

GAO

Report to the Chairman and Ranking
Member, Special Panel on Postal
Reform & Oversight, Committee on
Government Reform, House of
Representatives

May 2004

POSTAL SERVICE

Progress in Implementing Supply Chain Management Initiatives





Highlights of [GAO-04-540](#), a report to the Chairman and Ranking Member, Special Panel on Postal Reform & Oversight, Committee on Government Reform, House of Representatives

Why GAO Did This Study

The Postal Service is on the cusp of a major transformation to improve its fiscal outlook. One part of this transformation involves procurement. The Postal Service is homing in on supply chain management, a process that has helped successful private-sector companies leverage their buying power and identify more efficient ways to procure goods and services.

To assist congressional efforts to enact fundamental postal reform, GAO was asked to determine (1) the extent to which the Postal Service has been successful in implementing and realizing savings from its supply chain management initiatives and (2) whether these initiatives have had an effect on small businesses.

What GAO Recommends

GAO is recommending that the Postal Service improve implementation of its bulk fuel program, consider adjustments to reverse auction procedures, and focus more attention on small businesses in carrying out supply chain management initiatives. In written comments on a draft of this report, the Postal Service generally agreed with our recommendations and stated that it will consider reestablishing small business targets if current achievements begin to slip. GAO believes the Postal Service should have a mechanism in place to ensure accountability and transparency in its small business contracting.

www.gao.gov/cgi-bin/getrpt?GAO-04-540.

To view the full product, including the scope and methodology, click on the link above. For more information, contact David Cooper at (202) 512-4841 or cooperd@gao.gov.

POSTAL SERVICE

Progress in Implementing Supply Chain Management Initiatives

What GAO Found

The Postal Service has had mixed success in implementing the supply chain management initiatives we reviewed: the bulk fuel program; reverse auctions for transportation contracts; and national contracts for boxes, custodial supplies, labels, retail packaging, and tires. The Postal Service reported over \$78 million in fiscal year 2003 savings and revenue from these initiatives. However, the Postal Service has been unable to recover millions of dollars in potential savings because of implementation problems with the bulk fuel program. For other savings initiatives, baseline data used to calculate savings were, in some cases, inaccurate or could not be validated because the Postal Service lacks a system for harnessing annual spending data.

Three Major Savings Initiatives Have Encountered Difficulties

| Initiative | Intended benefit | Challenges |
|--------------------|---|--|
| Bulk fuel program | Leverage Postal Service's buying power of millions of gallons of diesel fuel purchased by highway contractors who deliver mail to U.S. distribution centers | Postal Service projected \$18 million in annual savings but reported only \$1.1 million in savings for fiscal year 2003; many highway contractors have been reluctant to participate in the program; millions of dollars will not be recouped due to lack of automated system to accurately adjust fuel prices. |
| Reverse auctions | Enable highway contractors to compete for contracts by using Web-based bidding | Over \$5.9 million in savings were reported for fiscal year 2003; \$2.1 million of this amount is questionable because of incorrect baseline data; some auction procedures may not elicit best price. |
| National contracts | Consolidate smaller contracts for goods and services into large, nationwide contracts | \$71.1 million in savings and revenue were reported for fiscal year 2003 under the national contracts GAO reviewed; GAO could not validate this amount because the Postal Service has no accurate baseline information on how much was spent on these commodities prior to the supply chain management initiative. |

Source: GAO's analysis of Postal Service data.

Since the Postal Service started using the national contracts GAO reviewed, the number of small business suppliers has dropped dramatically. Acquisition plans for most of these contracts did not address small business participation, either at the prime or subcontractor level. GAO could not determine the effect that the bulk fuel program and reverse auctions have had on small businesses because Postal Service contracting officers and contractors have been using incorrect business size standards, and, as a result, the reported small business accomplishments are not accurate. Further, the Postal Service's new supplier diversity policy does not establish targets for contracting with small businesses. Therefore, the Postal Service will have difficulty gauging the effect of supply chain management initiatives on these businesses and holding contracting officers accountable for implementing the policy's objective of ensuring improvement in the Postal Service's relationships with small businesses.

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Abbreviation

SBA Small Business Administration

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United States General Accounting Office
Washington, DC 20548

May 17, 2004

The Honorable John M. McHugh
Chairman
The Honorable Danny K. Davis
Ranking Member
Special Panel on Postal Reform & Oversight
Committee on Government Reform
House of Representatives

The United States Postal Service faces formidable financial, operational, and human capital challenges because of unfunded liabilities, stagnant revenues, inefficient operations, and a business model that is unsustainable. The increasing popularity of e-mail, instant messaging, and wireless technology, to name a few, poses a long-term threat to the Postal Service's core business—First-Class Mail (primarily letters) and Standard Mail (primarily advertising). In April 2001, we placed the Postal Service's transformation and long-term outlook on our high-risk list,¹ and we recently reported that comprehensive Postal Service reform is urgently needed. While the Postal Service achieved notable success in fiscal year 2003, this respite is likely to be short-lived because First-Class Mail continues to decline, key costs are rising, and productivity gains are likely to slow.²

In the face of these challenges, the Postal Service has been under pressure to cut costs while improving overall performance. Part of its reform strategy is to find more efficient ways to procure goods and services. In fiscal year 2003 alone, the Postal Service spent over \$11.3 billion on such items as supplies, services, rent, and transportation. To reduce spending, Postal Service officials have been focusing on supply chain management, the process used to integrate the flow of goods and services from the

¹ The high-risk list identifies federal programs or operations that are highly vulnerable to waste, fraud, abuse, and mismanagement or that require urgent attention to ensure that the government functions in the most economical, efficient, and effective manner possible.

² U.S. General Accounting Office, *Major Management Challenges and Program Risks: U.S. Postal Service*, [GAO-01-262](#) (Washington, D.C.: Jan. 2001); *U.S. Postal Service: Bold Action Needed to Continue Progress on Postal Transformation*, [GAO-04-108T](#) (Washington, D.C.: Nov. 5, 2003); *U.S. Postal Service: Key Elements of Comprehensive Postal Reform*, [GAO-04-397T](#) (Washington, D.C.: Jan. 28, 2004).

suppliers to delivery of the end product to the retail customer.

Commercial companies use this management process to help reduce costs and to do business in the most efficient way possible. Since fiscal year 2000, with the help of supply chain management initiatives, the Postal Service reported that it has saved about \$866 million by leveraging its buying power and insisting on continuous improvement.

To assist congressional efforts to enact fundamental postal reform, you asked us to determine (1) the extent to which the Postal Service has been successful in implementing and realizing savings from its supply chain management initiatives and (2) whether these initiatives have had an effect on small businesses. The Postal Service is an independent establishment of the government's executive branch that is expected to act like a business and is not subject to the Small Business Act.³ Nevertheless, the Postal Service has developed a 3-year plan to maintain a supplier base that includes small, minority-owned, and woman-owned businesses and tracks contracts awarded to those businesses.⁴ As agreed, we focused our work on three major supply chain management initiatives:

- bulk fuel program, an effort to leverage the Postal Service's buying power for the millions of gallons of fuel purchased by highway contractors who transport mail;⁵
- reverse auctions, a Web-based tool that enables highway contractors to compete for contracts in an electronic bidding format; and
- national contracts, the consolidation of smaller contracts for goods and services into large, nationwide contracts.⁶

We conducted our review from July 2003 to April 2004 in accordance with generally accepted government auditing standards. Details on our scope and methodology are discussed in appendix I.

³ 15 U.S.C. section 632(b).

⁴ Minority- and woman-owned businesses can be large or small.

⁵ The bulk fuel program for highway contractors is one component of the Postal Service's fuel management program. The fuel management program is intended to provide quality fuel for postal contractors and Postal Service-owned vehicles and to reduce postal expenses associated with purchase and delivery of fuel.

⁶ In an earlier report, we addressed one of those national contracts—an office supply contract awarded to Boise Corporation. U.S. General Accounting Office, *Contract Management: Postal Service's National Office Supply Contract Has Not Been Effectively Implemented*, GAO-03-230 (Washington, D.C.: Jan. 17, 2003).

Results in Brief

The Postal Service has had mixed success in implementing the supply chain management initiatives we reviewed, as discussed below. Although the Postal Service reported over \$78 million in fiscal year 2003 savings and revenue from these initiatives, in some cases the baseline data used to calculate the savings are inaccurate or unverifiable.

- *Bulk fuel program:* This savings initiative has gotten off to a slow start and has been plagued by implementation problems that became apparent during a pilot program that ended two years ago. The Postal Service originally projected \$18 million in annual savings under this program, but reported only \$1.1 million in savings for fiscal year 2003. The Postal Service has repeatedly scaled back its projections after realizing that some highway contractors have a strong preference for buying fuel from their own suppliers instead of from national suppliers designated by the Postal Service. The Postal Service has also been unable to increase the number of fueling locations available for highway contractors under the bulk fuel program. Further, the Postal Service has not yet implemented an automated system for adjusting fuel prices, which fluctuate on a weekly basis and can be significantly higher or lower than the values specified in highway contracts. Thus, the Postal Service must go through a tedious manual process to make accurate fuel price adjustments to the contract prices in order to recoup savings. The process is so labor-intensive and time-consuming that the Postal Service has thus far been unable to capture millions of dollars in potential savings.
- *Reverse auctions:* The Postal Service has had some success with this bidding tool and has used it increasingly in the past year. In some cases, however, the Postal Service may not have obtained the lowest prices possible because only one bid was received or competing contractors may not have had sufficient time to submit their final bids. Fiscal year 2003 savings were reported as over \$5.9 million. We found that \$2.1 million of these savings are questionable, however, due to such factors as inadequate baseline data and lack of competition during the auctions.
- *National contracts:* The Postal Service has begun to take steps to consolidate its spending on selected commodities in an effort to leverage its buying power, reducing the number of suppliers for the commodities we reviewed and directing employees to purchase their supplies from national contracts. It claimed \$71.1 million in savings and revenue in fiscal year 2003 from the national contracts we reviewed: boxes, custodial products, labels, retail packaging, and tires. However, because the Postal Service lacked accurate baseline data on what it had spent on these commodities prior to the supply chain management initiative, we were unable to validate the reported savings and revenue. The lack of accurate

baseline data is not a problem unique to the Postal Service; in our prior work, we found that commercial companies also struggled to establish reliable baseline data when their spending on goods and services was highly decentralized.

According to Postal Service reports, the national contract initiative has resulted in a decrease in small business prime contracts for the commodities we reviewed. In planning these purchases, Postal Service officials did not in most cases proactively explore options for keeping small businesses involved, either as prime or subcontractors. This situation runs counter to the intent of the Postal Service's supplier diversity program, which states that each purchase plan must demonstrate active efforts to use small, minority-owned, and woman-owned businesses. We were unable to determine the effect of the bulk fuel and reverse auction initiatives on small businesses because Postal Service contracting officers and contractors have consistently used incorrect small business size standards. Thus, the Postal Service's report that small highway contractors received \$2.3 billion, representing a majority of the Postal Service's fiscal year 2003 small business contracts, is unreliable. As the Postal Service continues to implement its supply chain management initiatives, it will be unable to measure the effect of these initiatives on small businesses because its new supplier diversity policy no longer includes targets for contract dollars awarded to these businesses.

We are recommending that the Postmaster General of the United States take actions to improve implementation of the bulk fuel program, refine reverse auction savings estimates and procedures, and focus more attention on small business issues in carrying out supply chain management initiatives. In written comments on a draft of this report, the Postal Service generally agreed with our recommendations. While the Postal Service does not plan to establish small business targets at this time, it stated that it would consider reestablishing targets for small business contracts if its current achievements begin to slip.

Background

The Postal Service, an independent establishment of the executive branch of the U.S. government,⁷ is a \$68-billion organization⁸ consisting of more than 37,000 post offices and 350 major mail-processing and distribution

⁷ 39 U.S.C. section 201.

⁸ As reported in the Postal Service's 2003 Annual Report.

facilities. We recently reported that the Postal Service's current business model is outdated and inflexible and, in April 2001, we placed the agency's long-term financial outlook and transformation efforts on our high-risk list. We suggested that the Postal Service work with Congress and other stakeholders to develop a comprehensive plan that would address its financial, operational, and human capital challenges. In response, the Postal Service issued its Transformation Plan in April 2002.

Also in 2002, the President's Commission on the United States Postal Service was appointed to examine the Postal Service's current operations and propose recommendations for a more viable future while minimizing the costs to U.S. taxpayers. The commission's July 2003 report recommended several fundamental changes, some of which involve procurement reform. The commission said that the Postal Service could save hundreds of millions of dollars by adopting practices that have substantially lowered costs for private-sector retailers. Our prior work has shown that commercial companies have achieved significant savings by leveraging their buying power through taking a strategic approach to acquisition.⁹ The Postal Service operates more as a business than as a government agency. For example, it is responsible for generating revenue to cover its operating expenses and is not subject to the Federal Acquisition Regulation that guides most federal agencies' procurement practices.

In recent years, the Postal Service has undertaken a number of supply chain management initiatives intended to streamline acquisitions and save money. A January 2002 revision to its purchasing manual added a section on the supply chain management philosophy and its importance to Postal Service purchasing.¹⁰ According to the Postal Service's Comprehensive Statement on Postal Operations, supply chain management depends on close interaction among end users, buyers, and suppliers, with a focus on

⁹ U.S. General Accounting Office, *Best Practices: Improved Knowledge of DOD Service Contracts Could Reveal Significant Savings*, [GAO-03-661](#) (Washington, D.C.: June 9, 2003) and *Best Practices: Taking a Strategic Approach Could Improve DOD's Acquisition of Services*, [GAO-02-230](#) (Washington, D.C.: Jan. 18, 2002).

¹⁰ On March 24, 2004, the Postal Service proposed to amend its purchasing regulations in order to implement the acquisition portions of its Transformation Plan and the similar recommendations of the President's Commission on the United States Postal Service as they relate to the acquisition of property (except real property) and services. 69 Fed. Reg. 13786 (Mar. 24, 2004).

creating long-term contracts, as well as ongoing analysis and improvement of operating and administrative processes and costs.

Two of these initiatives, the bulk fuel program and reverse auctions for highway contracts, are targeted at efforts to save on transportation costs. Fueling the Postal Service's transportation network is no small feat. Diesel fuel is a major Postal Service expense, totaling almost \$340 million in fiscal year 2003 for the thousands of highway contractors who consumed about 225 million gallons of fuel.¹¹ With this volume of fuel purchasing, even a 1-cent difference in price per gallon can result in millions of dollars in savings for the Postal Service. Recognizing the potential for savings, the Postal Service launched the bulk fuel pilot program in the late 1990s. The Postal Service negotiated a discounted fuel price with a national supplier and directed a small number of highway contractors to purchase their fuel from this supplier rather than from various local and regional sources. In fiscal year 2001, the Postal Service expanded the program to two national suppliers.

In fiscal year 2002, the Postal Service began to use reverse auctions, a Web-based bidding tool, for emergency highway transportation contracts (short term, temporary routes during the December holidays, for example). The Postal Service has hired a firm to conduct the auctions on its behalf.¹² Before this online tool became available, contracting officials solicited bids from potential contractors by fax and telephone. Utilizing the Web, the Postal Service can now seek contract bids on a reverse auction site, where competitors can see one another's bids in real-time and take this information into account when deciding on the price they will

¹¹ The Postal Service estimates that it has about 10,000 highway contractors; however, this number is not precise because each of the 11 district offices uses a unique reporting number to identify their contractors and, therefore, double-counting is likely to occur. In addition, we found that the same contractor may be listed under multiple names, each of which is considered a separate contractor.

¹² The Postal Service has used reverse auctions on a limited basis for other than highway contracts. Our review covered only the reverse auctions for highway contracts. The Postal Service's Office of Inspector General recently conducted a review looking at the effectiveness of reverse auctions for goods and services for other than highway contracts. Office of Inspector General, U.S. Postal Service, *Use of Reverse Auctions*, CA-AR-04-001 (Arlington, VA: Feb. 26, 2004). The Postal Service entered into a contract with Lean Logistics on November 21, 2002, totaling \$305,000 including contract modifications, to conduct reverse auctions for emergency highway transportation contracts. The contract was extended by one year on December 12, 2003, for an additional \$240,000.

offer. The Postal Service's intent in using this tool is to obtain the lowest price possible by garnering increased competition.

A third initiative, national contracts, is intended to consolidate the Postal Service's spending on certain commodities. Postal Service employees have typically purchased supplies in a highly decentralized manner, from local, regional, or national businesses. Millions of dollars are spent using cash or purchase cards or through contracts. By negotiating contracts with selected suppliers based on volume discounts and directing employees to use these contracts, the Postal Service plans to leverage its buying power and save money.

Success of Savings Initiatives Has Been Mixed, and Some Reported Savings Cannot Be Validated

The Postal Service has had mixed success in implementing the supply chain management initiatives we reviewed. The bulk fuel program has been hampered by implementation difficulties, but the Postal Service has had some success using reverse auctions and has used this tool increasingly. The Postal Service has also begun to consolidate its spending on boxes, custodial products, labels, retail packaging, and tires through the use of national contracts. However, some of the claimed savings from reverse auctions were overstated, and we could not validate the \$71.1 million in reported savings and revenue from the national contracts we reviewed because the Postal Service lacked accurate baseline data on what had been spent on the commodities before the supply chain management initiative.¹³

Bulk Fuel Implementation Difficulties Have Prevented Projected Savings from Being Realized

The bulk fuel program has gotten off to a slow start, beset by a number of implementation difficulties. Only 600 of the roughly 17,000 highway routes are involved in the program, although the Postal Service had expected a much greater level of participation. Consequently, the Postal Service is far from realizing its originally projected savings of \$18 million per year, capturing only about \$1.1 million in savings in fiscal year 2003. It may forgo collecting over \$3 million in potential savings due to the implementation problems.

The difficulties the Postal Service has encountered are primarily due to (1) resistance from many highway contractors; (2) setbacks in the Postal

¹³ The Postal Service recently asked its Inspector General to assess the methodology used to calculate savings from supply chain management initiatives.

Service's plans to expand the number of fuel delivery locations under the program; and (3) lack of an automated system to accurately capture fuel prices, which means that inaccurate and burdensome manual calculations must be used.

First, some highway contractors have refused to participate in the bulk fuel program. A few have gone as far as filing court actions challenging the Postal Service's right to direct them to certain fueling sites. This resistance is due to a number of factors. One has to do with profit. Contractors' fuel costs are intended to be "pass-through" costs, with the Postal Service reimbursing the contractors for the fuel costs specified in their contracts. The contract prices are based on an estimated price per gallon and an estimated number of gallons to be consumed annually. If the contractors' actual price per gallon paid deviates from the contract's estimated price per gallon by 5 cents or more, they may submit a request for a contract price adjustment.¹⁴ Updated fuel cost information from the contractor can be required if the contracting officer suspects that the contractor is being allowed reimbursement for fuel costs greater than those actually being incurred. However, given the volume of contracts, it is difficult and resource intensive to keep up with the fuel price changes, and therefore contracting officers primarily rely on the contractors to submit fuel adjustments. In practice, however, according to Postal Service officials, contractors are typically quick to submit an adjustment when they are paying more than the contract price, but slow to do so when they are able to obtain the fuel more cheaply. For highway contracts not under the bulk fuel program, contractors have been able to retain the difference between their actual expenditures for fuel and their contract price. The procedures for contract price adjustments under the bulk fuel program do not allow contractors this opportunity.

Contractors have cited other reasons for resisting the program. They say they have built strong business relationships with their local fuel suppliers and that those suppliers are more responsive than the major suppliers designated in the bulk fuel program. They also believe that, as a business decision, they should be able to elect where to purchase their fuel. Some have shown that they can buy fuel more cheaply from their local suppliers than under the bulk fuel program. Postal Service officials point out that, while it is true that in certain cases the bulk fuel price may not be the

¹⁴ The fuel cost reimbursed to the contractors is based on the estimated annual gallons. This estimate is not adjusted based on actual gallons consumed.

lowest, the only way that the savings can be achieved is if a large number of contractors participate in the program. They also note that fuel is supposed to be a pass-through cost and, therefore, contractors should not be concerned that the bulk fuel price may be higher than a discount rate they may be able to obtain on their own.

Second, effective implementation has been hampered by the Postal Service's lack of success in bringing new fueling locations into the bulk fuel program. Postal Service officials recognize that, with only 44 locations available to contractors to buy fuel under the program, the Postal Service's anticipated savings cannot be achieved. In a solicitation issued April 8, 2003, the Postal Service requested proposals from fuel suppliers in an effort to add 22 locations to the program. The intention was to increase the number of gallons highway contractors purchase at bulk fuel prices by having these additional suppliers distribute fuel purchased from the two national bulk fuel companies. However, the Postal Service received no acceptable offers from suppliers for new fueling sites and is now considering additional approaches to expand the number of fueling locations.

Third, the Postal Service does not have an automated system for gathering information on the number of gallons of fuel highway contractors purchase and the price they pay under the bulk fuel program. Therefore, manual procedures must be used to adjust contract prices in order to secure savings for the Postal Service. During the pilot program, the Postal Service recognized the need to automate its fuel adjustment system but expanded the program before the system was in place. We found that manual price adjustments have been inaccurate. Contrary to Postal Service procedures, which direct contracting officers to adjust contract prices based on the quantity of fuel purchased by contractors as well as the price they pay, contracting officials are simply adjusting the contract price based on the contractors' average weekly price per gallon paid at bulk fuel sites—without factoring in the number of gallons purchased. This approach could result in lost savings for the Postal Service and, in some cases, contractors being shortchanged. In addition, we found that the price per gallon under the bulk fuel program did not include a special sales tax that some states require highway contractors to pay for diesel fuel. For example, one contractor paid \$1,656 to cover this tax in a 3-week period, which the contracting officer's adjustment did not include. Although the contractor brought the situation to the attention of the Postal Service contracting officer, the contracting officer took no action to fix the problem until we called it to the Postal Service's attention. According to postal officials, because of our finding, they have updated all of the state

tax information with the information received from a national fuel tax consultant and are working with the bulk fuel suppliers to obtain reports that detail taxes charged at each delivery site.

Manual adjustments also pose an administrative burden for Postal Service contracting personnel and highway contractors. A study conducted for the Postal Service shows that fuel adjustments can take as long as 30 minutes per contract. Contractors must submit invoices or other documentation to show how many gallons of fuel they purchased and at what price. Without this information, the Postal Service cannot make accurate fuel cost adjustments and achieve savings. However, one of the primary reasons for the bulk fuel program was to reduce the administrative burden associated with manual adjustments. The program's intention was not to require highway contractors to submit receipts for every single fuel transaction at the pump or to have Postal Service contracting officers wade through daily transactions in order to make monthly adjustments in highway contracts.

Postal Service officials recognize that, until an automated system is implemented for capturing transaction data at the pump, the bulk fuel program will not be as successful as they had hoped. They are taking steps to automate the process. In a pilot effort involving three bulk fueling locations, the Postal Service created an electronic system that automatically adjusted contract prices based on the actual gallons purchased and prices paid at the pump. Because of the success of this pilot effort, the Postal Service plans to use the system for all contracts under the bulk fuel program. However, a program official said the system is behind schedule and will not be even partially available until the end of fiscal year 2004, and full implementation is not expected until at least a year later.

These implementation difficulties have resulted in significantly lower savings than expected and a struggle to recoup millions of dollars from contractors participating in the program. In 1999, the Postmaster General told Congress that 75 percent of highway contractors' fuel, about 170 million gallons, would be purchased under the bulk fuel program and would yield annual savings of over \$18 million.¹⁵ After further analysis,

¹⁵ Hearing before the Subcommittee on the Postal Service, Committee on Government Reform, House of Representatives, 106th Congress, October 21, 1999. In July 2001, the Postal Service's Inspector General confirmed that the \$18 million in projected annual savings was reasonable, assuming that the Postal Service was able to expand the program as anticipated and obtain 12 cents in savings per gallon. Office of Inspector General, U.S. Postal Service, *Bulk Fuel Purchase Plan*, TR-AR-01-004 (Arlington, VA: July 27, 2001).

however, the Postal Service lowered its estimate to 95 million gallons of fuel and annual savings of \$8.8 million starting in fiscal year 2004.¹⁶ Late in fiscal year 2003, the projected savings were further lowered to \$4.7 million, because highway contractors under the bulk fuel program purchased only 50 million gallons of fuel. However, Postal Service officials realized that they had failed to recoup \$3.9 million of this amount because contractors were not initiating fuel price adjustments but, rather, were retaining the difference between the bulk fuel price and their contract price. The Postal Service subsequently implemented the manual, monthly adjustment system discussed earlier, retroactively attempting to collect overpayments from contractors, and has now reported fiscal year 2003 savings of about \$1.1 million. However, the Postal Service said that it may decide to forgo an additional \$3.5 million in potential 2003 savings because of the administrative burden of retroactively adjusting contract prices.

Some Success with Reverse Auctions, but Procedures and Reported Savings Could Be Improved

The Postal Service has had success with reverse auctions for highway contracts and has used them increasingly, but some procedures could be improved to enable it to obtain lower prices. The Postal Service claimed over \$5.9 million in savings from these reverse auctions in fiscal year 2003, but about \$2.1 million of these savings are questionable. For some auctions the reported savings were overstated, and in other cases savings were claimed for auctions when no bids were received.

Since May 2002, reverse auctions have been conducted for 659 of about 17,000 highway contract routes, and use of the auctions has been increasing each year; over 400 of these auctions occurred in fiscal year 2004. In implementing the auctions, however, the Postal Service may not be getting the lowest price possible in some cases. For example, we found that 181 of the 659 auctions ended with only one bid received. In cases where there is only one bidder, we believe that the Postal Service may not be getting the best price because there were no other bidders to drive down the price. In these cases, contracting officers do not attempt to negotiate a lower price with the sole bidder. According to one of these successful bidders, his only bid was high and would not have been his final offer had there been competing bids. To keep the bids within an acceptable range, the Postal Service establishes a reserve price, or a maximum price it is willing to accept, based on market research prior to starting the auction. Postal Service officials stated that, because they

¹⁶ The lowered estimate was based on an estimated savings of 9.3 cents per gallon.

establish a low reserve price, they are confident that the Postal Service is obtaining fair and reasonable prices even when only one bid is received.

Another area of concern is whether the highway contract reverse auction procedures provide sufficient opportunity for bidders to submit their best price. The Postal Service uses a practice known as “overtime” for reverse auctions for certain goods and services, but not for highway contracts. Typically, just before an auction comes to a close, there is a rush of activity from bidders. To ensure that the winning bid is the lowest possible, the Postal Service’s reverse auctions for other than highway contracts provide the option of an overtime process until bidding comes to a halt. Rather than have every auction automatically close at a given time and thereby reward the contractor who waited until the very last second to place its bid,¹⁷ the overtime process provides all suppliers with an additional increment of time to react to last-minute bids if they believe they can offer a lower price. For example, under the overtime process, if a final bid is submitted within the last minute, the auction can be extended by 5 minutes or more to allow other bidders a chance to make a better offer. Postal Service officials noted that they had considered the possibility of using overtime procedures, but were concerned that some suppliers may not be available to participate in an overtime event because they lack the administrative staff to monitor the bidding.

The Postal Service began claiming savings from reverse auctions in fiscal year 2003, reporting over \$5.9 million in savings from 111 auctions held that year. For many of these auctions, data were not available for making direct comparisons with contracts for prior highway routes. Therefore, the Postal Service used statistical analysis to derive the savings, a common practice when historical data are unavailable. However, for 6 of these auctions—for which the Postal Service claimed \$800,000 in savings—we could not substantiate the savings. Based on our analysis of the Postal Service’s methodology, we found no statistical evidence to support its approach. Another 24 highway contracts awarded through reverse auctions did have direct comparisons with previously awarded contracts, making it easier to project savings. We examined the largest of these contracts, with claimed savings of \$1.2 million, and found that the savings were derived from incorrect baseline data. The baseline used to calculate the savings was based on an outdated contract rate of \$11.65 per mile,

¹⁷ Of the 446 highway contract auctions conducted between October 2003 and February 2004, 75 percent received bids in the final minute.

although a recent modification to the contract had a rate of \$4.87. Thus, the savings from this auction were significantly overstated.

Furthermore, the Postal Service claimed savings from 7 reverse auctions that expired with no bids received. Subsequently, the Postal Service faxed the requirements to known suppliers in relevant geographic areas, requested bids, and eventually awarded contracts. The Postal Service claimed \$108,005 in reverse auction savings for these contracts even though the contractors did not participate in a reverse auction.

Based on our findings, Postal Service officials agreed to lower their claimed savings for these reverse auctions.

National Contract Initiative Under Way, but Lack of Accurate Baseline Data Renders Reported Savings and Revenue Questionable

In turning to national contracts for certain items, the Postal Service has attempted to reduce costs and improve efficiency in its acquisition approach by directing employees to make purchases from designated suppliers. Prior to its use of national contracts, the Postal Service purchased corrugated boxes, custodial products, labels, retail packaging, and tires from a large number of suppliers. The Postal Service has negotiated contracts for these commodities with a smaller number of suppliers in order to leverage its buying power. For example, prior to the initiative, the Postal Service estimates it had over 1,000 suppliers for custodial products and 22 suppliers for labels. It now has 2 contracts for custodial products and 6 for labels. For fiscal year 2003, the Postal Service reported \$71.12 million in savings and revenue through the national contracts for the five commodities we reviewed, as shown in table 1.

Table 1: Reported Savings/Revenue for Fiscal Year 2003 from Five National Contract Initiatives

| Dollars in millions | |
|--------------------------------|--------------------------|
| Type of supply | Reported savings/revenue |
| Corrugated boxes | \$2.96 |
| Custodial products | 16.38 |
| Labels | 5.70 |
| Retail packaging ^a | 41.26 |
| Tires for mail delivery trucks | 4.82 |
| Total | \$71.12 |

Source: U.S. Postal Service.

^aUnlike the other initiatives, which are intended to generate savings, this contract is meant to bring additional revenue to the Postal Service. The Postal Service purchases such items as wrapping paper and bubble wrap mailers from the contractor and then offers them for sale in local post offices. The revenue is reported as part of overall supply chain management savings.

However, we were not able to validate these reported savings and revenue because they are based on unreliable baseline data. Given the highly decentralized nature of its procurements and the fact that many supplies have traditionally been purchased using cash and purchase cards, the Postal Service could not determine how much had been spent on these commodities prior to the supply chain management initiative. Postal Service contracting officers agreed that solid baseline data were not available, but stated that they did the best they could with the data they had, such as using accounts payable data where feasible.

The Postal Service is not the only major organization that has had difficulty in tracking what it is buying. Our prior work has found that major commercial companies often do not have a good grasp of how much their individual business units are spending, where their dollars are going, and whether their purchases are meeting business needs at the best overall value. To reduce costs, leading companies have reengineered their approach to acquisition and changed the way they manage their spending.¹⁸ Among other things, they use information systems to get a clearer picture of what their business units are spending, rather than taking months to examine individual purchase orders and piece together data from various financial and management information systems to get at best a rough idea of what is being spent.

Postal Service officials have been working for a number of years on a new system—planned for full implementation by the end of fiscal year 2006—that will enable them to better track contract expenditures, thus providing them with more accurate data on savings from national contracts. However, the Postal Service will continue to lack detailed knowledge of what is being spent outside of contracts, such as through cash and purchase cards.¹⁹ Therefore, it will be difficult for the Postal Service to know with any degree of certainty whether the consolidated contracts are producing the desired results and what, if any, additional improvements are needed to realize the benefits expected from the national contract initiative.

¹⁸ [GAO-02-230](#).

¹⁹ We discussed the problems the government has faced in collecting details on purchase card expenditures in two prior reports. U.S. General Accounting Office, *Contract Management: Government Faces Challenges in Gathering Socioeconomic Data on Purchase Card Merchants*, [GAO-03-56](#) (Washington, D.C.: Dec. 13, 2002) and *Contract Management: Agencies Can Achieve Significant Savings on Purchase Card Buys*, [GAO-04-430](#) (Washington, D.C.: Mar. 12, 2004).

More Attention Needed to Ensure Small Business Participation in Supply Chain Management Initiatives

When the Postal Service consolidated its purchasing under the national contracts we reviewed, the number of small businesses participating as prime contractors declined. In planning these acquisitions, Postal Service officials often did not proactively explore ways in which to make these contracting dollars available to small businesses, either as prime or subcontractors. We could not gauge the effect on small businesses as a result of the other supply chain management initiatives we reviewed—the bulk fuel program and reverse auctions for highway contracts—because contracting officers and highway contractors used incorrect small business size standards and, consequently, the reported small business dollar amounts are unreliable. As it proceeds with its supply chain management initiatives, the Postal Service will have difficulty measuring the effect on small businesses because its new supplier diversity policy, while indicating a commitment to increasing contracts to small and diverse businesses, does not establish targets—such as dollar amounts or number of contracts—to measure success.

Small Business Participation Has Been Reduced as a Result of National Contracts

The number of small business suppliers has dropped in four of the five commodities we reviewed. Table 2 shows the effect of the national contract initiative on small business participation.

Table 2: Effect of National Contracts on Small Business Participation

| Type of supply | Reported number of businesses before consolidation | Reported number of businesses after consolidation ^a |
|--------------------------------|---|--|
| Corrugated boxes | 3 large 2 small | 2 large |
| Custodial products | Exact number unknown; estimate is about 200 large and about 800 small | 1 large 1 small |
| Labels | 7 large 15 small | 3 large 3 small |
| Retail packaging | Exact number unknown; estimate is about 20, many of which were local businesses | 1 large |
| Tires for mail delivery trucks | 4 large | 1 large |

Source: U.S. Postal Service.

^aAs of February 2004.

In planning most of these initiatives, contracting officers and other Postal Service officials did not consider ways to ensure that small businesses

would have the chance to compete for contracting dollars, although the Postal Service's supplier diversity plan states that each purchase plan must consider the use of small, minority-owned, and woman-owned businesses. Further, Postal Service regulation requires the contracting officer to manage supplier diversity as a strategic business initiative. In only one case—custodial products—was full attention paid to the effect of the consolidated contract on small businesses. In planning this acquisition, Postal Service officials recognized that some of these products were being purchased from local businesses and that there would be a drop in supplier diversity as a result of the consolidation. Acquisition planning documents show that market research and outreach were conducted with the intent of identifying potential small businesses to compete for the contract. Ultimately, two contracts were awarded—one to a large business and the other to a small business.

Further, in only one of the five commodities we reviewed was the prime contractor's intent to subcontract with small businesses considered to any extent in awarding the contract. For custodial products, small business subcontracting was one of the evaluation factors in the solicitation. The large business, when submitting its proposal under the solicitation, included a supplier diversity plan with a 28.8 percent small business goal; however, this goal was revised to 2.1 percent after the contract was awarded.

Our prior work has found that leading commercial companies take several steps to ensure that small businesses serve some of their acquisition needs because they believe it makes good business sense, especially in the communities where they do business.²⁰ These steps include considering diverse businesses in acquisition planning, ensuring that supplier diversity is considered in selecting contractors, justifying the reason when there is a lack of diverse supplier participation, and encouraging small suppliers who have limited resources to form joint ventures so they can compete effectively for large contracts.

²⁰ [GAO-03-661](#).

**Incorrect Application of
Small Business Size
Standards Makes It
Difficult to Measure
Impact of Other Initiatives**

In fiscal year 2003, the Postal Service reported that \$2.3 billion, or 59 percent of its small business dollars, went to highway contractors. We were unable to gauge the effect of the bulk fuel program and reverse auctions on these contractors because Postal Service contracting officers and the contractors themselves had not used the correct size standard for defining a small business. As a result, the reported small business dollars for highway contractors are unreliable.²¹

Postal Service regulation directs contracting officers to use the Small Business Administration's (SBA) regulations to ascertain whether a size standard other than the 500 employee ceiling should be used to determine whether a business is small. SBA has defined the size standard for small bulk mail truck transportation businesses as average annual receipts at or below \$21.5 million, rather than the number of employees.²² However, five Postal Service contracting officers we spoke with, who together are responsible for almost 60 percent of all highway contracts, routinely define a small business as one with 500 or fewer employees. Postal Service supplier diversity officials told us that the criterion of no more than 500 employees is used virtually without exception.

We also found that the Postal Service has disseminated inaccurate guidance on small business size standards. Until recently, a form that highway contractors use to place themselves on the Postal Service mailing list stated that businesses with 500 or fewer employees are considered small businesses. Postal Service officials have corrected this form. In addition, the Postal Service's Web site contains a document, "Supplier Diversity Terms," that defines a small business as one with no more than 500 employees. Postal Service officials are correcting this document.

²¹ In 2001, the Postal Service Inspector General found that fiscal year 1999 supplier diversity statistics were incomplete and unreliable and resulted in the Postal Service's overstating or incorrectly classifying dollars awarded to small, minority-owned, or woman-owned businesses. Office of Inspector General, U.S. Postal Service, *Supplier Diversity Program for Supplies, Services, and Equipment Purchases*, CA-AR-01-005 (Arlington, VA: Sept. 6, 2001). In 2003, we reported that the Postal Service provided documents showing the actions it had taken to address the Inspector General's recommendations. However, we did not independently determine whether the actions taken by the Postal Service improved the reliability of its supplier diversity data. U.S. General Accounting Office, *U.S. Postal Service: Status of Inspector General's Recommendations on the Supplier Diversity Program*, GAO-04-57R (Washington, D.C.: Oct. 6, 2003).

²² 13 CFR 121.201 (subsector 484). SBA has recently proposed modifications to its small business size standards. It plans to use the number of employees and eliminate the revenue threshold for most industries. 69 Fed. Reg. 13129 (Mar. 19, 2004).

We selected eight highway contractors who do a substantial amount of business with the Postal Service—about \$390 million in fiscal year 2003—and who were reported as small businesses. We determined that five of the eight were not small businesses. Each of them had more than 500 employees and average annual receipts exceeding \$21.5 million. When we spoke with these five contractors, we found that they were also confused about the appropriate small business size standard, believing it to be 500 employees. Part of the confusion stemmed from the fact that a form requiring them to self-certify their size when responding to a Postal Service solicitation states that companies with 500 or fewer employees are considered small businesses, unless SBA has established a different size standard.

Further, we found that, in some cases, Postal Service contracting specialists were filling out the size standard for the contractors rather than having them self-certify as a large or small business. Two of the contractors we spoke with had noticed that the Postal Service had identified their businesses as small when they considered themselves large. The contractors noted the errors on the form, but the changes were not made in the Postal Service’s records. Postal Service officials have stated that they have now taken steps to ensure that the forms are not filled out by the Postal Service for the contractors.

Highway contracts were not the only area where we found reporting errors. One contractor under the national contract initiative for corrugated boxes reported that it was a small business and received the Postal Service’s 2002 Quality Supplier Award for “Small Business–Manufacturing.” However, this company is owned by a large corporation.²³ The contractor stated that it identified itself as a small business because the individual subsidiary has fewer than 500 employees.

New Supplier Diversity Plan Lacks Targets to Measure Small Business Participation

It will be difficult for the Postal Service to measure progress in small business contracting because its new 3-year supplier diversity plan, issued in October 2003, does not specify targets for small business procurement dollars. The prior supplier diversity plan, which covered the 1999 to 2003 time frame, included such targets, with increasing dollar amounts for these

²³ Where corporations are affiliates (one controls or has the ability to control the other), both corporations’ receipts or employees count in determining the small business size. 13 CFR 121.103.

businesses over the 5-year period. Without targets in place against which to measure performance, the Postal Service has no way to determine whether its supplier diversity policies are being successfully implemented. Further, there is no mechanism in place to hold Postal Service officials accountable for implementing the Postal Service’s objective of ensuring a continuing focus on, and improvement in, its relationships with small and diverse businesses. Our prior work has found that, as part of their diversity policies, leading commercial companies set specific goals to measure performance—such as percentage of total contract dollars awarded to small businesses—and consider gradually increasing the goals on an annual basis.

Conclusions

Leveraging buying power through the use of supply chain management can lead to significant savings, and the Postal Service is on the right track in starting to focus on these opportunities. However, the Postal Service can improve aspects of the initiatives, such as working out implementation problems that have plagued its bulk fuel program. While the lack of accurate baseline information against which to measure savings is, to some degree, an inherent problem in an environment of decentralized spending—and a problem not unique to the Postal Service—the Postal Service can take steps to capture more reliable information on its supply chain management initiatives so that it knows whether the initiatives are producing the desired results.

The Postal Service also faces the challenge of achieving necessary savings while following its own diversity policies. More attention needs to be paid to the effect of supply chain management initiatives on small businesses. As the Postal Service moves forward with its supply chain management initiatives, reliable data and an emphasis on the importance of small business participation are the key factors needed to make its supplier diversity policy work. Given the lack of targets for small business participation in the new supplier diversity policy, however, it will be difficult to hold contracting officers and other key officials accountable for improving the Postal Service’s relationships with small businesses.

Recommendations for Executive Action

We recommend that the Postmaster General of the United States take the following seven actions:

To move toward an accurate and less burdensome method of recouping savings under the bulk fuel program

-
- place a high priority on automating the fuel price adjustment system, and
 - develop a time-phased plan for expanding the number of fueling locations.

To capture accurate savings from its reverse auctions for highway contracts and ensure that the Postal Service gets the best possible price

- encourage contracting officers to try to negotiate further price reductions when only one bid is received, and
- conduct an analysis to determine whether reverse auction overtime procedures would result in the Postal Service's achieving additional savings.

To improve small business reporting and participation

- train contracting officers on the appropriate size standards for different types of businesses and direct them to post the proper standard in the solicitation;
- direct contracting officers and other acquisition personnel to (1) explore during acquisition planning ways that small business participation can be addressed in a supply chain management environment and (2) document their decisions; and finally,
- establish targets for small business participation in Postal Service contracts.

Agency Comments and Our Evaluation

In written comments on a draft of this report, the Postal Service generally agreed with our recommendations. It stated that, while many improvement plans were in place prior to receiving the results of our review, it welcomed the additional information and recommendations and plans to use them to further refine its supply chain management efforts. The Postal Service agreed with our recommendations on the bulk fuel program and reverse auctions for highway transportation contracts. The Postal Service noted that the auctions covered by our report represent a relatively small amount of total reverse auction spending volume; however, the highway transportation auctions we reviewed also account for the vast majority—over 90 percent—of auctions held. On the issue of small business reporting and participation, the Postal Service stated that it would conduct random sampling to check small business certifications, provide training to reinforce existing policies that require supplier diversity to be addressed in acquisition plans, and focus attention on subcontracting plans and reporting. It also noted that the more recent acquisition plans under supply chain management initiatives place stronger emphasis on addressing supplier diversity issues. The Postal

Service stated that our findings on the national contract initiatives would help drive further improvement by ensuring that contracting officers continue to address supplier diversity in their acquisition plans.

The Postal Service stated that, while it understands our recommendation to establish targets for contracting with small businesses, its current approach is to establish baselines from achievements obtained in the previous year so that purchasing units can advance their accomplishments in successive years. By monitoring results quarterly and tracking small business participation throughout the process, the Postal Service believes it can effectively identify and focus its improvement efforts. It stated that it would consider reestablishing targets for small businesses if results start to slip. The Postal Service's response implies that the current achievement level is a baseline against which improvements to small business contracting will be measured. However, we believe that the Postal Service needs to have in place a mechanism to ensure that contracting officers and other key officials are held accountable for improving small business contracting and to provide transparency into the Postal Service's improvement efforts.

The Postal Service also provided technical comments, which we incorporated as appropriate.

We are sending copies of this report to other interested congressional committees and the Postmaster General of the United States. We will also make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

Please contact me at (202) 512-4841 or Michele Mackin at (202) 512-4309 if you have any questions regarding this report. Other major contributors to this report were Lily Chin, Eric Fisher, Paul Greeley, Judy Lasley, MacDonald Phillips, Russ Reiter, and Sylvia Schatz.

A handwritten signature in black ink that reads "David E. Cooper". The signature is written in a cursive style with a large, prominent initial "D".

David E. Cooper
Director, Acquisition and
Sourcing Management

Appendix I: Scope and Methodology

To determine the extent to which the Postal Service's supply chain management initiatives have resulted in savings, we reviewed the highway contractor bulk fuel program and reverse auctions for transportation services and selected five commodities that have been consolidated into national contracts: corrugated boxes, custodial products, pressure-sensitive labels, retail packaging, and delivery vehicle tires. We selected these contracts because they had large projected savings and represented a range of Postal Service commodities. We reviewed our prior report on the Postal Service's national office supply contract¹ and Postal Service Inspector General reports on the bulk fuel pilot program and reverse auctions.

In reviewing the bulk fuel program and reverse auctions, we interviewed Postal Service officials in headquarters as well as 5 of the Postal Service's 11 transportation contract managers. We selected these managers because they were large users of the bulk fuel program and reverse auctions. We also met with a representative of the National Star Route Mail Contractors Association, which represents a number of large and small highway contractors. For the bulk fuel program, we reviewed program documentation regarding the Postal Service's projected savings per gallon and program implementation. For the reverse auctions, we obtained Postal Service May 2003 policy guidance and information on each of the 659 reverse auctions held since May 2002. Drawing data from the Lean Logistics reverse auction Web site, we analyzed information on when the Postal Service posted the requirement, the name of the contractors placing bids, bid amounts, and the dates and times these bids were placed. We did not compare the information drawn from the Web site with Postal Service contract files, but we verified the overall number of auctions with Postal Service officials. We also reviewed the methodology supporting the Postal Service's reported reverse auction savings. Using Postal Service data, we performed various statistical analyses, including replicating the Postal Service's methodology, to determine whether the estimated savings were reasonable. We also conducted a literature review of studies and research concerning the benefits of using reverse auctions.

For the national contracts, we interviewed the responsible program officials and contracting officers in Dallas, Texas; Denver, Colorado;

¹ U.S. General Accounting Office, *Contract Management: Postal Service's National Office Supply Contract Has Not Been Effectively Implemented*, GAO-03-230 (Washington, D.C.: Jan. 17, 2003).

Memphis, Tennessee; Philadelphia, Pennsylvania; and Washington, D.C., and reviewed the contract files. We also obtained the Postal Service's initial projected savings for these national contracts and their actual claimed savings from the Postal Service Supply Chain Management Office. We did not validate these reported savings or determine the extent to which Postal Service buyers were using the contracts.

To determine whether supply chain management initiatives have had an effect on small businesses, we compared prior suppliers' business sizes with those of current suppliers under the national contracts, based on information from the contracting officers. We did not validate the reported business sizes. We also reviewed the individual acquisition plans for each commodity to determine if small business participation was considered in the acquisition planning. For the bulk fuel program and reverse auctions, we interviewed Postal Service policy officials, program officials, and contracting officers. We also discussed with eight highway contractors their business size, including the number of employees and average annual receipts. We reviewed the Small Business Administration's small business size standards and obtained concurrence from a Postal Service policy official that \$21.5 million in total average annual receipts should be used as the size standard for highway contractors to qualify as a small business. Because the Postal Service has a commercial business orientation in many respects, we used our prior work to identify some of the efforts that leading companies have taken to address the issue of supplier diversity.² During that review, we identified leading commercial companies and discussed with them their policies and procedures for ensuring that small or minority-owned contractors had the opportunity to participate in their contracts.

We conducted our review from July 2003 to April 2004 in accordance with generally accepted government auditing standards.

² U.S. General Accounting Office, *Best Practices: Improved Knowledge of DOD Service Contracts Could Reveal Significant Savings*, GAO-03-661 (Washington, D.C.: June 9, 2003).

Appendix II: Comments from the U.S. Postal Service

KEITH STRANGE
VICE PRESIDENT, SUPPLY MANAGEMENT



May 10, 2004

Mr. David E. Cooper
Director, Acquisition and Sourcing Management
United States General Accounting Office
Washington, DC 20548-0001

Dear Mr. Cooper:

Thank you for providing the Postal Service with the opportunity to review and comment on the draft report entitled, Postal Service: Progress in Implementing Supply Chain Management Initiatives (GAO-04-540). Your report confirms issues that we have also recognized and are working to address. In addition, the report identifies some implementation issues that we need to improve upon.

We appreciate the General Accounting Office (GAO) recognizing the importance of the implementation of commercial supply chain management best practices at the Postal Service. Doing so is consistent with our Transformation Plan and the recommendations of the President's Commission on the United States Postal Service. As the report indicates, GAO has documented the success of private sector companies in implementing the same practices that the Postal Service has started to implement over the past three years. By expanding and improving upon our supply chain management (SCM) initiatives, we will continue to lower costs and further the business objectives of the Postal Service. Your report highlights just a few of our programs. Since the middle of Fiscal Year 2000, when our SCM initiatives really started, we have realized savings, cost avoidance, and net revenue generation totaling over \$1 billion from more than one hundred SCM initiatives. This level of success provides clear support for our SCM business philosophy and attendant business practices.

While our success to date is positive, there are challenges. In fact, your report highlights that many of the implementation challenges facing the Postal Service are similar to those faced by major companies. Your report also identifies several aspects of our programs that can be improved, and we certainly agree that monitoring and continuous improvement will lead us to even greater success. While many improvement plans were in place prior to receiving the results of this review, we welcome the additional information and recommendations that your report provides and will use them to further refine our efforts.

Bulk Fuel Program

The bulk fuel program presents a significant savings opportunity for the Postal Service. When fuel is purchased under the program (versus through individual highway transportation contractor reimbursement), we achieve a savings of over nine cents per gallon. When compared to the Department of Energy's fuel index price, the savings is approximately eleven cents per gallon. Yet, as your report points out, there are both stakeholder and operational challenges in implementation. We understand your concern regarding our interim recoupment process; however, until full implementation of our automated Fuel Asset Management System (FAMS) later this year, our interim process will allow us to garner substantial savings. Further, it will only cost the Postal Service \$130,000 to perform the adjustments necessary to achieve savings of \$4.7 million. We believe this is a reasonable business investment pending full automation of our fuel adjustment process. In accordance with your recommendation, we have placed a high priority on implementation of FAMS. We are also developing a time-phased plan to expedite the implementation of new fueling sites to enable a larger number of highway contractors to participate in the bulk fuel program, resulting in an increased number of gallons for which savings can be captured.

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Highway Transportation Contract Reverse Auctions

Our highway contracting reverse auction tool generally compresses pricing, reduces cycle time and enhances competition. While the auctions covered by this report represent a relatively small amount of our total reverse auction spending volume (about 5%), we agree with your recommendation that price negotiation and expanded use of overtime deserve further investigation and will build on the success you noted. The importance of maintaining consistency, fairness and integrity in our processes will be paramount as we proceed with these efforts. In fact, to reduce overall bid event costs, we plan on transitioning reverse auction opportunities for highway and other Supply Management contracts to one standard self-service application that features overtime functionality. Another area that we take very seriously is establishing a challenging reserve price to ensure the award amount is fair and reasonable. Even when only one bid is received, the Postal Service realizes savings. While we expect that setting the appropriate reserve rate will yield a fair offer for the requested service, each contracting officer has the responsibility to determine whether a particular purchasing situation calls for negotiations. In doing so, factors such as pricing history, comparisons with results obtained in similar competitive reverse bid events, performance, delivery requirements, quality, and the cost-benefit of conducting negotiations are considered.

Baseline Data

Your report highlights the need to establish accurate baseline data to calculate savings for our national contracts, in addition to savings on reverse auctions. Since this is the same challenge facing many organizations today, in December 2003 we requested the support of our Office of Inspector General to identify opportunities for improvement, and in March 2004 they started their review. In addition, based on recommendations following their review of our reverse auction process in February 2004, we are in the process of revising our savings process guidelines. Also, by Fiscal Year 2006 more detailed data on contract commodity spending will be available for establishing baseline data. We also agree that solid baseline data were not universally available when undertaking national contract initiatives. However, these data were used to scope spending and transaction volume to assist suppliers with developing pricing strategies and volume-based discounting, not to calculate cost savings. Since our initial SCM initiatives, we have worked to strengthen our process for evaluating cost savings. This evaluation process requires commodity portfolios to calculate the difference between historical prices paid and prices paid under the national contracts. In the absence of reliable historical pricing, the portfolios are required to use other verifiable baseline data in calculating savings, such as market benchmark data. Retail pricing is never used to establish baseline prices. This approach often results in "true" cost savings being understated. However, we have elected to take a conservative approach to measuring and reporting cost savings to ensure that the credibility of our SCM initiatives is maintained. Further, the methodology and calculations used to claim savings are reviewed for reasonableness by a unit independent of Supply Management. The review process is continuous and actual unit volume and prices are updated annually to assure cost savings estimates are accurate.

Program Initiatives and Supplier Diversity

The objectives of our national contract initiatives require special emphasis. The optimization and rationalization process we are using to re-align our supply base achieves more than just cost reductions and savings. It is feasible for the Postal Service to communicate and share resources to sustain continuous improvement and e-procurement initiatives with only a limited number of suppliers. A more streamlined supplier base promotes closer cooperation, coordination, and mutual understanding and trust in order to improve supply chain velocity, responsiveness to changing requirements, and customer satisfaction. These efforts will ultimately increase the quality of the goods and services the Postal Service purchases. Some consolidation of our supplier base (both large and small businesses) has taken place and will take place in the future on strategically sourced national contracts. However, a significant portion of the Postal Service's spending is not readily conducive to national contracts. While we continue to explore cost reduction opportunities, local purchasing will continue to be a source of business opportunity for many small business suppliers. In addition, we have successfully stepped up our efforts to ensure second tier subcontracting opportunities for small and diverse businesses.

We are concerned over the report's implication that the number of our small business suppliers has dropped. While this statement is accurate for the five contracts that you reviewed, the overall value and

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number of Postal Service prime contract awards to small businesses actually increased from Fiscal Year 2002 to 2003. The goal for Federal agencies has been 23% of their obligations. The Postal Service generally achieves over 40% of commitments to small businesses each fiscal year.

Last year we requested assistance from our Inspector General to test the effectiveness of our supplier self-certification approach. Their report covered a sample of our supplies and services contracts and did not offer any suggestions for program improvement. Despite the limited scope of the review, the results revealed that our self-certification approach is working. We are using these review results as a baseline for continual assessment of our supplier self-certification process. In addition, the planned system improvements identified above will also allow us to move to reporting small and diverse business awards by actual expenditures, providing data that are both timely and more accurate.

As you know, the Small Business Administration announced proposed modifications to its small business size standards in the Federal Register dated March 19, 2004. Feedback from small firms and recent studies had indicated that the current standards are too complicated and confusing. Following their revisions of the standards, we will launch an awareness campaign to reach our contracting officers to ensure the proper standards are used when posting our solicitations at the Federal Business Opportunities web site. Other initiatives for improvement include random sampling to check small business certifications; training to reinforce our existing policies that require addressing supplier diversity in our purchase plans; proper use of subcontracting plans in the supplier selection process; and the importance of accurate and timely subcontracting reporting.

The Postal Service continuously benchmarks and incorporates best practices from both industry and the federal sector to ensure that we have a world-class supplier diversity process. As a result, our Supplier Diversity Plan represents the best of both private and federal sector practices. With the expanded use of SCM, we have stressed the importance of reaching out to small and diverse businesses through subcontracting opportunities. We agree that the five purchase plans you assessed do not all meet our current standards for addressing supplier diversity issues. These five plans range from two to five years old, and you did find that the most recent plan was much stronger. We believe that our focus and access to supply base data has improved significantly and this finding will help us drive further improvement by ensuring that contracting officers continue to address supplier diversity in their purchasing plans.

We understand GAO's recommendation to establish general targets for contracting with small businesses. However, an approach more consistent with Supply Management's strategic plan, where the commodities, stakeholders, environment, and marketplace are considered when addressing small business participation, renders meaningful performance indicators and a more direct line of accountability for purchasing personnel. Our approach requires establishing "effort-based indicators" and provides the means for our organization to gauge the effectiveness of our relationships with small businesses in all aspects of the purchasing process (planning, sourcing, subcontracting, and quarterly tracking). Under our program we establish baselines from achievements obtained in the previous year for purchasing units to advance their accomplishments in successive years. Monitoring our results quarterly and tracking progress of small business participation throughout the process enables us to effectively identify and focus our improvement efforts. We will consider re-establishing targets for small business if results start to slip.

We appreciate the efforts and professionalism of your review team. This report will certainly help us with our SCM continuous improvement efforts. We remain committed to fully achieving the supply chain management priorities of the Postal Service. If you or your staff would like to discuss any of these comments further, I am available at your convenience.

Sincerely,



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