September 30, 2004

RUDOLPH K. UMSCHEID
VICE PRESIDENT, FACILITIES

SUBJECT: Management Advisory –
Lessor Maintenance Enforcement
(Report Number CA-MA-04-006)

This report presents the results of the survey phase of our self-initiated review of lessor maintenance enforcement (Project Number 03XG035CA000).

Results in Brief

Postal Service management could improve its opportunities to reduce overall lease operating expenses. Specifically, personnel responsible for repair projects in the Dallas, Colorado/Wyoming, and Capital Districts did not always process rent reduction requests. Also, Facilities Service Office (FSO) personnel did not include the cost of investigations and studies for repair projects in the Dallas and Fort Worth Districts in future rent reductions. As a result, the Postal Service incurred expenses for repairs that it could have properly required the lessor to accomplish under the lease agreement, and therefore missed an opportunity to reduce overall lease operating expenses by approximately $26,507. These expenses represent funds that could be put to better use ($20,507) and unrecoverable costs ($6,000) and will be reported as such in our Semiannual Report to Congress.

We recommended the Postal Service process missed rent reduction requests; develop and implement an interim policy to monitor and track projects eligible for rent reductions; enhance the Single Source Provider tracking system to include a process to monitor and track projects eligible for

1735 N Lynn St.
Arlington, VA 22209-2020
(703) 248-2100
Fax: (703) 248-2256

rent reduction requests; and develop and implement a policy to include the cost of investigations and studies in future rent reductions.

Management's comments indicated partial agreement with recommendation 1, fully agreed with recommendations 2 and 3, and disagreed with recommendation 4. Since management's comments are based on information obtained subsequent to our fieldwork and we take no exception to the information presented, management's comments are responsive to our recommendations. Management has taken or planned corrective actions that are responsive to our recommendations. Management's comments, in their entirety, are included in Appendix C of this report.

Background

As of May 2004, the Postal Service's active leased facility inventory contains over 28,000 leased facilities comprised of approximately 99 million interior square feet. Annual rent for these leased facilities is over $830 million.

Maintenance responsibility, included in the lease agreement as Maintenance Rider – Lessor Responsibility, must be correctly determined to:

- Avoid damaging relationships between the Postal Service and the lessor.
- Preclude legal complications and lawsuits from breach of contract, caused by misinterpreting maintenance responsibility provisions.
- Avoid incurring expenses to correct maintenance problems that are the lessor's responsibility.[1]

Postal Service lease agreements do not require the lessor to perform preventive maintenance work.[2] Additionally, lessors responsible for maintaining Postal Service facilities under the terms of the lease agreement are not required to make improvements the Postal Service might desire.[3]

[1] Realty Acquisition Handbook, RE-1, Section 741.1.
[2] Realty Acquisition Handbook, RE-1, Section 741.31.
[3] Realty Acquisition Handbook, RE-1, Section 741.31.

From January 1998, through September 2003, the Postal Service committed about $70 million for 2,995 maintenance and repair projects in the Southwest Area.

The contracting officer of the facilities organization decides if repair costs incurred by the Postal Service should be absorbed by the postmaster/installation head or deducted from future rents due the lessor.[4]

Objectives, Scope, and Methodology

Our survey objective was to determine if the Postal Service had adequate controls to enforce lessor maintenance responsibilities.

We initially reviewed 100 maintenance repair projects with committed funds totaling over $3.5 million in the Dallas and Fort Worth Districts from fiscal years 1998 through 2003.[5] We expanded our review to include 50 additional roofing and heating, ventilation, and air conditioning (HVAC) maintenance repair projects from the Colorado/Wyoming, Chicago, and Capital Districts.[6]

We extracted 150 maintenance repair projects from the Facilities Management System for Windows (FMSWIN). We then reviewed lease agreements to determine maintenance responsibility, and identified 11[7] complete repair projects where maintenance was the responsibility of the lessor. We interviewed applicable postmasters and district Administrative Service Office (ASO) and FSO personnel regarding procedures for enforcing lessor maintenance responsibility. We also reviewed current Postal Service policies and procedures, and obtained and reviewed documentation to support future rent reductions.

This review was conducted from November 2003 through September 2004 in accordance with the President's Council on Integrity and Efficiency, Quality Standards for Inspections. We discussed our observations and conclusions with appropriate management officials and included their comments, where appropriate.

[4] Realty Acquisition Handbook, RE-1, Section 742.312.
[5] 8 roofing projects with committed funds totaling $1.1 million; 32 heating, ventilation, and air conditioning (HVAC) projects with committed funds totaling $594,000; 60 "other" repair projects with committed funds totaling $1.8 million.
[6] 25 projects from the Colorado/Wyoming District with committed funds totaling $721,000; 5 projects from the Chicago District with committed funds totaling $118,000; 20 projects from the Capital District with committed funds totaling $201,000.
[7] 8 in Dallas/Fort Worth Districts, 1 in Chicago District, 1 in Capital District and 1 in Colorado/Wyoming District.

We relied on computer-generated data from FMSWIN to extract maintenance repair projects for leased facilities in the Dallas, Fort Worth, Colorado/Wyoming, Chicago, and Capital Districts. We believe the computer-generated data was sufficiently reliable for that purpose. However, we did not rely on any computer-generated data to support the opinions or conclusions in this report.

Prior Audit Coverage

The Office of Inspector General issued a management advisory report, Management of Facility Lease Program (Report Number CA-MA-03-009, dated September 30, 2003). This report concluded that FSO personnel did not always identify and document the condition of facilities prior to lease renewal. It also provided information on the Postal Service's Single Source Provider Program. Management agreed with our recommendations to implement procedures to use the newly created facility condition checklist to identify and document the condition of facilities prior to lease renewal, communicate this information to responsible facilities service office personnel, enforce the requirement to identify and send the lessor a letter of outstanding maintenance items when the lessor is responsible for maintenance, and establish and implement procedures to document outstanding maintenance items prior to assuming maintenance responsibility from the lessor. To address these issues, management issued a policy memorandum on September 30, 2003, that included an update to the Maintenance Rider - USPS Responsibility. Additionally, Postal Service included the updated maintenance rider in the new lease template. Upon conclusion of testing in the Great Lakes FSO, the updated lease template will be released to the remaining FSOs.

Opportunity Exists to Reduce Overall Lease Operating Expenses

Postal Service management could improve its opportunities to reduce overall lease operating expenses by enhancing controls to enforce lessor maintenance responsibilities. Specifically, personnel responsible for repair projects in the Dallas, Colorado/Wyoming, and Capital Districts did not always process rent reduction requests. Also, FSO personnel did not include the cost of investigations and studies in future rent reductions.

The Postal Service reduced future rent by the cost of maintenance repairs that were the lessor's responsibility for projects in the Fort Worth and Chicago Districts totaling $42,185. However, the Postal Service paid for repairs on three projects totaling $26,507[8] that were the lessor's responsibility but did not reduce future rent.

Projects with No Future Rent Reduction				
Project Number	Facility Name	District	Repair Type	Dollar Amount
C23252	Custom House	Capital	Replace HVAC	$11,739
G32084	Copeville	Dallas	Repair Parking Lot	6,000
E91797	Fowler Station	Colorado/Wyoming	Replace Roof	8,768
	Total			**$26,507**

In these projects, we did not find any documentation to show that ASO personnel took any action to initiate the rent reduction.

This occurred because procedures do not exist to monitor and track projects that qualify for rent reductions.

Regarding investigations and studies, we identified four projects totaling $11,678 that were initiated to determine maintenance responsibility but were not included in future rent reductions.

Projects With No Future Rent Reduction				
Project Number	Facility Name	District	Project Type	Dollar Amount
G61128	Greenville	Dallas	HVAC Equipment Study	$2,680
G65272	Mesquite	Dallas	Roof/HVAC Investigation	4,148
G50270	Jacksboro	Fort Worth	HVAC Investigation	824
G69645	Greenville	Dallas	HVAC Study	4,026
	Total			**$11,678**

The results of these investigations and studies showed that the lessor had responsibility for the repair. However, the costs to conduct them were absorbed as an expense to the

[8] We initially identified five projects totaling $113,260; however, subsequent to our fieldwork Postal Service management provided additional documentation to show resolution of the issues for the Station A and Airlawn Station projects. Furthermore, the total cost for the Copeville, Texas, project was $22,015; however, Postal Service management estimated the repair portion at $6,000.

Postal Service because a policy does not exist to include these costs in future rent reductions. [9]

As a result, the Postal Service incurred expenses for repairs that it could have properly required the lessor to complete under the lease agreement. Also, the Postal Service missed an opportunity to reduce overall lease operating expenses by $26,507. (See Appendix B).

As stated in our prior audit report, Management of Facility Lease Program (Report Number CA-MA-03- 009), dated September 30, 2003, Postal Service management recently initiated the Single Source Provider Program. This program will consolidate repair and maintenance functions previously performed by district ASO personnel into a single function within the FSOs. It has been fully implemented in one FSO and is scheduled for implementation at all offices over the next several years. As part of this program, the Postal Service developed a Web-based project tracking system. Also, district ASO personnel will no longer be responsible for initiating maintenance repair projects, and responsibility for lessor maintenance enforcement shifts from the postmaster/installation head to FSO personnel. Instead, all required documents will be generated by the FSO, and processed through the district and area offices. These initiatives are designed to enhance communication regarding maintenance repair issues and should reduce the risk that future rent reduction requests are not processed.

During a meeting on January 21, 2004, management agreed to modify existing procedures to include monitoring and tracking rent reduction requests as an interim procedure, prior to implementation of the Single Source Provider Program. That action, in addition to enhancing the Single Source Provider Web-based tracking system, should reduce overall lease operating expenses Postal Service-wide. Therefore, we do not plan to conduct audit work beyond the survey phase at this time.

[9] Subsequent to our fieldwork, Postal Service management obtained advice from legal counsel that indicates these studies are not chargeable to the lessor at the time they are obtained; however, they may be recoverable if the project is litigated.

Recommendation

We recommend the Vice President, Facilities**:**

1. Direct the Facilities Service Office managers to process rent reductions for the five projects identified during our review.

Management's Comments

Management indicated partial agreement with recommendation 1. They agreed to coordinate with legal counsel to determine if a rent reduction is appropriate for the Custom House and Fowler, Colorado, projects totaling $20,507. Also, since the Copeville, Texas, project included improvement of the parking lot, Postal Service management stated that the FSO is negotiating with the lessor to recover the portion attributed to repair. However, the Postal Service had responsibility for the repair of the HVAC at Dallas Station A. Therefore, those funds cannot be recovered. Also, rent recovery for the Airlawn Station project was resolved as part of a larger civil settlement with the lessor. Finally, the cause for no rent reduction for the Custom House project was erroneously stated.

Evaluation of Management's Comments

Management's comments are responsive to our recommendation. Management's actions taken or planned should correct the issues identified in the finding.

Since information provided in management's response was not available during the time of our fieldwork and was not provided during our meeting on January 21, 2004, we met again on August 31, 2004, to discuss updates.

We accept management's justification not to request a rental reduction for the Dallas Station A and the Airlawn facilities and have removed these costs from total funds put to better use.

We agree that the cause for no rent reduction for the Custom House project was erroneously stated and have revised our report accordingly. Also, on the Copeville, Texas, project, we removed the total project cost from funds put to better use. Instead, we classified $6,000 as unrecoverable cost because the ASO did not follow proper procedures to enforce lessor maintenance. Therefore, there is not an opportunity to recover that cost.[10]

Recommendations

We recommend the Vice President, Facilities:

2. Develop and implement an interim policy to monitor and track projects eligible for rent reductions effective until full implementation of the Single Source Provider Program in all Facilities Service Offices.

3. Enhance the Single Source Provider Web-based tracking system to include a process to monitor and track projects eligible for rent reduction requests.

Management's Comments

Management agreed with recommendations 2 and 3 and issued a directive to the FSOs dated September 1, 2004, to use FMSWIN to track maintenance projects that are the lessor's responsibility under the lease. The FSOs will be required to share this directive to ASOs in areas where the Facilities Single Source Provider Program has not been fully implemented. Furthermore, at the end of each month, headquarters Facilities will generate a report of all projects where the lessor has maintenance responsibility and furnish the report to the FSO manager to follow up on the rental reduction action. Additionally, the Facilities Single Source Provider Program Response Line provides a field to track rent reduction and the directive will remind users to complete this information.

Evaluation of Management's Comment's

Management's comments are responsive to recommendations 2 and 3 and actions taken or planned should correct the issues identified in the finding.

Recommendation

4. Develop and implement a policy to include in future rent reductions the cost of investigations and studies that conclude that maintenance responsibility belongs to the lessor.

Management's Comments

Management disagreed with our recommendation. Management stated the cost of investigations and studies is considered a cost of doing business and these reports prove invaluable when lessor deferred maintenance becomes the subject of a dispute between the lessor and the Postal

[10] Correspondence received from Postal Service management subsequent to our fieldwork and receipt of management's comments.

Service. Advice from legal counsel indicated the cost of studies may be recoverable if the project is litigated. However, they could not be chargeable to the lessor at the time they are obtained.

Evaluation of Management's Comments

The purpose of recommendation 4 was to encourage Facilities officials to include the cost of investigations and studies in future rent reductions in order to reduce overall lease operating expenses. In a meeting on January 21, 2004, management expressed interest in implementing this suggestion. However, subsequent to our fieldwork, management obtained advice from legal counsel that the studies are not chargeable to the lessor at the time they are obtained. We accept management's justification not to include the cost of all investigations and studies in rent reductions when they are obtained. Therefore, although we feel that monitoring these costs would decrease overall costs, we will not pursue this issue further, and the dollars will not be reported as unrecoverable costs.

We appreciate the cooperation and courtesies provided by your staff during the review. If you have any questions, or need additional information, please contact Lorie Siewert, Director, Supply Management and Facilities, or me at (703) 248-2300.

/s/ Colleen A. McAntee

Colleen A. McAntee
Deputy Assistant Inspector General
for Financial Management

Attachment

cc: Patrick R. Donahoe
George L. Lopez
Sylvester Black
Jerry D. Lane
George W. Overby
Keith E. Lashier
Carl T. January
Steven R. Phelps

APPENDIX A. ABBREVIATIONS

ASO	Administrative Service Office
FMSWIN	Facilities Management System for Windows
FSO	Facilities Service Office
HVAC	Heating, ventilation, and air conditioning

APPENDIX B

PROJECTS WITH NO FUTURE RENT REDUCTION

Funds Put to Better Use:

Repairs Paid for by Postal Service That Were the Responsibility of Lessor:	$ 20,507

Unrecoverable Cost:

Repairs Paid for by Postal Service When Proper Lessor Enforcement Procedures Were Not Followed	$ 6,000
Total	$ 26,507

NOTES

Repairs paid for by Postal Service that were the responsibility of the lessor represents the cost of repairs made by the Postal Service for the Custom House and Fowler Station projects identified in our review.

Repairs paid for by Postal Service when proper lessor enforcement procedures were not followed represents a portion of the total cost of repairs/improvements on the Copeville, Texas, project.

FUNDS PUT TO BETTER USE - Funds that could be used more efficiently by implementing recommended actions.

UNRECOVERABLE COST - Costs that should not have been incurred and are not recoverable.

APPENDIX C. MANAGEMENT'S COMMENTS

RUDY UMSCHEID
VICE PRESIDENT, FACILITIES

UNITED STATES
POSTAL SERVICE

August 16, 2004

COLLEEN MCANTEE, DEPUTY ASSISTANT INSPECTOR GENERAL
FOR FINANCIAL MANAGEMENT

SUBJECT: Transmittal of Draft Management Advisory – Lessor Maintenance Enforcement (Report Number CA-MA-04-DRAFT)

The following are our comments regarding the subject Draft Management Advisory.

Recommendation 1. We recommend the Vice President, Facilities direct the FSO managers to process rent reductions for the five projects identified during our review.

Management Response. Management does not agree with the recommended action for the reasons specific to each of the five projects below.

You noted in the report that three projects, completed by the local Administrative Service Offices (ASO's), were not sent to the appropriate Facilities Service Office (FSO) to initiate rental deduction. The other two projects were forwarded to the FSO, but the FSO personnel did not process the appropriate rental reduction paperwork.

Project C23252 at the Custom House Station, Washington, DC, was for replacement of the HVAC unit in the amount of $11,739; the project was completed in June 2000 by the ASO. Your report indicates that the "ASO personnel forwarded appropriate repair documentation to FSO personnel, but FSO personnel did not adequately process..." At the time the project was completed, the Capital Metro FSO was in existence; at the time the office closed, their files transferred to the Eastern FSO. The Eastern FSO reviewed the facility file and cannot locate the request for the rental reduction. If the OIG has a copy of the request and supporting documentation, the Eastern FSO will review the paperwork to determine if proper maintenance procedures were followed. If the supporting documentation is adequate, the Eastern FSO will further review the matter with legal counsel to determine if a rental deduction is appropriate four years after the project was completed.

Project G32084 for Copeville, TX, was for the *repair* of the parking lot in the amount of $22,015. A review of the project completed by the ASO indicates that this project included *replacement* of the parking lot (including approximately $1,700 for design), not *repair*. The ASO did the work without contacting the lessor, who was responsible for parking lot repairs according to the lease. The FSO is currently negotiating with the lessor; however, if any monies are recovered from the lessor, it is anticipated that only the portion of the monies that can be deemed *repair* will be recovered.

Project C70661 for Dallas, Station A, involved a repair to the HVAC in the amount of $19,121, which was completed in June 2001. A review of the lease on this facility indicates that USPS has maintenance responsibility for this repair, therefore, these funds cannot be recovered. As noted in the report, the ASO did not request a rental deduction for this repair which was appropriate action since the repair was USPS responsibility.

4301 WILSON BOULEVARD, SUITE 300
ARLINGTON, VA 22203-1861
703-526-2727
FAX: 703-526-2740

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Project G24906 for emergency HVAC repairs in the amount of $51,617 at Airlawn Station in Dallas was completed by the ASO in September 2000, but was not forwarded to the FSO for rental deduction (although the repair was a lessor responsibility under the contract). All repairs, including emergency repairs, require that the landlord be properly notified and given an opportunity to complete the repairs. The ASO did not request a rental deduction, nor could they produce documentation where they notified the lessor (Mr. Spodek) of the need for repairs. The Dallas FSO has advised that the potential rent recovery was resolved as part of a larger settlement of Civil Action No. 3:98-CV-0687-M (USDC NO RX-Dallas Division).

Project E91797 for roof replacement in the amount of $8,768 in Fowler, Colorado, was completed in June 2001. The 10-year lease at an annual rent of $7,973 expires in January 2005. According to the report, the ASO did not initiate a rent deduction on this facility. The FSO did locate a request dated September 15, 2001, from a former headquarters contracting officer to the lessor for reimbursement in the amount of $8,768 by October 15, 2001. The lessor then requested copies of the roofing bids. After that, the file is silent. In the spring of 2002, headquarters transferred the file to the FSO, but failed to request that the FSO pursue this action. A review of the file and information obtained by the OIG indicates that maintenance procedures were followed; therefore, the FSO will have legal counsel review the information and determine if a rental deduction is appropriate *once a new lease is in place* since the remaining time of the existing lease does not provide sufficient rents from which to deduct the repairs.

Recommendation 2. Develop and implement an interim policy to monitor and track projects eligible for rent reductions effective until full implementation of the Single Source Provider (SSP) Program in all FSOs.

Management Response. We agree with this recommendation. Management will issue a directive to the FSOs by September 1 to use FMSWIN to track maintenance projects that are the lessor's responsibility under the lease. FSOs that have not implemented FSSP or have only partially implemented FSSP will be required to share this directive with their appropriate ASO offices to ensure compliance. The technology is currently in place in FMSWIN such that, when a project is entered in FMSWIN, the summary screen has a box that can be checked to indicate that the project is the lessor's responsibility. The user entering the project must click on the box "Lessor Responsibility for Project." At the end of each month thereafter, Headquarters Facilities will run a report of all projects where this indicator is checked and furnish the report to the FSO manager to follow up on the rental deduction action.

Recommendation 3. Enhance the Single Source Provider Web-based tracking system to include a process to monitor and track projects eligible for rent reduction requests.

Management Response. We agree with this recommendation. Currently, the FSSP Response Line provides a field to track rent deductions. The directive being issued by September 1 will remind users to complete this information.

Recommendation 4. Develop and implement a policy to include in future rent reductions the cost of investigations and studies that conclude that maintenance responsibility belongs to the lessor.

Management Response. Management does not agree with this recommendation. The Postal Service bears the cost of investigations and studies because past experience has shown that such reports prove invaluable when lessor deferred maintenance becomes the subject of dispute between the lessor and USPS. Advice from legal counsel indicates that these studies are not chargeable to the lessor at the time they are obtained; however, the cost of the studies may be recoverable if the project is litigated.

This draft reflects five "maintenance" projects that were initiated at the ASO level. The report concludes that, in three of the five projects, the FSO was not asked to initiate a rent deduction. In one of the two remaining cases, the request was not pursued by the FSO because the work involved a substantial improvement rather than a repair.

We take exception to the draft report's conclusion that $113,260 was for repairs that the USPS paid for and that the OIG concluded were the responsibility of the lessor. Of the $113,260, the largest sum of $51,617 was resolved as part of a larger settlement, noted above, and no further recovery is possible; the $22,015 was mainly considered an improvement, and not a repair; the $19,121 was, in fact, USPS responsibility under the terms of the lease; the $11,739 may be recovered, if appropriate procedures were followed and pending legal counsel review; and the $8,768 was not recouped because of file transitioning; again, the FSO will review the matter with legal counsel to determine if USPS is entitled to the rent deduction. If so, once a new lease is negotiated, the FSO will attempt to recover this cost. Therefore, of the $113,260 that the report states "could be put to better use", only two projects, totaling $20,507, may be recoverable.

The report also states that $11,678 for investigations and studies were determined to be "unrecoverable" costs, and the recommendation was made that these costs be part of future rental deductions. Our opinion, which is supported by legal counsel, is that these costs are not recoverable from the lessor as part of future rental deductions, but may be recoverable if litigation ensues. We see these costs as justified costs or, perhaps, the cost of doing business, which have proved their cost worthiness during litigation.

Under the FSSP program, the ASO personnel will no longer be responsible for initiating maintenance repair projects; instead, postmasters/installation heads will contact the FSO directly. Lessor maintenance enforcement projects will be established and tracked in FMSWIN, and eventually through the FSSP Response Line, as noted above.

We appreciate the opportunity to respond to the draft report. Should you have further questions or concerns regarding our response, please contact Cathy Bailey at 703-526-2760.

Rudy Umscheid

cc: Mr. Donahoe
Mr. Rapp
Mr. Black
Mr. Lane
Mr. Lopez
Mr. January
Mr. Pak
Ms. Siewert
Mr. Moore