Statement of
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United States Postal Service
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House Committee on Government Reform
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Chairman Burton and Members of the Committee, on behalf of the Office of Inspector General (OIG), United States Postal Service, I am pleased to submit this written statement concerning actions the Postal Service can take to improve its performance, accountability, and financial position.

As a result of the efforts of the House Committee on Government Reform, and in particular the leadership of Representative John McHugh, Congress created an independent OIG for the Postal Service in 1996. I am the first independent Inspector General for the Postal Service under the Inspector General Act and have held this position since January 1997.

As you know, under the Inspector General Act, my office conducts independent audits, reviews, and investigations of postal programs and operations. Therefore, we are uniquely situated to bring to Congress and Postal Service stakeholders an independent assessment of postal operations because we are knowledgeable of postal operations but do not report to Postal Service management and are not under their control.

This statement brings to your attention some of the issues regarding opportunities to improve critical management practices of the Postal Service, including contracting, budget and return on investment, labor management,

systems development, computer security and privacy, and strategic planning. In one review we identified almost $1 billion in cost avoidances over a 7 year period for a project to establish a nationwide toll-free response line. In another project, which is still in draft, we have potentially identified that outsourcing a major repair function would cost the Postal Service $1.1 billion more over a 10 year period than performing the function in-house. In addition, our other projects have identified almost $515 million in fines, recoveries, restitution, potential savings, and cost avoidances on postal operations over a number of years. Finally, we have identified $64 million in costs that could have been spent in a more appropriate manner.

We would like to note that the Postal Service has generally been receptive and responsive to issues we have brought to their attention over the last four years. Because of their willingness to address these issues, we are developing an effective working relationship.

The Postal Service is projecting a $2 to $3 billion loss this year and has indicated that a rate increase is needed along with reform flexibility in the areas of labor and operations, pricing, products, investments, and oversight. The Postal Service has indicated that the main reasons for this projected loss include reduced revenues from the Postal Rate Commission's decision, cost of living adjustments, and a continued soft economy. While we are in the process of assessing the reasonableness of this projected loss it is apparent that the Postal Service is facing significant financial challenges as evidenced by the deterioration in its current financial condition.

While the Committee is assessing the Postal Service's call for reform, the Postal Service must still address their critical management and financial practices. While progress has been made by the Postal Service in recent years to improve these practices, we believe that continued effort must be given to improving

performance and accountability throughout the Postal Service. Specifically, we believe:

- Contracting activities need proper control and oversight to prevent fraud, waste, abuse, and mismanagement;
- Performance data and financial information must be reliable for senior managers to make sound business decisions;
- Labor management and personnel practices must be improved;
- Mail processing systems must deliver;
- Computer security and privacy must preserve the customers' trust.; and
- Organizational structure and strategic planning must address the core mission.

Critical Management Practices

Although the Postal Service is seeking reform, we believe there are many improvements it can make today to strengthen its performance and improve efficiency. The following sections discuss the major issues that the Postal Service needs to address.

Contracting activities need proper control and oversight to prevent fraud, waste, abuse, and mismanagement

The Postal Service operates an $8 billion per year contracting program. We have found that the Postal Service has not always followed its own procurement policies or sound contracting principles. Over the last four years, our reviews

have disclosed that such contracting practices have resulted in $467 million in fraud, waste, abuse, mismanagement, and other recoveries on postal contracting programs.

As a result of our efforts and with the subsequent cooperation of Postal Service management, the Postal Service recovered over $12 million from a major telecommunications contractor and can avoid an additional $58 million in erroneous billings. Because the Postal Service did not adequately monitor contractor performance, it was repeatedly billed for work that was not performed and for substandard work. Postal Service management is reviewing all future bills to ensure correct billings, which should result in future savings.

In another recent case, a married couple who were Postal Service employees defrauded the Postal Service of more than $3 million because internal controls were ineffective. One spouse approved nonexistent purchases submitted by the other. The couple then fled to Venezuela with the proceeds and converted the stolen money into foreign investments, jewelry, and real property. Both employees were caught, returned to the United States, and convicted. As part of their sentence, the couple was ordered to repay over $3 million. Forfeiture actions to recover the money are currently underway. In order to prevent such frauds in the future, the Postal Service needs to ensure that appropriate internal controls exist and are enforced and that systems and data are available to validate contractor charges for services rendered, or work performed.

The Postal Service awards millions of dollars annually in cost reimbursement contracts. Our work has shown the Postal Service has not always reviewed and approved its contractors' cost accounting systems prior to the award of cost reimbursement contracts. This impairs the Postal Service's ability to effectively review contractor billings, creates the potential for billing frauds and may result in excess charges to the Postal Service.

For example, we identified significant deficiencies in a major contractor's estimating system and concluded that the Postal Service could not rely upon any of the contractor's proposed costs. This contractor has received more than $1 billion in postal contracts to date. Reliance on this system could result in the Postal Service paying for costs that are not associated with postal work. To date, we have questioned $37 million in proposed costs from this contractor, and our work on reviewing other contracts is continuing.

On numerous occasions we have found situations where contractors were improperly involved in writing their own contracts. For example, in one case a contractor was allowed to establish the Postal Service's contract requirements. The contractor then received a series of sole source contracts, valued in excess of $300 million, to provide these requirements. Under federal government contracting regulations this conduct would be specifically prohibited; however, under postal policies this is not specifically prohibited. We determined that if these contracts had been competitively bid, the Postal Service could have saved $53 million.

We have also identified repeated examples of contractors providing multi-million dollar services without a formal contracting agreement. The Postal Service has used "letter contracts" and "strategic alliance agreements" which do not contain adequate provisions to protect the interests of the Postal Service. The use of strategic alliances in the Postal Service is a growing practice, particularly in its electronic business initiatives. For example, in one major electronic commerce initiative, the Postal Service entered into a long-term relationship with a contractor to provide new electronic commerce services. The contract did not fully address computer security, privacy of Postal Service customer information, and audit rights. One clause that was included could have restricted the right of the Postal Service to investigate criminal activity relating to the contract. Although these deficiencies were brought to Postal Service management's

attention almost one year ago, the contract still has not been amended to address these issues.

Our work further identified instances where contract management could be improved to support contracting decisions and the review of contractor billings. We have identified many instances where there was not adequate information available to support payments to contractors. We also determined that quality assurance procedures and training of Postal Service contracting officials needed to be strengthened to properly monitor work performed by contractors. For example, in one investigation we determined that the Postal Service paid over $800,000 for asbestos abatement work that was either over billed or not performed. As a result of our investigation, Postal Service management ensured that the work was completed, initiated actions to obtain refunds for all over billings, and ensured that the contractor reimbursed the additional costs that were incurred by the Postal Service.

Another example of poor controls deals with inadequate monitoring of contractor performance. In one case that we are still reviewing, a contractor was responsible for reporting performance information on a major 10 year, $3.6 billion equipment network. As part of its responsibilities, the contractor reported on its own performance as well as prepared and verified its own invoices. In our opinion, approving contractor bill payment is an inherently postal function that should not be delegated to a contractor. Furthermore, under no circumstances should a contractor be allowed to approve its own bills for payment. Management recently received our draft report and has yet to respond.

Finally, we note that the Postal Service is exempt from standard federal contracting rules to enable it to realize greater efficiency and operate in a more business-like manner. As demonstrated in the examples above, our reviews of postal contracting practices suggest that although the Postal Service has realized some efficiencies, they have also weakened important internal controls. We

believe that while a strict adherence to federal contracting regulations is not needed, there is a clear need to strengthen internal controls throughout all postal contracts. These controls are the Postal Service's first line of defense against fraud, waste, abuse, and mismanagement.

Performance data and financial information must be reliable for senior managers to make sound business decisions

During some of our reviews, we found that Postal Service officials did not always effectively plan, control, and allocate organizational resources to invest in and support the Postal Service's goals. Further, we found that the Postal Service could improve its estimates for return on investments so that they can be achieved and supported. The Postal Service is a $65 billion business and must require that timely and accurate information be provided to senior managers for making informed business decisions. While we recognize the challenge in managing a budget of this size, Postal Service management can more effectively control and address its projected budget shortfall with accurate information to support budget estimates

In our review of the process used to manage the Postal Service Headquarters' $4.1 billion budget, we noted that 50 of the 100 program budgets that comprise this figure were not based on current or complete studies and analyses to ensure that program funding requirements were appropriate. Therefore, Postal Service officials could not be assured that the programs were appropriately staffed and funded and that cuts may have a long term detrimental effect on other aspects of the program, including revenue.

The Postal Service tracks expenses when paid, but it does not track expenses that have been incurred but not paid. While we have been told that this does not affect the overall postal budget because the major expenses are salaries and benefits, it is very significant at the program level. At this level, other expenses,

such as contracts, travel, and goods and services, are of major concern. Vice presidents and program managers have expressed concerns to us regarding the inability to monitor expenses on a timely basis. In addition, without this information, it is difficult for them to effectively develop, justify, and defend program budgets.

The Postal Service uses a detailed process to justify and analyze the cost/benefits of projects over $5 million for major equipment programs and facilities. In work that we have performed over the last four years, we have noted that for many projects management presented programs for approval without adequate documentation and analysis. We have recently completed a comprehensive review of this process in which we evaluated the methods used by the Postal Service to validate and monitor this annual expenditure of several billion dollars. We are also reviewing performance measurements to determine whether they are complete and reported timely to senior Postal Service managers. These measures will allow managers to track subsequent program performance and adjust funding in order to assure that Postal Service funds are justified, cost effective, or beneficial to their operations.

The Postal Service uses return on investment to determine the economic viability and cost benefits of its programs. We continue to question some of the Postal Service's return on investment projections because they do not always possess the data to make these projections. Lack of accurate data could have a direct impact on postal income projections.

For example, we have looked at return on investment on numerous postal projects. In each of these reviews we believe that Postal Service management could have used more reliable and complete data. In one instance, a $500 million automation project for 23 sites was projected to have a return on investment of approximately 5 percent. However, our analysis showed that the return on investment at the time of approval should have been almost a negative

9 percent. Therefore, the approval of this investment was based on inaccurate information.

In a draft report we previously discussed, we reviewed a program to repair postal equipment. The Postal Service estimated savings from the program to be $300 million over a 10 year period. Instead we found that the program, as deployed, may not result in the projected savings, but will result in costing the Postal Service $1.1 billion more over the 10 year life of the program.

We are also concerned that the Postal Service has entered into a number of agreements whereby the Postal Service is guaranteeing revenue to their business partners. The Postal Service assumes the risk in the venture, even though it does not know what the revenue will be.

For example, in one recent agreement the Postal Service provided an annual revenue guarantee over the 10 year life of the contract, even though the Postal Service has little or no experience in this area. To date, in an ongoing review, we have not been able to verify how the revenue guarantees were derived, but the amount of revenue being guaranteed appeared to us to be unrealistic. Further, the Postal Service has not yet been able to provide sufficient information to justify the revenue guarantee. Furthermore, in the year since this program commenced, the Postal Service told us that revenues from the program have been below their original projections. The Postal Service is currently revising their projections based on the economic slowdown.

Labor management and personnel practices need to be improved

Controlling personnel costs is imperative to the Postal Service because these costs account for over three quarters of its operating budget. Labor management relations are significant to the viability of the Postal Service. Poor labor management relations can have a negative impact upon employee morale and

productivity. Our work has shown that the Postal Service has had difficulty in labor management relations and we believe there are opportunities for cost savings.

One of the concerns that has continued to get media, congressional, and employee attention is the Postal Service's pay for performance program, which covers 84,000 employees. We reviewed this program and questioned whether the Postal Service should be making payments under the program at the same time it was requesting a rate increase, considering a reduction in workforce, and projecting a net profit, which was less than the projected payout. Since then, we have learned that the actual payments were $197 million at the same time the Postal Service lost $199 million.

The Postal Service justifies the pay for performance program, stating that productivity improvements are driven by this program and are promised at the beginning of the year before knowledge of actual profit or loss is known. In addition, the Postal Service believes that without this program they would not have achieved their reported record productivity improvements. We are continuing to review this program to determine whether it actually enhances productivity.

As part of their efforts to improve working conditions, the Postal Service commissioned a study on violence in the workplace. The study concluded that although employees believed they were at greater risk to be a victim of workplace violence than the average worker in the United States, actual results did not support this belief. The Postal Service has acknowledged these concerns, and continues to take actions to address these issues, such as the improvement of their threat assessment capability and ensuring that managers are accountable in this area. In addition, they have established a workplace environment improvement program to enhance working conditions.

However, we continue to receive allegations from employees who believe they have been harassed, intimidated, and subjected to violence. We continue to find this troublesome and believe it has a potential impact upon the financial profitability of the Postal Service because of increased grievances, Equal Employment Opportunity (EEO) complaints, work slowdowns, and morale issues.

Recently, we issued four audit reports documenting employee allegations that certain Postal Service managers at facilities in New Jersey, California, South Carolina, and Alaska have utilized intimidation, harassment, and abusive management practices. In one of these cases, during our interview with the manager, he played with an empty .38 caliber shell casing. In response to these reports, the Postal Service has taken steps at these facilities to improve the work environment by conducting climate assessments and initiating joint labor-management meetings.

The full cost of these problems to the Postal Service is difficult to assess. For example, the Postal Service is unable to provide the cost of processing the 126,000 grievance and arbitration cases currently pending. While the Postal Service has developed a new grievance tracking system, it does not track cost. Knowing how much these employee related problems are costing the Postal Service – and it could be in the millions of dollars – might give management more of an incentive to correct this situation.

The Postal Service has announced that with the projected loss, there could potentially be office closings and reductions in force. These events can be traumatic to employees and may increase workplace tension. The Postal Service needs to be able to react to any workplace incident that may arise from this tension. We note that the Postal Service has recently closed 23 out of 55 remote encoding facilities, primarily staffed by contractors, without adverse incidents.

Recently, we completed audits of 26 Postal Service districts' violence prevention and response programs. These reviews disclosed that the Postal Service effectively responded to violent situations. However, they need to proactively follow threat assessment procedures to prevent workplace violence. If such situations would erupt, the potential financial liability could be substantial. Further, even though the Postal Service is taking cost cutting measures, reductions in this area would be inappropriate.

In the area of workplace safety, the Postal Service has potential liability in terms of:

- Substantial fines from the Occupational Safety and Health Administration, including treble damages if the violation is determined to be willful. Furthermore, significant violations have the potential for shutting down postal facilities.

- Workers' compensation claims, potential lost workdays of Postal Service workers, and claims for workplace injuries by Postal Service contractors and customers.

For example, in one review we found that Postal Service management did not ensure that appropriate action was taken to correct safety violations and safeguard employees. We were told that these unsafe conditions were not corrected due to concerns that repairs could cause mail delays.

Individual Postal Service managers have direct authority over large sums of money and resources, and when not judiciously administered, this authority may result in abuse, affect the public's trust in the Postal Service, and depress employee morale. The following are examples where incidents occurred. In each case, Postal Service management took corrective action.

- A review of an EEO settlement agreement revealed that Postal Service managers have the authority to settle EEO complaints against themselves. In one example, a former vice president approved a settlement of $52,000 where he was the alleged discriminating official.

- Our reviews of relocation payments questioned the payment for employee moves of less than 20 miles when there appeared to be no benefit to the Postal Service. We identified over $240,000 in relocation expenses paid to two senior Postal Service officials for local moves, without full disclosure to the Board of Governors.

- We found some executives misused official vehicles and used Postal Service employees as chauffeurs for prolonged periods of time throughout the Postal Service. This occurred because controls over the vehicles were either inadequate or nonexistent. Specifically, we found over 520 instances (460 instances by one individual), involving nine executives, where inappropriate use took place. However, we could not determine the full extent of the misuse because of the lack of documentation.

Mail processing systems must deliver

Since 1998, the Postal Service has deployed $3.2 billion in automated mail processing equipment. We recognize that the Postal Service has been a leader in implementing and integrating automated mail processing equipment. While we support their initiatives to improve automation we believe it is imperative that the Postal Service ensures that the technology works as intended and that their investments are sound. We reviewed $1.2 billion of this deployed equipment and identified instances of defects and immature technology. This condition existed because the Postal Service does not always follow their process for ensuring projects are developed on time, within budget, according to requirements, and with expected benefits.

Numerous systems we reviewed have contained defects and immature technology. Because of these problems, the Postal Service often lowers the performance requirements in order to justify deployment. In most cases, Postal Service management then relies upon manual labor to supplement the performance shortfalls of these systems, which contradicts the original premise for automated equipment investments. The following are examples of postal systems and the issues that existed at the time of deployment, and at the time of our reviews. Postal Service management recently informed us that these issues have been addressed. We will verify this information as time permits.

For example, the Postal Service expended $81 million on a mail processing automation project that was intended to process 15 mail trays per minute. When the equipment was deployed, the actual performance was only 10 mail trays per minute. Despite this reduced capability, Postal Service management chose to deploy the system without assessing the negative impact on the original savings used to justify the approval of this automation project. Therefore, it is unclear whether the Postal Service will achieve the anticipated savings on this project.

We reviewed another automation project originally intended to provide mail transport equipment at 42 postal sites, at a projected cost of $500 million. However, because of a lack of reliable cost and performance information, $500 million will only provide for deployment at 23 sites. Furthermore, the deployment has been delayed by a year. In addition, we identified at least $27.9 million more in program costs than originally projected.

After reviewing a $38 million robotics automation program, we determined the Postal Service was not capturing performance data to assess the effectiveness of the program. Without this data, Postal Service management could not accurately determine what, if any, return on investment was achieved. In addition, only 73 of the 102 units purchased were installed, and 9 were

subsequently removed by the receiving facilities. These 9 facilities determined, after deployment, that the units were of limited productivity and usefulness.

Finally, we reviewed a new $495 million system to replace existing retail systems at post offices. At the time of project approval, the system was designed to capture detailed retail transaction information. However, we determined the system was not performing as originally required. As a result, Postal Service managers were not able to fully assess performance problems, identify issues to improve systems operations, or determine future training needs.

Computer security and privacy must preserve the customers' trust

In order to maintain the public's trust in the Postal Service, the security of its computers and the privacy of the information they contain must be ensured. This is particularly important in the electronic commerce area, where major private providers have been victimized by attacks upon critical computer systems, and by the theft of customers' sensitive personal information. A breach in computer security could paralyze mail operations and result in a loss of revenue through the compromise of the Postal Service's electronic commerce operations. Risks in this area could increase exponentially as a result of the Postal Service's recently announced initiative to allow all Postal Service employees to connect to the postal network from home.

Recently, we led an international team of investigators in convicting a group of hackers that attacked computer systems, including a postal system, throughout the United States and Canada. The team is continuing to investigate other hacker attacks against postal systems originating from inside and outside of the Postal Service. The Postal Service has been very cooperative in our investigations by identifying potential attacks and working with our office to resolve security incidents. We have also commenced a program to conduct penetration testing of computers throughout the Postal Service and, working with

Postal Service management, have identified weaknesses in various systems that could, if not corrected, compromise Postal networks.

We are aware that computer security is a major congressional priority. Last year, based upon the work of this Committee, Congress passed the Government Information Security Reform Act to improve government computer security. The Postal Service has concluded, and we agree, that this Act does not apply to postal computer operations. However, our audit and investigative work has determined that the Postal Service does not meet the best practices recommended by the Act and that a comprehensive computer security program is needed to protect critical systems, postal operations, and electronic business initiatives. In response to our activities, the Postal Service has agreed to improve computer security.

One of the main concerns in electronic commerce today is the preservation of personal privacy and the continued availability of Internet services. The Postal Service has commenced an aggressive campaign to provide a variety of electronic commerce services, including selling postal products on-line and providing electronic services. We recognize that electronic commerce presents major challenges and we, as well as the Postal Service, agree that security and privacy concerns are paramount.

However, we have identified several security and privacy concerns in these areas that we have discussed with Postal Service management, including their protection of information and disaster recovery. We are not disclosing the details of these reports in this statement but would be happy to discuss them in private with the Committee. We commend the Postal Service for recently appointing a Chief Privacy Officer and Chief Information Security Officer which will focus Postal Service management's efforts in these important areas.

We remain concerned that recent electronic business agreements with contractors and other business partners may have an adverse impact on postal computer security. Such agreements must contain language that will ensure postal computer security and privacy are not compromised. We have recommended that the Postal Service develop standard procedures to ensure that postal computer security and privacy are protected whenever there is connectivity between postal computers and the computers of their business partners. A breach in computer security in this area could result in theft of valuable information, jeopardize relationships with Postal Service business partners and customers, and result in a loss of revenue.

Organizational structure and strategic planning must address the core mission

In numerous reviews of postal programs, we have identified organizational issues such as fragmentation, decentralization, and a need for better focus, which affect the Postal Service's ability to control its costs and improve performance. An organization of the Postal Service's size, i.e., over 900,000 employees and 38,000 facilities, requires an efficient organizational structure that utilizes efficient business practices.

The following are examples of how decentralization and fragmentation affects the efficiency of the Postal Service:

- In one audit we found that the Postal Service deployed a $38 million automated system to process mail trays to reduce operating expenses. The systems were poorly planned and did not include all needed components. Because the decision to use the equipment after installation was not centralized, some managers who originally requested the system, unilaterally decided to remove the equipment and place it in storage. While on the one hand we understand managers not wanting ineffective

systems, on the other hand, the Postal Service has invested in this technology, much of which is now in storage or has been dismantled.

- The Postal Service incurred $23 million in repair expenses for a northwestern facility, originally purchased for almost $27 million. Postal Service management requested that we determine why this occurred. We found that because the decision to waive procurement requirements was decentralized, a Postal Service manager was able to bypass safeguards requiring a detailed engineering study prior to the purchase, which should have detected the building defects.

- We reviewed a revenue protection program and found that because the responsibility for the program was fragmented between Finance, Marketing, and area and district finance managers, each with a different focus, deficiencies were not prevented through early detection. Because of this lack of focus and fragmentation, we found that mailers perceived that they had been treated unfairly by the Postal Service. This process was an important tool for protecting postal monies and ensuring postage due the Postal Service was paid and expenditures for collection activities reduced.

Conclusion

In conclusion, while we believe that the Postal Service needs to improve in the areas noted above, we also recognize the challenge the Postal Service faces and applaud their efforts to meet this challenge. Specifically, we have noted that the Postal Service:

- Is aggressively seeking new technologies and business innovations to continue its role as a world leader in the delivery of communications and logistics services;

- Has recognized technology and has employed it in areas such as travel, contracts, and other areas to improve timeliness and efficiency;

- Has improved their threat assessment program and ensured that managers are accountable for these programs;

- Has identified automation initiatives as a way to control labor and workers' compensation costs;

- Has made a concerted effort to improve computer security, including appointing a chief information security officer and chief privacy officer; developing a comprehensive strategy to tighten computer and Internet security; and creating a computer emergency response team; and

- Has recognized at the highest levels the impact of technology on its core business processes and undertaken a concerted effort to redefine its mission into the 21st century and beyond.

We believe that in addition to these efforts, the Postal Service must continually reexamine its mission, core business functions, and fundamental management practices. The Postal Service should also seek appropriate guidance from Congress on its mission and core business functions. The independent oversight provided by Congress and the OIG will continue to assist the Postal Service as they make decisions in these challenging times. In our view, in order to ensure the success of future Postal Service operations, Congress and Postal Service management need to address these issues.