



# OFFICE OF INSPECTOR GENERAL

UNITED STATES POSTAL SERVICE

## Cost Segment 3 – Clerks and Mail Handlers

### Audit Report

Report Number  
CP-AR-17-007

March 22, 2017





# OFFICE OF INSPECTOR GENERAL

## UNITED STATES POSTAL SERVICE

### Highlights

***Opportunities existed to ensure mail processing cost data is accurate and complete, and to enhance the documented procedures.***

### Background

The Postal Accountability and Enhancement Act of 2006 requires the U.S. Postal Service to file an *Annual Compliance Report* (ACR) with the Postal Regulatory Commission within 90 days of the end of each fiscal year. The report analyzes cost, revenue, rates, and quality of service for all products. Further, it reports whether revenue for each mail class and service type covers its attributable costs, which are costs directly or indirectly caused by products.

As part of the ACR, the Postal Service develops the *Cost Segments and Components* report. This report provides estimates of costs attributable to mail classes, subclasses, and special services by cost segment and cost component. The report contained 17 active cost segments in fiscal year (FY) 2015. The Clerks and Mail Handlers Cost Segment – known as cost segment 3 – included salaries, benefits, and related costs of clerk and mail handler work.

The Management Operating Data System (MODS) performs key functions in the cost development process for the Clerks and Mail Handlers Cost Segment. Postal Service management uses MODS workhour data to derive the totals for many of the cost categories within the cost segment.

Our objective was to assess the accuracy and completeness of mail processing costs within the Clerks and Mail Handlers Cost Segment.

### What the OIG Found

The Postal Service correctly assigned expense accounts to the Clerks and Mail Handlers Cost Segment for FY 2015. However, opportunities existed to ensure mail processing cost data is accurate and complete.

The Postal Service correctly calculated mail processing costs based on the FY 2015 workhour data it extracted from the MODS in October 2015. However, discrepancies existed in workhours when comparing the FY 2015 MODS data the Postal Service extracted in October 2015 to the FY 2015 MODS data we extracted using the same methodology in October 2016. We found a total variance of over 4.6 million MODS hours between the two data reports.

Management indicated that the discrepancies were due to adjustments to MODS data after the close of FY 2015. Postal Service policy states that personnel can adjust MODS data with appropriate approval. However, current policy lacks details to control when changes to workhour data can occur or to record changes (adjustments) for tracking and verification purposes. Therefore, there was no way to determine when the adjustments were made and whether they were correct or necessary.

The MODS workhour discrepancies changed amounts for 42 mail processing cost categories reported in the FY 2015 ACR, such as the Automated Flats Sorting Machine, Automated



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Parcel and Bundle Sorter, and Platform cost categories. As a result, over \$1 million in mail processing costs may have been misallocated among various cost categories, which would cause attributable costs within those cost categories to be distributed inaccurately to mail products and special services.

Although the discrepancies did not have a material impact on the cost data in FY 2015, the ability to change MODS data after the close of the fiscal year without a tracking mechanism increases the risk of inaccurate cost data reports. It could also lead management and the Postal Regulatory Commission to rely on inaccurate information when determining mail class and service attributable cost coverage and when setting postal prices.

In addition, the Postal Service relied on current, documented procedures and the experience and knowledge of personnel to prepare the Clerks and Mail Handlers Cost Segment. However, the procedures could be improved by including:

- Steps and timelines for obtaining source data,
- A disclosure statement explaining why MODS data used to prepare the cost segment is subject to change,

- A list of finance numbers needed to compute mail processing costs,
- The methodology for mapping MODS workhours to mail processing cost categories, and
- Specific steps on how cost adjustments are calculated.

The improvements in the procedures would likely have not prevented the discrepancies discussed previously because the current design of the MODS system does not have capabilities to track adjustments or to enable users to view data from an earlier point in time. However, well-defined, documented procedures would improve transparency into the cost development process, preserve institutional knowledge, and help ensure data quality.

### What the OIG Recommended

We recommended management develop enhanced procedures or system capabilities that improve the integrity of MODS data. In the interim, we recommended management include in future ACR filings the input MODS data file and the date it was extracted. We also recommended management enhance the current documented procedures for preparing the Clerks and Mail Handlers Cost Segment.

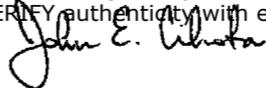
# Transmittal Letter



OFFICE OF INSPECTOR GENERAL  
UNITED STATES POSTAL SERVICE

March 22, 2017

**MEMORANDUM FOR:** SHARON D. OWENS  
VICE PRESIDENT, PRICING AND COSTING

E-Signed by John Cihota  
VERIFY authenticity with eSign Desktop  


**FROM:** John E. Cihota  
Deputy Assistant Inspector General  
for Finance, Pricing and Investments

**SUBJECT:** Audit Report – Cost Segment 3 - Clerks and Mail Handlers  
(Report Number CP-AR-17-007)

This report presents the results of our audit of Cost Segment 3 - Clerks and Mail Handlers (Project Number 16BG020CP000).

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Sherry Fullwood, director, Cost, Pricing and Investments, or me at 703-248-2100.

Attachment

cc: Corporate Audit and Response Management

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# Findings

**Discrepancies existed in MODS workhours, used to calculate mail processing cost pools, when comparing the FY 2015 MODS data the Postal Service extracted in October 2015 to the FY 2015 MODS data we extracted using the same methodology in October 2016.**

## Introduction

This report presents the results of our self-initiated audit<sup>1</sup> of the U.S. Postal Service's Cost Segment 3 - Clerks and Mail Handlers (Project Number 16BG020CP000). Our objective was to assess the accuracy and completeness of mail processing costs in the Clerks and Mail Handlers Cost Segment – called cost segment 3. See [Appendix A](#) for additional information about this audit.

The PAEA requires the Postal Service to file an *Annual Compliance Report (ACR)*<sup>2</sup> with the Postal Regulatory Commission (PRC)<sup>3</sup> within 90 days of the end of each fiscal year. The report analyzes cost, revenue, rates, and quality of service for all products and determines whether revenue for each mail class and service type covers its attributable costs.<sup>4,5</sup> The Postal Service develops the *Cost Segments and Components (CSC)* report as part of the ACR filing. The CSC report provides estimates of costs attributable to mail classes, subclasses, and special services by cost segment<sup>6</sup> and cost component.<sup>7</sup>

The Clerks and Mail Handlers Cost Segment includes the salaries, benefits, and related costs of clerks and mail handlers at Postal Service facilities. In fiscal year (FY) 2015, about 87 percent of total attributable costs within this cost segment were under the mail processing cost component group.<sup>8</sup> The Postal Service calculates the mail processing costs using payroll data, Management Operating Data System (MODS)<sup>9</sup> workhours, and In-Office Cost System (IOCS)<sup>10</sup> data.

## Summary

The Postal Service correctly assigned expense accounts to the Clerks and Mail Handlers Cost Segment for FY 2015. However, opportunities existed to ensure mail processing cost data is accurate and complete. The Postal Service correctly calculated mail processing cost pools<sup>11</sup> based on the FY 2015 MODS workhour data it extracted in October 2015. But, discrepancies existed in workhour totals when comparing the FY 2015 MODS data the Postal Service extracted in October 2015 to the FY 2015 MODS data we extracted using the same methodology in October 2016. We found a total variance of over 4.6 million MODS hours between the two data reports.

Management indicated that the discrepancies were due to adjustments to MODS data after the close of FY 2015. Postal Service policy states that personnel can adjust MODS data with appropriate approval. However, current policy lacks details for controlling or recording changes to workhour data for tracking and verification purposes. Therefore, there was no way to determine when the adjustments were made and whether they were correct or necessary.

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1 We performed this review as part of our mandate under the Postal Accountability and Enhancement Act of 2006 (PAEA) to audit the data collection systems and procedures that the Postal Service uses in its ratemaking process.

2 U.S. Code, Title 39—Postal Service, Subsection 3652(a).

3 The PRC is an independent establishment of the executive branch of the U.S. government that has regulatory oversight over many aspects of the Postal Service, including the development and maintenance of regulations for pricing and performance measures.

4 Attributable costs are those that are directly or indirectly caused by a product or service.

5 PAEA requires that each class of mail and special service cover its attributable costs.

6 Cost segments generally correspond to major divisions of the postal system of accounts.

7 Cost components consist of cost elements that represent the finest level of cost analysis (with respect to estimating volume variability of costs) within a cost segment.

8 The Clerks and Mail Handlers Cost Segment has three cost component groups. The other two cost component groups are (1) window services and (2) administrative support and miscellaneous.

9 MODS collects and reports data on mail volume, workhours, and machine use at major mail processing facilities.

10 IOCS is a statistical sampling system that collects employee data and develops estimates of the proportion of workhours spent on various activities and handling or processing various categories of mail.

11 A cost pool represents the cumulative costs incurred from related activities performed within an organization. In FY 2015, there were 66 cost pools within the mail processing cost component group.

The MODS workhour discrepancies changed amounts for 42 mail processing cost categories reported in the FY 2015 ACR, such as the Automated Flats Sorting Machine, Automated Parcel and Bundle Sorter, and Platform cost pools. As a result, over \$1 million in mail processing costs may have been misallocated among various cost pools, which would cause attributable costs within those cost pools to be distributed inaccurately to mail products and special services.

Although the discrepancies did not have a material impact on the cost data in FY 2015, the ability to change MODS data after the close of the fiscal year without a tracking mechanism increases the risk of inaccurate cost data reports. It could also lead management and the PRC to rely on inaccurate information when determining whether revenue for each mail class and service type covered its attributable cost and when setting postal prices.

In addition, the Postal Service relied on current, documented procedures and the experience and knowledge of personnel to prepare Clerks and Mail Handlers Cost Segment. However, our analysis found the procedures could be improved by including:

- Steps and timelines for obtaining source data.
- A disclosure statement explaining why MODS data used to prepare the cost segment is subject to change.
- A list of finance numbers needed to calculate mail processing costs.
- The methodology for mapping MODS workhours to mail processing cost categories.
- Specific steps on how cost adjustments are calculated.

These improvements would likely not have prevented the discrepancies discussed previously because the current design of the MODS system does not have capabilities to track adjustments or to enable users to view data from an earlier point in time. However, well-defined documented procedures would provide greater transparency into the cost development process, preserve institutional knowledge, and help ensure data quality.

## Mail Processing Cost Pools

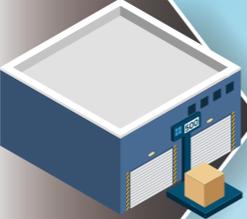
The Postal Service correctly calculated mail processing cost pools in the Clerks and Mail Handlers Cost Segment based on the FY 2015 MODS workhour data extracted in October 2015. However, discrepancies existed in MODS workhours when comparing the original FY 2015 MODS data the Postal Service extracted in October 2015 with FY 2015 MODS data the U.S. Postal Service Office of Inspector General (OIG) extracted in October 2016.<sup>12</sup> We found a total variance of over 4.6 million MODS hours between the two data reports. MODS performs key functions in the cost development process for the Clerks and Mail Handlers Cost Segment, including providing the workhour data used to derive the totals for many of the cost pools within the cost segment.

Using the MODS data extracted in October 2016, over \$1 million in mail processing costs were potentially misallocated among 42 cost pools, as shown in [Table 1](#).

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<sup>12</sup> The OIG used the same parameters as the original data extracted by the Postal Service in October 2015.

**Table 1. MODS Operations<sup>13</sup> With Workhour Discrepancies and Potential Impact on Mail Processing Cost Pools**

FACILITY GROUP	No. of MODS Operation Records With Discrepancies	Total MODS Hours Variance	No. of Cost Pools Affected	Potentially Misallocated Costs
 <b>MODS 1&amp;2 FACILITIES<sup>14</sup></b>	78	4,632,776	33	\$1,069,411
 <b>NETWORK DISTRIBUTION CENTERS<sup>15</sup></b>	12	9,849	9	\$54,145
 <b>TOTAL</b>	90	4,642,625	42	\$1,123,556

Sources: FY 2015 Cost Segment 3 Cost Pools and Other Related Information data reports; FY 2015 MODS hour data report.

Management indicated that the difference in workhours was due to adjustments made to MODS data after the FY 2015 closing period. The Postal Service's policy<sup>16</sup> states that personnel can make adjustments after 3 months with area-level approval, and make adjustments after 1 fiscal year with Postal Service Headquarters approval. However, the current policy lacks procedures to prohibit changes to workhour data after a period of time or to record changes for tracking and verification purposes. Postal Service personnel confirmed MODS does not have the capability to track adjustments or to enable users to view data from an earlier point in time.

<sup>13</sup> MODS operations are 3-digit numbers that designate uniquely defined activities (operations) performed in Postal Service facilities.

<sup>14</sup> Mail processing plants and post offices, stations, and branches that report operational data through MODS.

<sup>15</sup> Mail processing facilities that specialize in processing bulk mail and parcels.

<sup>16</sup> Handbook M-32, *Management Operating Data System*, March 2009. The policy states that personnel may make adjustments to MODS data for reasons such as workhours need to be reassigned because an employee's reporting area does not match the finance facility type, an employee was not clocked into the appropriate operation for which he or she was actually working, etc.

The ability to change MODS data after the closing period, without a tracking mechanism in place to view or verify those changes, could affect the integrity of Clerks and Mail Handlers Cost Segment data. Due to these limitations, management and external stakeholders cannot verify the accuracy of MODS workhour data used when the FY 2015 mail processing cost pools were developed. Also, management needs quality information – based on correct, current, retained, and verifiable source data – to make informed decisions. Inaccurate or incomplete source data could result in erroneous estimates.

The current design of the MODS system prevents verification of the accuracy of the MODS data the Postal Service used to calculate cost pool totals in October 2015. Based on the current, verifiable FY 2015 MODS data extracted in October 2016, 42 mail processing cost pools in the Clerks and Mail Handlers Cost Segment and, therefore, costs attributed to products and services within those cost pools, would have different totals than the Postal Service reported in the FY 2015 ACR filing to the PRC. Management and the PRC use this data to determine whether revenue for each class of mail and type of service covered attributable costs and to set postal prices. Therefore, unlimited and untraceable changes to MODS data could lead management and the PRC to rely on inaccurate information when analyzing and making decisions based on the cost data.

The potentially misallocated amount was only .01 percent of the total \$10.9 billion in mail processing costs. Although it did not have a material impact on the reporting of FY 2015 Clerks and Mail Handlers Cost Segment data, ineffective MODS controls pose an increased data integrity risk,<sup>17</sup> including the risk of reporting inaccurate mail processing costs for products and services.

## Documented Procedures

Opportunities existed to enhance the documented procedures for preparing the cost segment. The Postal Service used both the existing documented procedures and the experience and knowledge of personnel to prepare the Clerks and Mail Handlers Cost Segment. Personnel used four main sources as the documented procedures for allocating,<sup>18</sup> attributing,<sup>19</sup> and distributing<sup>20</sup> clerk and mail handler costs:

- The *Reallocation of the National Trial Balance Process and Instructions* identifies the data sources and guidelines for the reallocation process.<sup>21</sup> It provides comprehensive information on the sources of input data, the reallocation model, the contents of the *Reconciliation to Financial Statements and Account Reallocations* workbook,<sup>22</sup> and the procedures involved in performing the reallocation process.
- The preface of the *Cost Segment 3 Cost Pools and Other Related Information*<sup>23</sup> identifies the contents, inputs, and outputs of the cost pool workbooks. It also provides general information on the method and procedures employed by the Statistical Analysis System (SAS) programs used to prepare Clerks and Mail Handlers Cost Segment data. Additionally, the workbooks contained formulas in certain cells that identified the input data and calculations used to compute costs.

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17 The risk that the authorization, completeness, and/or accuracy of transactions as they are entered into, processed, summarized, and reported by application systems are compromised due to inadequate recording structures.

18 Allocating is the process of allotting accrued costs to specific cost pools.

19 Attributing is the process of calculating volume variable and product specific costs that are associated with a mail product or service. Volume variable costs are those that change with mail volume and operational activities.

20 Distributing is the process of assigning volume variable and product specific costs to individual mail products and services.

21 This process entails aligning expense accounts associated with various employee categories and activities among the various cost segments and cost components.

22 This workbook contained the expense accounts assigned to each cost segment and is a part of the ACR filing (PRC Docket Number USPS-FY15-NP29).

23 PRC Docket Number USPS-FY15-NP18.

- The preface of the *FY 2015 CRA “B” Workpapers*<sup>24</sup> provides general information on the inputs and modifications to the methodology used to calculate costs by cost segment. The “Doc” worksheet within the Clerks and Mail Handlers Cost Segment workbook included a brief description of the purpose and contents of each worksheet within the workbook. Additionally, the workbook contained formulas in certain cells that identified the input data and calculations used to compute costs.
- The *FY 2015 Summary Description of USPS Development of Costs by Segments and Components* describes in summary form the approach to costing employed by the Postal Service with specific reference to the CRA report for FY 2015. It shows dollar figures and their development from the perspective of postal costing concepts and objectives.

Management indicated the current documented procedures were sufficient to understand the methodology for developing cost pools and distributing attributable costs to products as the process is only performed by experienced personnel. However, our analysis found that important steps and information were missing from the documented procedures. The procedures could be improved by including:

- Steps on how and when source data is extracted from various databases or obtained from other functional groups. For example, the documented procedures do not describe how and when:
  - MODS workhour data is retrieved from WebMODS (via the Electronic Data Warehouse).<sup>25</sup>
  - IOCS data is obtained from the Cost Systems and Analysis group.<sup>26</sup>
  - Revenue, pieces, and weight (RPW) data is obtained from the Revenue and Volume Reporting group.<sup>27</sup>
- A disclosure statement explaining that the MODS data relied upon to prepare the Clerk and Mail Handlers Cost Segment is subject to change and the conditions under which those changes could occur. Information about the occurrence and rationale for MODS adjustments would make it clear to quality assurance reviewers why workhour data extracted at a later date may not match the data the Postal Service used to develop cost estimates. Further, since the data is used to prepare cost information for the ACR, it is important that changes to the data that could affect cost estimates be disclosed to promote transparency of the cost development process.
- A list of finance numbers needed to calculate the labor costs and extract MODS workhour data to compute cost pool totals. Finance numbers are needed to extract labor costs from the pay data system and MODS workhour data from WebMODS. Management believes general descriptions of facility groups in current documentation sufficiently explain their work and support their filings with the PRC. They explained that the finance numbers are not documented because they change over time and would need to be updated each year. However not all finance numbers change annually. Further, management has to update the finance number list prior to preparing the Clerks and Mail Handlers Cost Segment data each year to ensure accurate development of cost estimates. Therefore, the Postal Service could include this information within the documented procedures or as part of the annual ACR filing and update it as necessary. We were unable to fully follow their cost methodology or verify their calculations without this information.

<sup>24</sup> PRC Docket Number USPS-FY15-NP14.

<sup>25</sup> A repository for all data and the central source for information on retail, financial, and operational performance.

<sup>26</sup> Postal Service employees from the Statistical Programs functional area who extract the IOCS input data for the Clerks and Mail Handlers Cost Segment distribution calculations.

<sup>27</sup> Postal Service employees from the Statistical Programs functional area who extract the RPW input data for the Clerks and Mail Handlers Cost Segment adjustment calculations.

- Explanations for how MODS operations are mapped to cost pools and labor distribution codes<sup>28</sup> to compute cost pool totals. The Postal Service contractor<sup>29</sup> was able to provide this information during our review. However, the Postal Service should include this information within its own documented procedures.
- Steps on how to calculate cost adjustments. Management explained that third party reviewers could follow the methodology for the adjustments by tracing the formulas and cell references within the workbooks. However, we were unable to fully follow the methodology without additional detail on the source information for some of the data as well as the logic behind some of the calculations.

Having comprehensive documented procedures is widely known to be an important internal control and best business practice.<sup>30</sup> Well-defined documented procedures would provide greater transparency into the cost development process, which allows management and external stakeholders to validate the accuracy of cost calculations. These procedures could also serve as a training guide for new employees, prevent loss of institutional knowledge in the event experienced staff separate from the Postal Service, and ensure the mail processing cost calculations within the Clerks and Mail Handlers Cost Segment are complete and accurate.

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28 Labor distribution codes are 2-digit numbers that describe the major work assignments within a postal facility. The first digit represents the functional area (e.g., mail processing) and the second digit identifies the type of activity (e.g., supervision).

29 A Postal Service contractor prepares the Clerks and Mail Handlers Cost Segment data. Postal Service management stated they conduct a high-level review of the data after it is prepared. The review includes verifying that costs match up with the trial balance (revenue and expense system) and analyzing year-to-year product costs to identify any potential anomalies.

30 The Committee of Sponsoring Organizations of the Treadway Commission *Internal Control – Integrated Framework*, dated May 2013, emphasizes that well-defined documented policies and procedures support an entity’s achievement of its objectives. Additionally, Postal Service Handbook AS-805, *Information Security*, November 2016, states that formally documenting procedures is in line with business continuity objectives; increases organizational credibility with customers, business partners, and stakeholders; and ensures availability and accuracy of the information for stakeholders.

# Recommendations

***We recommend management develop enhanced procedures or system capabilities that improve the integrity of MODS data. In the interim, we recommend management include in future ACR filings the input MODS data file and the date it was extracted. We also recommend management enhance the current documented procedures for preparing the Clerks and Mail Handlers Cost Segment.***

We recommend the vice president, Pricing and Costing, in coordination with the vice president, Network Operations:

1. Develop enhanced procedures or system capabilities to limit or track *Management Operating Data System (MODS)* data adjustments made after the fiscal year closing period. Until the enhancements are made, include the MODS data file and the date it was extracted with the *Cost Segment 3 Cost Pools and Other Related Information* in future *Annual Compliance Report* filings to enhance transparency of the cost development process.
2. Enhance the current documented procedures to provide greater transparency into the cost development process and prevent the loss of institutional knowledge. The procedures should include steps for extracting data to perform mail processing cost calculations; a disclosure statement explaining why MODS data is subject to change; a list of finance numbers to compute cost pool totals; the methodology for aligning MODS operations to cost pools and labor distribution codes; and steps for calculating cost adjustments.

## Management's Comments

Management agreed in part with the findings and recommendations but identified important disagreements.

Management partially disagreed with recommendation 1, stating that changes to MODS procedures was not warranted because of the immaterial revisions to the data. Management asserted that about 4.5 million work hours of the 4.6 million workhours variance the OIG identified was associated with a single shift in hours between two MODS operations. This variance is not expected to occur in future fiscal years as efforts to comply with a prior OIG audit addressed this issue. Management also stated the existing procedures entail an escalation of management approvals of revisions as more time elapses between the original recording of the data and the revisions.

Management agreed to address concerns related to MODS data adjustments. In October 2017, management plans to download FY 2016 MODS data and compare it to the FY 2016 MODS data used in the cost segment 3 ACR calculations to determine if any material differences occur. Management added that the Postal Service has provided the PRC a complete MODS dataset to support ACR filings, filed in a folder separate from the main cost segment 3 documentation. Management agreed to continue filing the MODS data with the ACR filings but will include the date of extraction for the MODS data in the cost segment 3 documentation. Management's target implementation date is December 31, 2017.

Management partially disagreed with recommendation 2, stating the existing cost segment 3 documentation provides detailed information on the source data. Also, management stated the alignment of MODS operations to cost pools and labor distribution codes is specified in the PRC's accepted cost methodology. Any substantive changes to MODS operation to cost pool mapping is a methodology issue subject to PRC approval.

However, management agreed that the FY 2017 ACR process will:

- Include in the cost segment 3 documentation references to the MODS M-32 handbook regarding data adjustments.
- Provide a list of finance numbers required for data acquisition in nonpublic documentation.
- Document any methodological changes affecting cost pool assignments if approved by the PRC.

- Review cost adjustment spreadsheets for accuracy of source labeling and add clarifying material, if needed.

Management's target implementation date is December 31, 2017.

See [Appendix B](#) for management's comments in their entirety.

### **Evaluation of Management's Comments**

The OIG considers management's comments responsive to the recommendations in the report and corrective actions should resolve the issues in the report.

Regarding recommendation 1, the OIG understands MODS adjustments are necessary to correct errors and that adjustments to FY 2015 MODS workhour data did not have a material impact on the FY 2015 mail processing cost estimates. Nevertheless, we believe system data that can arbitrarily change well after the closing period with no hard close date or tracking mechanism in place poses a data integrity risk. However, the planned corrective actions to address recommendation 1 should enhance transparency of the cost development process for cost segment 3.

Regarding recommendation 2, the OIG found that information on how, when, and from where management obtained source data to develop cost estimates was not always clearly documented. We acquired much of the detail on source data from conversations with management. Also, we understand the approval process for methodology changes is the PRC's responsibility and authority. This audit was performed to determine whether the mail processing costs within cost segment 3 were accurate and complete. We believe citing the PRC docket and substantiating files that support the methodology used would further enhance documented procedures, as that information was not readily available or verifiable during the audit. Nonetheless, the planned corrective actions to address recommendation 2 should provide greater transparency into the cost development process and prevent the loss of institutional knowledge.

All recommendations require OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective actions are completed. Recommendations 1 and 2 should not be closed in the Postal Service's follow-up tracking system until the OIG provides written confirmation that the recommendations can be closed.

# Appendices

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## Appendix A: Additional Information

### Background

The PAEA requires that the Postal Service prepare an annual report that analyzes costs, revenue, rates, and quality of service. To comply, the Postal Service files the ACR with the PRC no later than 90 days after the end of each fiscal year.

The CSC report documents the costs used to prepare the CRA report. The objective of the CSC report is to detail the total attributable costs of the Postal Service. The costs are then allocated to individual products and services. The CRA compares attributable costs to revenue to determine whether each product's revenue covers its costs. Results of this comparison are included in the ACR. In FY 2015, there were 17 active cost segments reported in the CSC report. The largest cost segment, in terms of total and attributable costs, was the Clerks and Mail Handlers Cost Segment, which included the salaries, benefits, and related costs of clerks and mail handlers at Postal Service facilities.

The Postal Service develops costs annually for the CSC report using methods approved by the PRC. Costs are derived from the postal system of accounts<sup>31</sup> and are categorized as either attributable or institutional costs<sup>32</sup> using a variety of operational and statistical information sources. Data used to prepare the Clerks and Mail Handlers Cost Segment comes from sources such as the payroll system, MODS, and IOCS.

The Clerks and Mail Handlers Cost Segment is divided into three cost component groups: Mail Processing, Window Services, and Administrative Support & Miscellaneous. Clerk and mail handler costs for FY 2015 are summarized by cost component group in Table 2.

**Table 2. Cost Totals for Cost Component Groups**

FY 2015 Clerk & Mail Handler Costs by Cost Component Group (Thousands)			
Component Group	Accrued	Attributable	Institutional
3.1 Mail Processing	\$10,927,649	\$10,263,868	\$663,782
3.2 Window Services	\$2,482,043	\$933,049	\$1,548,994
3.3 Admin. Support & Misc.	\$985,255	\$657,895	\$327,360
<b>Total</b>	<b>\$14,394,947</b>	<b>\$11,854,812</b>	<b>\$2,540,135</b>

Source: FY 2015 Public Cost Segments and Components report.

In FY 2015, the vast majority of the attributable costs within the Clerks and Mail Handlers Cost Segment fell under the mail processing cost component group, as shown in [Table 3](#).

<sup>31</sup> The Postal Service's system of accounts is an 8-digit account numbering system consisting of a 5-digit primary code and a 3-digit sub-account code that is documented in the Account Number Control Master.

<sup>32</sup> Institutional costs are not volume variable or product specific. They make up the difference between total accrued costs and total attributable costs.

**Table 3. Cost Component Group Attributable Cost Percentages**

FY 2015 Clerk & Mail Handler Costs by Cost Component Group (Thousands)		
Component Group	Attributable Costs	Cost Percentage
3.1 Mail Processing	\$10,263,868	86.6%
3.2 Window Services	\$933,049	7.9%
3.3 Admin. Support & Misc.	\$657,895	5.5%
<b>Total</b>	<b>\$11,854,812</b>	<b>100%</b>

Source: FY 2015 Public Cost Segments and Components report.

Between FY 2013 and FY 2015, attributable clerk and mail handler costs accounted for about 29 percent of total attributable costs across all cost segments. The proportion of clerk and mail handler attributable costs to total attributable costs is shown in Table 4.

**Table 4. Clerk and Mail Handler Attributable Cost Percentages**

Clerk & Mail Handler Compared to Total Costs (Thousands)			
Cost Segments	FY 2013	FY 2014	FY 2015
Segments 3-4 Attributable Costs <sup>33</sup>	\$11,491,932	\$11,363,506	\$11,854,812
All Segments Attributable Costs <sup>34</sup>	\$39,550,228	\$39,530,333	\$40,437,610
<b>Percentage of Attributable Costs</b>	<b>29.1%</b>	<b>28.7%</b>	<b>29.3%</b>

Source: FYs 2013-2015 Public Cost Segments and Components reports.

## Objective, Scope, and Methodology

Our objective was to assess the accuracy and completeness of mail processing costs within the Clerks and Mail Handlers Cost Segment. The scope of this project was mail processing costs for FY 2015.

To accomplish our objectives, we:

- Identified processes, procedures, guides, and flowcharts on the development of the Clerks and Mail Handlers Cost Segment.
- Identified the data collection systems and procedures used to prepare Clerks and Mail Handlers Cost Segment information in the CSC report.
- Interviewed Postal Service and contractor personnel to determine how cost data was obtained and prepared and whether any part of the process was performed manually.

<sup>33</sup> The PRC approved the merger of cost segment 3 (formerly known as “Clerks and Mail Handlers – CAG A-J Offices”) and cost segment 4 (formerly known as “Clerks – CAG K Offices”) starting in the FY 2015 reporting cycle. Therefore, the attributable cost data shown for FYs 2013-2014 includes the attributable costs for the former cost segment 4.

<sup>34</sup> Only 18 of the 20 cost segments were active in FYs 2013-2014, and only 17 were active in FY 2015.

- Verified whether the general ledger expense accounts posted to the Clerks and Mail Handlers – CAG A-J Offices Cost Segment – and the Clerks – CAG K Offices Cost Segment<sup>35</sup> – were appropriate and accurately recorded.
- Validated whether mail processing costs were accurately allocated to cost pools.
- Reviewed the methodology for the SAS programming used to generate mail processing cost data and to distribute attributable costs to products and services.
- Verified whether adjustments to mail processing product costs were calculated accurately and consistently.
- Used the OIG MODS risk model to determine whether MODS operations used to develop mail processing cost pools showed up on exception reports for containing errors in reported workhours or volume.

We conducted this performance audit from September 2016 through March 2017 in accordance with generally accepted government auditing standards and included such tests of internal controls as we considered necessary under the circumstances. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. We discussed our observations and conclusions with management on February 16, 2017 and included their comments where appropriate.

We assessed the reliability of costing data applicable to the Clerks and Mail Handlers Cost Segment by interviewing personnel with the Postal Service's Cost Attribution group<sup>36</sup> and their external contractor to determine how the data was collected and analyzed. Additionally, we obtained expense account data, payroll data, MODS data, IOCS data, and RPW data from the Postal Service and the Enterprise Data Warehouse to verify the accuracy and completeness of mail processing cost calculations. Through our evaluation of this information, we determined that the data were sufficiently reliable for the purposes of this report. However, we did not assess the accuracy and completeness of source data from the accounting, pay data, MODS, IOCS, or RPW data collection systems.

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<sup>35</sup> Although cost segment 4 (formerly known as "Clerks – CAG K Offices") data was merged with cost segment 3 (formerly known as "Clerks and Mail Handlers – CAG A-J Offices") data in the FY 2015 CSC report, the PRC still requires the Postal Service to report the expenses associated with cost segment 4 separately from those associated with cost segment 3.

<sup>36</sup> Postal Service employees from the Pricing and Costing functional area who prepare the Clerks and Mail Handlers Cost Segment calculations.

## Prior Audit Coverage

The OIG did not identify any prior audits or reviews directly related to the objective of this audit. However, we did identify the following audits related to the major data collection systems that supply input data used to prepare the Clerks and Mail Handlers Cost Segment.

Report Title	Objective	Report Number	Final Report Date	Monetary Impact (in millions)
<i>Management Operating Data System Flat Mail Exceptions</i>	Determine whether Postal Service facilities are accurately reporting MODS Operation 179 workhours and mail volume.	CP-MA-16-001	10/13/2015	N/A
<i>In-Office Cost System Inputs into the Cost and Revenue Analysis Report</i>	Determine whether the mail processing portion of labor costs could be attributed to products and services using available automated data.	CRR-AR-12-004	5/30/2012	\$4.3
<i>Management Operating Data System</i>	Determine the impact MODS data would have on MODS-based productivities and their associated cost avoidance models and the attribution of mail processing costs to Postal Service products.	CRR-AR-12-002	12/13/2011	\$86.5

## Appendix B: Management's Comments

SHARON OWENS  
VICE PRESIDENT, PRICING AND COSTING



March 10, 2017

LORI LAU DILLARD  
DIRECTOR, AUDIT OPERATIONS

SUBJECT: Cost Segment 3 – Clerks and Mail Handlers  
(Report Number CP-AR-17-DRAFT)

The Postal Service has reviewed the audit performed by the Office of Inspector General on "Cost Segment 3 – Clerks and Mail Handlers" and appreciates the opportunity to provide feedback. Management agrees in part with the recommendations and findings, although important disagreements remain, as discussed below.

The Postal Service appreciates the finding that the "Postal Service correctly calculated mail processing costs based on the FY 2015 workhour data it extracted from the MODS [Management Operating Data System] in October 2015." The Postal Service agrees, as the audit team reports, that adjustments in FY2015 MODS data after October 2015 occurred and that these modified data are not reflected in costing work for cost segment 3.<sup>1</sup> Management further agrees with the audit team finding that, had these adjustments been taken into account, there would have been no material impact on Cost Segment 3 costs.<sup>2</sup>

The Postal Service, however, disagrees that changes to MODS procedures are warranted by the occurrence of immaterial revisions to the data. The existing procedures provide for an escalation of management approvals of revisions as more time elapses between the original recording of the data and the revisions. Moreover, the revisions in question occurred in substantial part as a byproduct of compliance with previous OIG audit recommendations for MODS data review and correction of exceptions where workhours and workloads do not align, as recommended by audit CRR-AR-12-002. On balance, the Postal Service believes that data review and revision procedures will improve the accuracy of MODS data. The Postal Service views the challenge that some such revisions inevitably may occur, or be observed, after the close of the fiscal year as a relatively minor issue.<sup>3</sup> As a result, the Postal Service disagrees with the recommended changes to MODS procedures.

<sup>1</sup> The need to report product costs 90 days after the end of the FY in the Annual Compliance Report (ACR) precludes consideration of data available after October.

<sup>2</sup> Apart from the finding in this audit that there was no material impact on FY2015 costs due to the post-October MODS adjustments, in audit CRR-AR-12-002 the Postal Service reviewed minor adjustments to FY2010 with the OIG auditors. That also led to the conclusion that the adjustments were analytically inconsequential, and indeed the issue of data revisions was not raised in the CRR-AR-12-002 report.

<sup>3</sup> The OIG states that the post-October MODS data adjustments in FY2015 lead to changes in the reporting of 4.6 million hours (more precisely, 4.632 million hours). However, 4.574 million of those hours were associated with a single shift in hours from operation 775 ("RBCS Keying") to operation 388 ("REC Mixed VCS Keying") at the Salt Lake City Remote Encoding Center (REC), which had determined as part of a data review that its Data Conversion Technicians were clocking into Labor Distribution Code (LDC) 15, the correct LDC, but the wrong 3-digit operation number to align with the REC workload. The Cost Segment 3.1 model does not use workhours for RECs below the LDC level, so the revision had no effect on costs. Further REC adjustments to MODS data of this magnitude will

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The Postal Service also disagrees in part with the audit report's determination of shortcomings in documentation of the Cost Segment 3 work. The report cites a need for the Cost Segment 3 documentation to include steps and timelines for obtaining source data. The existing Cost Segment 3 documentation provides detailed information on the source data, and working PC-SAS code that produces the Cost Segment 3 CRA inputs from the filed data. In addition to the filed documentation, the general ACR project plan already details timelines and deliverables for assembling all major aspects of the ACR, including specific Postal Service staff and contractors who provide and receive various datasets. The Postal Service disagrees that such a level of administrative detail in the regulatory filings would enhance the substance of the ACR documentation.

The report also recommends a disclosure statement explaining why MODS data used to prepare the analysis in the cost segment are subject to change. It should be noted that most MODS data are not revised at all. In addition, the Postal Service believes that the publicly filed MODS M-32, which describes the adjustment process including approvals required for changes, suffices as an indication that data are subject to revision.<sup>4</sup>

The Postal Service also notes that the specific finance number lists needed to produce the Cost Segment 3 data are limited to the set of finance numbers that identify certain specialized facility types (NDCs, ISCs and Customer Care Centers). The Postal Service agrees to add these to the nonpublic documentation.<sup>5</sup> Regarding documentation of specific steps in the cost adjustments in the Cost Segment 3 workpapers, the adjustments are carried out in linked workbooks and are consequently somewhat self-documenting. However, the Postal Service agrees to examine source labeling and explore adding footnotes to further explain calculations.

Finally, the audit team has recommended improvements in the documentation of the methodology for aligning MODS operations to cost pools and LDCs. First, it should be noted that the alignment of MODS operations and cost pools is specified in the Postal Regulatory Commission's (PRC's) accepted cost methodology. The combination of the Summary Description discussion and the explicit operation-to-pool maps provided in the documentation reflect the results of past public proceedings on methodology – providing a clear delineation of cost pool definitions.<sup>6</sup> In addition, the designation of the LDC for each MODS operation is specified in the MODS M-32 Manual. Any substantive changes to MODS operation to cost pool mapping is a methodology issue subject to PRC approval. As part of the rulemaking process whereby the PRC reviews and approves changes, the Postal

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not be necessary for subsequent fiscal years as efforts to comply with CRR-AR-12-002 have addressed this issue. The remaining 58,000 workhours account for the minor impact identified by the OIG; insofar as they are on the order of 0.01 percent of total Cost Segment 3.1 workhours, they would not be expected to have a substantial effect on cost estimates.

<sup>4</sup> The M-32 MODS Handbook already describes data revision procedures, including approval requirements based on the revision timing, which encompass revisions that may occur after the end of a fiscal year.

<sup>5</sup> Other aspects of the production process involve obtaining data for all finance numbers from certain sources and filtering the data into facility categories. While finance numbers are not sensitive information themselves, the cost and operating data identifying facilities, activities, costs, and workloads are commercially sensitive.

<sup>6</sup> The methodology for assigning operations to cost pools is the result of a number of public proceedings at the PRC, documented at great length in the PRC's archives. The current documentation describes both the nature of the activities in the cost pools (in the Summary Description) and the specific MODS operation assignments (in the technical ACR documentation).

Service would advance a rationale for any new methodology. If the PRC approves a change, the documentation including the ACR documentation and the CRA Summary Description would be revised to reflect the changes. Thus, the Postal Service believes the current documentation is more than adequate.

Recommendation 1:

Develop enhanced procedures or system capabilities to limit or track *Management Operating Data System (MODS)* data adjustments made after the fiscal year closing period. Until the enhancements are made, include the MODS data file and the date it was extracted with the *Cost Segment 3 Cost Pools and Other Related Information* in future *Annual Compliance Report* filings to enhance transparency of the cost development process.

Management Response/Action Plan

Management disagrees in part with this recommendation, as described above, but offers that, in order to allay any concerns about the post-October MODS data adjustments, in October, 2017, the FY2016 MODS data will be downloaded and compared to the FY2016 MODS data used in the Cost Segment 3 2016 ACR calculations, to determine if any material differences occur. The Postal Regulatory Commission already requests, and the Postal Service provides, a complete MODS dataset consistent with the ACR MODS inputs, though the MODS datasets have been filed in a separate folder from the main Cost Segment 3 documentation. The MODS data set for FY2015 was provided in ACR2015 folder USPS-FY15-NP35, and the FY16 dataset was provided in ACR2016 folder USPS-FY16-NP41. The Postal Service agrees to provide MODS data in the 2017 ACR proceeding, as was done in previous years, and will include the date of extraction for the MODS data in the Cost Segment 3 documentation. The Postal Service does not plan to implement additional limitations or further tracking for the reasons given above.

Target Implementation Date:

December, 2017

Responsible Official:

Manager, Cost Attribution

Recommendation 2:

Enhance the current documented procedures to provide greater transparency into the cost development process and prevent the loss of institutional knowledge. The procedures should include steps for extracting data to perform mail processing cost calculations; a disclosure statement explaining why MODS data is subject to change; a list of finance numbers to compute cost pool totals; the methodology for aligning MODS operations to cost pools and labor distribution codes; and steps for calculating cost adjustments

Management Response/Action Plan

Management disagrees in part with this recommendation but agrees that the FY2017 ACR process will include in the Cost Segment 3 documentation references to the MODS M-32 manual concerning the MODS data revision policy, provide a listing of finance numbers required for data acquisition in the nonpublic documentation, and review cost adjustment spreadsheets for accuracy of source labeling and add clarifying material, if needed. The Postal Service will document methodological changes affecting cost pool assignments if any such changes are approved by the Postal Regulatory Commission.

Target Implementation Date:

December, 2017

Responsible Official:

Manager, Cost Attribution

  
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**INSPECTOR  
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