

March 29, 2002

KEITH STRANGE
VICE PRESIDENT, PURCHASING AND MATERIALS

SUBJECT: Audit Report – Trailer Lease Justification
(Report Number TD-AR-02-002)

This report presents the results of our self-initiated audit of the Postal Service trailer fleet (Project Number 00PA032TR002). This report is one in a series of reports and focuses on the Postal Service's decision to lease 4,475 trailers rather than purchase them. Our objective was to evaluate whether the decision to lease trailers minimized cost.

The audit revealed the Postal Service could save \$85 million over the next 12 years by purchasing rather than leasing trailers, and that management did not comply with Postal Service investment policy, including the development of a Decision Analysis Report approved by the Board of Governors. We recommended management immediately prepare a Decision Analysis Report and submit it to the Board of Governors for approval.

Management disagreed with our findings and recommendations. They stated the National Trailer Lease was not a lease, but a service contract, and as a result, did not require a Decision Analysis Report or Board of Governors' approval. They also stated our \$85 million savings, forecast over the 12 year project life, was incorrect. Management's comments, and our evaluation of their comments are included in our report. We consider management's disagreement with our findings and recommendations unresolved, and plan to pursue the issues through the formal audit resolution process. The Office of Inspector General (OIG) considers recommendations 1 and 4 significant and, therefore, requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective actions are completed. These recommendations should not be closed in the follow-up tracking system until the OIG provides written confirmation that the recommendations can be closed.

We appreciate the cooperation and courtesies provided by you and your staff during the review. If you have any questions or need additional information, please contact Joseph R. Oliva, director, Transportation and Delivery, at (703) 248-2100, or me at (703) 248-2300.

Ronald K. Stith
Assistant Inspector General
for Core Operations

Attachment

cc: Richard J. Strasser, Jr.
John A. Rapp
Paul E. Vogel
Anthony M. Pajunas
J. Dwight Young
Susan M. Duchek

TABLE OF CONTENTS

Executive Summary	i
Part I	
Introduction	1
Background	1
Objective, Scope, and Methodology	1
Prior Audit Coverage	2
Part II	
Audit Results	3
Trailer Lease Not Cost Effective	3
Recommendations	6
Management's Comments	6
Evaluation of Management's Comments	6
Decision Analysis Report Not Used	7
Recommendation	8
Management's Comments	8
Evaluation of Management's Comments	8
Other Matters Identified	14
Appendix A. Audit Locations	15
Appendix B. Statistical Sampling and Projections for Trailer Lease Versus Purchase Review	16
Appendix C. 12-Year Economic Analysis of Purchased Versus Leased Trailers	25
Appendix D. Management's Subsequent Analysis	28
Appendix E. Management's Comments	29

EXECUTIVE SUMMARY

Introduction	This report presents our assessment of the Postal Service's decision to enter into a nationwide contract to lease common fleet trailers. This audit was self-initiated. The Postal Service uses a combination of both owned and leased trailers to transport mail. We initiated our audit to evaluate if the Postal Service's decision to enter into a nationwide lease contract was more cost effective than buying the trailers.
Results in Brief	Our audit determined that Postal Service officials made a decision to lease common fleet trailers based upon a business justification process that incorrectly reported that it was more advantageous to lease rather than purchase trailers. That decision will cost the Postal Service an additional \$85 million over a 12-year period. Our audit also revealed the Postal Service did not use a Decision Analysis Report to determine if the nationwide lease was cost effective. The initial 6-year lease totaling \$101 million is over the \$10 million threshold for Board of Governors approval, as required in the Handbook F-66, <u>General Investment Policies and Procedures</u> .
Summary of Recommendations	We recommended that management, purchase rather than continue the nationwide lease of common fleet trailers by preparing a Decision Analysis Report for submission to the Board of Governors. We also recommended that management, establish controls to ensure the use of a Decision Analysis Report for leases exceeding \$10 million per year.
Summary of Management's Comments	Management disagreed with our findings and recommendations. They stated the National Trailer Lease was a service contract, not a lease, and as a result, did not require a Decision Analysis Report or Board of Governors' approval. They also stated our \$85 million savings, forecast over the 12 year project life, was incorrect. Management's comments, in their entirety, are included in Appendix E of this report.

1
[REDACTED]

**Overall Evaluation of
Management's
Comments**

Management's comments were unresponsive to our recommendations. Consequently we view disagreement over our findings and recommendations unresolved and plan to pursue the issues through the formal audit resolution process.

Regarding the requirement for a Decision Analysis Report, Handbook F-66, General Investment Policies and Procedures, dated April 1999, requires both "leases" and "expense investments" to be supported by a Decision Analysis Report. The National Trailer Lease is both a lease and an expense investment. Management's position that the trailer lease is not a lease, but a service contract, is inconsistent with generally accepted accounting principles. Specifically, Statement of Financial Accounting Standards Number 13, Accounting for Leases, provides agreements transferring the right to use equipment, meet the definition of a lease, and emphasizes such contracts are leases even though substantial services by the contractor may be called for in connection with equipment maintenance. Further, Handbook F-66D, Other Investment Policies and Procedures provides that major operating expense projects include supplies, services, and maintenance—and that all major operating expense projects "must" be supported by a Decision Analysis Report. Consequently, even if the trailer lease was a contract for services—a position with which we do not concur—it would still require a Decision Analysis Report.

Regarding the requirement for Board of Governors' approval, Handbook F-66 states that Board of Governors approval is required when the discounted lease cost, including all renewal options, is \$10 million. It further requires Board of Governors notification whenever undiscounted costs exceed \$10 million. We calculated total discounted costs as \$171 million, more than 17 times the Board of Governors' threshold, and total undiscounted costs as \$250 million, or more than 25 times the Board of Governors' threshold.

Management did not agree with our estimated \$85 million savings because their various analyses were not prepared in accordance with Postal Service investment policy. During our audit we examined three lease versus buy analyses

prepared by management. The analyses omitted inflation from relevant calculations, used assumptions substantially more optimistic than specified by Postal Service policy, and inconsistently applied cost factors to owned trailers while omitting those factors from the cost of leasing. Our concerns with all analyses were similar—omissions, or inconsistent assumptions regarding inflation, trailer damage, staffing, and infrastructure needs—manipulate conclusions.

INTRODUCTION

Background

The Postal Service transports mail by trailer as one of the most cost-effective ways to move large volumes of mail and related equipment. The Postal Service uses almost 17,000 trailers of which 12,000 are leased. To replace expiring contracts for a large number of leased common fleet trailer contracts, and to lower the daily lease rate, the Postal Service entered into a 6-year nationwide lease with Transportation International Pool for 4,475 trailers and 31 converter gears for \$101 million. The contract also includes a renewal option for an additional 6 years. The decision process included a memorandum and recommendation for award approved by the vice president, Purchasing and Materials.

Objective, Scope, and Methodology

The objective of our audit was to evaluate if the Postal Service's decision to enter into a nationwide lease contract for trailers was more cost effective than owning the trailers.

To accomplish our objective, we conducted interviews and obtained supporting documentation for leasing and purchasing common fleet trailers at Postal Service Headquarters. We also reviewed maintenance work-orders and other related documentation from a total of 55 vehicle maintenance facilities for 1,738 Postal Service owned trailers. Geographic locations of sites are shown in Appendix A. In addition, we reviewed Postal Service policy and procedures and generally accepted accounting principles related to leases. Finally, we interviewed Postal Service and contractor personnel, conducted sampling of Postal Service owned trailers to establish preventive maintenance costs, inspected trailers, and performed statistical analysis.

To conduct sampling, we statistically selected 55 vehicle maintenance facilities. Our sample allowed us to statistically project maintenance costs for Postal Service owned trailers throughout the population of all facilities, and to a total nationwide population of more than 4,016 trailers. Details of our sampling methodology are contained in Appendix B.

We used a cash flow analysis to forecast the cost of buying versus leasing over a 12-year period. The methodology for the cash flow analysis is contained in Appendix C.

We conducted our audit between January 2001 and March 2002 in accordance with generally accepted government auditing standards, and included such tests of internal controls as were considered necessary under the circumstances. We discussed our conclusions and observations with appropriate management officials, and included their comments, where appropriate.

Prior Audit Coverage

We did not identify any prior audits or reviews related to the objective of the audit.

AUDIT RESULTS

Trailer Lease Not Cost Effective

The Postal Service's decision to lease common fleet trailers was not the most cost effective method of acquiring the trailers. The decision to lease rather than purchase trailers, was based upon a business justification process and will cost the Postal Service an additional \$85 million over a 12-year period.

Postal Service officials defined the business justification process as an analysis that is like a Decision Analysis Report¹ process but more abbreviated. The manager, National Mail Transportation, and the purchasing specialist/contracting officer, stated that the Purchasing Manual indicates a lease is for core day-to-day activities and does not require a Decision Analysis Report. Also, the purchasing specialist/contracting officer stated the Decision Analysis Report process takes a great deal of time. In addition, a program evaluation specialist in the Capital and Program Evaluation Office informed the contracting officer that the national trailer lease should be treated as a service contract, which does not require the preparation of a Decision Analysis Report. As a result of these statements by Postal Service managers, we reviewed relevant sections of the Purchasing Manual and Postal Service Handbook F-66, General Investment Policies and Procedures. However, we could not identify any provision that relieved the Postal Service managers from developing a Decision Analysis Report as specified by Handbook F-66.

Based upon the results of the business justification, Postal Service officials initiated a memorandum and recommended the award of a nationwide trailer lease. The memorandum included an attachment comparing the cost of leasing to the cost of ownership of trailers over a 12-year period. We analyzed the calculations included in the attachment and identified inaccurate computations that resulted in leasing rather than purchasing the trailers as being more cost beneficial. We found Postal Service officials used an inflation rate of 22 percent for maintenance costs instead of the Postal Service established rates of 2.8 percent for labor

¹ The Decision Analysis Report is a document prepared by the requiring organization to recommend an investment for approval. It must provide sufficient detail including back-up documentation to enable the approving officials to make an informed decision regarding the use of Postal Service funds.

and 1.7 percent for material.² As a result, the annual maintenance cost for purchasing a trailer was reported as \$3,267 instead of \$1,045, which overstated the cost by \$2,222. In addition, we identified that the cost of non-preventive maintenance costs were excluded from the cost of leasing trailers while included as a cost to purchase trailers. The errors were not identified, and the Postal Service entered into a 6-year nationwide lease for 4,475 common fleet trailers and 31 converter gears with Transportation International Pool for \$101 million with an option to renew for an additional 6 years.

We determined that historical maintenance costs, which were used as a cost of owning trailers in the business justification process, included both preventive maintenance costs, and the cost of damages and repairs. However, according to the contract, the contractor will only cover the preventive maintenance costs. The Postal Service is responsible for any accidents, damages, and repairs (non-preventive maintenance costs) that according to our 12-year cash flow analysis would total about \$64 million.

We used a statistical sample of fiscal year (FY) 2000 maintenance work-orders to determine repair costs that would be classified as preventive or non-preventive, based upon Transport International Pools repair standards. (See Appendix B). Our 12-year cash flow analysis of the lease and purchase of the trailers is summarized in Table 1.

² Vice president Finance, controller, memorandum dated March 15, 2000, Subject: Decision Analysis Report Factors/Cost of Borrowing Update provides escalation factors for Postal Service labor and other costs.

ACQUISITION ITEM	LEASE (MILLIONS)	PURCHASE (MILLIONS)
TRAILER	\$0	\$99
LEASE CONTRACT WITH PREVENTIVE MAINTENANCE	212	0
PREVENTIVE MAINTENANCE	0	33*
NON-PREVENTIVE MAINTENANCE	64	64
SALVAGE VALUE	0	(5)
TURN-IN RECONDITIONING	**	0
TOTAL	\$276	\$191
GROSS SAVINGS		\$85
CONTRACT TERMINATION		(2.8)
NET SAVINGS BY PURCHASE		\$82.2

TABLE 1: COST TO LEASE VERSUS PURCHASE TRAILERS

* COST IS BASED ON AVERAGE LABOR RATES FOR CURRENT CONTRACTS FOR MAINTENANCE AND REPAIR IN EFFECT AT VEHICLE MAINTENANCE FACILITIES.

** THE LEASE REQUIRES THE POSTAL SERVICE MAKE THE NECESSARY REPAIRS TO BRING THE TRAILER BACK TO A CERTAIN STANDARD AT THE END OF THE LEASE. THIS WILL BE AN ADDITIONAL COST TO THE LEASE.

In addition, we identified two Decision Analysis Reports³ to purchase trailers that demonstrated leasing is not economically justified given the length of time the Postal Service keeps trailers. We analyzed both Decision Analysis Reports and determined they both used the same methodology and were supported by historical records. However, the second Decision Analysis Report was not forwarded to the Board of Governors, in June 2000, because it conflicted with the national lease proposal.⁴ As a result, information that would have supported a decision to purchase trailers was not used or made available to the Board of Governors.

The manager, Logistics, and the manager, National Mail Transportation Purchasing, stated that there needs to be a balance between leased and purchased trailers to allow flexibility for the time when trailers are not being used. They stated the Postal Service would have the flexibility to return excess leased trailers to the leasing company while

³ A Decision Analysis Report dated April 13, 1997, to purchase 2,000 trailers, and a Decision Analysis Report dated April 21, 2000, to purchase 1,000 trailers.

⁴ Manager, Delivery, memorandum dated June 7, 2000, subject: Decision Analysis Report: 1,000 Trailers and 2,400 Mixed Delivery and Collection Vehicles.

purchased trailers will just sit in the yard unused. We contend that purchasing the 4,500 trailers will still leave over 7,000 leased trailers in the fleet that can be returned to the leasing company.

The manager, National Mail Transportation Purchasing, also stated that purchasing trailers will require additional infrastructure to manage the fleet at Postal Service facilities. We disagree. The Postal Service would not require additional infrastructure to service trailers that it owns. Trailer maintenance and repair could be outsourced at approximately the same cost as service provided under the lease agreement.

Recommendations	<p>We recommend the vice president, Purchasing and Materials:</p> <ol style="list-style-type: none">1. Prepare a Decision Analysis Report to purchase the common fleet trailers currently under the nationwide lease and submit it to the Board of Governors.2. Upon approval to purchase trailers, initiate action to purchase trailers and terminate the national lease.3. Obtain bids for nationwide maintenance and repair services for the common fleet trailers.
Management 's Comments	<p>Management disagreed with our findings and recommendations.</p>
Evaluation of Management's Comments	<p>The various issues and recommendations in this section, and in the next section of our report, are interrelated. In order to avoid redundancy in evaluating management's comments, we will defer discussion, and evaluate management comments at the end of our report.</p>

**Decision Analysis
Report Not Used**

A Decision Analysis Report was not used to determine the most economical method for a major cost to the Postal Service. Postal Service officials structured the lease for common fleet trailers as a service contract and used a memorandum and recommendation for award instead of a Decision Analysis Report. As a result, the Board of Governors was not provided the opportunity to assess and approve the decision to either lease or purchase the trailers.

Postal Service officials used a service contract to lease common fleet trailers over a 6-year period for \$16.8 million per year totaling over \$101 million. In addition, the contract includes an option to renew for another 6 years. Statement of Financial Accounting Standard Number 13 defines a lease as an agreement conveying the right to use property, plant, or equipment for a stated period of time. Agreements that transfer the right to use equipment meet the definition of a lease even though substantial services may be called for in connection with the operations or maintenance of such assets. An agreement that does not transfer the right to use property plant or equipment is not a lease. Since the National Trailer Lease agreement does transfer the right to use the equipment it would be considered a lease. According to Statement of Financial Accounting Standard Number 13, agreements for services that involve the use of equipment but do not convey the right to use the equipment to the recipient of such services would be accounted for as a service agreement. Based on the definition provided in the Financial Accounting Standards, the National Trailer Lease is a lease and not a service contract. Therefore, Postal Service officials did not follow generally accepted accounting principles. Further, the "service contract" should have been correctly characterized as a lease and a Decision Analysis Report prepared.

Also, the delegations of approval authority in Section 2 of, General Investment Policies and Procedures, Handbook F-66, April 1999, states the Board of Governors must approve all lease/rental agreements over \$10 million.

The manager National Mail Transportation Purchasing, disagreed and said the lease was for the core day-to-day activities. He further stated that the Purchasing Manual gives them the authority to meet competitive and business

needs. Therefore, he concluded that a Decision Analysis Report was not required. We reviewed the Purchasing Manual but found no information that would supersede Handbook F-66 or generally accepted accounting principles requirements.

The acting manager of Capital and Program Evaluation, stated that leases are always considered service contracts because the successful vendor would provide services for maintenance and repair along with the equipment. However, in our judgment, Postal Service officials inappropriately used a service component as a justification to structure the lease as a service contract.

Recommendation	<p>We recommend the vice president, Purchasing and Materials:</p> <p>4. Develop management controls to ensure use of a Decision Analysis Report for leases exceeding \$10 million per year.</p>
Management's Comments	<p>Management disagreed with our findings and recommendations. They stated:</p> <ul style="list-style-type: none">• The National Trailer Lease did not require a Decision Analysis Report because it was not a capital lease, but rather, a service contract.• The National Trailer Lease did not require Board of Governors' approval.• Our estimated \$85 million savings, forecast over the 12 year project life, was incorrect.
Evaluation of Management's Comments	<p>Management's comments are not responsive to our recommendations. We view disagreement with our recommendations 1 and 4 as unresolved and plan to pursue the recommendations through the formal audit resolution process.</p> <p>In our draft report we recommended the vice president, Purchasing and Materials, ensure leases meeting the characteristics of a capital lease be accounted for as the acquisition of an asset and the incurrence of a liability. We</p>

continue to believe that advice is prudent. However, since a lease contract does not have to be a capital lease to require a Decision Analysis Report, we eliminated the recommendation pertaining to capital leases from our report, revised the text accordingly, and deferred the capital lease issue for later consideration.

Decision Analysis
Report Requirements

Regarding the requirement for a Decision Analysis Report, Handbook F-66, General Investment Policies and Procedures, dated April 1999, identifies both "lease agreements" and "major operating expenses" as subject to Decision Analysis Report requirements. The National Trailer Lease is both a "lease" and a "major operating expense." Consequently, a Decision Analysis Report should have been prepared.

Management's position that the trailer lease is not a lease, but a service contract, is inaccurate. Handbook F-66 stipulates that generally accepted accounting principles like Financial Accounting Standards, as well as Postal Service policy, control Postal Service investments. Statement of Financial Accounting Standards Number 13, Accounting for Leases, provides agreements transferring the right to use equipment, meet the definition of a lease, and emphasizes such contracts are leases even though substantial services by the contractor may be called for in connection with equipment maintenance. Handbook F-66, Chapter 6, "Leasing Guidelines" requires leasing investment projects to be properly presented in a Decision Analysis Report.

Handbook F-66, Paragraph 1-4, "Types of Investments," defines a "major operating expense" as a corporate initiative resulting in the expenditure of operating funds in excess of \$7.5 over a project's life. The National Trailer Lease was a major corporate initiative involving a switch from a decentralized leasing program with multiple local contracts, to a centralized leasing program, with only one national contractor—and we projected expenditures exceeding \$250 million over the project's 12 year life. In addition, Handbook F-66D, Other Investment Related Policies and Procedures, provides that major operating expense projects include supplies, services, and maintenance—and that all major operating expense projects "must" be supported by a Decision Analysis Report. Consequently, even if the national trailer lease was a contract for services—a position

with which we do not concur—it would still require a Decision Analysis Report.

Board of Governors'
Approval

Regarding the requirement for Board of Governors approval. Handbook F-66, paragraph 2-5, "Delegated Authority for Expense Items," states that for purposes of determining whether a lease requires Board of Governors' approval, the cost of the lease is the present value of all lease payments over the lease term, including "all" periods covered by renewal options. The provision emphasizes that leases normally contain renewal options; stipulates "total" cost, including renewal options, "must" be considered when determining approval authority; and specifies the discounted project cost requirement for Board of Governors' approval is \$10 million.

We calculated the total discounted project cost, including the 6-year renewal option required by Postal Service policy, as \$171 million—or more than 17 times the Board of Governors' threshold.

Further, Handbook F-66D, Chapter 2, "Major Operating Expense Investments," provides that whenever undiscounted costs over a project's life exceed \$10 million, the Board of Governors must be notified. The chapter specifies that when determining approval authority, all undiscounted costs, including those for supplies, services, and maintenance, "must be considered." We forecast 12-year project costs exceeding \$250 million—or more than 25 times the Board of Governors' threshold.

Savings

Management did not agree with our projected \$85 million 12 year savings because their various analyses were not prepared in accordance with the requirements of Postal Service investment policy.

As we pointed out in our draft report, we examined the lease versus buy analysis management used to support their lease decision and found:

- It improperly used a 22 percent inflation rate to calculate routine maintenance on Postal Service owned trailers, when the inflation rate identified by Postal Service policy was 2.8 percent for labor and 1.7 percent

for materials. Consequently, the 12-year cost of owning trailers was overstated by almost \$120 million.

- Omitted inflation from the cost of leased trailer maintenance, and other leased trailer costs.
- Inconsistently assumed purchased trailers would incur damage, while leased trailers would not.

In addition, management's economic analysis did not consider the "actual useful life" of owned trailers beyond their "depreciable life" for accounting purposes. Trailers can actually be used well over 12 years. For example, our review of trailers in the New York Metro Area, dated March 30, 2001, identified trailers up to 30 years old that were still used for storage; and an internal Postal Service memorandum we examined during this audit stated that 343 trailers identified for replacement by a 1997 Decision Analysis Report, were still in service as of June 2000—even though they were more than 17 years old.

The internal memorandum also put management on notice that leasing was inconsistent with Decision Analysis Report experience. Specifically, the memorandum identified trailer Decision Analysis Reports prepared in April 1997 and in June 2000, and forcefully warned that leasing was not economically justified "given the length of time" the Postal Service actually kept trailers. The memorandum also questioned how management could reconcile their action to lease with Decision Analysis Report conclusions.

We examined the Decision Analysis Reports referred to in the Postal Service internal memorandum, and concluded the reports used consistent methodology and were supported by historical records. We subsequently shared our concern with management about what we considered errors in the "Memorandum and Recommendation" supporting their lease decision. As a result of errors we identified to management, and because the internal Postal Service memorandum clearly questioned the validity of their analysis, we are surprised management continues to cite their "Memorandum and Recommendation" as a basis for disagreeing with our findings.

Management stated that during the period between the issue of our draft report, and the issue of their formal response, in an attempt to resolve differences, they exchanged data with us on numerous occasions. We appreciated that opportunity. One such exchange took place on Tuesday, December 18, 2001. After that meeting, management supplemented their "Memorandum and Recommendation" by providing a second analysis they said used assumptions and estimates from our draft report (See Appendix D). We examined that document and found various inconsistencies with our report:

Cost at Renewal – Our analysis applied an inflation factor to contract renewal in year six as specified by Postal Service policy for calculations of this type. Management's analysis did not consider inflation, and assumed the Postal Service would be able to achieve a 14 percent reduction at contract renewal. Such an optimistic assumption is inconsistent with Postal Service policy and the generally accepted accounting principle of conservatism.

Trailer Damage – Management assumed damage to leased trailers would be substantially less than damage to owned trailers, and applied inflation to purchase trailer damage but not to leased trailer damage. Because of omissions or differing assumptions, management concluded damage to owned trailers over 12 years would be \$64 million, while damage to leased trailers over 12 years would be only \$16 million—a difference of 75 percent. Our analysis assumed damage would be approximately the same because trailers, whether, they are owned or leased, travel over the same roads, go to the same facilities, and are loaded or unloaded by the same people. Consequently, their operational use is unaffected by the "financing" decision whether to lease or buy.

Cost for Additional Staff and Infrastructure – Management assumed that purchased trailers would cost \$16 million more for staff and infrastructure. Our analysis assumed the requirement to operate, maintain, and store trailers was independent of the "financing" decision to lease or buy, and that cost would be the same whether it was outsourced or imbedded in a leasing contract. Consequently we did not identify a need for additional staff or infrastructure. We

noted Postal Service employees were already in place to track trailers, process damage claims, and adjudicate trailer damage—and we assumed existing employees could perform the same functions regardless of trailer ownership.

After we examined management's second analysis, we noted concerns similar to those we identified in the original lease versus buy analysis. We again shared our concerns with management; management again revised their analysis; and in their formal response to our draft report, presented a third analysis. However, because their third analysis still did not comply with the requirements of Postal Service investment policies and procedures, our concerns with the third version were similar to our concerns with the first two. Specifically, omissions, or unsupported assumptions regarding cost escalation at renewal, damage, staffing, and infrastructure can manipulate conclusions.

**Other Matters
Identified**

In their official response to our draft audit report, management included what they referred to as "Attachment 1 - Memorandum and Recommendation." Management represented the attachment as the actual "Memorandum and Recommendation" signed by the vice president, Purchasing and Materials, August 15, 2000, which awarded the trailer lease contract. We noted the signature block on "Attachment 1" was not executed, and discovered "Attachment 1" had been significantly altered from the original signed document. We are disturbed that some officials might erroneously believe merely substituting a word could change the legal or economic substance of a major Postal Service acquisition—and allow circumvention of internal controls designed to protect the resources and best interests of the Postal Service. We are also disturbed that a document submitted in a formal response to a draft audit report, would be materially altered from the official document it purported to represent.

The reason the alterations were important was because they supported management's position that the trailer acquisition was exempt from Decision Analysis Report requirements. The specific alterations included deletion of the phrase "National Trailer Lease," which was a prominent part of the title on the official "Memorandum and Recommendation" actually signed by the vice president. In addition, references to "lease contract," "lease," or similar terms, were deleted and replaced with terms like "service" or "service contract," more than 60 times.

We discussed this matter with management and management indicated the alterations were simply in error. However, we find the thoroughness of substitution effort troubling. Handbook F-66, paragraph 1-2, requires officials who make or recommend investment decisions, to interpret the intent of Postal Service investment policies, and to ensure accountability, credibility, and the best interest of the Postal Service are achieved. Consequently, we are referring the matter for further consideration, and whatever action may be warranted under the circumstances.

APPENDIX A. AUDIT LOCATIONS

POSTAL SERVICE VEHICLE MAINTENANCE FACILITIES

FACILITY	STATE	FACILITY	STATE
Birmingham	Alabama	Kansas City	Missouri
Sacramento	California	Raleigh	North Carolina
San Bernardino	California	Omaha	Nebraska
San Diego	California	New Brunswick	New Jersey
San Jose	California	Paterson	New Jersey
Santa Ana	California	Albany	New York
Stockton	California	Brooklyn	New York
Denver	Colorado	Buffalo	New York
Hartford	Connecticut	Syracuse	New York
Washington	District of Columbia	Cincinnati	Ohio
Ft. Lauderdale	Florida	Cleveland	Ohio
Jacksonville	Florida	Portland	Oregon
Miami	Florida	Lancaster	Pennsylvania
Mid-Florida	Florida	Pittsburgh	Pennsylvania
Tampa	Florida	Southeastern	Pennsylvania
West Palm Beach	Florida	Columbia	South Carolina
Atlanta	Georgia	Memphis	Tennessee
Bedford Park	Illinois	Nashville	Tennessee
Chicago	Illinois	Dallas	Tennessee
Gary	Indiana	San Antonio	Texas
South Bend	Indiana	Dulles	Virginia
Lexington	Kentucky	Merrifield	Virginia
New Orleans	Louisiana	Norfolk	Virginia
Brockton	Massachusetts	Richmond	Virginia
Baltimore	Maryland	Seattle	Washington
Portland	Maine	Tacoma	Washington
Detroit	Michigan		
Grand Rapids	Michigan		
Royal Oak	Michigan		

APPENDIX B

STATISTICAL SAMPLING AND PROJECTIONS FOR TRAILER LEASE VERSUS PURCHASE REVIEW

PURPOSE OF THE SAMPLING

One of the objectives of this audit was to assess the cost of trailer maintenance actions that would not be covered by the lessor in a leasing agreement. Such actions, for which the cost would be borne by the Postal Service, would include repairs for damage that was caused by Postal Service use of the equipment. In support of this audit objective, the audit team employed a stratified sample design that allowed statistical projection of the dollar amount of non-preventive maintenance and repair of trailers. The resulting projections are used as input to the cash flow analysis model documented in Appendix C.

DEFINITION OF THE AUDIT UNIVERSE

We obtained maintenance cost data from the Postal Service vehicle maintenance accounting system database, Vehicle Management Accounting System, based on the listing for FY 2000. Trailers were grouped into three categories defined by the model year for the trailers: (1) 1984/87, (2) 1991/92, and (3) 1998.

The universe for the 1984/87 model years consisted of 1,011 trailers in 69 Vehicle Maintenance Facility locations and reflected a total book value of scheduled and unscheduled maintenance and repairs of \$1,435,619.

The universe for the 1991/92 model years consisted of 1,019 trailers in 74 Vehicle Maintenance Facility locations with a total book maintenance and repair value of \$1,110,919.

The universe for the 1998 model year consisted of 1,986 trailers in 85 Vehicle Maintenance Facility locations with a total book maintenance and repair value of \$1,474,342.

SAMPLE DESIGN AND MODIFICATIONS

This audit used a stratified sample design with a two-stage selection of trailers within each stratum. For the stratification, Vehicle Maintenance Facility sites were grouped based on the number of trailers and the grand total of scheduled and unscheduled maintenance and repairs at the Vehicle Maintenance Facility for FY 2000. The original stratification included only the 1984/87 model year trailers. When the newer trailers

were identified, additional strata were included for sites that had the new trailers but none of the older ones.

For the 1984/1987 model year, a total of 32 Vehicle Maintenance Facility locations were randomly selected for review. A sample size of 26 sites was calculated based on an average of about 15 trailers per site (approximately 1,042 trailers at about 70 sites) and a desired total of about 380 trailers in the sample, to provide a two-sided 95 percent confidence interval with approximately 4 percent precision, based on auditor expectations of approximately a 50 percent level of compliance on one or more attributes.⁵ The original stratification of the 26 sites included the allocation of 20 sites to one stratum and 6 to another, with 13 sites eliminated from the universe because they had only one trailer each. The third stratum was later re-included, with an additional, 6 sites selected. The sample selection was random within each stratum, with 20 sites from stratum I ($N_I=33$), 6 sites from stratum II ($N_{II}=25$), and 6 sites from stratum III ($N_{III}=13$).

Table 1: Universe Count and First Stage Sample Size for 1984/87 Model Years

	Stratum	Description	Number of Vehicle Maintenance Facilities	First-Stage Sample
	I	AMOUNT \geq \$10,000	33	20
	II	AMOUNT $<$ \$10,000 and more than 1 trailers	23	6
	III	AMOUNT $<$ \$10,000 and one trailer	13	6
Total			69	32

The stratification as shown ensured that the strata were mutually exclusive and collectively exhaustive, thus covering the entire population of Vehicle Maintenance Facilities having 1984/1987 model year trailers.

At the first stage, Vehicle Maintenance Facilities were selected randomly within each stratum. At the second stage, trailers were selected from those at each Vehicle Maintenance Facility. All trailers were selected if the number of trailers at a Vehicle Maintenance Facility was less than or equal to 50. If there were more than 50 trailers, 50 trailers were randomly selected by the audit team using the Excel "randbetween" function. The resulting 1984/1987 sample included a total of 476 trailers at 32 sites.

The universe of Vehicle Maintenance Facilities having trailers from the 1991/1992 and 1998 model years include locations not in the original stratification. For each of these

⁵ Because we had no prior information regarding the mean and standard deviation, we were not able to calculate a sample size specifically designed for the variables. A 4 percent precision was used in an attribute-based size calculation because we expected to lose some precision when we worked with the variables data.

two later model years, two additional strata were added to the original three strata of locations pertinent to the first model year. The universe size and first-stage sample size are indicated in Tables 2 and 3 for the 1991/92 and 1998 model years, respectively. At the second stage, all trailers were selected if the number of trailers at a Vehicle Maintenance Facility was less than or equal to 50. If there were more than 50 trailers, 50 trailers were randomly selected by the audit team using the Excel "randbetween" function. The resulting 1991/92 sample included a total of 450 trailers at 40 sites; the resulting 1998 sample included a total of 812 trailers at 44 sites.

Table 2: Universe Count and First Stage Sample Size for 1991/92 Model Years

	Stratum	Description	Number of Vehicle Maintenance Facilities	First - Stage Sample
	I	Locations with 1984/1987 trailers having repairs \geq \$10,000	31	17
	II	Locations with 1984/1987 trailers having amount $<$ \$10,000 and $>$ one 1984/1987 trailer	14	4
	III	Locations with 1984/1987 trailers having amount $<$ \$10,000 and only one 1984/1987 trailer	9	5
	IV	Locations with 1992 trailers having amount \geq \$10,000, no 1984/1987 trailers	6	6
	V	Locations with 1992 trailers having amount $<$ \$10,000, no 1984/1987 trailers	14	8
Total			74	40

Table 3: Universe Count and First Stage Sample Size for 1998 Model Year

	Stratum	Range Description	Number of Vehicle Maintenance Facilities	First-Stage Sample
	I	Locations with 1984/1987 trailers having repairs \geq \$10,000	29	15
	II	Locations with 1984/1987 trailers having amount $<$ \$10,000 and $>$ one 1984/1987 trailer	17	3
	III	Locations with 1984/1987 trailers having amount $<$ \$10,000 and only one 1984/1987 trailer	11	6
	IV	Locations with 1998 trailers having amount \geq \$10,000, no 1984/1987 trailers	11	11
	V	Locations with 1998 trailers having amount $<$ \$10,000, no 1984/1987 trailers	17	9
Total			85	44

STATISTICAL PROJECTIONS OF THE SAMPLE DATA

METHODOLOGY

Sample data were projected using the combined formulas for estimation of a population mean and total for a stratified sample, as described in Chapter 5, and a two-stage sample, as described in Chapter 9, of Elementary Survey Sampling, Scheaffer, Mendenhall, and Ott, c.1996. For the total dollar value projections, we had book values for the FY 2000 universe and were, therefore, able to calculate the projections by including the Chapter 6 formulas for difference estimation from the same text.

RESULTS: 1984/87 Model Years (Universe = 1,011 Trailers)

1984/87 Variable 1: Total Cost

Based on difference estimation projection of the sample results, we are 95 percent confident the total cost of preventive maintenance and non-preventive maintenance parts and labor is \$1,557,177 to \$1,813,498. The resulting projection of the combined preventive maintenance and non-preventive maintenance cost is \$1,685,338 (average of \$1,667 per trailer).

Comparing the bounds above to the universe cost shown in the database, we would conclude that the database universe cost for the maintenance of the 1984/87 model year trailers is understated.

1984/87 Allocation of Postal Service Form 4541, section on Order Invoice for Vehicle Repair (PS Form 4541) section on Work Orders⁶ for preventive maintenance:

The projections for preventive maintenance parts and labor without PS Form 4541 costs are used to allocate the costs and labor hours associated with preventive maintenance costs in PS Form 4541 work orders. As a result, the PS Form 4541 preventive maintenance values for trailers from the 1984/87 model years are allocated 32 percent to parts and 68 percent to labor.

1984/87 Variable 2A: preventive maintenance and Allocated PS Form 4541, section on Cost of Parts:

Based on direct projection of the sample results from the 1984/87 model years, we are 95 percent confident the total cost of the preventive maintenance and PS Form 4541 parts is \$81,810 to \$211,307. The resulting projection of the preventive maintenance and PS Form 4541 parts cost (including allocated PS Form 4541 costs) is \$146,559 (average of \$145 per trailer).

⁶ The PS Form 4541 work orders are ones for which parts and labor are not separately identified; we allocated the PS Form 4541 cost to preventive maintenance and non-preventive maintenance parts and labor in the proportion in which they occurred for corresponding costs not associated with PS Form 4541.

1984/87 Variable 2B: preventive maintenance and Allocated PS Form 4541, section on Cost of Labor:

Based on direct projection of the sample results from the 1984/87 model years, we are 95 percent confident the total cost of the preventive maintenance labor is \$226,480 to \$402,189. The resulting projection of the preventive maintenance labor cost (including allocated PS Form 4541 costs) is \$314,334 (average of \$311 per trailer).

1984/87 Variable 2C: preventive maintenance and Allocated PS Form 4541, section on Labor Hours:

Based on direct projection of the sample results from the 1984/87 model years, we are 95 percent confident the total preventive maintenance and allocated preventive maintenance labor hours are 7,124 to 12,651. The resulting projection of the preventive maintenance labor hours (including allocated PS Form 4541 hours) is 9,888 (average of 10 per trailer).

1984/87 Allocation of PS Form 4541, section on Work Orders for Non-preventive Maintenance:

The projections for non-preventive maintenance parts and labor without PS Form 4541 costs are used to allocate the costs and labor hours associated with non-preventive maintenance costs in PS Form 4541 work orders. As a result, the PS Form 4541 non-preventive maintenance values for trailers from the 1984/87 model years are allocated 40 percent to parts and 60 percent to labor.

1984/87 Variable 2D: Non-preventive maintenance and Allocated PS Form 4541, section on Cost of Parts:

Based on direct projection of the sample results from the 1984/87 model years, we are 95 percent confident the total cost of the non-preventive maintenance parts and PS Form 4541 items is \$321,507 to \$566,236. The resulting projection of the non-preventive maintenance parts cost (including allocated PS Form 4541 costs) is \$443,871 (average of \$439 per trailer).

1984/87 Variable 2E: Non-preventive maintenance and Allocated PS Form 4541, section on Cost of Labor:

Based on direct projection of the sample results from the 1984/87 model years, we are 95 percent confident the total cost of the non-preventive maintenance labor (including allocated PS Form 4541 costs) is \$523,759 to \$790,807. The resulting projection of the non-preventive maintenance cost (including allocated PS Form 4541 costs) is \$657,283 (average of \$650 per trailer).

1984/87 Variable 2F: Non-preventive maintenance and Allocated PS Form 4541, section on Labor Hours:

Based on direct projection of the sample results from the 1984/87 model years, we are 95 percent confident the total non-preventive maintenance and allocated non-preventive maintenance labor hours are 16,476 to 24,876. The resulting projection of the non-

preventive maintenance labor hours (including allocated PS Form 4541 hours) is 20,676 (average of 20 per trailer).

RESULTS: 1991/92 Model Years (Universe = 1,019 Trailers)

1991/1992 Variable 1: Total Cost:

Based on difference estimation projection of the sample results, we are 95 percent confident the total cost of preventive maintenance and non-preventive maintenance parts and labor is \$1,081,285 to \$1,478,760. The resulting projection of the combined preventive maintenance and non-preventive maintenance cost is \$1,280,022 (average of \$1,256 per trailer).

Comparing the bounds above to the universe cost shown in the database, we would conclude that the database universe cost for the maintenance of the 1991/92 model year trailers is within the bounds of our projection; therefore, we cannot say that it is understated or overstated.

1991/1992 Allocation of PS Form 4541, section on Work Orders for preventive maintenance:

The projections for preventive maintenance parts and labor without PS Form 4541 costs are used to allocate the costs and labor hours associated with preventive maintenance costs in PS Form 4541 work orders. As a result, the PS Form 4541 preventive maintenance values for trailers from the 1991/92 model years are allocated 38 percent to parts and 62 percent to labor.

1991/1992 Variable 2A: preventive maintenance and Allocated PS Form 4541, section on Cost of Parts:

Based on direct projection of the sample results from the 1991/92 model years, we are 95 percent confident the total cost of the preventive maintenance and PS Form 4541 parts is \$83,664 to \$217,024. The resulting projection of the preventive maintenance and PS Form 4541 parts cost (including allocated PS Form 4541 costs) is \$150,344 (average of \$148 per trailer).

1991/1992 Variable 2B: preventive maintenance and Allocated PS Form 4541, section on Cost of Labor:

Based on direct projection of the sample results from the 1991/92 model years, we are 95 percent confident the total cost of the preventive maintenance labor is \$156,044 to \$345,767. The resulting projection of the preventive maintenance labor cost (including allocated PS Form 4541 costs) is \$250,906 (average of \$246 per trailer).

1991/1992 Variable 2C: preventive maintenance and Allocated PS Form 4541, section on Labor Hours:

Based on direct projection of the sample results from the 1991/92 model years, we are 95 percent confident the total preventive maintenance and allocated preventive maintenance labor hours are 4,942 to 10,893. The resulting projection of the preventive

maintenance labor hours (including allocated PS Form 4541 hours) is 7,918 (average of 8 per trailer).

1991/1992 Allocation of PS Form 4541, section on Work Orders for Non-preventive Maintenance:

The projections for non-preventive maintenance parts and labor without PS Form 4541 costs are used to allocate the costs and labor hours associated with non-preventive maintenance costs in PS Form 4541 work orders. As a result, the PS Form 4541 non-preventive maintenance values for trailers from the 1991/92 model years are allocated 41 percent to parts and 59 percent to labor.

1991/1992 Variable 2D: Non-preventive maintenance and Allocated PS Form, section on 4541 Cost of Parts:

Based on direct projection of the sample results from the 1991/92 model years, we are 95 percent confident the total cost of the non-preventive maintenance parts and PS Form 4541 items is \$175,779 to \$464,175. The resulting projection of the non-preventive maintenance parts cost (including allocated PS Form 4541 costs) is \$319,977 (average of \$314 per trailer).

1991/1992 Variable 2E: Non-preventive maintenance and Allocated PS Form 4541, section on Cost of Labor:

Based on direct projection of the sample results from the 1991/92 model years, we are 95 percent confident the total cost of the non-preventive maintenance labor (including allocated PS Form 4541 costs) is \$252,430 to \$663,271. The resulting projection of the non-preventive maintenance cost (including allocated PS Form 4541 costs) is \$457,850 (average of \$449 per trailer).

1991/1992 Variable 2F: Non-preventive maintenance and Allocated PS Form 4541, section on Labor Hours:

Based on direct projection of the sample results from the 1991/92 model years, we are 95 percent confident the total non-preventive maintenance and allocated non-preventive maintenance labor hours are 7,977 to 20,878. The resulting projection of the non-preventive maintenance labor hours (including allocated PS Form 4541 hours) is 14,427 (average of 14 per trailer).

RESULTS: 1998 Model Year (Universe = 1,986 Trailers)

1998 Variable 1: Total Cost:

Based on difference estimation projection of the sample results, we are 95 percent confident the total cost of preventive maintenance and non-preventive maintenance parts and labor is \$1,538,155 to \$1,888,351. The resulting projection of the combined preventive maintenance and non-preventive maintenance cost is \$1,713,253 (average of \$863 per trailer).

Comparing the bounds above to the universe cost shown in the database, we would conclude that the database universe cost for the maintenance of the 1998 model year trailers is understated.

1998 Allocation of PS Form 4541, section on Work Orders for preventive maintenance: The projections for preventive maintenance parts and labor without PS Form 4541 costs are used to allocate the costs and labor hours associated with preventive maintenance costs in PS Form 4541 work orders. As a result, the PS Form 4541 preventive maintenance values for trailers from the 1998 model years are allocated 40 percent to parts and 60 percent to labor.

1998 Variable 2A: preventive maintenance and Allocated PS Form 4541 section on Cost of Parts:

Based on direct projection of the sample results from the 1998 model years, we are 95 percent confident the total cost of the preventive maintenance and PS Form 4541 parts is \$86,618 to \$533,717. The resulting projection of the preventive maintenance and PS Form 4541 parts cost (including allocated PS Form 4541 costs) is \$258,219 (average of \$130 per trailer).

1998 Variable 2B: preventive maintenance and Allocated PS Form 4541, section on Cost of Labor

Based on direct projection of the sample results from the 1998 model years, we are 95 percent confident the total cost of the preventive maintenance labor is \$202,029 to \$569,981. The resulting projection of the preventive maintenance labor cost (including allocated PS Form 4541 costs) is \$386,145 (average of \$194 per trailer).

1998 Variable 2C: preventive maintenance and Allocated PS Form 4541, section on Labor Hours:

Based on direct projection of the sample results from the 1998 model years, we are 95 percent confident the total preventive maintenance and allocated preventive maintenance labor hours are 6,355 to 17,658. The resulting projection of the preventive maintenance labor hours (including allocated PS Form 4541 hours) is 12,147 (average of 6 per trailer).

1998 Allocation of PS Form 4541, section on Work Orders for non-preventive maintenance:

The projections for non-preventive maintenance parts and labor without PS Form 4541 costs are used to allocate the costs and labor hours associated with non-preventive maintenance costs in PS Form 4541 work orders. As a result, the PS Form 4541 non-preventive maintenance values for trailers from the 1998 model years are allocated 44 percent to parts and 56 percent to labor.

1998 Variable 2D: Non-preventive maintenance and Allocated PS Form 4541, section on Cost of Parts:

Based on direct projection of the sample results from the 1998 model years, we are 95 percent confident the total cost of the non-preventive maintenance parts and PS Form 4541 items is \$236,131 to \$775,457. The resulting projection of the non-preventive maintenance parts cost (including allocated PS Form 4541 costs) is \$505,934 (average of \$255 per trailer).

1998 Variable 2E: Non-preventive maintenance and Allocated PS Form 4541, section on Cost of Labor:

Based on direct projection of the sample results from the 1998 model years, we are 95 percent confident the total cost of the non-preventive maintenance labor (including allocated PS Form 4541 costs) is \$304,541 to \$964,175. The resulting projection of the non-preventive maintenance cost (including allocated PS Form 4541 costs) is \$634,498 (average of \$319 per trailer).

1998 Variable 2F: Non-preventive maintenance and Allocated PS Form 4541, section on Labor Hours:

Based on direct projection of the sample results from the 1998 model years, we are 95 percent confident the total non-preventive maintenance and allocated non-preventive maintenance labor hours are 9,580 to 30,058. The resulting projection of the non-preventive maintenance labor hours (including allocated PS Form 4541 hours) is 19,959 (average of 10 per trailer).

APPENDIX C

12-YEAR ECONOMIC ANALYSIS OF PURCHASED VERSUS LEASED TRAILERS

Savings Methodology

The 12-year cash flow of purchase and lease of equal number of trailers was compared to calculate the cost savings under the scenario of purchase.

1. Potential Savings--\$85 million over 12 years
2. Methodology
 - a. Capital Investment
1997 model trailer cost was escalated using 1.7 percent rate to calculate FY 2000 cost.
 - b. Salvage Value--5 percent.
 - c. Maintenance Cost – Contracting Out
 - i. Based on data collected from the sample sites for FY 2000 (Appendix B) (Average results for trailers from 3 model years).
 - ii. Labor rate: average of rate obtained from three sites.

Category	Results per Trailer, from Appendix B			Average	Contractor Rate	Cost for Cash Flow Model
	1984/87	1991/92	1998			
Preventive Maintenance Parts	\$145	\$148	\$130	\$141	Not applicable	\$141.00
Preventive Maintenance Labor	10 hours	8 hours	6 hours	8 hours	\$45.67	\$365.36
Non-Preventive Maintenance Parts	\$439	\$314	\$255	\$336	Not Applicable	\$336.00
Non-Preventive Maintenance Labor	20 hours	14 hours	10 hours	14.7 hours	\$45.67	\$669.83

The above computations above were rounded off.

d. Lease Cost

Daily Lease Rate Per Trailer: \$10.21 (including preventive maintenance) remains the same for 6 years (year 1 through 6). The lease is renewable for 6 years. Hence the analysis was performed for a total of 12 years of lease that matches with the 12-year life of purchased trailer. The escalation rate of 1.7 percent was used for the cash flow analysis and applied cumulatively at the beginning of the renewal period. Because the lease includes preventive maintenance labor, the 1.7 percent escalation rate is implied for the preventive maintenance labor also, a rate well below the baseline labor escalation rate.

e. Base Year Inputs to Cash Flow for 4,475 Trailers and 31 Converter Gears

i. Purchase:	\$99,446,606
Preventive Maintenance for trailers – Parts:	630,975
Preventive Maintenance for trailers – Labor:	1,634,986
Non-preventive Maintenance for trailers – Parts:	1,503,600
Non-preventive Maintenance for trailers – Labor:	<u>2,997,474</u>
Total:	\$106,213,641
ii. Lease including Preventive Maintenance:	\$ 16,792,285
Non-preventive Maintenance for trailers – Parts:	1,503,600
Non-preventive Maintenance for trailers – Labor:	<u>2,997,474</u>
Total:	\$21,293,359

APPENDIX D MANAGEMENT'S SUBSEQUENT ANALYSIS

APPENDIX D. MANAGEMENT'S SUBSEQUENT ANALYSIS

LEASE CONTRACT												
1 Month term	\$4,198,257.83											
6 Year term	\$77,888,713											
12 Year term	\$118,888,286											
Year	0	1	2	3	4	5	6	7	8	9	10	11
Current		\$4,198,258	\$4,198,258	\$4,198,258	\$4,198,258	\$4,198,258	\$4,198,258	\$4,198,258	\$4,198,258	\$4,198,258	\$4,198,258	\$4,198,258
Non-Prepaid												
Maintenance		\$1,348,646	\$1,348,646	\$1,348,646	\$1,348,646	\$1,348,646	\$1,348,646	\$1,348,646	\$1,348,646	\$1,348,646	\$1,348,646	\$1,348,646
TOTAL		\$4,198,258	\$4,198,258	\$4,198,258	\$4,198,258	\$4,198,258	\$4,198,258	\$4,198,258	\$4,198,258	\$4,198,258	\$4,198,258	\$4,198,258
12 Year Total NPV		\$42,882,349										
12 Year Total NPV		\$178,888,286										
PURCHASE												
Year	0	1	2	3	4	5	6	7	8	9	10	11
Term		\$98,000,000										
Prepaid		\$2,750,000	\$2,750,000	\$2,750,000	\$2,750,000	\$2,750,000	\$2,750,000	\$2,750,000	\$2,750,000	\$2,750,000	\$2,750,000	\$2,750,000
Maintenance												
Non-Prepaid		\$6,333,334	\$6,333,334	\$6,333,334	\$6,333,334	\$6,333,334	\$6,333,334	\$6,333,334	\$6,333,334	\$6,333,334	\$6,333,334	\$6,333,334
Maintenance												
Salvage												
Current		\$2,800,000										
Term												
Salvage												
TOTAL		\$12,833,334	\$12,833,334	\$12,833,334	\$12,833,334	\$12,833,334	\$12,833,334	\$12,833,334	\$12,833,334	\$12,833,334	\$12,833,334	\$12,833,334
12 Year Total NPV		\$118,888,286										
12 Year Total NPV		\$178,888,286										

* Includes one month of service (cash paid) (CL) (estimated \$2,800,000) cancellation cost.
 Because contract can be terminated with one month notice, this is the maximum amount of cash.

** 12 Year 1% OAC built down the contract termination as an option. Page 6 is shown as a total.

Because later and non labor items are included in maintenance, no attempt was made to calculate these items as a separate line item. Six year part was estimated a roughly based on ability to service contract. Occurrence of maintenance would have no financial impact.

FILED: 2020-07-20 10:00 AM
 Bureau of Internal Revenue
 10/1/2020

APPENDIX E. MANAGEMENT'S COMMENTS

NATIONAL MAIL TRANSPORTATION PURCHASING



January 7, 2002

RONALD K. STITH

THRU: KEITH STRANGE

KS
1/8/02

SUBJECT: National Trailer Lease Justification (Report Number TR-AR-02-DRAFT)

This is in response to the Inspector General's draft audit (Report Number TR-AR-02 DRAFT). Although there have been numerous exchanges of data and meetings to work through issues, and opportunities for improvement have been identified, resolution on all issues has not been attained. A full response to the audit findings is attached; however, the most significant objections to the findings are listed below.

Upon review of the draft audit report, supporting data, and business assumptions, the foundation for the audit findings is inconsistent with the National Trailer Service contract's terms and conditions and experience with trailer service contracts. Using estimates from the draft audit report, actual payment data, and proven postal business practices, over the 6-year term of the contract, the net benefit of the service contract is \$48.7 million (NPV) when compared to ownership. If the contract is renewed for an additional 6-year term, the NPV over the 12-year period is approximately \$21 million. These comparisons do not take into full consideration the infrastructure increases required to maintain this fleet expansion had purchasing been pursued. We do not agree with the report's finding that the Postal Service could save \$85 million over 12 years by purchasing trailers versus leasing.

The audit indicates that a decision analysis report (DAR) should have been prepared and Board of Governors' approval should have been obtained based on an assumption that this agreement is a capital lease. This contract, consistent with the Purchasing Manual, the Investment Policies and Procedures (F-66 Handbook), and the Board of Governors' bylaws, was determined to be a service contract for recurring services, not a capital lease, and, therefore, a DAR and Board approval was not required.

It is clear that the major differences around our views on the service contract versus purchase lie in the assumptions used to project costs over the 6-year term of the contract and the potential 12-year term if the option to extend is exercised. The consolidated national contract will provide clear cost data. We intend to use that data to perform another analysis before any decision is made to exercise the option to extend the trailer contract. We would welcome OIG review of that analysis prior to an extension.

Thank you again for your continued efforts in reviewing this contract and trying to resolve the differences in our views.

J. Dwight Young
JW Manager

475 I STREET PLAZA RM 4600
WASHINGTON DC 20260 6210
(202) 268 4314
Fax: (202) 268 4313

cc: Mr. Strasser
Mr. Strange
Mr. Vogel
Mr. Pajunas
Mr. Gunnels
Ms. Weir

Background Information

The draft audit report places a great deal of emphasis on the lease versus buy issue. However, the purpose of the trailer contract was to replace a number of smaller trailer service contracts that were negotiated locally in the Area offices. Simply put, a number of smaller (local) trailer service requirements were consolidated to achieve purchasing leverage. The bottom line is that these trailers had been in service for years as a local trailer service requirement at an average rate of \$11.57 per trailer, per day. The Area offices are now able to use newer trailers at a rate of \$10.21 per trailer, per day. That, along with other features of the new trailer service contract, results in a hard saving of \$13,420,688 during the six-year term of the service contract. If the Postal Service reaches agreement for the renewal for an additional six-year term, the total projected savings will reach \$27,526,190. The contracts are now being managed by the local Distribution Networks offices as a trailer service agreement with a 30-day walk away clause, as has been the business practice for many years. The responses below will further show that all the business goals (both financial and service) of this purchasing activity were accomplished. The following is a point-by-point discussion of each of the goals of the program.

Trailer Service (Short/Long-Term Benefits):

The Postal Service made a decision to consolidate a series of small trailer service contracts into the national trailer service contract in order to accomplish the following business goals, as were outlined in the Memorandum and Recommendation for Award (MRA) for the national trailer services contract:

Trailer Quality:

The average age of a trailer (excluding New York trailers) prior to the implementation of the current national trailer service contract was five years. The average age of trailers under the contract is three years. The newer equipment represents a value to the Postal Service that will produce improved performance reliability and less downtime. The newer trailers will also have a positive impact on the Postal Service's image in the communities that we serve. The trailers also have consistent material handling specifications throughout the fleet. This will have a positive impact on safety.

Trailer Leasing Costs:

A key goal to this program is to reduce both the total and unit cost of trailers under the service contract. Based on the hard data on the trailers that have been placed in service, the average unit cost has been reduced from \$11.57 per trailer, per day to \$10.21 per trailer, per day. For each year in operation, this will result in annual savings of \$2,236,778 on the base fleet. Based on the six-year term of the contract, this change will result in total savings of \$13,420,688.

Trailer Cost (HCR Contractors):

The national trailer service contract has a provision that will permit postal HCR contractors to use ad hoc trailers when needed, to support postal operations. This will result in reduced pass-through costs to the Postal Service. Although we are still working some contractual issues, we are planning for the HCR suppliers to get the contract rate of \$10.21 per trailer, per day.

Trailer Leasing Cost (Peak-Season):

Historically, each Area has contracted with various trailer suppliers to meet their peak season requirements. There will be savings of \$348,000 each year for peak season rentals.

The goals outlined above were discussed in the MRA. Based on our analysis, each of the goals of this purchase has been, or is well on its way to being, met.

AUDIT FINDINGS**Trailer Lease Not Cost Effective****OIG Finding:**

Postal Service officials made a decision to lease common fleet trailers based upon a business justification process that incorrectly reported that it was more advantageous to lease rather than purchase trailers.

Response:

The MRA does not recommend that the Postal Service lease rather than buy trailers based on an incorrect analysis of lease versus buy. The MRA states, in pertinent part, the following:

"A straight comparison of trailer ownership costs versus service costs would give a slight financial advantage to ownership." The same section of the report goes on to state that: "When you consider the total cost of ownership, the nod must go to leasing as the best service and financial option for the Postal Service." The MRA concludes by stating that in order for the Postal Service to meet its mission, there must be a proper balance between postal-controlled (owned) equipment and contracted equipment. The cost differences between owned and outsourced equipment should not affect the current proposed trailer service contract or proposed purchase of 1,000 trailers to replace aging trailers in the existing fleet. The recommendation clearly states that Postal Service needs both owned and outsourced equipment.

The decision to award the national trailer service contract was based on the overall business case and never claimed that on a head-to-head, narrowly focused comparison, that leasing was less costly than ownership, as is stated in the audit report referenced above. Given the Postal Service's overall business strategy and operating model of contracting out transportation and related services (the use of HCR in lieu of postal owned and operated equipment and personnel), it is less expensive in this case to use outsourced trailers (given the total cost of ownership). The following are some of the specific business reasons that leasing is the best business decision for the Postal Service in this case:

1. The management, administrative, and physical infrastructure to manage a postal-owned fleet of trailers (9,452 trailers BMC/MTEC fleets) is not in the Postal Service's current staffing model. Trailer ownership would require significant additional infrastructure and staffing;
2. Short-term trailer replacement;
3. Additional trailer flexibility (fleet sizing);
4. Trailer downtime contingencies would become a postal responsibility;
5. Save corporate value of initial dollar investment in the purchase of trailers;
6. Tort claims/insurance costs;
7. Use of aging trailers in years 6 through 12 of ownership; and
8. High damage repair of reinforced fiberglass trailers.

In summary, the decision to use a national service contract, which provides for leasing, is not strictly financial, as portrayed in the transmittal draft audit report, but an overall business decision. In fact, the MRA recommended that the Postal Service should continue to both purchase and use service agreements to acquire trailers, depending on the circumstances.

OIG Finding:

That decision will cost the Postal Service an additional \$85 million over a 12-year period.

Response:

The Postal Service has a 6-year service contract with the national trailer supplier and not a 12-year contract, as stated in the audit report. Based on our analysis, the NPV of leasing versus purchase for a 6-year term is \$48,741,825.

If the parties agree on the terms and conditions, the contract can be renewed. If we are unable to achieve a price reduction for years 7 through 12 (which we fully expect to achieve) the 12-year lease still has a positive NPV for leasing of over \$18 million (this issue is discussed later in document). As stated in the MRA, there is a slight financial advantage to ownership versus leasing if none of the other total ownership costs are taken into consideration.

Based on our review of the data and reference material used to support the report's financial projections for the cost of serviced equipment, the OIG report relies on a series of assumptions and data that is not verified, is inconsistent with the terms and conditions of the national service contract, and is inconsistent with postal financial experience with trailer service contracts. The combination of these factors has created flaws in the financial conclusions in the audit report. Following is a discussion of some of the areas in which we think the report's conclusions are incorrect.

Economic Price Escalation:

Based on our review of the report and earlier conversations with the OIG, the OIG has assumed that the daily service cost will remain flat for the first six years of the service and then increase by 10.4% for years seven through twelve. That would mean that the daily service cost would rise from \$10.21 per trailer, per day to \$11.27 per trailer, per day. The total impact of this assumption raises the total cost of serviced trailers by \$10,492,816 for the final six years of any contract renewal. This assumption is incorrect based on the terms of the contract and all of our experience in negotiating trailer service contract renewals. The national trailer service contract states that there will be no adjustment in the service rate except by mutual agreement of the parties (Clause H.7, lines 1066-1067). There are no plans to agree to an adjustment in the price during the initial term or any subsequent renewal periods. In fact, the plan is to reduce the rate for any subsequent contractual term.

The MRA clearly states the plan to achieve a cost reduction in the trailer service rate for any renewal of the contract. The Postal Service has achieved a reduction in the daily rate or the rate has remained unchanged for trailer service contract renewals for the same equipment. Generally, reductions range between -3% and -9%. There are a total of 37 trailer service renewals. In 23, or 62% of the renewal actions, the rates remained unchanged. In 11, or 30% of the cases, the rates were reduced between -3% and -9%. The only instances where rates were increased were those instances where we had the supplier make some substantive changes in the equipment. Therefore, the OIG assumption that the contract rate will increase is unfounded. Given the size of the contract and the supplier's ability to leverage, we expect to achieve a 14% reduction in the daily rate per trailer for years 7 through 12 of any service renewal. For this response, we have chosen to use 7% as a fair and reasonable estimate of potential savings based on past results. During the competitive bid process, there were offerors who bid in the range of \$9.00 per day, per trailer. These companies are smaller than the awardee and, therefore, they do not have the customer base over which to spread institutional and overhead cost. They also do not have the awardee's volume purchasing power. This will reduce the total trailer cost (for the years 7 through 12) below the current projected total contract price. If acceptable financial targets are unable to be achieved, the requirement will be re-competed. The trailer requirements will not change; therefore, based on previous performance, the cost will be reduced as outlined in the attachment, either through negotiations with the current supplier or through the competitive process. The MRA clearly states we plan to achieve a reduction in the daily rate. Given our experiences and plans, we cannot agree with the OIG's conclusion that rates will increase by 10.4%.

Based on our years of experience in leasing trailers, in 92% of the contracts reviewed, the lease price either remains constant or is reduced. A 10.4% increase for a service trailer contract is unprecedented in

our business experience and, therefore, we cannot accept the view that the contract price will increase by 10.4% for years 7 through 12 should we renew with TIP.

Projected Cost of Damage Claims:

Based on our review of the information outlined in the report and additional discussions with the OIG's office, the OIG had discussions with various Vehicle Maintenance Facility (VMF) managers and reviewed trailer repair reports for postal-owned and operated equipment (PS Form 4547), as well as the awarded supplier's trailer repair standards (preventative maintenance and non-preventative maintenance). Based on this review process, the OIG determined that the Postal Service would pay \$64,000,000 for damage to postal-owned and operated equipment over a 12-year period. Using the 4,506 trailer fleet at a total cost of \$64,000,000 for a 12-year operating period would indicate a cost of \$3.24 per trailer, per day for damages to postal-owned and operated equipment. The audit report then applies the results of the analysis of postal-owned and operated equipment to the base cost of serviced trailers. The assumption that serviced trailers would have the same level of damage cost as postal-owned and operated equipment is incorrect and inconsistent with past and current experiences.

The assumption is incorrect for two key reasons. The first reason that damage cost for serviced equipment is less than postal-owned and operated equipment is due to the fact that all maintenance and damage repairs are the direct responsibility of the contractor and not the Postal Service (see contract Clause M.2). This contract requirement positions the contracting officer and transportation operations management to evaluate the claim and accept it as postal damage (for which the Postal Service is financially liable), operating contractor damage, or fair wear and tear (for which the Postal Service is not liable). The second reason is that the actual payments for damages for serviced trailers, in the worst year (FY 2001), averages \$0.82 per trailer, per day. If we restricted the damage cost comparison to just the BMC fleet, which would be reasonable given the fact that the BMC fleet is being replaced, the damage cost per trailer, per day would be less than \$0.57 per day. At \$0.82 (the worst year) the cost is more than 400% below the OIG cost estimate for postal-owned and operated equipment. These recent documented payment experiences (four years of payments FY 1998-2001 through AP 12) are the best indicator of future cost.

As mentioned in our discussions with the OIG and referenced in the report, the trailer service supplier has first-line responsibility for all maintenance and trailer repairs. This means that this supplier must have the trailers inspected, and in those instances where the supplier thinks that the repair was necessitated by negligent act(s) or omissions of the Postal Service or its agent, the supplier has the option of filing a request for reimbursement.

In some instances, they accept the cost of repairs as fair wear and tear—in other instances they file a request for reimbursement. In those instances where a request for reimbursement for damages is filed, the request is evaluated and either paid in whole, in part, or rejected.

Based on past postal experience over the years, the supplier evaluates some damage as fair wear and tear and never files a claim. When we own the equipment, we must pay for every repair. In the case of owned equipment, there is no review of the repair; therefore, there is no discussion or dispute of responsibility for the damage or maintenance cost. The Postal Service, as it does today with owned equipment, would simply pay for the repair. The Postal Service's physical and staffing infrastructure has been designed to operate in this manner. In other instances, claims are rejected, either in whole or part. This, once again, reduces the bottom line cost of trailers under service contracts. Finally, in some instances, the suppliers filed appeals with the Postal Service Board of Contract Appeals (PSBCA). Dating back to 1980, the Postal Service has prevailed in the vast majority (seven out of eight) of these claims. It is from a combination of the day-to-day management differences that the damage claims for service contract trailers are substantially less than postal-owned equipment.

Additionally, the NMTP group is creating a function, which has as one of the responsibilities of the manager, the requirement to address opportunities to more effectively manage the cost of assets. Given

these plans, it is expected that the total cost of trailers, including damage, will be reduced in the coming months and years.

Although we have not quantified the economic value, most postal-owned trailers are made of a fiberglass material and are, therefore, more expensive to repair than the material used to manufacture the serviced trailer fleet.

Total Cost of Ownership:

A key cost that is not included in the audit report nor quantified in the MRA is the staffing required to manage an owned fleet. If we take the most conservative approach and add one employee at each major facility where we would have a trailer fleet (21 sites), it would cost a minimum of \$1,387,713.60 per year and \$16,652,563.20 over a 12-year period. This employee would be required to follow up on local contract management issues such as fleet reviews, trailer reviews, trailer tracking, adjudication of trailer damages, and maintenance claims, etc.

OIG Recommendation 1:

Prepare a Decision Analysis Report to purchase the common fleet trailers currently under the nationwide lease and submit it to the Board of Governors.

Response:

Based on our review of the audit report, we do not agree with this recommendation. As stated earlier, the statement that a DAR is required for the subject service is inconsistent with postal policy as it relates to transportation contracts. As you will note in section 4.5.1.a of the *Purchasing Manual*, trailer contracts are, by definition, transportation contracts. The fact that many of these contracts have a total value in excess of \$10 million does not mean that a DAR and/or Board of Governors approval is required. The Postal Service has a continual need for both serviced and owned trailers.

OIG Recommendation 2:

Upon approval to purchase trailers, initiate action to purchase trailers and terminate the national lease.

Response:

As discussed in this document, we do not agree with this recommendation. Given the Postal Service's current operating model, it would not be in the best service or financial interest of the Postal Service to implement this recommendation. The consolidation of the fragmented Area leases into a national service contract was a positive step with financial benefits to the Postal Service. We believe the appropriate course is to leave the contract in place, collect definitive cost data, and do another lease versus purchase assessment prior to exercise of the option to extend the contract.

OIG Recommendation 3:

Obtain bids for nationwide maintenance and repair services for common fleet trailers.

Response:

The repair and maintenance requirements—for serviced trailers—are part of the current service contracts and, therefore, are already contracted out. The possibility of the Postal Service completely contracting out maintenance and repairs for owned equipment raises a myriad of employee management financial issues (Article 32) that make the implementation highly problematic. The management, administrative, and physical infrastructure to manage a postal-owned fleet of trailers (9,452 trailers) is not in the Postal Service's current staffing model. Trailer ownership would require significant additional infrastructure equipment and staffing.

OIG Recommendation 4:

Develop management controls to ensure use of a Decision Analysis Report for services exceeding \$10 million per year.

Response:

The statement that a Decision Analysis Report (DAR) is required for the subject service is inconsistent with postal policy as it relates to transportation contracts. As you will note in section 4.5.1.a of the *Purchasing Manual*, trailer contracts are, by definition, transportation contracts. The fact that many of these contracts have a total value in excess of \$10 million does not mean that a DAR and/or Board of Governors (BOG) approval is required. Section 2-8.1 of the F-66 states the following:

"Supplies and services include expensed repairs and alterations and the renewal of ongoing or recurring service contracts. Throughout all levels of the organization, authority is granted to approve purchases of expense items contained in approved budget. Managers listed in the Delegations of Approval Authority may redelegate, in writing, portions of this authority."

The Delegations of Approval Authority (F-66, exhibit 2-1) states for Supplies and Services that "...Unless otherwise covered by these instructions, authority is granted to approve projects contained in approved budget. Contracting/purchase subject to Purchasing (ASM) policies..."

Since the trailer contract was a renewal of the existing ongoing or recurring supplies/services contracts, Board approval was not required. As discussed in the MRA, the national trailer service contract will provide substantial savings and service improvements over the life of the contract.

The subject service is a continuation of an existing service (transportation) contract and, as such, does not require a DAR or Board approval (Ref. Delegations of Approval Authority Exh. 2-1, F-66 General Investment Policies and Procedures). As outlined earlier in this document, there are numerous total cost of ownership issues that make trailer leasing an excellent business option for the Postal Service, as in this instance. Although they are difficult to fully quantify, the business logic supporting these conclusions is crystal clear.

OIG Recommendation 5:

Ensure leases that meet the characteristics of a capital lease are accounted for as the acquisition of an asset and incurrence of a liability on Postal Service accounting records.

Response:

As stated earlier in this document, the national trailer service contract does not meet the investment criteria for a capital lease. As stated in the MRA, the Postal Service makes no up-front cash investment. In fact, the supplier invests a minimum of \$50+ million in equipment, and the Postal Service makes an accounting period payment only after using the equipment for 28 days. Therefore, there is zero capital investment and risk, and the national trailer service contract is not a capital lease. The Postal Service does not take title to a specific set of trailers. The supplier maintains a fleet of trailers as a service to the Postal Service for a flat fee. The supplier can change trailers, as he/she deems appropriate, as long as the requirements of the service contract are met.

As we normally measure business risk, we focus on capital investment, day-to-day operating responsibility, expense, and cost to exit the contract. We also look to the standard postal criteria for determining whether an equipment service is a capital service as follows:

Capital Investment:

The national trailer service contract does not meet the investment criteria for a capital lease. As stated in the MRA, the Postal Service makes no up-front cash investment. In fact, the supplier invests a minimum of \$50+ million in equipment, and the Postal Service makes an accounting period payment only after using the equipment for 28 days. Therefore, there is zero capital investment and risk, and the national trailer service contract is not a capital lease.

Day-to-Day Operations:

The second area of risk would be for the day-to-day fleet management and the cost of those operations. The supplier has total responsibility for day-to-day management of the fleet. The supplier must ensure that all preventive and non-preventive maintenance (damage repairs) is completed. It is only after damage repairs have been completed and the supplier files a claim that the Postal Service evaluates the claim to determine if it should be paid. If a trailer is out of service (for maintenance or damage), the supplier has four hours to provide replacement equipment or be subjected to equipment replacement costs. The supplier bears responsibility for both the fleet management and financial risks of day-to-day management. Given the fact that the supplier bears the risk, this contract does meet the definition of a capital lease.

Contract Termination/Equipment Disposal:

The third area of risk is the cost of contract termination or equipment disposal. Based on contract clause H.3., Termination, the Postal Service can terminate the contract with 30 days notice with a minimal liquidation payment. The six-year contract term is worth \$100,753,709. We can terminate with 30 days notice during the first three years of the contract and pay \$2,798,770 (2.78% of contract value) or terminate during the last three years of the contract and pay \$1,399,368 (1.39% of contract value). The question now becomes—who has the risk? This issue is discussed in the MRA. Clearly, the financial risk rests with the supplier and not the Postal Service.

In addition to the business criteria outlined above, an examination of this contract under the Generally Accepted Accounting Principles (GAAP) criteria for distinguishing a capital lease from an operating lease. (The GAAP criteria have been adopted as the Postal Service's standard criteria for lease capitalization in order to ensure that our financial statements are prepared in compliance with GAAP.) The contract between TIP and USPS is clearly not a capital lease, as it does not meet any of the following GAAP criteria:

A capital lease exists if the lease meets any of the following four criteria:

1. The "Transfer of Ownership Test." The lessee is to get property ownership at the end of the lease term. This criterion is still satisfied if ownership is transferred shortly after the end of the lease term.
2. The "Bargain Purchase Option Test." A bargain purchase option exists in which the lessee can either buy the property at a minimal amount or renew the lease at very low rental payments relative to the "going rates."
3. The "Economic Life Test." The lease term is 75% or more of the life of the property.
4. The "Recovery of Investment Test." The present value of minimum lease payments at the start of the lease equals or exceeds 90% of the fair market value of the property. Minimum lease payments do not include executory costs to be paid by the lessor, which are being reimbursed by the lessee. Examples of such costs are property taxes, insurance, and maintenance. Executory costs also include lessee payments to an unrelated third party to guarantee the residual value. When the lessor pays executory costs, any lessor's profit on such costs is construed the same as the executory costs.

In summary, as measured by reasonable business standards, as well as under Generally Accepted Accounting Principles, the national trailer service contract is not a capital lease and did not, for this and other reasons discussed earlier, require a DAR and/or BOG review and approval.

Conclusion:

When you take into consideration the combined effects of the differences in damage costs and preventative maintenance, as well as the time value of money and projected infrastructure costs, it is clearly in the Postal Service's best interest to service lease trailers versus buying. The savings are even greater when ad hoc rental and Christmas savings are factored into the equation. Without a doubt, the actions taken with this contractual action were the best business decision for the Postal Service.

**PAGES 39-53 OF THE ORIGINAL REPORT WITHHELD
UNDER 39 USC 410 (c)(2) b(3)**