

094170



RESTRICTED Not to be released outside the General Accounting Office except on the basis of specific approval by the Office of the United States General Accounting Office

WASHINGTON, D.C. 20548

RELEASED

GENERAL GOVERNMENT DIVISION

NOV 12 1974

B-114874

The Honorable H. R. Gross
House of Representatives

Dear Mr. Gross:

By letter dated July 30, 1974, you asked us to provide you with information on certain costs associated with the implementation of the National Bulk Mail System (NBMS). You expressed a desire that the development of these costs should not be a time-consuming process and that the information be provided as soon as possible. Accordingly, the information contained herein is based on data provided to us by the Postal Service since extensive work would have been required to independently develop answers to your questions.

The Service contracted with a private company to perform an economic analysis to determine the economic desirability of implementing and operating NBMS versus the present bulk mail processing system. Such an analysis should consider both the capital and operating costs of both systems. On the basis of this analysis, the Service estimated that a capital investment of \$950 million in NBMS would yield annual benefits of about \$500 million by 1984. We are enclosing our November 1, 1974, report to the Congress (B-114874) which discusses our evaluation of the planning of the NBMS.

STARTUP COSTS

The Service estimates that startup costs--associated primarily with relocating and training employees--for NBMS will amount to about \$63.3 million, as follows:

<u>Fiscal year</u>	<u>Amount</u>
1973	\$ 805,000 (Actual)
1974	17,922,000 (Actual)
1975	44,539,000 (Estimate)
Total	<u>\$63,266,000</u>

This cost estimate is a revision to the Service's original estimate of about \$72 million which you referred to in your letter. Postal Service officials told us that these costs were not included in the economic

~~710779~~
1094170

analysis justifying the system. These startup costs are a result of NBMS implementation and should have been considered in the economic analysis. Because of the time constraints, we could not determine to what extent these costs should have been considered as capital or operating costs in the economic analysis.

COST OF BULK MAIL
HANDLING EQUIPMENT TO
BE DECLARED OBSOLETE

Four categories of bulk mail handling equipment currently in use will be partially or completely obsolete as a result of implementing NBMS. The Service's investment in this equipment as of August 22, 1974, is as follows:

<u>Category</u>	<u>Cost</u>	<u>Depreciation</u>	<u>Book Value</u>
Multibelt sorters	\$ 2,900,000	\$ 500,000	\$ 2,400,000
Multislide	2,800,000	200,000	2,600,000
Bulk conveyor	76,700,000	14,300,000	62,400,000
Parcel sorting machine	<u>20,100,000</u>	<u>4,300,000</u>	<u>15,800,000</u>
Totals	<u>\$102,500,000</u>	<u>\$19,300,000</u>	<u>\$83,200,000</u>

According to Postal Service officials, some or all of the multislide will be used as sack sorters and many of the bulk conveyors will continue in use. They said that sack sorters will be used at Sectional Center Facilities to distribute bulk mail to their respective associate offices and for some preferential mail processing. The maximum depreciated value of obsoleted equipment as of August 1974 would, therefore, be about \$83.2 million assuming that all of the equipment listed above was declared obsolete. However, as noted above, it is unlikely that all of the equipment will be obsoleted. Nevertheless, although the equipment would be made obsolete as a result of implementing NBMS, such costs are considered to be "sunk costs" (costs that have already been incurred and cannot be recouped) and are not taken into consideration when performing an economic analysis. On the other hand, to the extent that this equipment can be used in nonbulk mail processing or sold, its fair market value should be considered in the economic analysis as a benefit of implementing NBMS.

CLOSE-DOWN COSTS

Postal officials do not anticipate closing down any major postal facilities at this time as a result of implementing NBMS, other than some truck terminals and leased annexes. They told us that the costs associated with closing such terminals or annexes would not be significant and may be offset by savings associated with such closedowns.

They said, therefore, that they did not consider these costs in the analysis and have not estimated any costs of closing offices. They said that, unless an entire facility is closed, no costs will be incurred. We believe that, if any post offices are closed as a result of implementing NBMS, any costs associated with such closing should be considered as a cost to the system. By the same token, however, any savings resulting from closings would be a benefit to the system. If the savings equal the costs, the Postal Service would be correct in not considering this item in their analysis.

ANNUAL DEPRECIATION,
MAINTENANCE, REPAIRS,
AND ENERGY COST

The average annual depreciation cost for NBMS is estimated by the Service to be about \$42 million based on a 15-year life for mechanized equipment and a 40-year life for buildings. Personnel costs for maintenance in fiscal year 1976--which is the first full year of operation--are budgeted at about \$31.7 million. This includes the cost of preventive maintenance, general maintenance, and custodial maintenance performed by Postal Service personnel. These personnel costs are based on wages as set forth in the current labor-management agreement, and an allowance was not made for a possible increase in salary costs due to the negotiation of a new agreement in 1975. The annual cost for major repairs of bulk mail equipment using contract services for the same year is budgeted at \$3.6 million.

The Postal Service estimates that the annual utility costs in fiscal year 1976 will be about \$9,000,000--including \$671,000 for fuel, \$7,500,000 for electricity and other utilities, and \$860,000 for communications.

According to a Service official, these costs were considered by the Postal Service when making an economic analysis of the system, and should be considered as an annual operating cost of NBMS.

COST OF POST
OFFICE CONVERSIONS

With the exception of the costs of certain loading dock modifications to Sectional Center Facilities and associated offices--which were included in the economic analysis--the Service has not estimated the costs of converting existing post offices to process other than bulk mail. Postal officials told us that the implementation of the NBMS will give local postmasters the opportunity to use vacated space to improve the operations of their post offices; but, that any decision on converting post offices to process other than bulk mail would only be made after an analysis is performed to determine the economic desirability of using the vacated space for such processing. They said further that

the determination as to the cost of such conversions attributable to NBMS implementation would have to be made on a facility by facility basis, and that these costs were not considered in the economic analysis because they believe that the benefits resulting from these conversions would at least equal, or be greater than, the costs. We believe that to the extent that implementation of NBMS causes conversion to any other postal facilities, the costs of such conversions are part of the cost of implementing NBMS while, at the same time, any benefits resulting from such conversions should be an NBMS savings. In any event, these costs and savings should be estimated for planning purposes.

CANCELING ARCHITECTURAL
AND ENGINEERING CONTRACTS

On June 13, 1972, we reported to the Chairman, Subcommittee on Postal Facilities and Mail, House Committee on Post Office and Civil Service (B-171594), that 20 architectural-engineering contracts awarded between June 1964 and March 1970 for planning and designing postal facilities had been terminated or suspended after about \$8 million had been expended. This work was abandoned as a result of the Service's decision to implement separate systems to process bulk and preferential (letter) mail. The Service has since deferred action on the Preferential Mail System.

As was the case with obsolete equipment, however, these are "sunk costs" and would not be considered in an economic analysis even though they are partially attributable to NBMS implementation.

- - - -

In summary, with the exception of the costs of obsolete equipment and canceled architectural-engineering contracts, all of the questioned costs should have been considered in the economic analysis justifying the system. According to Service officials, some costs--such as the annual depreciation, maintenance, repair, and energy costs--were considered, but others--such as startup costs and costs to convert existing post offices--were not. On the other hand, any benefits accruing from postal facility conversions or closings were also not considered and would be an NBMS savings. As noted previously, the costs of obsolete equipment and canceled architectural and engineering contracts, although resulting from the decision to implement NBMS, are considered to be "sunk costs" and are not taken into consideration when performing an economic analysis.

B-114874

We do not plan to distribute this report further unless you agree or publicly announce its contents.

Sincerely yours

John D. Heller for
Victor L. Lowe
Director