

GAO

Report to the Chairman, Subcommittee
on Treasury, Postal Service, and General
Government, Committee on
Appropriations, House of
Representatives

September 1995

POSTAL SERVICE

Performing Remote Barcoding In-House Costs More Than Contracting Out



General Government Division

B-261001

September 13, 1995

The Honorable Jim Lightfoot
Chairman, Subcommittee on Treasury,
Postal Service, and General Government
Committee on Appropriations
House of Representatives

Dear Mr. Chairman:

This report responds to your March 9, 1995, request that we compare the direct costs to the U.S. Postal Service of contracting out for remote barcoding services versus having the work done by postal employees. You also asked that we identify various advantages and disadvantages of using postal employees compared to contractors for these services.

Remote barcoding is the means by which barcodes are added to addresses on the mail that cannot be read by the Service's automated mail processing equipment. Images of these pieces are transmitted over telephone lines to off-site locations where operators read and key in enough address information to allow the equipment to produce a barcode. The Service began remote barcoding in 1991 at two test sites operated by contractors. Following a July 1991 decision to contract out all remote barcoding, the Service established 17 more contractor-operated remote keying sites serving 25 postal facilities.

The American Postal Workers Union (APWU), representing postal clerks, and the National Association of Letter Carriers (NALC), representing city carriers, filed national-level grievances contesting the decision to contract out. The arbitrator's decision, while upholding the Service's right to contract out, also ruled that the remote barcoding jobs must first be offered to current and interested postal employees capable of being trained to perform the work. Because of uncertainty about how to implement the decision, as well as a desire to strengthen the labor-management relationship, in November 1993 the Service agreed with APWU to bring the work in-house. The Service and the union also agreed that only 30 percent of the workhours would be from career, bargaining unit employees. The remaining 70 percent of the workhours would be from transitional employees receiving lower pay and limited benefits. In the Service's view, this mix of career and transitional workhours allowed the jobs to be performed in-house with an acceptable return on investment, even though it recognized that the in-house cost would be higher than the cost of contracting the work out.

Results in Brief

For a 36-week period, from July 23, 1994, through March 31, 1995, we estimated, on the basis of Postal Service data, that in-house barcoding of about 2.8 billion images cost about \$4.4 million, or 6 percent more than if the images were processed by contractors. This 6 percent cost differential was based on an in-house mix of 89 percent transitional and 11 percent career employee workhours through March 1995. On the basis of data provided by the Service, we project that remote barcoding will eventually process the equivalent of about 23 billion letters annually. If other factors remain the same, at a ratio of 70 percent transitional and 30 percent career workhours required by the Service-union agreement, we estimate the cost differential would increase to about 14 percent, or about \$86 million annually, not adjusted for inflation, to process 23 billion letters. An unresolved issue between postal management and the union representing transitional employees is whether these employees should receive additional benefits. If the transitional employees had benefits similar to career employees, we estimate that the cost difference would be 28 percent, or about \$174 million annually.

The Service recognized that the use of postal employees for the remote barcoding costs more than contracting out. However, it expected that the advantage of using postal employees would be improved relations with APWU. The Service said that it is disappointed in its progress with APWU in building productive labor-management relations. In contrast, APWU said that the use of postal employees is providing the opportunity for the Service and APWU to cooperate in establishing and operating remote barcoding sites.

Background

Remote barcoding is a part of the Service's letter mail automation efforts that began in 1982. In the late 1980s, the Postal Service determined that it needed a system for barcoding the billions of letters containing addresses that cannot be read by the Service's optical character readers. Remote barcoding entails making an electronic image of these letters. The images are electronically transmitted to remote barcoding sites where data entry operators enter enough address information into a computer to permit a barcode to be applied to the letter. The barcode allows automated equipment to sort letters at later stages in the processing and delivery chain.

The Service made a decision in July 1991 to contract out remote barcoding based on a cost analysis that showed that contracting out would result in an expected savings of \$4.3 billion over a 15-year period. The Service's

analysis was based on the pay levels and benefits that the Service expected to provide at that time, which exceed pay levels currently expected for in-house work. In November 1993, the Postal Service reversed its decision to contract out the remote barcoding function as a result of an arbitration award. The Service expected that agreeing to use postal employees for remote barcoding would improve its relations with APWU.

In 1991, the Service had determined that contracting out was appropriate because (1) the remote barcoding workers would not touch the mail and security of the mail was not at risk, (2) much of the work would be part-time employment and result in lower overall costs, and (3) technological advances in optical character recognition would enable equipment to read this mail and eventually phase out the remote barcoding. As detailed in our earlier report¹ on the Service's automation program, the Postal Service's plans for remote barcoding have since changed—it now anticipates increased use of the method with no phase-out date.

On the basis of the expected total work load equivalent to 23 billion letter images per year and a processing rate of 750 images per console hour, we estimate that the Service will employ the equivalent of at least 17,000 operators for remote barcoding. This is a minimum based on console hours only and does not take into account such other time as supervision, management, and maintenance.

In November 1990, the clerk and carrier unions filed national grievances challenging the Service's plan to contract out remote barcoding services. Subsequent to its July 1991 decision, the Service awarded 2-year contracts (with an option to renew for a 2-year period) to 8 firms for remote barcoding services for 17 sites. In late 1992, additional remote barcoding deployment was put on hold pending the outcome of the grievances, which ultimately went to arbitration.

On May 20, 1993, the arbitrator concluded that the Service failed to honor certain contractual rights of postal employees. The decision required the Service to first offer the jobs to those postal employees who were interested in and qualified for the jobs before contracting out for the remote barcoding service. The decision did not require that the jobs be offered to new postal hires, and Postal Service officials believed that an

¹Postal Service: Automation Is Taking Longer and Producing Less Than Expected (GAO/GGD-95-89BR, Feb. 22, 1995).

option such as specifying a few sites to be operated by postal employees and contracting out for the remaining ones would have complied with the arbitrator's decision.

On November 2, 1993, the Service agreed with APWU that remote barcoding jobs would be filled entirely by postal employees. In 1994, the Service resumed remote barcoding deployment, opening 14 remote barcoding sites where postal employees are to provide services for 22 mail processing plants. In September 1994, the Service converted two contractor sites serving two plants to in-house centers. It plans to convert the remaining sites by the end of 1996 and to eventually operate up to 75 centers that would serve 268 plants and process the equivalent of about 23 billion letters annually.

In-House Remote Barcoding More Costly Than Contracting Out

Based on cost data provided by the Postal Service, we compared costs incurred during a 36-week period from July 23, 1994, through March 31, 1995, for remote barcoding at the 15 contractor facilities (17 until 2 were converted to in-house operation on September 6, 1994) and the Service's 14 in-house facilities (16 after September 6, 1994). We estimated that the total direct cost of processing 1,000 images averaged \$28.18 at the in-house centers compared to \$26.61 at the contractor locations, a difference of 6 percent. The cost difference was the greatest at the beginning of the period when the in-house sites were getting started and stabilized at about a 6-percent difference during the last 3 accounting periods (12 weeks). About 2.8 billion images were processed in the Service's centers during the 36-week period. We estimated that processing these images in the in-house facilities cost the Postal Service about \$4.4 million, or 6 percent more than processing them in contractor-operated sites.

The 6-percent difference will increase in the future as required changes in the mix of employees staffing the postal remote barcoding centers occur. The Service uses both career and transitional employees, who earn different wages and benefits. Transitional employees receive \$9.74 an hour, Social Security benefits, and earn up to one-half day annual leave every 2 weeks. The career employees start at \$11.44 an hour and receive health benefits, life insurance, retirement/Social Security benefits, a thrift savings plan, sick leave, and earn up to 1 day of annual leave every 2 weeks. For the postal remote barcoding sites we reviewed, 89 percent of the workhours were generated by transitional employees. By agreement with APWU, no more than 70 percent of the workhours in these centers is to be generated by transitional employees. The Service is working toward

this level, and transitional employee workhours are declining while career workhours are increasing as the Service converts and replaces its transitional employees. We estimate that had the required 70/30 ratio of transitional to career employee workhours been achieved for our comparison period, the in-house cost would have been \$30.33 per 1,000 images instead of \$28.18, for a cost difference of about 14 percent instead of 6 percent.

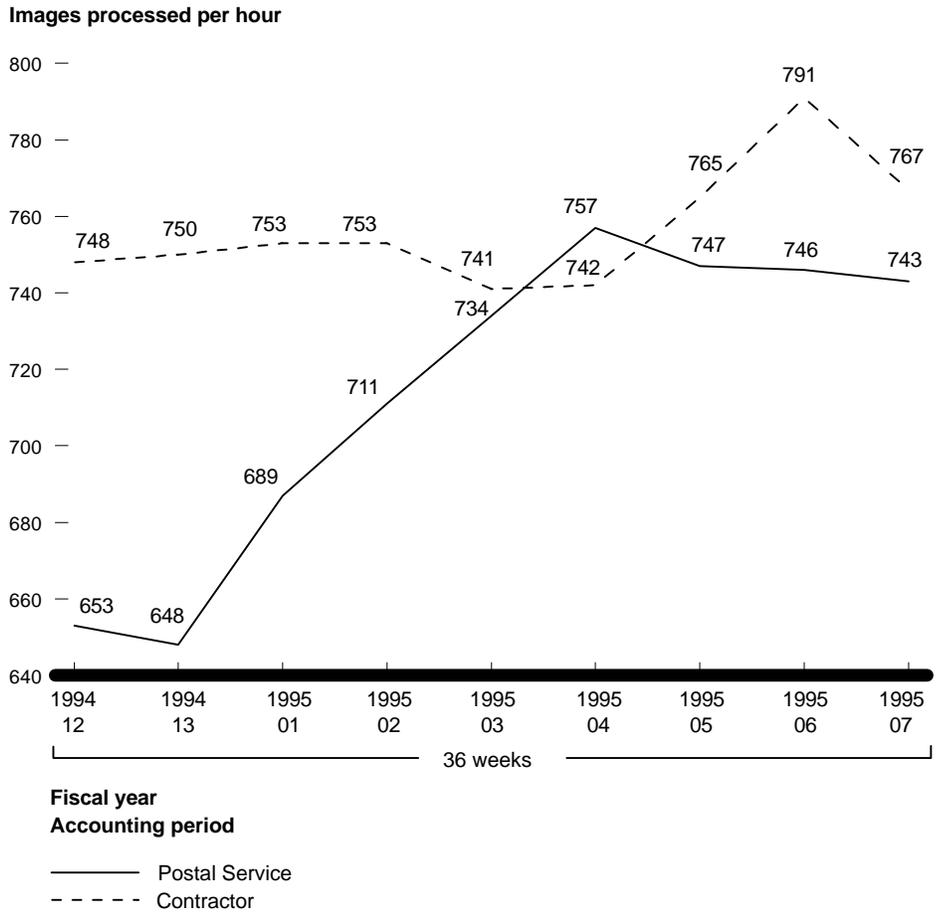
The Service projects that remote barcoding will eventually barcode about 31 billion letters annually. With the remote computer reader² expected to reduce the need for keying by about 25 percent, we estimated that remote barcoding centers will eventually process the equivalent of about 23 billion letters annually. If the 6 percent cost differential and the current ratio of 89 percent transitional and 11 percent career workhours were continued, we estimated the in-house cost for this volume would be about \$36 million more per year, not adjusted for inflation. If the cost differential we found continues, using postal employees would cost the Service about \$86 million more per year, or 14 percent, not adjusted for inflation, when the required ratio of 70 percent transitional and 30 percent career workhours has been achieved.

Benefits for transitional employees that are more comparable to those for career employees were at issue in the recent contract negotiations between the Service and APWU. It is reasonable to expect that wage and other cost increases may occur in the future for both in-house and contractor-operated sites. However, if the Service and APWU agree that transitional employees will receive additional benefits, the character of the jobs held by these employees will change, and the transitional employees will become more like career postal employees. Therefore, we also estimated the in-house and contract cost for remote barcoding if the cost of transitional employee benefits were the same as the cost of career employee benefits. On this basis, our estimate is that the differential would be about \$174 million, or 28 percent, not adjusted for inflation.

Using images per console hour as a measure, we determined that operator speed was similar between the contract sites and the in-house centers during the 36-week period. Contract keyers processed an average of 756 images per console hour, and postal employees processed 729 per hour. Figure 1 shows that differences in keying speed were the greatest at the beginning of the period and were more comparable at the end of it.

²The remote computer reader uses the same basic technology as the optical character reader but has more time to decipher an address image than the optical character reader.

Figure 1: Average Number of Images Processed by Postal and Contractor Employees, From July 23, 1994, Through March 31, 1995



Source: GAO analysis of Postal Service data.

The number of images per console hour was the best available measure we had for comparing the output of postal and contract employees. However, certain factors that are important to measuring performance were not similarly applied by the Postal Service and contractors. For example, contractors can receive a bonus for exceeding 650 images per hour and incur financial penalties for falling short of 640 images per hour. The Service requires its employees to maintain the standard of 650 images per hour, but no bonuses or penalties are involved. Accuracy standards are similar but involve financial penalties only for contractors. The program

that measures errors at contractor sites was not used at postal sites at the time of our review. The Service and the unions are in negotiations over what methods will be used to monitor the accuracy of postal employee operators.

Additionally, productivity data of both postal and contractor sites can be skewed if mail processing plants served by the sites do not process enough mail to keep the operators busy and they continue to be paid. The plants can also make operational decisions affecting whether a full or partial barcode is required from the remote barcoding site. Although partial barcodes are quicker to enter, thus increasing productivity in a specific center, this partially barcoded mail will have to be sorted at a higher cost somewhere downstream. The Service did not have data to break out images processed in-house and by contractors by full and partial barcoding.

In commenting on a draft of this report, APWU said that the period we used for our comparison is unfair to the postal-operated sites because they were just starting up, and productivity is typically lower during such periods. As shown in figure 1 above, postal images per hour were initially lower than the contractor’s images per hour. For this reason, we did not include data from any Service-operated center during its initial 12-week training period.

Figure 1 also shows that postal employee processed images per hour exceeded the contractor’s images per hour in accounting period 4. The cost difference from accounting period 4 until the end of the period was smaller than during the entire period. However, the difference did not consistently decrease throughout the period. As indicated in table 1, the difference was greater in the last accounting period than the average for both the period we used and the period recommended by the union during which the images processed per hour had leveled off.

Table 1: Comparison of Cost Per Thousand Images for Various Time Periods

Accounting periods	Contractor cost per 1,000 images	Postal cost per 1,000 images	Percent difference
FY 94: AP 12 & 13, and FY 95: AP 1 through 7	\$26.61	\$28.18	5.9
FY 95: AP 4, 5, 6, & 7	\$26.72	\$27.72	3.8
FY 95: AP 7	\$27.88	\$29.78	6.8

Source: GAO analysis of Postal Service data.

We believe that our comparison of costs over the nine accounting periods is preferable because it minimizes the effects of one-time and short-term fluctuations in cost and performance. For example, we are aware that contractor costs in the data included nonrecurring, extraordinary payments by the Postal Service of \$888,000 (or 0.87 percent of contractor costs) for workers' compensation claims at two sites. The claims covered a period beginning before our 36-week comparison period, but the Postal Service recorded the full cost in the period paid. Time did not permit us to analyze the cost data to identify and allocate all such extraordinary costs to the appropriate accounting periods.

Transitional Employees Substantially Reduce In-House Costs

The Service's use of transitional employees substantially reduced the difference expected earlier between contract and in-house costs. In its original decision in 1990 on obtaining remote barcoding services, the Postal Service estimated that over a 15-year period it could save about \$4.3 billion by using contract employees. That estimate was based on using existing career level 6 pay scale employees with full pay and benefits.

Under the November 1993 agreement with APWU, only 30 percent of the workhours are to be generated by career employees. This mix of transitional and career employees at the level 4 pay scale makes the Postal Service's cost closer to the cost of contracting out. The return on investment was estimated at 35.7 percent to contract out. The Service's cost comparison showed that the 70-30 mix of transitional and career workhours lowered the return on investment to 20.6 percent. Postal officials said this was still considered an acceptable return. The Service estimated that using level 4 pay scale career employees only would reduce the rate of return to 8 percent.

In commenting on a draft of this report, APWU pointed out that an important reason for having postal employees do this work is that the remote barcoding program, originally considered temporary, is now a permanent part of mail processing operations, and thus eliminates a reason for having contractors do it. This same rationale could be put forth by APWU and/or the Service to eliminate the reason for having temporary or transitional employees do the barcoding. If this occurred, the cost of in-house barcoding would increase significantly. We estimate that if all of the in-house workhours had been generated by career employees at the pay and benefit level for the period under review, in-house keying costs would have exceeded contracting costs by 44 percent, or \$267 million annually, based on a full production rate of 23 billion images per annum.

Advantages and Disadvantages of Using Postal Employees for Remote Barcoding

Service and APWU officials we contacted believed that a principal advantage of bringing the remote barcoding in-house was anticipated improved working relationships. Contractor representatives we contacted believed there were a number of advantages to contracting out, including lower cost, higher productivity, and additional flexibility.

Postal Service Expected Improved Relations With Postal Union

The decision to bring the remote barcoding in-house was not primarily an economic one since the Postal Service recognized it would cost more than contracting out. Postal officials expected that using postal employees for remote barcoding would improve their relations with APWU.

On November 2, 1993, when the Service decided to use postal employees for remote barcoding, the Service and APWU signed a memorandum on labor-management cooperation. This memorandum was in addition to an agreement signed by the Service's Vice President for Labor Relations and the President of APWU the same day for the use of postal employees to do remote barcoding in full settlement of all Service-APWU issues relating to implementing remote barcoding. The cooperation memorandum included six principles (see app. I) of mutual commitment to improve Service-APWU relationships throughout the Postal Service. It specified that the parties "must establish a relationship built on mutual trust and a determination to explore and resolve issues jointly."

The Postal Service's Vice President for Labor Relations and the President of APWU said that relations improved somewhat after the November 1993 agreements. The Vice President said that the decision to use postal employees for remote barcoding was "a very close call," but the agreements seemed to have the effect of improving discussions during the contract negotiations that had begun with the Service in 1994. He also said that APWU initially made offers in contract negotiations that looked good to the Postal Service.

Subsequent to the negotiations, however, the Vice President told us that he no longer believed that the experiment in cooperation with APWU was going to improve relations. According to the Vice President, APWU seemed to have disavowed the financial foundation for the remote barcoding agreement by proposing to (1) increase transitional employees' wages by more than 32 percent over the life of the new contract and (2) provide health benefits for transitional employees. The Postal Service believes these actions would destroy the significance of the 70/30 employee

workhour mix. Further, the Vice President said that APWU continues to be responsible for more than 75 percent of pending grievances and related arbitrations, which had increased substantially from the previous year.

The President of APWU said that having the remote barcoding work done by postal employees was allowing the Service and the union to build new relations from the “ground up.” He said that the cooperation memorandum mentioned above was incidental to the more fundamental agreement of the same date for postal management and the union to establish and maintain remote barcoding sites, working together through joint committees of Service and union officials.

Labor Relations Problems Are Longstanding

Poor relations between postal management and APWU and NALC, including a strike, were a factor prompting Congress to pass the Postal Reorganization Act of 1970. We reported in September 1994³ that relations between postal management and labor unions continued to be acrimonious. When negotiating new wage rates and employee benefits, the Service and the clerks and carriers have been able to reach agreement six out of nine times. However, for three of the last four times, the disputes proceeded to binding arbitration. Our September 1994 report detailed numerous problems on the workroom floor that management and the labor unions needed to address. We recommended that, as a starting point, the Service and all the unions and management associations⁴ negotiate a long-term framework agreement to demonstrate a commitment to improving working relations.

Our follow-up work showed that the Postal Service and APWU are still having difficulty reaching bilateral agreements. Following the 1993 cooperation agreement, the Postal Service and APWU began negotiations for a new contract to replace the 4-year contract that expired in November 1994.⁵ No final and complete agreement could be reached on all subjects in the negotiations, and the parties mutually agreed to engage in a period of mediation. The Postal Service and APWU did not reach agreement for a new contract, and the dispute has now been referred to an arbitrator as provided for in the 1970 act.

³U. S. Postal Service: Labor-Management Problems Persist on the Workroom Floor (GAO/GGD-94-201 A and B, Sept. 29, 1994).

⁴Along with four major labor unions representing clerks, city carriers, rural carriers, and mailhandlers, the Postal Service has three management associations that represent postmasters and supervisors.

⁵The provisions of the existing contract remain in effect until the Postal Service and clerks negotiate a new contract.

Further, the Postal Service and APWU, as well as two of the three other major unions, have been unable to agree to meet on an overall framework agreement that we recommended to deal with longstanding labor-management problems on the workroom floor detailed in our September 1994 report. In response to our report, the Postmaster General invited the leadership of all unions and management associations to a national summit to begin formulating such an agreement. APWU, NALC, and the National Postal Mailhandlers Union did not accept the invitation, saying that the negotiation of new contracts needed to be completed first.

Other Advantages and Disadvantages

Service officials, union officials, and contractor representatives we contacted cited other advantages and disadvantages of using postal employees rather than contractors for remote barcoding. The Vice President for Labor Relations said that the mix of transitional and career employees may create some management problems. He said the different types of employees receiving different wage rates and benefits, but working side by side doing the same work at remote barcoding sites, may create employee morale problems. However, he also said that the career-transitional mix provided the Service with the advantage of offering transitional employees opportunities for career postal jobs.

APWU officials said that remote barcoding is an integral part of mail processing and relies upon rapidly evolving technology, which they believed should not be separated into in-house and contractor operations because of a potential loss of management control and flexibility. They also said that the decision to use postal employees for remote barcoding was justified on the basis of cost studies by the Service showing a favorable return on investment.

Contractor representatives cited a number of advantages to using contract employees. They said that, for a variety of reasons, contractor sites are less costly than postal sites. They believed that contract employees operate at higher productivity rates because contractors, unlike the Postal Service, can provide incentive pay that results in higher keying rates. They also said that contractors can exercise more flexibility in handling variations in mail volume levels because of procedures for adjusting staffing levels on 2-hour notice, as provided in the contracts. However, Service officials pointed out that under the 1993 agreement with APWU, transitional employees can be sent home without notice if work is not available, but the career employees can not.

Objectives, Scope, and Methodology

Our objectives were to (1) compare, insofar as postal data were available, the direct costs of contracting out remote barcoding with the direct costs of having the work done by postal employees; and (2) identify possible advantages and disadvantages of using postal employees rather than contractors to do the work.

At Postal Service headquarters, we interviewed Service officials responsible for remote barcoding implementation and contracting, as well as those responsible for the Service's labor relations and financial management. We met on two occasions with the President of the American Postal Workers Union and other union officials and with three representatives of remote barcoding contractors to obtain their views on the advantages and disadvantages of using postal employees for remote barcoding services. We visited two remote barcoding sites: the contractor site in Salem, VA, and the Lynchburg, VA, site, which recently converted to in-house operation.

We also reviewed, but did not verify to underlying source records, Postal Service data on costs associated with remote barcoding done by contract and postal employees. Further, we confirmed our understanding of remote barcoding and verified some of our information by reviewing the results of related work done in March and April 1995 by the Postal Inspection Service. The Inspection Service did its work at five remote barcoding sites (three Service-operated, including one recently converted from contractor-operated, and two contractor-operated) to compare and contrast certain administration and management practices followed at the sites. Details on our cost comparison methodology are contained in appendix II.

A draft of this report was provided to heads of the Postal Service, APWU, and the Contract Services Association of America for comment in April 1995. Subsequent to the initial distribution of the draft, the Postal Service provided us with revised cost data. We provided a revised draft to the three organizations prior to completion of the comment process, and the comments received were based on the second draft.

We did our work from March through June 1995 in accordance with generally accepted government auditing standards.

Postal Service, APWU, and Contractor Representative's Comments

The Postal Service, APWU, and the Contract Services Association of America provided written comments on a draft of this report.

The Postal Service concurred with the information contained in the report regarding the costs of remote barcoding in contractor and postal operated sites and the reasons for bringing the work in-house. The Service said that it had hoped that bringing the remote barcoding work in-house would foster better relations with APWU. The Service expressed disappointment that APWU continued to maintain an adversarial posture that hindered progress toward improving their relationship. (See app. III for the text of the Postal Service's comments.)

APWU characterized our draft report as being inaccurate and substantially biased. It also expressed the opinion that a report on this subject is premature because the data necessary for adequate evaluation are not yet available. More specifically, APWU said that the draft report (1) overstated the cost of in-house barcoding, (2) understated the costs of contracting out, (3) ignored important considerations that favor doing the work in-house, and (4) understated the significance of improvements in labor relations made possible by the APWU/Postal Service agreement to do remote barcoding in-house.

APWU criticized the draft report as being premature because we used data from a period when postal remote barcoding facilities were just beginning operations, while contractor facilities represented mature operations, thereby overstating the cost of in-house operations. It said that this mature versus start-up comparison imparted a serious bias to our estimate of the cost differential. While we agree that the longer the period of comparison the more preferable, a longer period did not exist for the comparison we were asked to perform. It is also important to note that we excluded from the 36-week time period we used for our cost comparison the initial 12-week training period that each in-house site experienced before becoming operational.

In response to APWU's comments, we clarified our text to more clearly convey that our comparison excluded the 12-week training period for the in-house sites. We also further analyzed the data to identify variances in costs during the 36-week period, especially the later part of the 36-week period, when in-house sites were more mature. This analysis showed that in-house operations were consistently more expensive than contractor operations. We noted that the in-house operations will become more expensive if the workforce mix changes to include more career employees

and fewer transitional employees as is presently planned, and/or if the transitional employees receive increased benefits. We also qualified our estimates of future costs by pointing out that circumstances could change and discussing how that might happen.

APWU asserted that the draft report understated the cost of contracting for remote barcoding because we ignored such potential costs as overruns by government contractors and future strikes by contract employees. We did not ignore the possibility of increased contractor costs. We limited our cost analysis to actual costs because we had no basis for assigning dollar values to possible future events, such as employee strikes and potential cost overruns by contractors. Instead, we provided a narrative discussion of such factors. We expanded our discussion of these factors in response to APWU's comments.

APWU also said that the draft report ignored important considerations favoring in-house operations, such as the importance to postal managers of maintaining full integration and control of the barcoding effort. APWU asserted that in-house operations are inherently preferable from a management point of view. We do not believe that this necessarily holds true. A broad body of work we have done in other areas⁶ shows some successes and economies that have resulted from contracting out certain activities by various federal, state, and local governments.

APWU also said that the draft report understated the significance of improvements in labor relations made possible by the agreement between APWU and the Postal Service to perform remote barcoding in-house. APWU characterized the agreement as a cornerstone of the parties' efforts to build a constructive and productive relationship and cited some examples that it considered to be representative of positive progress in efforts to improve the relationship between the parties.

After receiving APWU's comments, we revisited with Postal Service officials the issue of the effect of the agreement on labor management relations to assure ourselves that we had correctly characterized the Postal Service's position. The officials confirmed that we had, explaining that while the Postal Service believed at the time that the agreement was reached it would have a positive effect, the Service now believes that its relationship with APWU has deteriorated since the 1993 agreement. We added language to further ensure that the final report presents a balanced discussion of the

⁶See, for example, District of Columbia: City and State Privatization Initiatives and Impediments (GAO/T-GGD-95-194, June 28, 1995).

differing views of the affected parties. (See app. IV for the text of APWU's comments and our detailed response to these comments.)

The Contract Services Association of America believed we should have put more information into our report regarding what the Association said was a complete breakdown in the Postal Service's labor-management relations. In view of our previous extensive work evaluating the state of labor-management relations in the Postal Service,⁷ we did not evaluate labor-management relations; but at various places in the report, we describe the various parties' perceptions of the labor-management relationship. The Contract Services Association of America also offered other comments and technical clarifications, which we incorporated in the report where appropriate. (See app. V for the text of the Contract Services Association of America's comments.)

We are providing copies of this report to Senate and House postal oversight and appropriation committees, the Postmaster General, the Postal Service Board of Governors, the Postal Rate Commission, the American Postal Workers Union, and other interested parties.

Major contributors to the report are listed in appendix VI. If you have any questions, please call me on (202) 512-8387.

Sincerely yours,



J. William Gadsby
Director, Government Business
Operations Issues

⁷GAO/GGD-94-201 A and B, Sept. 29, 1994.

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Abbreviations

APWU	American Postal Workers Union
NALC	National Association of Letter Carriers

Principles of Mutual Commitment Agreed to by the Postmaster General and American Postal Workers Union (APWU) President on November 2, 1993

“1. The APWU and the Postal Service hereby reaffirm their commitment to and support for labor-management cooperation at all levels of the organization to ensure a productive labor relations climate which should result in a better working environment for employees and to ensure the continued viability and success of the Postal Service.

“2. The parties recognize that this commitment and support shall be manifested by cooperative dealings between management and the Union leadership which serves as the spokesperson for the employees whom they represent.

“3. The parties recognize that the Postal Service operates in a competitive environment and understand that each Postal Service product is subject to volume diversion. Therefore, it is imperative that management and the Union jointly pursue strategies which emphasize improving employee working conditions and satisfying the customer in terms of service and costs. A more cooperative approach in dealings between management and APWU officials is encouraged on all issues in order to build a more efficient Postal Service.

“4. The Postal Service recognizes the value of Union involvement in the decision making process and respects the right of the APWU to represent bargaining unit employees. In this regard, the Postal Service will work with and through the national, regional, and local Union leadership, rather than directly with employees on issues which affect working conditions and will seek ways of improving customer service, increasing revenue, and reducing postal costs. Management also recognizes the value of union input and a cooperative approach on issues that will affect working conditions and Postal Service policies. The parties affirm their intent to jointly discuss such issues prior to the development of such plans or policies.

“5. The APWU and the Postal Service approve the concept of joint meetings among all organizations on issues of interest to all employees, but which are not directly related to wages, hours or working conditions, such as customer service, the financial performance of the organization and community-related activities. In this regard, the APWU will participate in joint efforts with management and other employee organizations to address these and other similar issues of mutual interest.

“6. On matters directly affecting wages, hours or working conditions, the Postal Service and the APWU recognize that separate labor-management

**Appendix I
Principles of Mutual Commitment Agreed to
by the Postmaster General and American
Postal Workers Union (APWU) President on
November 2, 1993**

meetings involving only the affected Union or Unions are necessary. The parties are encouraged to discuss, explore, and resolve these issues, provided neither party shall attempt to change or vary the terms or provisions of the National Agreement.”

Methodology for Comparing the Cost of In-House and Contractor Remote Barcoding Sites

Selection of Time Period for Comparison

The Postal Service's fiscal year is made up of 13 4-week accounting periods. The time period we selected for comparing the cost of contract and in-house remote barcoding included nine accounting periods (36 weeks) from July 23, 1994, through March 31, 1995. We selected the July 23, 1994, date because this was the first day of the first accounting period after the Service-operated remote barcoding centers completed the 12-week training period for the first system. We then included data on each in-house center for the first full accounting period following the period in which the 12-week training period was completed. We did not include two centers (Lumberton, NC, and Laredo, TX) for the accounting period in which they were converted to in-house sites.

In-House Sites

We determined direct costs incurred by the in-house centers as reflected by the Postal Service Financial Reporting System and contract records for the selected accounting periods. This included all significant costs, such as the pay and benefits for employees and on-site supervisors and managers (about 94 percent of the direct cost), equipment maintenance, communication lines, travel, training, rent, utilities, and supplies. To this we added factors for Service-wide employee compensation not charged directly to any postal operations. These included the Postal Service's payments for certain retirement, health and life insurance, and workers compensation costs, and increases in accrued leave liability due to pay raises. According to Postal Service data, these additional compensation costs ranged between 1.3 and 8.9 percent of direct pay and benefits for transitional and career employees in 1994 and 1995.

Except for contract administration personnel, we did not allocate any headquarters costs to the in-house or contractor sites. This was because these costs were unlikely to be significantly different regardless of whether the sites were contracted out or operated in-house.

Postal Service area offices incurred some cost for remote barcoding. Some area offices had appointed remote barcoding system coordinators, who spent some time assisting and overseeing the postal sites. Their level of involvement in the centers varied from area to area, and data on the amount of involvement were not readily available centrally. We did not attempt to estimate this cost because of the lack of data and because we do not believe it would have been large enough to materially affect our results.

Contractor Sites

For the contractor sites, we used the actual contract cost to the Postal Service, which included the full cost of the remote barcoding services, except for equipment maintenance. We added the contract cost of maintenance for the equipment at the contractor sites, which was provided by the Postal Service to the contractors. We also added the cost of Postal Service personnel involved in administering the contracts, both at headquarters and at the facilities serviced by the coding centers. The estimate of this cost was provided by the Postal Service.

Comments From the U.S. Postal Service



August 8, 1995

Mr. J. William Gadsby
Director, Government Business
Operations Issues
United States General Accounting Office
Washington, DC 20548-0001

Dear Mr. Gadsby:

Thank you for providing us an opportunity to comment on the draft report entitled, Postal Service: Performing Remote Barcoding In-House Costs More Than Contracting Out.

We agree with the report's principal findings that using postal employees to do the work of remote barcoding costs more than having the work performed by contractor personnel and that the Postal Service took the initiative to improve relations with the American Postal Workers Union (APWU) by bringing the barcoding work in-house. We would also note that remote barcoding, whether performed by contractors or done in-house, is producing significantly more cost savings than alternative, more labor-intensive methods of processing mail that cannot be handled by our automation equipment.

Since we began offering the remote barcoding jobs to current postal employees, as the arbitrator's decision required, we have not had a good response from employees interested in changing to these jobs. In order to staff the Remote Barcoding System (RBCS) sites adequately, and at the same time operate the system economically, we have hired temporary employees who are converted to career status after successfully completing training in compliance with our regulations. As RBCS sites are being initially activated, they are staffed primarily with these temporary employees. This strategy, plus the increasing productivity at the sites, has helped us keep our costs down. Our current costs for operating the system with postal employees are not substantially higher than when the work was contracted out. As the report notes, even when we reach the agreed-upon ratio of 70 percent transitional employee workhours and 30 percent career employee workhours, we will still have a favorable return on investment.

Although we knew that bringing the work in-house would increase our costs somewhat, we decided to do it in order to foster better relations with the APWU. We had hoped that by our making a good faith effort to resolve the RBCS staffing issue amicably, the union's national leadership would have been willing to work with us in similar good faith on other issues as well. We are disappointed that we have not been able to make progress with the APWU in building a productive labor-management relationship.

If you wish to discuss any of these comments, my staff is available at your convenience.

Best regards,

A handwritten signature in cursive script that reads "Marvin Runyon".

Comments From the American Postal Workers Union, AFL-CIO

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



American Postal Workers Union, AFL-CIO

1300 L Street, NW, Washington, DC 20005

July 14, 1995

Moe Biller, President
(202) 842-4246

J. William Gadsby, Director
Government Business Operations Issues
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Gadsby:

National Executive Board

Moe Biller
President

William Burrus
Executive Vice President

Douglas C. Holbrook
Secretary-Treasurer

Thomas A. Neill
Industrial Relations Director

Robert L. Turnstall
Director, Clerk Division

James W. Lingberg
Director, Maintenance Division

Donald A. Ross
Director, MVS Division

George N. McKeithen
Director, SDW Division

Regional Coordinators

James P. Williams
Central Region

Jim Burke
Eastern Region

Elizabeth "Liz" Powell
Northeast Region

Terry Stapleton
Southern Region

Raydell R. Moore
Western Region

The following are the comments of the American Postal Workers Union, AFL-CIO (APWU) on your June 12, 1995 draft report entitled Postal Service: Performing Remote Barcoding In-House Costs More Than Contracting Out.

As we explain in some detail later in these comments, your report on this subject is premature because the data necessary to evaluate this program are not yet available. In addition to being based on invalid data, your draft report errs in material respects; it understates the costs of contracting out and underestimates the productivity of postal employees with the result that it substantially overstates any possible cost advantage of contracting out remote barcoding. Based upon the preliminary data available, the APWU believes the GAO estimate of the possible cost differential should be approximately 2.25 percent. It remains our opinion, however, that such an estimate is premature.

The draft also understates the significance of improvements in labor relations made possible by the agreement on remote bar coding by postal employees. The draft wholly ignores other important considerations that support the decision not to contract out this work.

The Cost Comparison Is Based on Invalid and Unrepresentative Data

A fatal weakness in the draft report is that it uses data from a period when postal remote bar coding facilities were just beginning operations. In a 36 week period from July 23, 1994 through March 31, 1995, the draft compares the costs at 15 contractor facilities with the costs at 16 in-house facilities. The problem with this time period is that



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while the 15 contractor sites all represent mature operations, the 16 in-house facilities were in their start-up phase during the entire length of the 36-week period. This mature versus start-up comparison imparts a serious bias to the GAO estimate of the cost differential. It is typical for productivity in a start-up operation to be lower than productivity in the same operation when it matures.

Figure 1 of the draft report shows a distinct upward trend in productivity in the postal facilities over the 36-week period. The number of images processed per hour at postal facilities increased steadily over the 36-week period, from 653 images per hour to 743 images per hour, a 14 percent increase, yet the draft report is based on a comparison of average keying rates during the entire 36-week period.

A valid analysis of productivity at postal facilities would require use of data from mature facilities in which productivity has leveled off. This error alone accounts for most of the differential found by the draft report. With this adjustment, the estimated variable cost of postal facility operations is in the range of \$630 million to \$650 million per year, rather than the \$696 million estimated by the draft report. In reality, we believe productivity data from fully mature postal facilities will favor postal employees over contractor employees.

The error caused by the use of invalid postal productivity data is compounded by the fact that the draft report uses its erroneous initial conclusions as a basis for extrapolating to determine a possible cost differential for the complete program. Thus, a relatively small cost differential, invalidly determined, is multiplied many times.

The draft report also speculates, without any empirical basis, that productivity in mature postal remote bar coding facilities employing 70 percent transitional employees (TEs) and 30 percent career employees would be no higher than the startup productivity in facilities employing 88 percent transitional employees. We dispute that contention. It is not valid to ignore the effects of employee turnover on training costs and productivity. The 30 percent of the workforce made up of career postal employees will be productive and stable.

See comment 1.

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See comment 2.

Another important omission from the draft report is its failure to present its findings regarding labor cost differences in terms of the total direct cost of the remote bar coding program, including capital and other costs that would not be incurred by the Postal Service but for this program. The draft report states that the purpose of the report is to "compare the direct costs...of contracting out...versus having the work done by postal employees." By omitting some of the direct costs of the program, the draft report gives an inflated estimate of the estimated percentage differential in direct costs. Any percentage differential estimated or assumed to exist would be one factor to be taken into account in determining whether or how to maintain the program. We estimate that the total direct cost of the program will be approximately \$800 million on average per year rather than the \$612 million used as the base in the draft report.

With these adjustments, and not retracting our more fundamental objection to basing any estimate on the data presently available, we believe the GAO data would support an estimated cost differential of approximately \$18 to \$38 million per year. Based on a program cost of \$800 million, this would indicate a cost differential of 2.25 to 4.75 percent, well below the 10 percent threshold necessary to justify contracting out under the Postal Service Controller's Guidelines for the Preparation of Cost Data for Comparison with Contracting Out Proposals (at page 3).

The Draft Report Ignores Important Practical Considerations That Favor Doing The Work In-House

See comment 3.

Certainly, GAO is well aware of "cost overruns" by government contractors, having called national attention to their prevalence. The absence of a discussion of cost overruns and their sources from your draft imparts a glaring bias to the draft report.

See comment 4.

At page 2 of the draft report, you state that the Postal Service decided to bring RBCS work back in-house "because of uncertainty about implementing the [arbitration] decision, as well as a desire to strengthen the labor-management relationship." These observations ignore other important reasons for having postal employees do this work. One reason is that the RBCS program is no longer considered to be a temporary program. As you observed, the temporary nature of the program was one reason for the decision to contract out the work. The fact that RBCS will become a permanent part of postal mail processing operations eliminates that reason

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for contracting the work out and provides a reason for using postal employees to perform the work.^{1/}

Inexplicably, your draft report ignores the importance to postal managers of maintaining full integration and control of this important program by postal management. You have completely ignored the concept of dynamic value in your report, as opposed to measuring value as a static quality. Any competent management consultant will advise you that control over a substantial portion of an operation, particularly where that portion of the operation is closely integrated with the entire operation of the company, is a significant consideration in determining how work should be performed. This is particularly true in this case, because the program is reliant upon rapidly evolving technology, and the Postal Service must have flexibility in determining the size and scope of the program. The Postal Service will be much better served by controlling and directing this important part of its mail processing operation.

Furthermore, the APWU is of the opinion that elements of the Postal Service contracts for RBCS keying were open to legal challenges, and those challenges would have been made. The APWU and several other unions were prepared to organize contractor employees. Even moderate organizing success would have changed the cost comparison. An example is provided by the contractor site in Oakland, California, where the contractor's employees received health benefits. It is also noteworthy that your draft report wholly omits reference to the fact that contractor employees would have the right to strike. The ability of postal contractors to pass costs through to the Postal Service, including escalating labor costs, is another factor totally omitted from your report. We gave you specific information on this point at our meeting to discuss your April 26, 1995 draft. The revised draft report does not discuss the information we gave you, much less deal with its implications.

^{1/}The Postal Board of Governors was advised by postal management at its June 7, 1994 meeting that the Postal Service Engineering Department does not believe the Postal Service will ever be able to do without remote bar coding (Transcript of Proceedings, at page 123).

See comment 5.

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See comment 6.

Your report correctly observes that "a complete assessment of the productivity among bar coding locations is difficult due to insufficient data on a variety of factors." This is certainly correct. The draft also observes, without further analysis, that "contractors can receive a bonus for exceeding 650 images per hour. . . ." According to the numbers in the draft report, this threshold is being exceeded by 15 percent. Responsible analysis requires that you at least estimate the cost impact of this factor. Of course, you may prefer to advise the Committee that valid conclusions are impossible at this stage. You should resist political pressures to rush to press with your half-formed impressions.

See comment 7.

Another critical problem with the draft report is that it fails to analyze error rates. Career postal employees, and TEs employed by the postal service, will be held to an error rate of no more than two percent (2%). Contractors have a commitment to meet an error rate of no more than three percent (3%). Data recently made available to the APWU by the Postal Service indicate that, in 1995, contractor error rates were substantially higher than permitted (in fact gross error rates were nearly double, and weighted adjusted error rates were nearly 1% higher than, the permissible level) under their contracts. These data are highly significant to the cost and practicality of contracting out remote barcoding work. You should not issue your report until you have analyzed these data that are now available from the Postal Service.

See comment 8.

The Draft Understates The Importance Of The Labor Relations Impact Of The Agreement To Perform Remote Barcoding In-House

In conjunction with the agreement between the American Postal Workers Union and the Postal Service on performing barcoding in-house, the parties also entered a landmark agreement on labor-management cooperation. That agreement was, and continues to be, a cornerstone of the parties' efforts to build a constructive and productive relationship. For example, the parties created 10 joint committees to deal with issues such as ergonomics, self-directed work (Group Leader), career opportunities for TEs, training, and development of methods to ensure productivity and accuracy. These committees continue to function and have been an effective method of dealing efficiently with the myriad issues that arise when a new program is begun.

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It is false to assert, as your draft report does, "that the Service and the clerks and carriers have rarely been able to reach agreement, and that disputes have been settled by binding arbitration." Since the beginning of collective bargaining, we have agreed to six collective bargaining agreements without resort to interest arbitration, and we have been compelled to go to interest arbitration three times, including the pending interest arbitration. The APWU is still hopeful that a negotiated settlement of the pending collective bargaining dispute will be possible in the few weeks remaining prior to the issuance of an interest arbitration award.

Regardless of whether the parties are able to reach a fully negotiated agreement for the 1994 national agreement, you should not overlook the many tentative agreements reached between the parties on non-economic matters. Although these agreements are contingent on reaching a full agreement on the entire contract and may therefore not become effective, they nevertheless represent months of constructive negotiations between the parties. A number of the tentative agreements deal directly with building a more effective framework for labor management relations. For example, we have tentative agreements to improve the focus and status of joint labor-management meetings, to provide alternatives to the usual dispute resolution procedures, and to engage in joint study and find solutions for longstanding problems. We believe the work the parties have invested in these tentative agreements will provide a basis for future cooperation.

Moreover, your focus on whether we have negotiated a 1994 collective bargaining agreement ignores very substantial other progress in labor relations between the APWU and the Postal Service. We will not attempt to detail all that progress in this brief written response to your draft report. We do want to state categorically, however, that your attempt to disparage efforts by the parties to improve their relationship is unwarranted and incorrect. Apart from the negotiations reference above, the parties have engaged in ad hoc joint studies, joint trips and meetings, and joint teleconferences to deal with matters of mutual concern. Progress has been made in these areas and we believe it will continue.

We find your repeated references to alleged "employee morale problems caused by a mix of different types of employees doing the same job but receiving different pay and benefits" (for example at

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p. 4) ludicrous. The American Postal Workers Union represents all career employees and transitional employees. The notion that GAO is better-acquainted with the attitudes of our members than we are is ridiculous. Your acquaintance with labor issues apparently comes from contractors who believe their employees would be happier than postal employees because they would all be paid less and forced to work under more onerous working conditions than postal workers. Our transitional employees prefer to work for the United States Postal Service and are confident that the American Postal Workers Union will represent them fairly and in their best interests. Morale would be far worse if they were compelled to work for low-wage, nonunion contractors.

The Draft Report Is A Biased Document Requested By The Subcommittee Chairman For Political Reasons

We observe that your report on this subject was requested by the Chairman of the Subcommittee on Treasury, Postal Service, and General Government of the Committee on Appropriations. The Postal Service does not receive any subsidy through Federal Government appropriations. Although there are appropriations for "revenue foregone" due to reduced postage rates for charitable organizations, and appropriations are necessary for programs that benefit postal employees and postal retirees, these programs are not net expenses of the Federal Government because the Postal Service and mailers pay the costs of the Postal Service. We therefore question the apparent urgency of the Subcommittee's request that GAO evaluate this program. There can be no good reason for this hasty action. Any attempt to interfere with the contract between the American Postal Workers Union and the Postal Service would be inappropriate and possibly unconstitutional.

We have a fundamental objection to the use of political pressure to affect collective bargaining decisions by the United States Postal Service. It is perfectly clear that disappointed Postal Service contractors who wish to profit from remote bar code sorting have brought pressure on the Subcommittee. The contractors' views now find expression in your draft report. We particularly object to the political pressure the Subcommittee is attempting to bring on the Postal Service to change its decision on remote bar coding, a collective bargaining decision made by management in the best interests of the Postal Service. We also object to the manipulative use of the United States General Accounting Office to achieve political ends.

See comment 9.

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See comment 10.

The first draft report by GAO on this subject dated April 26, 1995 was so badly flawed that you were forced to withdraw it and change it very substantially in a subsequent draft. That April 1995 report was prepared by GAO without any effort to consult with the American Postal Workers Union. If, in addition to talking with postal officials, you had chosen to consult with this Union, and not just with the private-sector lobbyists representing contractors who do business with the Postal Service, some of your mistakes could have been corrected in advance of the April 26 draft.

See comment 11.

The June 12, 1995 draft is still badly flawed, and it is so biased that it is largely invalid. It would be more responsible for you to advise the Subcommittee that data deficiencies and analytical problems make a valid comparison impossible at this stage. You should resist political pressures to jump to conclusions.

See comment 12.

You assert that an early Postal Service cost analysis of remote barcoding "showed that contracting out would result in an expected savings of [a substantial amount] over a 15-year period." The early cost analysis that is the basis of your statement was prepared prior to the grievance arbitration between the APWU and the United States Postal Service. At that time, there were no transitional employees. It is misleading to take a number from that analysis performed years ago and in a different context and assert it now as fact. Moreover, without going into too much detail at this time, we observe that the so-called "cost analysis" was obviously upwardly biased even at the time it was done. For example, the analysis compared the cost of contracting out with the cost of using career Level 6 postal workers with nine years' seniority to perform the work in-house. No one has ever considered using Level 6 postal workers to do data entry work. Transitional RBCS employees work at the entry level for Level 4. Continued reliance on a cost analysis comparing contracting out with Level 6 career postal employees is unjustifiable. You have stated your objective to be comparison of costs of performing this work in-house versus contracting the work out. You seek to base your draft report on actual data. There can be no valid purpose for making reference to an irrelevant, and inflated, earlier cost analysis by the Postal Service.

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Conclusion

In sum, we observe that the draft report is inaccurate in material respects and substantially biased overall. In significant respects, the draft distorts the comparison by minimizing the costs and disadvantages of contracting out and overstating the costs of performing the work in-house. In a program of the magnitude of RBCS, the result of pushing in the wrong direction on both margins is to substantially undermine the validity of the report. We urge you to ensure that your report is sufficiently balanced, and appropriately qualified where necessary, to ensure that it does not become a political document, thereby perverting GAO's intended role in the legislative process.

Sincerely,


Moe Biller
President

MB:mjm

See comment 13.

The following are GAO's comments on the letter dated July 14, 1995, from the American Postal Workers Union.

GAO Comments

1. In light of APWU's view that the 36-week period we used was not representative, we included an additional analysis in the report covering shorter and more recent time periods. This analysis shows that the cost difference varies depending on the period selected. Using the most recent 4-week period, the cost for in-house keying was greater than for the full 36-week period. However, because costs for any given period can contain extraordinary payments, we believe comparison periods should be as long as feasible to minimize the effects of those nonrecurring costs.
2. APWU suggested that our analysis failed to recognize some of the direct costs associated with the entire remote barcoding program, including capital costs. The total cost of the remote barcoding program was not the focus of our review. Our objective was to compare the direct cost of performing remote keying services in-house versus under contract. Where the cost to the Postal Service was the same whether the work was to be done in-house or by contract, we did not include such cost in our comparison. This methodology is consistent with the Service's Guidelines for the Preparation of Cost Data for Comparison With Contracting Out Proposals. Using this approach, we did not include such costs as video display terminals, keyboards, and computers, for example, that were provided as government-furnished equipment to the contractors and also used at postal-operated sites. Our report discloses in appendix II the cost elements that we considered in our comparison and identifies cost elements not considered.
3. APWU asserted that the draft report understated the cost of contracting for remote barcoding because we ignored such potential costs as overruns by government contractors. It is true that we have reported on cost overruns incurred by government contractors. However, our reports citing contractor overruns were based on after-the-fact evaluations of actual contract costs compared to estimated contract costs. In addition, many instances of cost overruns occur when the scope of work is not well defined and deals with advanced technologies. This does not appear to be the case in remote barcoding where the scope of work is well defined. In addition, it would not be appropriate for us to speculate about the future cost that might be incurred by the Service's remote keying contractors.

4. APWU said that our draft report ignored important reasons for having postal employees do remote barcoding, citing as one reason that the remote barcoding program is no longer considered temporary. While the point that the remote barcoding program is no longer considered a temporary program would be a valid consideration in a decision on whether to contract out, it was not cited by Postal Service officials in any records we reviewed or in our discussion with Service officials as a reason for having postal employees do the work. Rather, the reasons were related primarily to anticipated improvements in the Service's relations with APWU. We estimate that if all of the in-house workhours had been generated by career employees at the pay and benefit level for the period under review, in-house keying costs would have exceeded contracting costs by 44 percent, or \$267 million annually, based on a full production rate of 23 billion images per annum.

5. APWU said that our analysis did not take into consideration several contractor costs that could be passed on to the Postal Service. APWU said that it and several other unions were prepared to organize contractor employees and that even moderate organizing success would change the results of our cost analysis. As an example, APWU pointed to one contractor site where the contractors' employees received health benefits. APWU apparently did not understand that we had in fact included these health benefit costs in our comparison. We agree that potential future costs could affect the cost differential if they occur; however, we have no basis for anticipating what the dollar value of such costs might be. Thus, we used actual cost data when available and discussed in narrative fashion possible changes in circumstances that might affect future costs.

6. APWU said that while our draft report observed that contract employees can receive a bonus for exceeding 650 images per hour, we did not estimate the cost impact of these potential bonuses. The costs for contracting out that we used in our estimates included the cost of actual bonuses paid to contractors for exceeding the standard of 650 images per hour and thus include the cost impact of this factor. We had no basis for estimating how bonuses may change in future periods.

7. APWU stated that the draft report failed to analyze barcoding error rates. The cost for contracting out that we used included penalties assessed against contractors for exceeding the maximum 3-percent error rate. We revised the text to clarify the reason that we could not compare error rates of postal employees and contract employees.

8. We recognize in the report that APWU believes that the agreement to bring the remote barcoding in-house has improved labor relations. However, the report also recognizes that this view does not agree with the Postal Service's view. Moreover, the Postmaster General has recently said that it is clear that the collective bargaining process is broken. We deleted the word rarely and revised the text to reflect that the union has gone to interest arbitration three out of nine times. We made no judgments about the attitudes of postal employees. Rather, our report attributes to a Postal Service official the comment that a potential employee morale problem could result from the mix of transitional and career employees.

9. APWU said that the draft report was a biased document requested by a Subcommittee of the Committee on Appropriations for political reasons, including pressure to affect collective bargaining positions. The Subcommittee has not suggested to us in any way what the results of our analysis should be. We approached this assignment like all others, attempting to meet our customer's legitimate oversight needs in an objective, independent, and timely manner.

10. APWU stated that our initial draft was flawed. As explained in our Objectives, Scope, and Methodology section of this report (see p. 12), subsequent to the initial distribution of a draft of this report, the Postal Service provided us with revised cost data. We provided a revised draft to APWU prior to completion of the comment process. We considered the comments of APWU in preparing this report. We received APWU comments in two meetings, both of which were attended by the APWU President, other APWU officials, and outside legal and economic advisers to APWU. APWU also provided written comments on a draft of this report, which are included in full.

11. APWU stated that the draft is still flawed, biased, and largely invalid. We believe that the data included in our report provide a fair (and best available) representation of the actual cost of operating remote barcoding sites by the Postal Service and by contractors for the periods indicated. As stated in the report, future cost differentials will depend on the circumstances at that time.

12. APWU believed that our use of a Postal Service analysis performed in prior years was misleading. We included the Service's 1990 cost estimate because it led to the decision, followed until 1993, to use contractors for all remote barcoding services. We revised the text to reflect that the

original Postal Service estimate was based on level 6 employees and that currently level 4 employees do the work at in-house sites.

13. In summary, APWU said that our draft report was inaccurate and substantially biased. APWU urged us to ensure that the final report is sufficiently balanced and appropriately qualified. We reviewed the draft report to further ensure that it presented the results of our analysis clearly and with a balanced tone. As discussed in our preceding comments, we added information and language where we thought it helped to clarify the report's message or the positions of the affected parties.

Comments From the Contract Services Association of America



CONTRACT SERVICES ASSOCIATION OF AMERICA
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*Putting the private sector to work...
for the public good.*

26 June 1995

Mr. J. William Gadsby, Director
Government Business Operations Issues
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Gadsby:

Thank you for the opportunity to comment on the General Accounting Office's draft report "Postal Service: Performing Remote Barcoding In-House Costs More Than Contracting-Out" (GAO/GGD-95-143). I am pleased to have the opportunity to provide you with the Contract Services Association of America's (CSA) comments on the draft and will look forward to any opportunities that might arise to discuss our comments in more detail.

First, it is important to note that we believe GAO has performed a valuable service by seeking to effectively and accurately assess the relative costs of performing the remote barcoding work in-house vs. by contract. We have maintained for a long time that, when all costs are equalized and measured fairly, the private sector is almost always the more cost-effective and efficient source of performance. This report certainly provides strong support for that belief.

In fact, the report identifies a potential cost differential of some \$1.72 billion over ten years, which, given the Postal Service's continuing financial difficulties, is impossible to ignore. Moreover, a careful reading of the information in the report leaves little doubt about the very real and immediate need for the Postal Service to reverse its decision to perform the RBCS work in-house. To do otherwise would be fiscally irresponsible and a disservice to the Postal Service's customers.

In addition, the figures in the report are based on GAO's estimate of 17,000 operators eventually being employed by the Postal Service, an estimate the report itself refers to as "a minimum". Therefore, the report should make abundantly clear that the cost differential estimates, as significant as they are, also represent only minimums, and that the actual differentials are likely to be even more significant.

At this point, I would like to clarify some of the key points that we believe should be adjusted in the final report:

(1) Depth of Sort (pg. 11)

As noted in the report, contractors performing the RBCS work are given strong incentives to achieve the finest possible depth of sort; that is, to code the mail to the actual delivery point. No such incentives exist for Postal Service employees thus preventing them from achieving the savings that RBCS could achieve.

Now on p. 11.

**Appendix V
Comments From the Contract Services
Association of America**

J. W. Gadsby
RE: GAO/GGD-950143
June 26, 1995
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CSA fully agrees with GAO and the USPS that a failure to achieve the greatest possible depth of sort, which results in the need for additional sorts downstream in the process, leads to higher sorting costs. The report, however, does not provide any estimates, in dollars or percentages, of what those increased costs might be. CSA recommends that GAO include these costs in its determination of cost differences.

(2) Accuracy (pg. 11)

The report states that "accuracy standards are similar" for in-house and contractor performance. Yet, while this is technically correct, it fails to account for the fact that actual performance by contractors is measured quite differently than actual performance by in-house operations. At contract sites, "audit modules", which measure overall site accuracy and performance, are in constant use. And contractors pay a penalty for error rates that exceed 3%.

The modules are not utilized at sites where the work is performed by USPS employees, nor is there a penalty of any kind assessed for higher than acceptable error rates. Since all errors in coding must be corrected downstream at significant expense, minimizing error rates is of great importance to the process.

CSA agrees with others who strongly believe that the audit modules are a more accurate, effective and comprehensive means of measuring overall site performance, and should thus be utilized at all sites. Moreover, if comparisons of data are to be continued and are to be fair and accurate, they must be based on a common set of data.

(3) Overhead Costs

The report notes that GAO's analysis specifically did not include the costs of supervisory and other management time. Based on the experience of our member companies, we would suggest that a figure of roughly 7% for supervisory time would be in keeping with private sector norms. Thus, that amount should be added to the cost estimates contained in the report in order to render them as fair and accurate as possible.

(4) Return On Investment

In its initial decision to perform RBCS work in-house, the Postal Service cited improved labor-management relations as the principal benefit of such a decision. At the time, the Postal Service also acknowledged that its costs would be higher than they would be had the work been contracted. Thus the anticipated Return on Investment (RoI) was reduced from 35.7% to 20.6%. Moreover, the 20.6% was based on the use of predominantly transitional workers.

Now, however, with the RBCS program envisioned as being permanent, it is becoming increasingly likely that the currently transitional workers will become

Now on p. 6.

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permanent workers, causing costs to rise once more and the Rol to drop precipitously.

CSA believes this fact should be included in the report. After all, it is further evidence of the lack of any sound business rationale to support the Postal Service's decision. Indeed, when taken in combination with the fact, as documented in the report, that the Postal Service has experienced no meaningful improvement in its relations with labor subsequent to the decision to retain RBCS work in-house, the absence of virtually any Rol becomes even more significant.

(5) Characterization of Labor-Management Relations (pg. 15)

In the Appendix (page 15) of the report, GAO states that the Postal Service and its unions have been unable to reach agreement on a new contract and have thus been forced to go to binding arbitration. However, on Page 4 of the report text, the report only references "difficulties" the two sides are having, and makes no mention of the abject failure of the parties to reach a new labor agreement (arguably the clearest indicator of the state of labor-management relations).

Because the Postal Service, early on, established improved labor-management relations as its principal, if not sole, justification for retaining the work in-house, it is crucial that any assessment of the success or failure of the RBCS program include an accurate and complete characterization of the relationship between the parties. As such, the reference on Page 4 to "difficulties" should be expanded to include language relative to the almost complete breakdown of labor-management relations within the Postal Service.

In conclusion, let me reiterate that final point once more, since it gets to the heart of the matter. The GAO was asked to investigate the relative costs of in-house versus contractor performance of the RBCS work. The term "costs", of course, refers to more than direct dollar value, and includes such things as employee morale, labor-management relations, and more.

in looking at the RBCS program, it is clear that the "costs" of keeping the work in-house are extremely high, both in dollars and in employee morale/relations. For instance, any experienced manager will tell you that having workers at a single site performing the same work for different wages and benefits is a source of significant and unavoidable discontent (yet, this is precisely what the Postal Service agreed to do at the RBCS sites). This must, therefore, be highlighted as an additional cost of in-house performance (a point touched on but not highlighted enough in the report). Likewise, there has been no real improvement in labor-management relations; in fact, they remain highly acrimonious.

For all of these reasons, the original Postal Service decision to contract-out the RBCS workload was clearly the correct one, while its later decision to terminate the contracting program and perform the work in-house represents a grave and expensive error, the substantial costs of which will continue to be borne by the Postal Service's customers.

Now on p. 10.

Now on p. 10.

Now on p. 10.

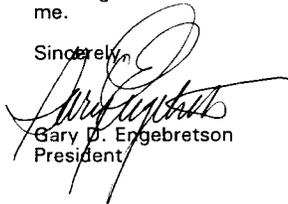
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GAO is to be commended for a generally excellent report. We hope you will accept the recommendations offered here and, through this report, help put the process back on a more rational and defensible track.

Once again, my thanks for the opportunity to provide CSA's comments on the draft report. If we can be of further assistance, or if you would like to convene a meeting to discuss these comments in more detail, please do not hesitate to call me.

Sincerely,



Gary D. Engebretson
President

GDE/s

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