate documentation, damages and needed corrective actions are not being adequately pursued.

The Inspector General Act of 1978, as amended, requires that we specify the dollar value of unnecessary costs or potential savings we identify. Because of control weaknesses, including data integrity and documentation problems, we could not precisely quantify the dollar value of unnecessary costs or potential savings. However, using as a baseline the rate of missed opportunity during the analysis period June 28, 2003, through May 31, 2005, and assuming a constant rate if control weaknesses are not corrected, the Postal Service can, over the next 2 years, correct weaknesses, recover as much as \$3.2 million in damages, and save as much as \$3.5 million by correcting problems caused by the Postal Service.

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**Recommendation**

We recommend the vice president, Network Operations Management:

1. Aggressively pursue damages where possible, consistent with an assessment of the costs of pursuing such recoveries.

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**Management's Comments**

Management agreed with our recommendation. They stated that where it made financial sense, the Postal Service would pursue collection of damages from

commercial air carriers. Management's comments, in their entirety, are included in the appendix of this report.

<b>Recommendation</b>	2. Ensure that all systems for implementing contract damage provisions are functioning as intended.
<b>Management's Comments</b>	Management agreed with our recommendation. They stated that Network Operations Management would ensure all systems were functioning as intended.
<b>Recommendation</b>	<p>We recommend the vice president, Network Operations Management:</p> <p>3. Strengthen the control environment by issuing or updating required policies and procedures; training employees; and taking other control steps as required.</p>
<b>Management's Comments</b>	<p>Management agreed with our recommendation. They stated that:</p> <ul style="list-style-type: none"> <li>• Relevant policies and procedures were updated on June 4, 2004, and October 8, 2004.</li> <li>• Final policy for repossessions/reassignments was issued as of October 21, 2004.</li> <li>• Terminology would be clearly defined in October 2005 to eliminate ambiguity in repossession reason codes.</li> <li>• New surface air support system mobile devices would be deployed and activated commencing in October 2005 and would enhance performance controls.</li> <li>• Refresher training would commence in October 2005 and would continue throughout the deployment and activation of the new surface air support system mobile devices.</li> </ul>

Although management's response was unclear as to why, management also stated that while they agreed with our

recommendation, they did not agree with our finding. Their disagreement notwithstanding, management concurred that delays in system implementation and training had prevented the Postal Service from collecting monies that were due, and that by implementing our audit recommendations, the Postal Service would be able to properly administer that process.

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**Evaluation of  
Management's  
Comments**

Management's comments are responsive to our recommendations and we consider management's actions, taken or planned, sufficient to address those recommendations. We appreciated the open communication management provided throughout our audit, and during our standard process for closing significant recommendations, we will seek to continue that cooperation and resolve any disagreement with our findings.



## APPENDIX. MANAGEMENT'S COMMENTS

PAUL VOGEL  
VICE PRESIDENT, NETWORK OPERATIONS MANAGEMENT



KIM H. STROUD

SUBJECT: Transmittal of Draft Audit Report – Commercial Air Network Operations  
(Report Number NL-AR-05-DRAFT)

Please find attached a response to the recommendations on the subject audit report which focused on the effectiveness of the *commercial air network* and identified cost savings opportunities.

Your audit confirmed many of the conclusions that we had previously drawn and had been working to correct. The audit states that significant cost savings could be realized by pursuing irregularities in carrier operations that involve monetary administrative assessments, and supplying field personnel with control tools and training to effectively use those tools.

We agree and, in fact, our control policies related to Repossessions/Reassignments have been final since October 21, 2004. The policy for irregularities has been final since November 1, 2004. Enhancements to the surface air support system mobile devices and field training will commence in the October 2005 time frame and close the loop on the initial collection of data to initiate the performance controls desired. Collection of irregularity data is critical to complete the adjudication process and issue assessments.

In response to the conclusion that the U.S. Postal Service (USPS) missed an opportunity to collect fines or incurred additional costs of approximately \$7,277,563 from contract inception, we concur that delays in system implementation and training prevented us from collecting the monies due the USPS. By implementing the recommended actions in your audit, we will be able to properly administer this process.

Should you require further information, please contact John Bonafilia, Manager, Commercial Air Operations, at (202) 268-2784.

A handwritten signature in dark ink, appearing to read "Paul Vogel".

Paul Vogel

Attachment

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WASHINGTON DC 20260-7100  
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FAX: 202-268-6251  
www.usps.com

- 1) **Recommendation – Aggressively pursue damages where possible, consistent with an assessment of the costs of pursuing such recoveries.**

**We agree with the recommendation.**

Where it makes financial sense, the U.S. Postal Service will pursue collection of damages from commercial air carriers.

- 2) **Recommendation – Ensure that all systems for implementing contract damage provisions are functioning as intended.**

**We agree with the recommendation.**

Network Operations Management will ensure all systems are functioning as intended.

- 3) **Recommendation – Strengthen the control environment by issuing or updating required policies and procedures; training employees; and taking other control steps as required.**

**We agree with the recommendation, but not the finding.**

The relevant policies and procedures were updated on June 4, 2004, and October 8, 2004. Final policy was issued and remains in place for repossessions/reassignments as of October 21, 2004.

Refresher training is scheduled to commence on October 2005 and will continue throughout the deployment and activation of the new surface air support system mobile devices.

Repossession terminology will be clearly defined on October 2005 to eliminate ambiguity within the repossession reason codes.