September 23, 2008

DAVID E. WILLIAMS, JR.
MANAGER, PROCESSING OPERATIONS

SUBJECT: Audit Report – Assessment of the Remote Encoding Center Network Consolidation Process (Report Number EN-AR-08-007)

This report presents the results of our audit of the Remote Encoding Center (REC) network consolidation process (Project Number 08XG014EN000). Our objectives were to assess the process and criteria used to realign the REC network and validate reported cost savings for calendar years (CY) 2006 and 2007. The U.S. Postal Service requested this audit and we conducted it in cooperation with Postal Service officials. This audit addresses network streamlining in the strategic risk category as well as staffing and process efficiency in the operational risk category. Click here to go to Appendix A for additional information about this audit.

Conclusion

Our review concluded:

- The Postal Service effectively reduced the size of its REC network. Management closed 47 facilities in response to workload reductions, which resulted in a 41 percent decrease in REC network operating costs from 1999 to 2007. Management had valid reasons for selecting specific RECs for closure; however, the business cases justifying their decisions were sometimes confusing. Adding more details explaining the methodology would add clarity as the realignment process continues.

- Projected cost savings for 2006 and 2007 were generally supported; however, the projected cost savings for 2007 were overstated by approximately $300,000. This occurred because equipment depreciation expenses were incorrectly included in the savings calculation.

Process and Criteria Used to Realign the Remote Encoding Center Network

The Postal Service successfully realigned its REC network and reduced the number of REC facilities from 55 in 1999 to eight at the end of 2007. Management determined the amount of excess capacity and consolidated the REC network in response to workload reductions, resulting in a 41 percent decrease in operating costs. At the same time, image workload was expanded to include unreadable flats and parcels,[1] undeliverable as addressed mail, and change of address forms. Management was successful in reducing the REC network because approximately 70 percent of the employees were temporary, the physical location of the sites was not significant, the RECs were planned as temporary facilities, and stakeholder resistance was minimal.

The Postal Service developed criteria to identify RECs for closure and business cases justifying the decisions. However, some of the business cases were confusing. For example, management did not clearly explain the rationale for some REC closings. Adding more details to clarify the methodology used to select RECs for closure would improve the realignment process as it continues. Click here to go to Appendix B for more details.

2006 and 2007 Cost Savings Reported

The Postal Service's reported cost savings of $5.9 million for 2006 and $7.1 million for 2007 were generally supported. However, when we compared the reported savings to the amount achieved, we found the Postal Service had overstated its 2007 savings by approximately $300,000. This occurred because the Postal Service inadvertently included equipment depreciation expense in their savings calculations, although that expense was not eliminated by management's closure of the RECs. In addition, we could not validate $2,258 in rent expenses used in the 2007 reported savings. Accurate and complete financial data is important for supporting management decisions and strengthening stakeholder confidence in the realignment process. Click here to go to Appendix B for more details.

We recommend the Manager, Processing Operations:

1. Clarify the methodology used to select remote encoding centers for closure in future business cases.

2. Revise 2007 remote encoding center closure savings from $7.1 million to $6.8 million.

[1] Flats are large envelopes, and parcels are packages.

Management's Comments

Management agreed with our recommendations and plans to more clearly state the methodology used to identify remote encoding centers for consolidation in future business cases. Additionally, management plans to update the closure savings to reflect the $6.8 million in savings for 2007. Management's comments, in their entirety, are included in Appendix C.

Evaluation of Management's Comments

The U.S. Postal Service Office of Inspector General (OIG) considers management's comments responsive to the recommendations and the corrective actions should resolve the issues identified in the report. The OIG considers recommendation 1 significant, and therefore requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective actions are completed. The recommendation 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 your staff. If you have any questions or need additional information, please contact Michael A. Magalski, Director, Network Optimization, or me at (703) 248-2100.

E-Signed by Robert Batta
VERIFY authenticity with ApproveIt

Robert J. Batta
Deputy Assistant Inspector General
for Mission Operations

Attachment

cc: Patrick R. Donahoe
William P. Galligan
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APPENDIX A: ADDITIONAL INFORMATION

BACKGROUND

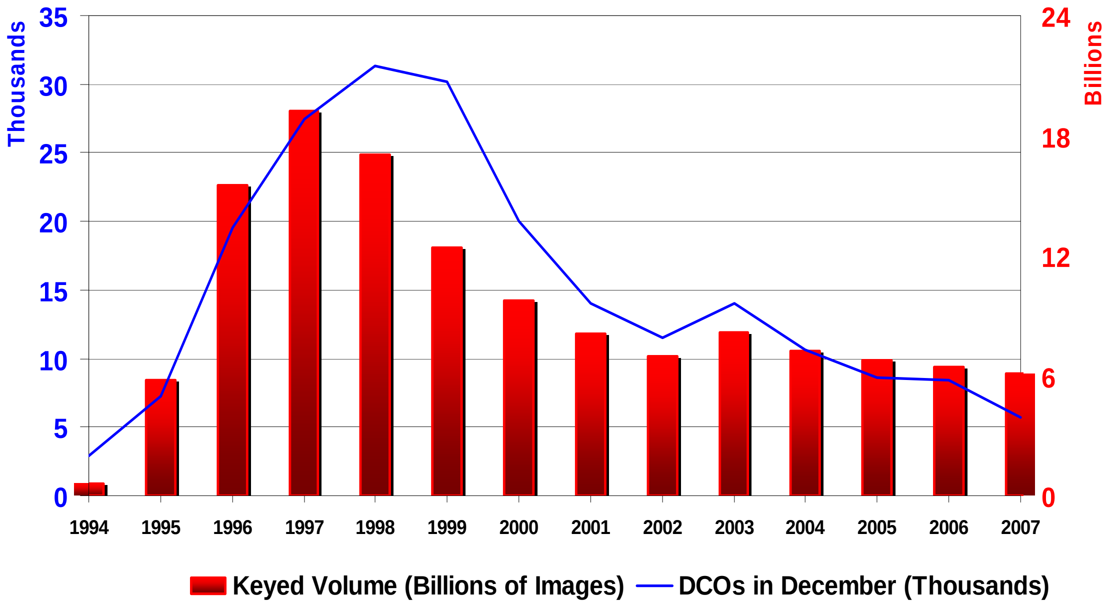
In 1994, Postal Service officials established RECs as a temporary solution to assist facilities in processing mail with unreadable addresses. When a mailpiece first arrives at a mail processing facility, Optical Character Readers (OCRs) and Remote Computer Readers (RCRs) read the address and apply a barcode to the mailpiece. If the mail processing equipment is unable to read the address, it transmits an electronic image of the mailpiece to the REC. The image is then displayed on a video display terminal for REC data conversion operators (DCOs) to interpret. The DCOs enter the requested information into the system, which electronically transmits it back to the mail processing facility. At the processing facility, a barcode is applied to the mailpiece, which is then sent to its destination.

Figure 1: DCO Workstations Inside the Wichita, Kansas REC

By 1997, the Postal Service had established a network of 55 RECs, which processed over 24 billion images per year.[2] With improved technology RECs can now also process flat and parcel[3] images. However, as OCR and RCR capabilities improved, the volume of images sent to the RECs declined, prompting Postal Service officials to consolidate REC facilities. Figure 2 shows the decline in total images RECs processed and the corresponding decrease in the number of DCOs between fiscal years (FYs) 1994 and 2007.[4]

[2] When the Postal Service first established RECs, they processed only letter mail with unreadable addresses.
[3] REC sites began processing flats in 2002 and parcels in 2004.
[4] December is the month that the highest number of DCOs work at the RECs.

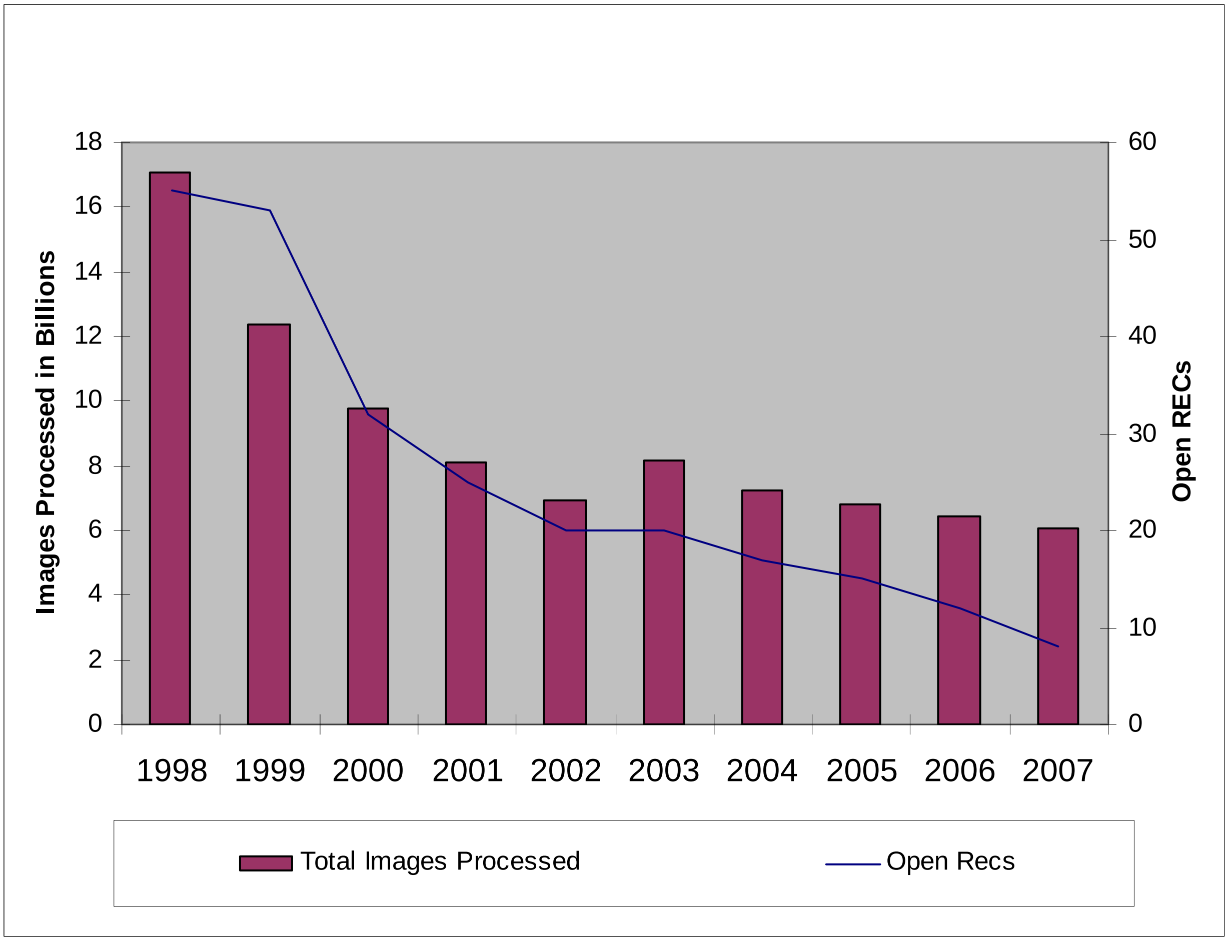
Figure 2: Total Images RECs Processed and the Corresponding Decrease in the Number of DCOs between FYs 1994 and 2007



Source: U.S. Postal Service

In 1999, the Postal Service initiated the REC network realignment process by developing standardized criteria to identify excess capacity in the network and a business case explaining why specific RECs were selected for closure. The Postal Service effectively decreased the number of RECs from 55 to eight by the end of 2007 and at the same time expanded the types of images sent to the RECs. Figure 3 shows the number of images and REC sites by year.

Figure 3: Images Processed and Number of Open RECs by FY



Source: OIG analysis of Postal Service data

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives were to assess the process and criteria used to realign the REC network and validate reported costs savings for CYs 2006 and 2007. We visited and interviewed managers at headquarters; the Wichita, Kansas, and Charleston, West Virginia RECs; and mail processing facilities supported by those RECs. We gathered and reviewed information related to REC operations and the realignment process; criteria used to identify RECs for closure; related policies and procedures; and the Decision Analysis Report (DAR) for the *Wichita, Kansas and Salt Lake City, Utah Remote Encoding Center Network Consolidations.*[5] In addition, we compared current REC operations with operations before the start of the network realignment in 1999, and we validated the reasonableness of reported savings associated with RECs closed in 2006 and 2007.

[5] We did not audit the DAR for the *Wichita, Kansas, and Salt Lake City, Utah REC Network Consolidations*.

We relied on Postal Service data systems: the Web Enterprise Information System, the Facility Management System (FMS), and the Web Remote Encoding Center Operations Analysis Database. We used these systems to obtain data on the volume of unreadable mail processed through the RECs, the number of DCOs assigned to the RECs, and the lease costs associated with RECs closed in 2006 and 2007. We did not test the validity of controls over these Postal Service data systems. However, as alternate audit procedures, we reviewed source documents and discussed data with responsible officials.

To assess the reasonableness of the reported savings from facility leases, we extracted the Facility Detail Report from the FMS for all RECs closed in 2006 and 2007 and compared the lease costs in the report to the lease costs used by the Postal Service. To validate the savings attributed to labor costs, we calculated the labor savings by multiplying the number of full-time equivalents by the rate identified by the Postal Service for each REC. We then compared our results with the Postal Service's reported savings.

We conducted this performance audit from December 2007 through September 2008 in accordance with generally accepted government auditing standards and included such tests of internal controls as we considered necessary under the circumstances. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We discussed our observations and conclusions with management officials on August 12, 2008, and included their comments where appropriate.

PRIOR AUDIT COVERAGE

No prior audits related to the scope of this audit have been issued in the past 3 years.

APPENDIX B: DETAILED ANALYSIS

Process and Criteria Used to Realign the Remote Encoding Center Network

The Postal Service effectively evaluated excess capacity and realigned the REC network by reducing the number of RECs from 55 in 1999 to eight by the end of 2007.[6] As a result, the Postal Service reduced its number of DCOs from 30,200 to 5,708 and overhead costs from $406.9 million to $240.2 million. Management eliminated excess capacity by identifying RECs for closure and developing a plan to redistribute the workload to the remaining RECs. Management was successful in reducing the REC network because approximately 70 percent of the employees were temporary, the physical location of the sites was not significant, the RECs were planned as temporary facilities, and stakeholder resistance was minimal. Figure 4 summarizes the reductions that resulted from consolidating the REC network.

Figure 4: Reductions Resulting From REC Network Consolidation

	1999	2007	Reduction
REC Facilities	55	8	47
Data Conversion Operators	30,200	5,865	24,492
Total Network Operating Costs	$406.9 million	$240.2 million	$166.7 million

The Postal Service developed criteria to identify RECs for closure and business cases to justify the decisions. However, terminology used in some of the business cases was confusing. This occurred because management considered the business cases internal documents and stated that parties involved in the realignment process understood the terminology. As the realignment process continues, additional clarity may be needed.

The Postal Service developed a business case that listed the criteria used to identify RECs for closure. These criteria were:

- Operating costs
- Facility costs
- Career opportunities
- Facility's ability to absorb additional plant workload
- Hiring base
- Risk

We found that wording in some of the business cases was confusing, and management did not clearly explain the rationale for some REC closings. For example, the business case for the closing of the Bowling Green, Kentucky, and Albany, New York, RECs in 2004 stated that the RECs had processing costs in the "lowest quarter of the 20

[6] The Postal Service has announced plans to close the Selma, California, and Pittsburgh, Pennsylvania, RECs in 2008.

remaining RECs." After clarification from management, we learned that these RECs had the highest processing costs. As the realignment process continues and larger RECs are closed, a more clearly written business case with additional methodology details would avoid confusion.

2006 and 2007 Cost Savings Reported

The Postal Service's reported cost savings of $5.9 million for 2006 and $7.1 million for 2007 were generally supported.

- We validated the reasonableness of savings associated with labor and facility lease costs, which represent the majority of reported savings. Figure 5 shows the percentage of savings validated.

Figure 5: Reported Savings and Dollars Validated

REC Name/Year Closed	Postal Service Reported Savings	Dollars Validated by OIG			Percentage of Validated Savings[7]
		Facility Annual Lease	Labor Savings[8]	Total Dollars	
San Bernardino, CA (2006)	$1.5 million	$190,628	N/A	$190,628	N/A
Peoria, IL (2006)	$2.2 million	$220,800	N/A	$220,800	N/A
Akron, OH (2006)	$2.2 million	$126,234	N/A	$126,234	N/A
Modesto, CA (2007)	$1.7 million	$285,000	$914,709	$1,199,709	71
Beaumont, TX (2007)	$2.0 million	$479,340	$935,092	$1,414,432	71
Fayetteville, NC (2007)	$1.6 million	$213,025	$1,146,566	$1,359,591	85
Tampa, FL (2007)	$1.8 million	$343,814	$1,320,187	$1,664,001	92

- We found the savings reported for 2007 were overstated by more than $300,000. This occurred because Postal Service personnel inadvertently included equipment depreciation costs in their savings calculation, although closing the RECs did not eliminate the depreciation costs. In addition, we could not validate $2,258 in rent expenses for the San Bernardino REC that were

[7] The percentages shown in this column represent the amount of Postal Service reported savings the OIG validated.
[8] We could not validate the reported labor savings for the RECs closed in 2006. The DAR did not show the labor savings for each REC, and the Postal Service was not able to provide additional information. However, we validated the total labor savings reported in the DAR for the three RECs closed in 2006.

included in 2007 reported savings. Figure 6 compares the Postal Service's lease costs to the OIG's calculations of lease costs.

Figure 6: The Postal Service's Reported Lease Savings and the OIG's Calculations

REC	Postal Service Lease Data	OIG Lease Data Calculations			Difference Between Lease Savings Reported by Postal Service and OIG Calculations
		Facility Detail Report	Other Costs Included[9]	Total Lease	
San Bernardino, CA	$190,628	$188,370		$188,370	$2,258
Peoria, IL	$220,800	$220,800		$220,800	$0
Akron, OH	$126,234	$126,234		$126,234	$0
Modesto, CA	$285,000	$210,000	$75,000	$285,000	$0
Beaumont, TX	$479,340	$479,340		$479,340	$0
Fayetteville, NC	$213,025	$157,430	$55,595	$213,025	$0
Tampa, FL	$343,814	$216,000	$127,814	$343,814	$0

The *Postal Accountability and Enhancement Act*, dated December 8, 2006, requires the Postal Service to establish a network plan showing how it intends to eliminate excess capacity and identify the anticipated costs, cost savings, and other benefits associated with eliminating excess capacity. In addition, the Postal Service must submit an annual report to Congress showing how the elimination of excess capacity has impacted or will impact realignment efforts.

Although the Postal Service achieved most of the projected cost savings by consolidating the REC network, it overstated these savings by at least $302,000. As a result, the Postal Service saved approximately $6.8 million instead of $7.1 million in 2007. Accurate and complete financial data is important for supporting management decisions and strengthening stakeholders' confidence in the realignment process.

[9] These leases also required payments for maintenance costs.

APPENDIX C: MANAGEMENT'S COMMENTS

PROCESSING OPERATIONS

UNITED STATES POSTAL SERVICE

September 15, 2008

Robert J. Batta
Deputy Assistant Inspector General for Mission Operations
1735 North Lynn St.
Arlington, VA 22209-2020

SUBJECT: Assessment of the Remote Encoding Center Network Consolidation Process *(Report Number EN-AR-08-DRAFT)*

Thank you for the opportunity to review and comment on the subject draft audit report.

Management agrees with the findings in this assessment of the Remote Encoding Center Network Consolidation Process.

Recommendation [1]:
Clarify the methodology used to select remote encoding centers for closure in futures business cases.

Response
We agree that the methodology used to identify remote encoding centers for consolidation can be more clearly stated in future business cases.

Recommendation [2]:
Revise the 2007 remote encoding center closure savings from $7.1 million to $6.8 million.

Response
We agree to update the closure savings for fiscal year 2007 to reflect the $6.8 million as recommended. We will adjust the savings calculation to exclude the depreciation expenses.

David E. Williams
Manager Processing Operations

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