Office of Inspector General

April 21, 2005

JOHN M. NOLAN
DEPUTY POSTMASTER GENERAL

SUBJECT: Vehicle Management – National Trailer Lease – Unresolved Audit Recommendations (Report Number NL-MA-05-001)

This report is a follow-up on unresolved recommendations from our audits of the Postal Service's National Trailer Lease (Project Number 05YG001NL002).

During fiscal year 2000, the Postal Service began a major, multiphased, corporate initiative to terminate local trailer contracts, centralize trailer acquisition at Corporate Headquarters, and commit to a single national contractor. In September 2000, the Postal Service signed a "National Trailer Lease" with Transportation International Pool, Inc., a wholly-owned trailer leasing subsidiary of General Electric. The anticipated cost of the 12-year agreement was more than $250 million. We issued several reports on the acquisition. Collectively or individually, our reports concluded:

- The Postal Service did not adequately consider the number of trailers required, and consequently, may have leased more trailers than needed.
- The Postal Service could have saved money by purchasing needed trailers, instead of leasing them.
- The acquisition decision was not supported by reliable data, necessary documentation, or adequate records.
- The acquisition decision did not comply with the analytical or approval requirements of Postal Service "expense investment" policy, which requires leases and major corporate initiatives to be supported by a decision analysis report.

We recommended that in accordance with investment policy, management prepare a decision analysis report and submit it to the Board of Governors for approval. However, management stated that they were not obligated to prepare a decision analysis report or comply with investment policy because the acquisition was not a capital investment; the National Trailer Lease was not a lease; decision analysis reports were too costly to prepare; and the procurement did not reach the Governors' threshold of materiality.

1735 N Lynn St.
Arlington, VA 22209-2020
(703) 248-2100
Fax: (703) 248-2256

In July 2002, to resolve disagreement, you instructed Operations to complete a trailer plan analysis, and Finance to independently verify it “just as capital projects are.” Since capital projects are analyzed and verified in accordance with decision analysis report procedures specified by Postal Service investment policy, we welcomed your instructions to management, and considered them responsive to our decision analysis report recommendation.

In April 2004, Corporate Audit Response notified us that management had completed the analysis and verification you directed. Since you instructed management to analyze and independently verify the leasing plan “just as capital projects are,” we anticipated that the analysis and verification would be prepared and validated with the same exacting criteria as a decision analysis report.

Our examination of the “analysis” identified it as substantially the same as management’s response to our original 2002 draft audit report. That response was the subject of our original audit resolution referral. Consequently, we concluded that the analysis was not prepared in accordance with your instructions. Our examination of the Finance “verification’” also concluded that the verification was not prepared in accordance with your instructions.

Since the resubmitted audit response and verification did not comply with our expectations, we considered disagreement with our audit recommendations unresolved. We recommended that you (1) reinforce and clarify your instructions to management and (2) establish guidance to clarify the appropriate level of analysis and authority when leases or major operational investments are not covered by investment policy.

On December 1, 2004, we met with management officials to review our conclusions. As a result of that meeting, subsequent discussion, and in the context of other related audit work, management agreed to reaffirm previous commitments. Specifically, management reaffirmed that:

- They would use new data to perform a new analysis of the trailer leasing plan, and that they would perform the analysis in sufficient time to allow the Office of Inspector General (OIG) to examine it before the first National Trailer Lease extension in 2006.

- They would clarify Postal Service investment policy as part of an entire revision of Postal Service Handbook F-66, General Investment Policies and Procedures.

In consideration of management’s commitment to clarify policy and perform a new analysis, we will close outstanding unresolved decision analysis report recommendations from previous audit reports (See Appendix A). Closing the unresolved audit recommendations will have the effect of removing the associated monetary findings from the Semiannual Report to Congress, and those reports can be closed in the Postal Service follow-up tracking system. We commend management for their continuing efforts to work with us to resolve these issues.

The OIG considers recommendations 1 and 2 significant, and therefore requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when 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 your efforts to facilitate the audit resolution process. If you have any questions, please contact me at (703) 248-2300.

/s/ Gordon C. Milbourn III

Gordon C. Milbourn III
Assistant Inspector General
for Audit

Attachment

cc: Patrick R. Donahoe
Richard J. Strasser
Lynn Malcolm
Paul E. Vogel
Keith Strange
Steven R. Phelps

INTRODUCTION

Background

During fiscal year 2000, the Postal Service began a major, multiphased, corporate initiative to terminate local trailer contracts, centralize trailer acquisition at Postal Service Headquarters, and commit to a single national contractor.

In September 2000, the Postal Service signed a "National Trailer Lease" for 4,475 trailers with Transportation International Pool, Inc., a wholly-owned trailer and equipment leasing subsidiary of General Electric. The anticipated cost of the 12-year agreement was more than $250 million. Management stated that the centralized national contract would reduce the average cost to lease a trailer from $11.57 to $10.21 per day, and save the Postal Service more than $2.2 million annually.

National Trailer Lease equipment at the San Francisco Bulk Mail Center February 11, 2004

In March 2002, the New York Metro Area requested 1,500 additional trailers under National Trailer Lease Phase II. The lease plus renewal option was again 12 years, and the anticipated cost exceeded $40 million. New York explained they were excluded from Phase I because at the time Phase I was negotiated, their local contracts would not expire for three years.

We audited National Trailer Lease Phase I and Phase II (See Appendix A), and concluded that the Postal Service did not properly analyze the trailer procurement decision. Specifically:

- The Postal Service did not adequately consider the number of trailers required, and consequently, may have leased more trailers than needed.

- The Postal Service could have saved money by purchasing needed trailers instead of leasing them.

- The acquisition decision was not supported by reliable data, necessary documentation, or adequate records.

- The acquisition decision did not comply with Postal Service "expense investment" policy.

We recommended that in accordance with investment policy, management prepare a Decision Analysis Report and submit it to the Board of Governors for approval.

National Trailer Lease equipment at the San Francisco Bulk Mail Center February 11, 2004

Management acknowledged that the New York acquisition was a planned phase of the National Trailer Lease, and that policy required multiphased acquisitions to be presented as a single plan. Management agreed that New York already had more trailers than needed, agreed to immediately return 300 trailers to suppliers, and estimated that returning trailers would save more than $1 million annually. Management also acknowledged that Postal Service computer data was unreliable because it did not accurately capture all operational requirements.

However, management stated that they were not obligated to comply with investment policy or prepare a decision analysis report because:

- The acquisition was not a capital investment.

- The "National Trailer Lease" was not a lease, it was a service contract.

- Decision analysis reports were too costly to prepare.

- The National Trailer Lease did not reach the Governors' threshold of materiality.

Management's position was inconsistent with investment policy:

- An acquisition does not have to be a "capital investment" to be subject to policy. The policy identifies "expense investments" as another investment category subject to its provisions.

- The policy explains that "expense investments" include both leases and major corporate initiatives, and further defines major corporate initiatives as operating fund expenditures exceeding $7.5 million over a project period.

- For purposes of determining project period, investment policy requires the inclusion of the initial lease term plus all renewal options. The National Trailer Lease plus renewal option is 12 years.

- Investment policy requires that lease agreements exceeding $10 million be forwarded to the Board of Governors for final approval. The anticipated cost of the National Trailer Lease is more than $250 million.

Since management did not concur with our opinion that Postal Service investment policy applied, we referred the matter to audit resolution. During resolution, the Deputy Postmaster General instructed Operations to complete a trailer lease analysis, and instructed Finance to verify it just as capital projects are. Capital projects are analyzed and validated in accordance with investment policy, specifically the decision analysis report provisions of Postal Service Handbook F-66, General Investment Policies and Procedures. We welcomed the Deputy Postmaster General's instructions to management, and considered the instructions responsive to our decision analysis report recommendation.

Investment policy stipulates that before a lease versus buy analysis is performed, organizations requesting the acquisition must first establish that the investment is actually needed. The provisions emphasize that the investment decision to actually acquire assets must always be separated from the lease or buy financing decision. In 2001, senior management issued a memorandum addressing lease versus buy. The memorandum—like the Deputy Postmaster General's instructions—specified that the same exacting criteria used for a capital purchase should be used for equipment leases.

April 9, 2001

Memorandum to Postal Service Officers:

"…In 'lease versus buy' alternatives, the substitution of leasing equipment instead of purchase must be examined under the same exacting criteria as a capital purchase. Circumventing the capital process by leasing equipment does not help the bottom-line, and does have an immediate impact on our cash outlays…"

Richard J. Strasser, Jr.	**John E. Potter**
Chief Financial Officer	**Chief Operating Officer**
Executive Vice President	**Executive Vice President**

In April 2004, Corporate Audit Response notified us that management had completed the analysis and verification the Deputy Postmaster General directed on July 22, 2002.

Objective, Scope, and Methodology

The objective of this report is to notify management of our opinion regarding the documents submitted to address the Deputy Postmaster General's instructions and our recommendations.

During our work, we interviewed Postal Service officials, examined documents and supporting records submitted by management, reviewed related ongoing audit work, and consulted with statisticians, economists, financial analysts, and other subject matter experts.

Work associated with this report was conducted from May 2004 through April 2005 in accordance with the President's Council on Integrity and Efficiency, Quality Standards for Inspections. We discussed our observations and conclusions with appropriate management officials and included their comments where appropriate.

RESULTS

Trailer Acquisition Analysis

The documents Corporate Audit Response provided did not properly consider:

- Whether all trailers acquired were actually needed.
- Whether needed trailers should be owned or leased.

Consequently, they were inconsistent with Postal Service investment policy and the Deputy Postmaster General's instructions. As a result, disagreement with our recommendations remained unresolved.

Two National Trailer Lease trailers passing near Springfield, Massachusetts, March 2, 2004

Management Commitments

Two commitments, by management in 2002, drove our expectations regarding the analysis management was to prepare.

- On January 7, 2002, management explained that the new trailer lease would provide new data; that they would use that new data to perform a new analysis before the first lease extension in 2006; and that they would welcome OIG review of the new analysis prior to lease extension.
- On July 22, 2002, the Deputy Postmaster General told us that management would analyze and independently verify the leasing plan so that the analysis would be comparable to what would be found in a decision analysis report.

Our examination of the "analysis" identified it as substantially the same as management's response to our original 2002 draft audit report, which was the subject of our original audit resolution referral. We published management's original response, in its entirety, in our report dated March 29, 2002—and also published a detailed critique. Concerns specified in our critique remain the same.

Beyond our detailed critique of management's original audit report response, the documents management submitted in 2004, did not comply with the Deputy Postmaster General's instructions or investment policy. For example:

- The Deputy Postmaster General instructed Operations to complete a trailer lease analysis. The resubmitted response was prepared by Supply Management—not Operations.

- Investment policy specifies that the project sponsor analyze operations to determine if the acquisition is actually needed. The resubmitted response never contained an operational requirement assessment, and consequently, never evaluated whether all trailers were actually necessary.

- Investment policy requires accurate data, and states that when computer generated data is not reliable, data must be collected manually. The resubmitted response relied on inaccurate data. Our ongoing work identified significant data and record retention weaknesses. Consequently, we questioned the need for 700 trailers in the New York Metro Area, and the need for 250 trailers in the Northeast Area.

- Investment policy requires that various phases of a project requiring implementation over several years be presented as a single project. The resubmitted response related only to National Trailer Lease Phase I—not Phase II. As a result, the response was incomplete. In May 2004, officials explained that the Phase II analysis management agreed to perform in 2002 was not yet complete, and would not be completed for several months. The Phase II analysis still has not been completed.

Independent verification

The Deputy Postmaster General instructed Finance to independently verify Operations' analysis "just as capital projects are." Capital projects are verified in accordance with Postal Service investment policy, which defines "independent verification" as synonymous with "validation." The policy states:

> *"A **validation is** an independent **verification** of the accuracy and integrity of the statements, assumptions, data, and performance tracking methods presented in support of a project."*

However, Finance acknowledged that a validation was not done. Finance explained that there was an important distinction between a validation and a verification, that the Deputy Postmaster General only directed a verification, and never intended a validation. Finance emphasized that since a decision analysis report was not prepared, a validation was not required.

Consequently, the Finance verification was not conducted in accordance with the validation standards specified by investment policy. For example:

- Ongoing audit work identified numerous data integrity, documentation, record retention, and internal control issues. Senior Postal Service officials agreed computer data associated with trailer use is unreliable, and in several reports, we noted that inaccurate data and other internal control issues constrained our work. Finance did not evaluate or verify the accuracy, reliability, or completeness of data underlying the resubmitted response; did not confirm, as required, that supporting documentation complied with investment policy; and did not identify exceptions associated with data integrity issues.

- The resubmitted response did not include a requirement assessment to determine how many trailers were actually needed, and Finance did not identify the absence of a requirement assessment as an exception to investment policy.

Since the analysis and verification were not substantially the same as a decision analysis report and validation; since

National Trailer Lease Phase I and Phase II were not presented as a single plan; and because there was no requirement assessment to consider if all the trailers acquired were actually needed, it is our opinion that the resubmitted response, and the Finance verification of that response, did not address the Deputy Postmaster General's instructions. Consequently, we considered disagreement with our audit recommendation unresolved.

It is the OIG's position that the analytical, verification, and approval procedures established by Postal Service expense investment policy, for leases and major corporate initiatives, provide an excellent framework for analyzing, validating, and approving major procurement decisions. Management contends that the National Trailer Lease was neither a lease nor an initiative, and that as a result, Postal Service investment policy does not apply. Based on that interpretation, we could not identify a Postal Service policy that provided the analytical discipline commensurate with a $250 million trailer acquisition. Consequently, we are concerned about a potential policy void.

Recommendation

We recommend the Deputy Postmaster General:

1. Reinforce and clarify instructions to Postal Service management regarding the analysis and verification of the National Trailer Lease.

2. Establish guidance to clarify the appropriate level of decision analysis and authority, consistent with the magnitude of the business decision being made, when leases or major operational changes are not covered by investment policy.

Management Agreements

On December 1, 2004, we met with management officials to review our conclusions. As a result of the meeting, subsequent discussion, and in the context of other related audit work, management agreed to reaffirm previous commitments. Specifically, management reaffirmed that:

- They would use new data to perform a new analysis of the trailer leasing plan, and that they would perform the analysis in sufficient time to allow the OIG to examine it before the first National Trailer Lease extension in 2006.

- They would clarify Postal Service investment policy as part of an entire revision of Postal Service Handbook F-66, General Investment Policies and Procedures.

Evaluation of Management Agreements

Management's agreements are responsive to our recommendations, and we consider their commitment to clarify policy and perform a new analysis sufficient to address the issues we identified.

In consideration of management's commitment to clarify policy and perform a new analysis, we will close outstanding unresolved decision analysis report recommendations from previous audit reports as follows:

- Trailer Lease Justification (Report Number TD-AR-02-002, March 29, 2002).
- New York Metro Area Operational Use of Trailers (Report Number TD-MA-03-001, January 29, 2003).
- New York Metro Area Trailer Acquisition – Lease versus Buy (Report Number TD-AR-03-009, March 31, 2003).

Closing the unresolved audit recommendations will have the effect of removing the associated monetary findings from the Semiannual Report to Congress, and those reports can be closed in the Postal Service follow-up tracking system. We commend management for their continuing efforts to work with us to resolve these issues.

APPENDIX A. PRIOR REPORT CONCLUSIONS

This report explains that our various reports on National Trailer Lease Phase I and Phase II, either collectively or individually, concluded the Postal Service did not properly analyze the trailer procurement decision—and we provided specific examples. The purpose of this appendix is to cross reference the specific examples to various reports.

"The Postal Service did not adequately consider the number of trailers needed for operations, and consequently, may have leased more trailers than needed."

- New York Metro Area Operational Use of Trailers (Report Number TD-MA-03-001, January 29, 2003).

"The Postal Service could have saved money by purchasing needed trailers instead of leasing them."

- Trailer Lease Justification (Report Number TD-AR-02-002, March 29, 2002).
- New York Metro Area Trailer Acquisition – Lease versus Buy (Report Number TD-AR-03-009, March 31, 2003).

"The acquisition decision was not supported by reliable data, necessary documentation, or adequate records."

- Trailer Lease Justification (Report Number TD-AR-02-002, March 29, 2002).
- New York Metro Area Trailer Acquisition – Lease versus Buy (Report Number TD-AR-03-009, March 31, 2003).

"The acquisition decision did not comply with Postal Service 'expense investment' policy."

- Trailer Lease Justification (Report Number TD-AR-02-002, March 29, 2002).
- New York Metro Area Trailer Acquisition – Lease versus Buy (Report Number TD-AR-03-009, March 31, 2003).