



Office of Inspector General | United States Postal Service

Audit Report

Marketing Mail Letters Workshare Discounts

Report Number CP-AR-18-006 | August 1, 2018



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Highlights

Objective

The U.S. Postal Service offers a postage rate discount to mailers for presorting, pre-barcoding, handling, or transporting of mail. These workshare discounts incentivize mailers to perform specific activities that the Postal Service would otherwise have to perform. They allow the Postal Service to increase operational efficiencies, avoid some mailing costs, stimulate mail volume growth, and improve service. The Postal Accountability and Enhancement Act of 2006 (PAEA) mandates that, with certain exceptions, the Postal Regulatory Commission (PRC) ensure workshare discounts do not exceed the cost avoided by the Postal Service as a result of the workshare activity.

Our objective was to assess the accuracy and reliability of the Marketing Mail letters cost avoidance model used to develop mail processing workshare discounts. We also reviewed pricing strategies for Marketing Mail workshare discounts to determine compliance with PRC directives.

What the OIG Found

Opportunities existed for the Postal Service to ensure the accuracy and reliability of mail processing cost estimates for Marketing Mail letters. While we found no errors in model calculations, some inputs may be outdated. The cost model contained four inputs from case studies and testimonials that had not been updated for over 2 decades. These outdated inputs may not reflect current operating conditions.

“ Opportunities existed for the Postal Service to ensure the accuracy and reliability of mail processing cost estimates for Marketing Mail letters.”

The Postal Service did not have a formal schedule or process to periodically measure the impact of changes to certain inputs on cost estimates. Further, there was no formal process to determine the feasibility of revising inputs that are not regularly updated. While management stated they review cost model inputs for appropriateness, they did not have documented cost-benefit or sensitivity analyses to support their decision to not update the inputs prior to our audit.

The use of inputs that are not periodically updated may impact the accuracy and reliability of mail processing cost estimates for Marketing Mail letters. As a result, the Postal Service cannot ensure that workshare discounts impacted by potentially outdated inputs do not exceed the cost avoided, comply with PAEA, and increase operational efficiencies.

We also found the Postal Service developed pricing strategies to bring noncompliant Marketing Mail workshare discounts that exceeded the cost avoided into compliance with PAEA. We evaluated these strategies and found the Postal Service either changed the discounts to comply with PAEA or made incremental price adjustments to phase out the excessive discounts over time. The Postal Service should continue to periodically review pricing strategies to ensure they reflect existing operations and align with the cost avoided by workshare activities. Since the Postal Service has implemented a reasonable strategy and action plan to address noncompliant Marketing Mail workshare discounts, we are not making recommendations on this subject at this time.

What the OIG Recommended

We recommended management document the periodic review of non-recurring inputs in the Marketing Mail letters cost model, to include conducting and maintaining documentation of cost-benefit and sensitivity analyses.


Transmittal Letter

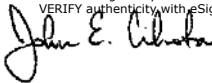


OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

August 1, 2018

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 and Pricing

SUBJECT: Audit Report – Marketing Mail Letters Workshare Discounts
(Report Number CP-AR-18-006)

This report presents the results of our audit of Marketing Mail Letters Workshare Discounts (Project Number 18BG005CP000).

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 and Pricing, or me at 703-248-2100.

Attachment

cc: Corporate Audit Response Management

Results

Introduction/Objective

This report presents the results of our self-initiated audit of Marketing Mail Letters Workshare Discounts (Project Number 18BG005CP000). We performed this audit as part of our mandate under the Postal Accountability and Enhancement Act of 2006 (PAEA)¹ to regularly audit the data collection systems and procedures used to collect information and prepare reports.² Our objective was to assess the accuracy and reliability of the Marketing Mail letters cost avoidance model used to develop mail processing workshare discounts. We also reviewed pricing strategies for Marketing Mail workshare discounts to determine compliance with Postal Regulatory Commission (PRC)³ directives. See [Appendix A](#) for additional information about this audit.

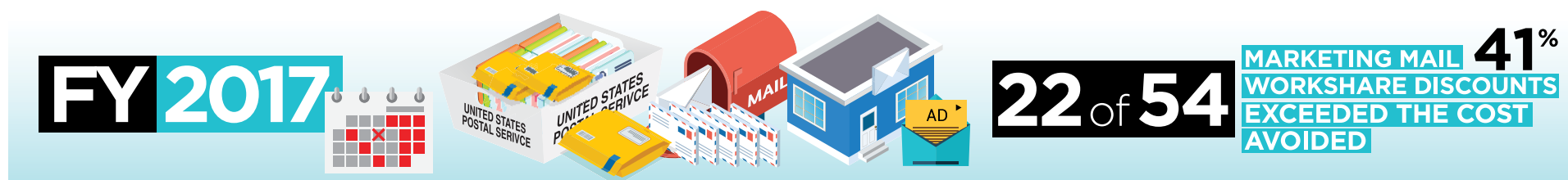
Background

The U.S. Postal Service offers a postage rate discount to mailers for presorting, pre-barcoding, handling, or transporting mail. These workshare discounts incentivize mailers to perform specific activities prior to dropping the mail at a postal facility. The Postal Service uses the discounts to increase its operational

efficiencies by encouraging mailers to perform mail preparation and processing activities it would otherwise have to perform. For example, when a mailer presorts its mail, the Postal Service saves the machine processing time and labor it takes to prepare unsorted, or less finely sorted, mail before transporting to carriers for delivery. Workshare discounts have also allowed the Postal Service to stimulate mail volume growth and improve service.

The PAEA mandates that the PRC ensure workshare discounts do not exceed the cost avoided by the Postal Service as a result of the workshare activity,⁴ unless justified by a statutory exception.⁵ The Postal Service's current methodology to determine the cost avoided applies various operational and statistical information to actual costs incurred. See [Appendix A](#) for additional information about this methodology.

In fiscal year (FY) 2017, 22 of 54 Marketing Mail workshare discounts (about 41 percent) exceeded the cost avoided. Of all the mail classes, Marketing Mail had the highest number of workshare discounts with passthroughs⁶ above 100 percent, as shown in [Table 1](#).



¹ 39 U.S.C. §§ 101 et seq.

² 39 U.S.C. § 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 39 U.S.C. § 3622(e)(2).

⁵ Statutory exceptions include the following: (1) the discount is associated with a new postal service, a change to an existing postal service, or a new workshare initiative related to an existing postal service; (2) the discount is for mail matter of particular educational, cultural, scientific, or informational value; (3) the discount is necessary to avoid rate shock, and the amount above costs avoided will be phased out over time; (4) the discount is necessary to induce mailer behavior that furthers the economically efficient operation of the Postal Service, and the amount above costs avoided will be phased out over a limited period of time; and (5) reduction or elimination of the discount would impede the efficient operation of the Postal Service.

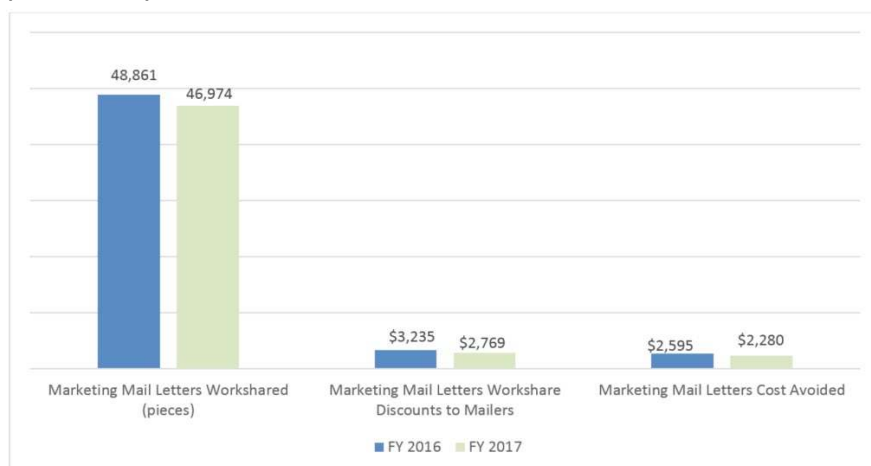
⁶ Passthroughs represent the relationship between the amount of the workshare discount and the cost avoided as a percentage. Workshare discounts with passthroughs above 100 percent represent rates that exceeded the cost avoided.

Table 1. FYs 2016 and 2017 Workshare Discounts Exceeding Cost Avoided and Total Discounts by Mail Class

Mail Class	FY 2016		FY 2017	
	No. of Discounts with Passthroughs Above 100 Percent	No. of Total Discounts	No. of Discounts with Passthroughs Above 100 Percent	No. of Total Discounts
First-Class Mail	7	14	5	12
Marketing Mail	19	71	22	54
Periodicals	13	33	11	31
Package Services	9	13	4	12
TOTALS	48	131	42	109

Source: FYs 2016 and 2017 *Discounts and Passthroughs of Workshare Items* library references in PRC Dockets Number ACR2016 and ACR2017.

In FY 2017, Marketing Mail letters represented about 54.1 billion pieces. Additionally, workshared Marketing Mail letters comprised of about 87 percent (about 47 billion) of the total Marketing Mail letters volume. The Postal Service granted about \$2.8 billion in workshare discounts to mailers and reported about \$2.3 billion in costs avoided for Marketing Mail letters, as shown in Figure 1. However, in FYs 2016 and 2017, the Postal Service granted discounts in excess of about \$640 million and \$489 million, respectively, over costs avoided.

Figure 1. FYs 2016 and 2017 Marketing Mail Letters Workshare Discounts (in millions)


Source: FYs 2016 and 2017 *Public Cost and Revenue Analysis Report* and Postal Service analysts.

Finding #1: Marketing Mail Letters Cost Model Inputs

Opportunities existed for the Postal Service to ensure the accuracy and reliability of mail processing cost estimates for Marketing Mail letters. The Marketing Mail letters cost model calculates mail processing unit cost estimates

“The Postal Service did not have a formal schedule or process to periodically measure the impact of changes to certain inputs on cost estimates.”

for all of the associated rate categories, such as Automation Area Distribution Center (AADC) Letters and Automation 5-Digit Letters. Management stated the process of updating cost estimates begins with using the previous years’ model spreadsheets, updating the recurring inputs,⁷ and carrying forward the non-

⁷ Recurring inputs are items such as volume, Management Operating Data System (MODS) data, or Web End-of-Run data that change annually.

recurring inputs.⁸ During our audit, some mailers expressed concerns that cost models use input data from outdated cost studies, which impacts the accuracy of workshare discount calculations.

While we found no errors in the Marketing Mail letters cost model calculations, some inputs may not reflect current operating conditions. The model contained four productivity inputs from case studies and testimonials that the Postal Service had not updated for over 2 decades, as shown in Table 2. The Postal Service

did not have a formal schedule or process to periodically measure the impact of changes to certain inputs on cost estimates. Specifically, personnel did not document decisions on whether to conduct or forgo updates to studies or the results of analyses that supported those decisions. Without documented analyses and priorities, the Postal Service cannot reliably determine the feasibility of a special study or make informed decisions on whether to update non-recurring inputs based on empirical data.

Table 2. Marketing Mail Letters Cost Model Inputs Last Updated Over 20 Years Ago

Worksheet	Input	Source	Source Year
Productivity	Manual Incoming Secondary Delivery Units	USPS Testimony to PRC; Docket No. MC95-1, Exhibit USPS-T-10F	1995
Productivity	Post Office Box Delivery Point Sequence (DPS) Wall	USPS Testimony to PRC; Docket No. MC95-1, Exhibit USPS-T-10J	1995
Productivity	Post Office Box Non-DPS Wall	USPS Testimony to PRC; Docket No. MC95-1, Exhibit USPS-T-10J	1995
Productivity	Manual Plant Bundle Sorting Productivity	USPS Testimony to PRC; Docket No. MC95-1, Exhibit USPS-T-10B	1995

Source: PRC Docket Number ACR2016.

A prior U.S. Postal Service Office of the Inspector General (OIG) audit conducted eight years ago⁹ disclosed that 13 model inputs in the letter cost models for First-Class Mail and Standard Mail (now referred to as Marketing Mail) were potentially not representative of current operations. The four productivity inputs we identified were also cited in the report. At that time, the Postal Service agreed to determine the feasibility of updating the cost inputs and create a prioritized list for completing the updates. Based on collaboration with the PRC, management later determined it was not appropriate to unilaterally create a prioritized list of non-recurring data inputs that need to be updated. Additionally, management stated they were seeking guidance from the PRC regarding future updates to model inputs. Prior to

this audit, however, there had been no PRC-accepted feasibility or special studies for the four productivity inputs that were last updated in 1995.¹⁰

The Postal Service indicated it had not updated the four productivity inputs because they are non-recurring inputs, and there had been no significant operational changes to related processes since they were last updated. In addition, the four productivity inputs are associated with manually casing the mail, and management did not believe a material change occurred to these manual processes since 1995. Further, the PRC does not require the Postal Service to regularly review or update cost studies and inputs to the cost avoidance models.

⁸ Non-recurring inputs are generally based on studies or testimonies that do not get updated annually.

⁹ *First-Class and Standard Mail Workshare Discounts* (Report Number MS-AR-10-003, dated July 2, 2010).

¹⁰ In December 2010, the Postal Service proposed updates to manual incoming secondary and post office box walling productivities based on a new field study. However, in June 2011, the PRC rejected the proposal due to concerns about the statistical reliability of the results of the study.

Management stated they regularly review cost model inputs for appropriateness. An analyst performs informal cost-benefit analyses to determine the cost-effectiveness of conducting a special study to update non-recurring inputs. The analyst also conducts sensitivity analyses to measure whether changes to the inputs would have a material impact on cost estimates. However, the Postal Service did not have documented cost-benefit or sensitivity analyses to support their decision to not update the four productivities identified. Further, analysts responsible for the cost models currently perform cost-benefit and sensitivity analyses on an ad-hoc basis.

The Postal Service and PRC use unit cost estimates derived from cost models to calculate cost avoidance estimates, set workshare discounts that further the efficient operations of the Postal Service, and determine whether the discounts comply with PAEA. The use of input data that has not been updated in over 20 years could cause the Postal Service to generate inaccurate or unreliable cost estimates for workshare rate categories, to the extent the inputs do not reflect current operations. Changes to operations since that time may require these inputs to be adjusted upward or downward to be representative of current conditions.

As a direct result of our audit, Postal Service officials conducted a sensitivity analysis of the manual productivity inputs we identified to assess any material changes associated with the estimated costs avoided. The sensitivity analysis indicated, for example, that if there were 10 percent increases in the four productivities for the manual processing inputs identified above, holding all other inputs constant, the estimated costs avoided for Marketing Mail letter workshare rate categories would increase by \$1.5 million. The analysis indicated that, at this time, there would be no significant impact to Marketing Mail letter cost estimates as a result of changes in the manual mail productivity inputs.

Without periodic analyses of non-recurring cost model inputs and their impact on cost estimates, there is limited assurance that all inputs reflect current processing operations or that decisions to forego updates are supported by quantitative data.

As a result, the Postal Service cannot ensure workshare discounts comply with PAEA, increase operational efficiencies, or align with accurate and reliable cost avoidance estimates. Periodic analysis of these inputs would facilitate improved workshare rate-setting decisions and further the efficiency, mail volume, and service goals of the Postal Service.

The Postal Service took corrective action by conducting a sensitivity analysis on the four productivity inputs identified to determine the impact on cost estimates. Therefore, we are not making a recommendation to update those inputs at this time.

Recommendation #1

The Vice President, Pricing and Costing, should direct the Manager, Cost Attribution, to document the periodic review of non-recurring inputs in the Marketing Mail letters cost model, to include conducting and maintaining documentation of cost-benefit and sensitivity analyses.

Finding #2: Marketing Mail Workshare Discount Pricing Strategies

During our audit, we found the Postal Service developed pricing strategies to bring noncompliant Marketing Mail workshare discounts that exceeded the cost avoided into compliance with PAEA. In the FYs 2016 and 2017 *Annual Compliance Determination (ACD)*¹¹ reports, the PRC reported that eight Marketing Mail workshare discounts exceeded the cost avoided without an accepted PAEA statutory exception, as shown in [Table 3](#).

“During our audit, we found the Postal Service developed pricing strategies to bring noncompliant Marketing Mail workshare discounts that exceeded the cost avoided into compliance with PAEA.”

¹¹ The ACD is a report issued by the PRC in response to the *Annual Compliance Report (ACR)* submitted by the Postal Service to the PRC. In the ACD, the PRC determines whether any price or fee in effect during the year under review were not in compliance with applicable provisions and whether any service standards were not met.

Table 3. FYs 2016 and 2017 Noncompliant Workshare Discounts Exceeding the Cost Avoided

FY	Workshare Discount	Pass-through
2016	Automation AADC Letters	121.4%
	Non-automation 5-Digit Non-machinable Letters	125.4%
	Non-automation 3-Digit Non-machinable Letters	113.0%
	Automation Flats Sequencing System (FSS) Non-Scheme Flats	176.6%
	Automation FSS Scheme Flats	333.3%
	Non-automation FSS Non-Scheme Flats	175.0%
	Nonprofit Network Distribution Center (NDC) Irregular Parcels	133.6%
	NDC Marketing Parcels	115.9%
2017	Automation AADC Letters	121.4%
	Non-automation AADC Machinable Letters	106.3%
	Non-automation 3-Digit Non-machinable Letters	113.6%
	Non-automation 5-Digit Non-machinable Letters	127.9%
	Flat Pieces on 5-Digit Carrier Route Pallets Entered at Origin, Destination NDC (DNDC), Destination Sectional Center Facility (DSCF), and Destination Delivery Unit (DDU)	111.1%
	Commercial and Nonprofit Basic Carrier Route Flats Entered at DDU	107.2%
	Commercial and Nonprofit High Density and Saturation DNDC Flats	114.0%
	Commercial and Nonprofit High Density and Saturation DSCF Flats	124.7%

Source: FYs 2016 and 2017 ACD reports.

Due to the timing of the rate change, some of these discounts came into compliance before the FY 2017 ACD was released. For the remaining discounts, the PRC directed the Postal Service to align the discounts with the cost avoided during the next rate change or to provide a statutory exception.

Due to the complexity of the rate-setting process, workshare rates sometimes exceed the cost avoided without an accepted statutory exception. This process includes a PRC-mandated methodology and timeline for developing and submitting annual cost avoidance estimates. These estimates fluctuate from year-to-year and can be volatile due to changes to incurred costs, model inputs, and calculations. Therefore, significant changes to workshare rates to match cost avoidance estimates could cause rate shock and send inefficient pricing signals to mailers. In addition, cost avoidance estimates are reported in December of each year as part of the ACR. However, these estimates are published after the annual price change is approved, which prevents management from considering the estimates in the current year's price calculations.

We evaluated pricing strategies for the noncompliant Marketing Mail workshare discounts that exceeded the cost avoided. We found the Postal Service either changed the discounts to comply with PAEA or made incremental price adjustments to phase out the excessive discounts over time. The Postal Service should continue to periodically review pricing strategies to ensure they reflect existing operations and align with the cost avoided by workshare activities. Since the Postal Service has implemented a reasonable strategy and action plan to address noncompliant Marketing Mail workshare discounts, we are not making recommendations at this time.

Management's Comments

Management agreed with the recommendation in our report; however, they expressed some concerns over certain statements. Regarding concerns from mailers that outdated input data was used in cost models, management noted that since the concerns were not a part of public record, they were unaware of the issues. Management also disagreed with our statement that without documented analyses and priorities, the Postal Service cannot reliably determine the feasibility of studies or determine whether to update inputs. Finally, management noted the number of Marketing Mail discounts cited in our report should be 71, not 67.

Regarding recommendation 1, management agreed to conduct and document sensitivity analyses in conjunction with its periodic review of non-recurring inputs in the Marketing Mail letters cost model. However, the decision on whether inputs should be updated will be based on management's expertise, judgment and a cost-benefit analysis metric. Management agrees to justify and document the basis for its decision related to updating non-recurring inputs. Management set a target implementation date of March 31, 2019.

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

Evaluation of Management's Comments

The OIG considers management's comments responsive to the recommendation and the corrective action should resolve the issues identified in the report. Regarding management's comment that they were not aware of mailer concerns over the use of outdated inputs, we agree these comments were not a part of public record. The comments from mailers were shared with the OIG during interviews over the course of this audit.

Regarding management's disagreement with the statement made in our finding, the OIG believes documented analysis and priorities are necessary to support their decision-making process and ensure regular evaluation of cost model inputs. Regarding the number of workshare discounts, there were several discussions between the OIG and Postal Service management regarding what is technically considered a discount. The OIG originally cited 71 Marketing Mail discounts based on our analysis of PRC dockets. We revised the number to 67 based on documentation provided by the Postal Service after the exit conference. Based on management's comments, we have updated the report to reflect 71 discounts, as originally cited.

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

Appendices

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Appendix A: Additional Information

Scope and Methodology

The scope of our audit was to assess the accuracy and reliability of the unit cost estimates derived from the mail processing component of the FY 2016 Marketing Mail letters cost model. The model identified the mail processing unit costs of eight workshare discounts for Marketing Mail letters, as shown in Table 4.

Table 4. Mail Processing Workshare Discounts for Marketing Mail Letters and FYs 2012-2017 Passthroughs

Workshare Discount	FY 2012 Pass-through	FY 2013 Pass-through	FY 2014 Pass-through	FY 2015 Pass-through	FY 2016 Pass-through	FY 2017 Pass-through
Automation Mixed Automated Area Distribution Center (MAADC) Presort Letters	-100.0%	400.0%	800.0%	325.0%	800.0%	1300.0%
Nonautomation Nonmachinable 5-Digit Presort Letters	120.8%	137.7%	143.1%	123.6%	125.4%	127.9%
Automation AADC Presort Letters	76.2%	106.7%	137.5%	140.0%	121.4%	121.4%
Nonautomation Nonmachinable 3-Digit Presort Letters	144.4%	161.9%	119.2%	113.0%	113.0%	113.6%
Nonautomation Machinable AADC Presort Letters	88.9%	100.0%	112.5%	106.3%	100.0%	106.3%
Nonautomation Nonmachinable Area Distribution Center (ADC) Presort Letters	121.3%	135.7%	118.9%	88.5%	97.4%	100.0%
Automation 5-Digit Presort Letters	90.0%	95.0%	81.8%	65.4%	73.1%	80.0%
Automation 3-Digit Presort Letters	50.0%	0.0%	0.0%	0.0%	0.0%	N/A ¹²

Source: FYs 2012-2017 ACDs and PRC Dockets Number ACR2012 through ACR2017.

To determine cost avoidance estimates, the Postal Service identifies a baseline category of mail, or benchmark, for each workshare discount. The benchmark includes mail that serves the same market and is likely to be workshared if a sufficient incentive is available. For example, the benchmark for AADC Presort Letters would be the rate category for the next, less finely sorted, presort level, which is Mixed AADC Presort Letters. The Postal Service computes the difference between unit cost estimates, derived from cost models, for the workshare rate category and that for the benchmark category to determine the cost avoided.

¹² Automation 3-Digit Presort Letters was not offered as a workshare discount in FY 2017.

We also reviewed the sufficiency of pricing strategies for Marketing Mail workshare discounts that exceeded the cost avoided without a PRC-accepted statutory exception in FYs 2016 and 2017. We assessed whether the pricing strategies developed by the Postal Service complied with PRC directives in the FY 2016 and FY 2017 ACDs.

To accomplish our objective, we:

- Reviewed the FYs 2016 and 2017 ACRs and ACDs to identify workshare discounts that exceeded the cost avoided and those significantly below the cost avoided.
- Reviewed Postal Service regulations, policies, and procedures regarding workshare discounts and cost avoidance models.
- Reviewed prior audit recommendations and management actions related to the workshare discount program.
- Reviewed applicable PRC filings related to setting, maintaining, and supporting workshare discounts.
- Conducted meetings with stakeholders to identify their concerns regarding workshare discount processes, discuss potential improvements to the program, and determine how the workshare discount program impacts the workforce.
- Interviewed personnel in the Cost Attribution and Pricing groups to determine the processes for developing and updating the Marketing Mail letters cost model and for setting and maintaining Marketing Mail letters workshare discounts.
- Trended Marketing Mail unit cost avoidances, discount rates, and passthroughs to identify whether there had been significant changes or volatility.
- Conducted site visits to Postal Service facilities and a mail service provider to observe workshare activities, identify the types of costs avoided, and

understand the impact of changing discounts. We visited the following plants in the Capital Metro Area:

- Dulles Processing and Distribution Center (P&DC), Dulles, VA.
 - Northern Virginia P&DC, Merrifield, VA.
- Verified the existence and effectiveness of quantitative analyses to support Marketing Mail letters workshare discounts.
 - Evaluated the FY 2016 Marketing Mail letters cost model to determine if it (1) included accurate and updated cost data and inputs in the calculations, (2) reflected current operations, and (3) captured and aggregated all relevant cost data.
 - Reviewed justifications and supporting documentation for Marketing Mail letters workshare discounts that exceeded the cost avoided in FYs 2016 and 2017 for sufficiency and reasonableness.
 - Reviewed pricing strategies for Marketing Mail letters workshare discounts that exceeded the cost avoided without a justifiable statutory exception in FYs 2016 and 2017.
 - Used the OIG MODS¹³ risk model to review exception reports for errors in reported work hours or volume. The OIG MODS risk model exception reports identify (1) work hours recorded in an operation with no mail volume, or (2) mail volume recorded in an operation with no work hours. We found that 218 of 370 (about 59 percent) MODS operations used in the Marketing Mail letters cost model had reporting errors in FY 2016. Reporting errors in these operations could impact the accuracy of cost estimates derived, in part, from the data collected for these activities.

We conducted this performance audit from February 2018 through August 2018 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

¹³ MODS is a systematic approach to gather, store, and report data on workload, workhours, and machine utilization.

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 July 3, 2018 and included their comments where appropriate.

We assessed the reliability of computer-generated data for the Marketing Mail letters cost model through discussion with personnel from the Postal Service Cost Attribution and Pricing groups. We conducted a comparison of key information and data against separately prepared documents provided by management. We determined the data was sufficiently reliable for the purposes of this report.

Prior Audit Coverage

Report Title	Objective	Report Number	Final Report Date	Monetary Impact
<i>Workshare Discounts for Automated Mail Processing</i>	To review workshare discounts related to automated mail processing to identify those that may no longer be valuable to the Postal Service.	CP-AR-15-002	6/8/15	\$875,973,601

Appendix B: Management's Comments

SHARON OWENS
VICE PRESIDENT, PRICING AND COSTING



July 24, 2018

LAZERICK POLAND
ACTING DIRECTOR, AUDIT OPERATIONS

SUBJECT: Marketing Mail Letters Workshare
Report No. CP-AR-18-DRAFT
Project No. 18BG005CP000

Postal Service Headquarters has reviewed the findings and the recommendation outlined in the Office of Inspector General (OIG) Marketing Mail Letters Workshare report.

Below are three comments from the Postal Service from the contents of the report:

OIG report: Page 3, Paragraph 1: "During our audit some mailers expressed concerns that cost models use input data from outdated cost studies which impacts the accuracy of workshare discount calculations."

USPS Comments: The current regulatory environment provides mailers ample opportunity to express concerns in the public record with materials filed in the Annual Compliance Report (ACR). Mailers also have the opportunity to review the cost models and perform their own simulations and suggest updates to the numerous recurring and non-recurring inputs. However, because no citations to Commission dockets are included in the report, management assumes that the mailers' comments are not part of the public record. The Postal Service was unaware of these concerns and consequently did not address them publicly.

OIG report: Page 3-4, Paragraph 2: "The Postal Service did not have a formal schedule or process to periodically measure the impact of changes to certain inputs on cost estimates. Specifically, personnel did not document decisions on whether to conduct or forgo updates or the results of analyses that supported those decisions. Without documented analyses and priorities, the Postal Service cannot reliably determine the feasibility of a special study or make informed decisions on whether to update non-recurring inputs based on empirical data."

USPS Comments: Management does not believe that the lack of documented analyses and priorities results in the inability to determine the feasibility of conducting a special study. The achievability of performing a special study is largely determined by the amount of available resources. Special studies are expensive to update, so extensive planning is required to have confidence that the data collected in the study will pass Commission scrutiny. For example, if resources only permit a few observations being recorded, it is more likely that the study will not be initiated because of the increasing likelihood of it being rejected by the Commission, after a potential lengthy and costly litigation process.

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OIG Report: Table 1 on Page 2: "No. of Total Discounts" for Marketing Mail in FY2016 in the OIG Report are 67.

USPS Comments: The actual number of total discounts for Marketing Mail in FY 2016 that the OIG and the Postal Service agreed upon earlier was 71. In fact, 71 was the figure that was printed in the discussion draft that was sent prior to the meeting between the OIG and the Postal Service held on July 3, 2018.

The following is the response of the Postal Service to the OIG recommendation contained in the report:

Recommendation #1

"The Vice President, Pricing and Costing, should direct the Manager, Cost Attribution, to document the periodic review of non-recurring inputs in the Marketing Mail letters cost model, to include conducting and maintaining documentation of cost-benefit and sensitivity analyses."

Management Response/Action Plan

Management agrees to conduct and document sensitivity analyses in conjunction with its periodic reviews of non-recurring inputs in the Marketing Mail letters cost model. The timing of periodic reviews will be determined separately for each set of non-recurring inputs based on their relative importance in determining the unit costs. The documentation will include sensitivity analyses of the cost impacts that result from various percentage changes to each relevant set of non-recurring inputs. However, the decision as to whether one or more sets of non-recurring inputs should be updated is subjective. The choice relies on management expertise and judgment. Thus, the decision cannot be determined by a simple cost-benefit analysis metric. Before a costly update is initiated, management must have some basis to believe that the set of non-recurring data elements being used have materially changed. Management often reaches this conclusion after discussions with operations or through direct observations. Ultimately, however, the decision to initiate an update to non-recurring inputs is a binary choice that is dependent on two primary factors: 1) accuracy of the non-recurring input regardless of its vintage; and 2) relative importance of the non-recurring input in determining unit costs. These two criteria do not lead to a specific cost-benefit metric that determines the outcome. However, management agrees to justify and document the basis for its decision related to updating non-recurring inputs.

Target Implementation Date for Sensitivity Analyses: March 31, 2019

Responsible Official: Manager, Cost Attribution



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