



OFFICE OF
**INSPECTOR
GENERAL**
UNITED STATES POSTAL SERVICE

Postal Service Pricing Strategy

Audit Report

December 9, 2011

Report Number CI-AR-12-002



HIGHLIGHTS

IMPACT ON:

Pricing management, existing customers, new customers, and employees.

WHY THE OIG DID THE AUDIT:

Our initial objective was to determine an effective alternative option(s) to the U.S. Postal Service's current pricing strategy. As our work progressed, we modified our objective to determine the Postal Service's adequacy and agility for managing existing prices and introducing new prices to ensure cost coverage and protect revenue.

WHAT THE OIG FOUND:

There are over 7,600 domestic prices for the three product lines and almost 50 percent of these prices contain low to no mail volume. In addition, customers must use a *Domestic Mail Manual* that is more than 1,700 pages in order to do business with the Postal Service. Also, quarterly volume and revenue data used to support product pricing is approximately 140 days old. The Postal Service relies on statistical sampling data, because the data cannot be completely obtained from its accounting systems. By comparison, its domestic competition has easily available real-time product data.

WHAT THE OIG RECOMMENDED:

We recommended the Postal Service develop a strategic plan to simplify pricing supported by real-time volume and revenue data as envisioned by the Postal Accountability and Enhancement Act of 2006 allowing management to make competitive decisions in the market place. In addition, we recommended developing and implementing an optimized, modern pricing structure to reduce barriers to new market entrants and promoting ease of use.

WHAT MANAGEMENT SAID:

Management agreed there is room for simplification of price tables in products heavily used by consumers and it has plans to implement simpler pricing options in January 2012. Additionally, it is currently reviewing its costing systems and revenue and volume reporting and has chartered an initiative to optimize pricing.

AUDITORS' COMMENTS:

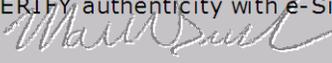
Management's comments are responsive to the recommendations and the stated corrective actions should resolve the issues identified in the report.

[Link to review the entire report](#)



December 9, 2011

MEMORANDUM FOR: MAURA ROBINSON
VICE PRESIDENT, PRICING

E-Signed by Mark Duda 
VERIFY authenticity with e-Sign


FROM: Mark W. Duda
Assistant Inspector General
for Audit

SUBJECT: Audit Report – Postal Service Pricing Strategy
(Report Number CI-AR-12-002)

This report presents the results of our audit of the Postal Service's Pricing Strategy.
(Project Number 10YG015CI000).

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Michael L. Thompson, director, Planning, Innovation, and Optimization, or me at 703-248-2100.

Attachments

cc: Paul Vogel
Corporate Audit and Response Management

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Introduction

This report presents the results of our audit of the Postal Service's Pricing Strategy (Project Number 10YG015CI000). Our initial objective was to determine an effective alternative option(s) to the Postal Service's current pricing strategy. As our work progressed, we modified our objective to determine the Postal Service's adequacy and agility for managing existing prices and introducing new prices to ensure cost coverage and protect revenue. We plan to follow this project with additional analysis of the complexities of the Postal Service's mail acceptance and preparation process as described in the *Domestic Mail Manual*¹ (DMM). This self-initiated audit addresses strategic risk. See [Appendix A](#) for additional information about this audit.

The Postal Service delivers over 170 billion² letters, flats, and parcels annually and identifies its mailing standards and pricing rates in the DMM. The DMM is over 1,700 pages and contains all rates and standards governing mailing services. Included in the DMM is the Price List, Notice 123, which lists more than 10,000 domestic and international prices the Postal Service charges for three primary product lines: letters, flats, and parcels, along with additional services such as insurance, delivery confirmation, and certified mail.

Conclusion

In this time of decreasing mail volume, any unnecessary barriers to entry for Postal Service customers and new entrants should be reduced or removed to encourage mail use. There are over 7,600 domestic prices for the three primary product lines (letters, flats, and parcels) and almost 50 percent of these prices contain low to no mail volume. In addition, customers must use a DMM that is over 1,700 pages and continually growing in order to understand how to do business with the Postal Service. Major mailers use software packages to determine the postage for their mailings because of the complexity of Postal Service pricing. We believe customers should not have to use software to calculate their own postage. This complexity does not make it easy to do business with the Postal Service. The DMM needs to be made radically more customer-centric.

The reverse is also true — it is difficult for Postal Service employees to transact business with customers because of this complexity. With so many prices and rules, clerks are challenged to ensure prices customers pay are accurate and often customers know more about prices than the clerk responsible for collecting correct postage. Handbook DM-109³, the manual that explains to Postal Service employees how to process mail from large commercial mailers, is over 200 pages long. Difficulty in understanding and applying such complex rules and rates results in revenue assurance issues.

¹ *Mailing Standards of the United States Postal Service*, updated October 4, 2010.

² *United States Postal Service Annual Report 2010*.

³ *Business Mail Acceptance*.

There is also a lack of real-time daily volume and revenue data for management's use. Quarterly volume and revenue data used to support product pricing is approximately 140 days old before it is available to management. This delay in volume and revenue data is due to the Postal Service's reliance on statistical sampling data because the data cannot be completely obtained from Postal Service accounting systems. By comparison, its domestic competition has easily available real-time product data.

Surprisingly, the methodology used by the Postal Service to ensure cost coverage and support prices is much the same methodology as initially established following the Postal Reorganization Act (PRA) of 1970, which established a postal ratemaking process built around an independent regulatory commission. The Postal Accountability and Enhancement Act of 2006 (the Postal Act of 2006) streamlined the pricing and classification process to increase predictability and reduce administrative burdens on all parties. The Postal Act of 2006 allows flexibility for pricing and the price adjustment process, yet the Postal Service has not made significant changes in the nearly 5 years since the law was passed.

The Postal Service has used pricing flexibilities, with the flat rate box campaign and, more recently, the Marketing Mail Made Easy/Every Door Direct Mail-Retail™ campaign. Recently, the Postal Service has shown success in new simple shipping programs. The Postal Service's president and chief marketing/sales officer said "...when we make it simple to mail, our customer's will do business with us." These initiatives appear promising, but the Postal Service should fully explore pricing simplification and flexibilities to determine their potential. For instance, the U.S. Postal Service Office of Inspector General (OIG) proposed a Sample Pricing Table which could reduce the total number of domestic prices by 97 percent.

The current pricing structure is complex and the methodology for ensuring that prices cover costs has not kept pace with the available technology. The Postal Service has not fully explored using the flexibilities granted in the law, and it does not have a strategic plan for pricing to take advantage of the flexibilities of the Postal Act of 2006. Thus, it is difficult to price new products, ensure prices provide appropriate incentives to effect revenue growth, and have effective strategic pricing in the marketplace. Changes are needed to support mail volume growth and increase revenue.

Barriers to Entry

Barriers to entry for Postal Service customers and new entrants should be reduced or removed to encourage mail usage. Major mailers use software packages to determine the postage for their mailings because of the complexity of Postal Service pricing. Mailers need softwares because there are over 7,600 domestic prices for the three primary product lines and a DMM with over 1,700 pages. The prices and the DMM continue to grow with each update.

Also, Postal Service employees may not fully understand the current complex pricing structure. Postal Service managers use Handbook DM-109 (consisting of over 200 pages) and the internal Acceptance and Verification Job Aids, with an additional 90 pages, to explain to Postal Service employees how to process incoming mail. Recent OIG audits⁴ determined that Postal Service employees did not always perform the required verifications or reviews to ensure the mail was properly prepared or was eligible for the rate claimed. These mail verification mistakes result in lost revenue and productivity. We will be exploring the associated complexities in mail preparation requirements more comprehensively in a subsequent audit project.

Old Systems Relying on Statistical Sampling

The data required to provide volume and revenue information cannot be completely obtained from Postal Service accounting systems because they do not identify all the specific categories of mail or contain volume and weight information. The accounting systems information is supplemented with statistically projected data from the Origin Destination Information System – Revenue, Pieces, and Weight system (ODIS-RPW). ODIS-RPW information is produced on a quarterly and annual basis and is considered 95 percent statistically reliable. The forecasted statistical data takes about 140 days to produce from the beginning of each quarter to the time the reports are available. The lack of timely volume and revenue data and the lengthy lead time to implement pricing changes does not provide the Postal Service the ability to effectively respond to a rapidly changing market or to ensure it is meeting organizational goals.

Without near real-time volume and revenue data for products, it is unlikely management can ever manage prices/products effectively. Assuming a price/product could be appropriately priced to generate new revenue and cover costs, unknown changes in volume or revenue could indicate that a product thought to be profitable has actually become unprofitable.

Domestic competitors have real-time data to support their extensive pricing levels, unlike the Postal Service. These competitors use barcode scanners to read every mailpiece barcode, allowing for daily real-time updates for all mailpiece locations. One competitor can scan each piece at least 12 times from pick-up to delivery. Individual price per piece information would allow competitors to determine the profitability of each piece on a daily basis. This, in turn, would allow for informed management decisions about existing and proposed prices. Both of the large domestic competitors have significantly more prices in their schedules than the Postal Service; however, they have data systems that are able to support such schedules.

⁴ *Fiscal Year 2010 Financial Installation Audit – Mountain Home Business Mail Entry Unit – Mountain Home, AR* (Report Number FF-AR-10-125, dated March 15, 2010);, *Fiscal Year 2010 Financial Installation Audit – Tyler Business Mail Entry Unit – Tyler, TX* (Report Number FF-AR-10-077, dated January 15, 2010);, *Fiscal Year 2009 Financial Installation Audit – Asbury Park Business Mail Entry Unit – Asbury Park, NJ* (Report Number FF-AR-09-106, dated February 27, 2009); *Fiscal Year 2009 Financial Installation Audit – Glen Mills Business Mail Entry Unit – Glen Mills, PA* (Report Number FF-AR-09-128, dated March 25, 2009).

The Postal Service does not have the systems necessary to provide the detailed data like its competitors, thus, it is challenging to support extensive, complex pricing structures and a variety of pricing options.

Management said they use quarterly volume and revenue data as the main inputs for their annual pricing models. However, they stated there is also daily data available for approximately 65 percent of the total mail volume through *PostalOne!*. However, management does not use this daily data.

As a result of inadequate or unavailable volume and revenue data, the Postal Service's efforts to sustain and/or generate revenue with existing and potential customers may be ineffective. Specifically, the following recent examples indicate some of the challenges and risks in product pricing, due in part to the following data limitations:

- The fiscal year (FY) 2009 Standard Mail Volume Incentive Program (“Summer Sale”) offered a 30 percent credit to customers for additional volume mailed over a specified threshold. The Postal Service could not confirm standard mail volumes that mailers claimed were mailed.⁵
- For FY 2009, 14 market-dominant products and services did not cover attributable costs, collectively losing in the aggregate \$1.7 billion.⁶ In September 2010, the Postal Service rejected an OIG recommendation to develop a plan for products to cover their costs and contribute to overhead. Management disagreed with this recommendation to the extent that a “detailed transparent plan, with established milestones,” implies that once such a plan is established, the Board of Governors cannot fulfill their statutory duty to balance all relevant considerations in establishing prices.⁷ However, best practices, along with the dire financial position of the Postal Service, suggest it would be prudent to provide the Board of Governors with strategies and options for each product that is not covering costs so they can carry out their decision-making responsibilities.
- In September 2009, the U.S. General Services Administration (GSA) awarded a contract for express and ground domestic delivery services to United Parcel Service (UPS) of America, Inc. The GSA anticipated the contract would save taxpayers more than 1 billion dollars over 5 years by offering shipping costs at deep commercial retail rate discounts. The ability of UPS to track each package means they are able to offer services the Postal Service cannot. For example, UPS is able to provide reports on spend and savings which helps track progress toward meeting goals established by the Office of Management and Budget.
- In April 2008, the Postal Service implemented a Negotiated Service Agreement with the Bank of America Corporation designed to pay incentives primarily for

⁵ *FY 2009 Standard Mail Volume Incentive Program*, page 2 (Report Number FF-AR-10-196, dated July 16, 2010).

⁶ *Postal Regulatory Commission (PRC) FY 2009 Annual Compliance Determination*, page 6.

⁷ *Impact of Postal Accountability and Enhancement Act Price Caps*, page 17 (Report Number CRR-AR-10-005, dated September 27, 2010).

improvements to the read/accept rates of its mail. However, the baseline data used to determine the improvements was 1999 system-wide data, not specific to the corporation.⁸ Since read/accept rates for mail processing equipment have improved in the intervening years, the 1999 rates did not provide a valid baseline for the agreement.

- In February 2008, the Postal Service proposed giving mailers a 1.4 cent workshare discount for pre-barcoding non-automation machinable mixed automated area distribution center letters⁹. Postal Service letter-sorting equipment can readily apply the barcodes in the course of processing this mail, at a cost of only 0.3 cents per mailpiece.¹⁰ As a result, the PRC approved the discount but lowered it by 1.1 cents to 0.3 cents. Management told the OIG this change impacted only 733 million pieces of Standard Mail, with a total monetary impact of about \$8 million annually.

Prices Not Used

The Postal Service has over 7,600 domestic prices for three primary product lines: letters, flat mailings (such as magazines and catalogs), and parcels. The complexity of the prices can overwhelm Postal Service employees and rate payers and discourage new customers. This complexity also reduces the Postal Service's ability to act quickly in response to the ever-changing market.

The OIG found that in FY 2010, 2,361 domestic prices (31 percent of the 7,600 domestic prices) were not used. In addition, 1,237 domestic prices (17 percent of the 7,600 domestic prices) had a volume of less than 10 pieces. Therefore, almost half of the over 7,600 domestic prices are not used by customers or have low mail volume.

A company's price, whether it is high or low, can be as much a part of a brand's identity as the product itself. Offering so many prices, with so many not being used, can add another unnecessary barrier to entry.

See [Appendix B](#) for FY 2010 Revenue, Pieces, and Weight (RPW) information broken down by revenue and piece percentage.

⁸ PRC Docket Number MC2007-1.

⁹ Letters that are for delivery in the service area of more than one automation area distribution center.

¹⁰ PRC Order Number 66, *Review of Postal Service Notice of Market Dominant Price Adjustment*, pages 33-34, March 17, 2008.

The Postal Service Does Not Have a Strategic Plan for Pricing

The Postal Service does not have a strategic plan or mission statement for pricing. In addition, Postal Service strategic documents such as *The Strategic Transformation Plan 2006 – 2010*, *Vision 2013*, and *Ensuring a Viable Postal Service for America: An Action Plan for the Future* do not include strategic plans for pricing. A mission statement defines an entity's reason for existence. A strategic plan or mission statement should be a clear and succinct statement of management's purpose for postage and associated costs.

Management provided the vice president's role mandate and a pricing optimization strategic initiative for our review. These documents are part of an ongoing Postal Service-wide strategic initiative process. The role mandate, although detailed, is about the individual and shared accountability of the vice president and is not a pricing strategy. The strategic initiative is part of an overall portfolio of initiatives to return the Postal Service to financial viability and is not directly related to a separate pricing strategy.

A pricing strategy would help the Postal Service position itself in the marketplace, differentiate the value of its products from those of the competition, and help it understand its data management needs to be competitive. Any entity that attempts to operate without a strategy or a mission statement runs the real risk of being unable to verify that it is on course.

Management told us that "...the idea of a pricing plan, separate from a broader discussion of product strategy, is of little use." They view prices, price changes, and pricing structures as aspects of mail products and a pricing strategy as one element of a wider product goal. This wider view by Postal Service management is also not part of a strategic plan or mission statement.

Postal Rate Making Has Not Fundamentally Changed

The overall rate-making methodology still used internally by the Postal Service to ensure cost coverage and support prices is much the same methodology as initially established following the PRA. The PRA contains certain guidelines to establish postal rates including the requirement that rates be fair and equitable and cover the cost of operating the Postal Service.

The Postal Act of 2006 streamlined the pricing and classification process to increase predictability and reduce administrative burdens on all parties. It also modified the rate-setting methodology to limit price increases for market-dominant mail classes to the annual inflation rate, while providing new flexibility in competitive pricing for shipping services.

The Postal Act of 2006 requires market-dominant product price increases to be tied to the Consumer Price Index (CPI) price cap. It also requires the PRC to monitor the

Postal Service's rates for market-dominant and competitive products. Aside from these requirements, it does not provide additional pricing guidelines for the Postal Service.

Based on issues we have identified above, and other possible barriers affecting the Postal Service and its current pricing structure, the OIG reviewed the Postal Act of 2006 to determine whether the Postal Service is able to redesign or implement a new cost model to determine its attributable costs for pricing. The OIG notes that nothing in 39 U.S.C. would prevent the Postal Service from devising a new set of cost models and pricing models, as long as:

- The pricing structure for market-dominant products remains tied to the Consumer Price Index for Urban Consumers (CPI-U), as required by 39 U.S.C. §3622(d).
- The competitive product pricing structure is able to cover "costs attributable."
- The new pricing methodology would not allow for any cross subsidization among the classes of products (39 U.S.C. §3631).

The U.S. Code is written in a fairly broad manner, allowing the Postal Service, in conjunction with the PRC, to develop regulations that explicitly outline any new cost pricing model.

OIG Sample Pricing Table

As a part of our audit work, we developed a Sample Pricing Table based on averaging and combining existing Postal Service prices. In our sample pricing table, we began by pricing letters and flats by weight (ounces) and parcels by using a flat rate box size concept. We used flat rate box pricing as a model, because of its recent success in increasing revenue. As the vice president, Shipping Services, noted; ". . . flat rate boxes continue to attract business and residential shippers. . . [and]. . . they're a key revenue generator."¹¹

The sample pricing table reduces the total number of domestic prices by 97 percent for letters, flats, parcels, and additional services, in part, by averaging some of the current rates in an attempt to simplify the pricing structure. This type of proposed pricing is an option the Postal Service could consider to reduce pricing complexity. We were unable to find any information in the Postal Act of 2006, the DMM, the U.S. Code, or the Code of Federal Regulations that would prohibit the averaging of rates, as long as the average rates cover the attributable costs¹². We also recognize that there are always perceived winners and losers when pricing changes are made.

During the audit, management agreed that unnecessary complexity is undesirable and should be eliminated, consistent with the Postal Service's strategic priorities, including reducing cost, encouraging volume growth and retention, and improving efficiency. The

¹¹ *USPS NewsLink*. November 29, 2010, "[Anything but Flat, Flat Rate Box Enjoys a Record-Setting October.](#)"

¹² The Postal Act of 2006 defines "costs attributable" as the "direct and indirect postal costs attributable to such product through reliably identified causal relationships." See 39 U.S.C. § 3631(b).

Postal Service is currently reviewing its costing systems and revenue and volume reporting and has chartered an initiative to optimize pricing.

OIG Proposed 240 Domestic Prices vs. Postal Service 7,626 Domestic Prices

Prices	Letters	Flats	Parcels	Total
Notice 123	281	580	6,765	7,626
OIG Sample Prices	65	71	104	240

See [Appendix C](#) for additional information about the OIG Sample Pricing Table.

OIG Pricing Blog “Reducing the Number of Prices”

The OIG uses blogs to gather ideas from Postal Service employees and customers, colleagues in the Inspector General community, colleagues from other national Postal Service audit and investigative organizations, and the general public. We do this to make our audits as open and transparent as possible and we encourage stakeholders to participate on our audits, whenever possible.

Our blog was titled "Reducing the Number of Prices." Overall, the blog had 128 respondents, with 89 percent indicating the Postal Service should streamline the DMM and pricing. Further, one blogger commented that the Postal Service’s price structure was mimicking the U.S. Tax Code. Also, mailers, employees, and the public do not understand all the prices the Postal Service offers.

See [Appendix D](#) for OIG Pricing Blog.

Recommendations

We recommend the vice president, Pricing:

1. Develop a strategic plan to simplify pricing that is supported by real-time volume and revenue data as envisioned by the Postal Act of 2006 to allow management to make competitive decisions in the market place.
2. Using a simplified cost pricing system and real-time data, develop and implement an optimized, modern pricing structure as part of an overall methodology to reduce barriers to new market entrants and promote ease of use by existing customers and Postal Service employees.

Management’s Comments

Management agreed there is room for simplification of price tables in products heavily used by consumers and it should strive to eliminate unnecessary complexity. Management responded to recommendation 1 stating the Postal Service has plans to implement simpler pricing options in January 2012. Additionally, it is currently reviewing its costing systems and revenue and volume reporting and has chartered an initiative to

optimize pricing, which management believes will lead to programs that identify additional simplification opportunities. Regarding recommendation 2, management stated the Postal Service is currently reviewing its costing systems and revenue and volume reporting and has chartered an initiative to optimize pricing. Additionally, management believes current programs and recent actions also address the ease of use issues raised in our report.

Management further stated the Postal Service is actively implementing programs to simplify and streamline its product offerings. However, management believes there is value in maintaining options for customers—specifically large commercial mailers—who are willing and able to manage mailing logistics, as they help them to cooperatively manage mailing costs. Management also recognized that its data systems do not provide the maximum potential level of data granularity and that they could use increased granularity to support pricing and cost analysis. Management stated, however, the additional benefit derived from the additional data must be weighed against the additional cost the Postal Service would incur to collect it. See [Appendix E](#) for management's comments, in their entirety.

Evaluation of Management's Comments

The OIG considers management's comments responsive to the recommendations and management's corrective actions should resolve the issues identified in the report. In reference to management's comments, the Postal Service agrees that it should strive to eliminate unnecessary complexity and plans to implement simpler pricing options in January 2012 and in subsequent annual price changes. They are currently reviewing its costing systems, revenue, and volume reporting in an effort to optimize pricing.

The OIG considers both recommendations significant and therefore requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective actions are completed. These recommendations 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.

Appendix A: Additional Information

Background

The Postal Service is an independent agency of the U.S. government, responsible for providing postal service in the U.S. It is one of the few government agencies explicitly authorized by the U.S. Constitution.

In the middle of the 19th Century, the Post Office Department (POD) changed the rate structure based on the number of sheets in a letter and the distance a letter traveled. In 1863, the Congressional legislation created a mail rate for each half-ounce of the mailpiece's weight. This was the first law to establish a uniform rate, regardless of the distance traveled, thus, providing universal service to customers regardless of their domestic location. The law also created three classes of mail: First-Class Mail, which included letters; Second-Class Mail for publications issued at regular periods; and Third-Class Mail, which includes all other mail.

The PRA signed by President Richard Nixon on August 12, 1970, replaced the cabinet-level POD with the independent Postal Service and established an independent Postal Rate Commission. The PRA took effect on July 1, 1971. At this time, the POD was reorganized as a quasi-independent corporation of the federal government and acquired its present name. The Postal Service is self-sufficient and has not directly received taxpayer dollars since the early 1980s, with a few minor exceptions.

Historically, the Postal Service's business model relied on rising First-Class Mail® volume to cover the cost of operating the expanding delivery network. However, since 2007, First-Class Mail volume has decreased by more than 18.1 billion pieces, while the delivery network has expanded by more than 2.9 million new delivery points. The decline in First-Class Mail volume is due, in large part, to electronic diversion as businesses, non-profit organizations, governments, and households increasingly rely on e-mail and other electronic means to conduct financial transactions and send correspondence. This dynamic, understandably, was not anticipated in the 1970 business model.

On December 20, 2006, President George W. Bush signed the Postal Act of 2006 into law. The Postal Act of 2006 transformed the Postal Rate Commission into the Postal Regulatory Commission (PRC) and assigned significant new responsibilities to the agency. It requires the PRC to develop and maintain regulations for a modern system of rate regulation. The Postal Act of 2006 also assigned new and continuing oversight responsibilities to the PRC, including annual determinations of Postal Service compliance with applicable laws, development of accounting practices and procedures for the Postal Service, review of the universal service obligation, and assurance of transparency through periodic reports. New enforcement tools include subpoena power and the authority to direct the Postal Service to adjust rates and take other remedial action and levy fines in cases of deliberate noncompliance with applicable postal laws.

The intent of the Postal Act of 2006 was to design a modern pricing and regulatory system to increase predictability and reduce administrative burdens on customer, potential consumers, and employees. This legislation allows the Postal Service the ability to streamline pricing and classification, retain excess revenue, compete fairly in the marketplace, and respond effectively to economic conditions.

The Postal Act of 2006 resulted in several changes to the Postal Service's pricing structure. Specifically this law requires:

- Separation of cost between market-dominant and competitive products.
- Replacement of the cost-of-service style pricing system with a price-cap regime in which average annual price increases for each mail class are not to exceed the overall consumer price inflation growth measured by CPI-U index.
- Elimination of the PRA break-even requirement, allowing retention of excess generated revenue.
- Postal Service price discounts that do not surpass the calculated work-sharing related cost avoidance.

ODIS-RPW provides the official RPW estimates for domestic products reported in the Postal Service's Annual Report. Furthermore, the Postal Service uses ODIS-RPW test data to advise senior management on budgeting and planning issues and to plan the Postal Service budget based on forecasts of mail volume, workload, and overall productivity. The data are also used to monitor productivity increases associated with automation programs, assess deviations of actual volume from projected volume, and analyze other major Postal Service activities affecting costs and revenue.

PostalOne! is a Web-based data system that provides an electronic link between a customer's mailing information and the Postal Service's business mail acceptance and induction processes. Each mailing that arrives at a postal facility is accompanied by a postage statement (electronic or manual) that details the volume, weight, and postage paid for the mailing by price category for each product. This data is entered into *PostalOne!* and reported to various other systems, including ODIS-RPW. Approximately 65 percent of total mail volume is captured by *PostalOne!*.

Objective, Scope, and Methodology

Our objective is to determine the Postal Service's adequacy and agility for managing existing prices and introducing new prices to ensure cost coverage and protect revenue.

To accomplish our objective, we:

- Researched and analyzed the Postal Service's DMM and Price List Notice 123 for strategic opportunities.
- Reviewed applicable policies and procedures and other pertinent documentation.
- Performed an analysis of pricing approaches with domestic competition.
- Reviewed Postal Service pricing for low to no volume data prices.
- Reviewed Postal Service strategy documents.
- Developed alternative pricing options for consideration by Postal Service management.
- Discussed the OIG's pricing options with Postal Service Headquarters.
- Obtained public opinion using a blog titled "Reducing the Number of Prices."

We conducted this performance audit from March 2010 through December 2011 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(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective(s). We discussed our observations and conclusions with management officials on September 15, 2011 and included their comments where appropriate.

We assessed the reliability of Postal Service pricing data by reviewing supporting documentation provided by Postal Service management. We determined that the data were sufficiently reliable for the purposes of this report.

[Prior Audit Coverage](#)

The OIG has not performed prior audits related to this objective.

Appendix B: Fiscal Year 2010 Revenue, Pieces, and Weight Information

The OIG found that, in FY 2010, parcel prices comprised 89 percent of the over 7,600 domestic prices, but accounted for only 18 percent of Postal Service revenue and only 2 percent of Postal Service volume. In contrast, 185 First-Class and Standard Letter prices (2 percent of the 7,600 domestic prices) accounted for 68 percent of Postal Service revenue and 86 percent of Postal Service volume.

Fiscal Year 2010 Revenue and Pieces Information				
			Percentage of Total	
Letters	Revenue (000)	Pieces (000)	Revenue	Pieces
First Class Letters and Cards	\$ 12,752,771	28,584,912	22.86%	19.99%
First Class Presort Letters and Cards	15,975,346	46,225,386	28.63	32.33
<u>Standard Letters</u>	<u>9,204,304</u>	<u>48,298,835</u>	<u>16.50</u>	<u>33.78</u>
Total Letters	\$ 37,932,421	123,109,133	67.99%	86.10%
			Percentage of Total	
Flats	Revenue (000)	Pieces (000)	Revenue	Pieces
First Class Flats	\$ 3,117,724	2,483,992	5.59%	1.74%
Standard Flats	2,579,517	7,049,183	4.62	4.93
Bound Printed Matter Flats	190,409	229,752	0.34	0.16
<u>Periodicals</u>	<u>1,878,835</u>	<u>7,269,470</u>	<u>3.37</u>	<u>5.08</u>
Total Flats	\$ 7,766,485	17,032,397	13.92%	11.91%
			Percentage of Total	
Parcels	Revenue (000)	Pieces (000)	Revenue	Pieces
First Class Parcels	\$ 1,131,181	574,429	2.03%	0.40%
Standard Not Flat-Machinables and Parcels	602,318	682,403	1.08	0.48
Parcel Post	614,937	61,408	1.10	0.04
BPM Parcels	321,564	244,736	0.58	0.17
Media and Library Mail	368,766	122,322	0.66	0.09
Express Mail	827,898	42,553	1.48	0.03
Priority Mail	5,656,639	809,471	10.14	0.57
Parcel Select Mail	503,795	268,357	0.90	0.19
<u>Parcel Return Mail</u>	<u>64,961</u>	<u>28,467</u>	<u>0.12</u>	<u>0.02</u>
Total Parcels	\$ 10,092,059	2,834,146	18.09%	1.98%
Total Letters, Flats, and Parcels	\$ 55,790,965	142,975,676	100.0%	100.0%

Appendix C: OIG Sample Pricing Table

As a result of our audit, the OIG developed a sample pricing table, which we provided to management. We created the table by combining some existing Postal Service price categories and looking at opportunities to streamline other areas for easier customer and employee use. The sample pricing table reduces the total number of domestic prices by approximately 97 percent for letters, flats, parcels, and additional services. We recognize pricing will need to be revenue neutral. We also recognize that there are always perceived winners and losers with pricing changes.

In our sample pricing, we began by pricing letters and flats by weight (ounces) and parcels by using a flat rate box size concept. We used flat rate box pricing as a model because of its recent success in increasing revenue. As the vice president, Shipping Services, noted; “. . .flat rate boxes continue to attract business and residential shippers. . .[and]. . .they’re a key revenue generator.”¹³

Other important concepts include:

- First-Class Letter Mail and Standard Letter Mail are considered Letter Mail.
- Postcards are included as Letter Mail.
- All letters weighing above 3.5 ounces are considered Flat Mail.
- Letter dimensions remain unchanged for letters and flats.
- Post offices would accept up to 1,000 pieces of letter mail and over 1,000 pieces would be entered at designated acceptance locations.

Our pricing table is categorized by:

- Service Delivery.
 - Zone prices are averaged.
 - 1 to 3-Day Service.
 - 2- to 9-Day Service (similar to Standard Mail).
 - Non profit.
 - For profit.
- Guaranteed Delivery.
 - Zone prices are averaged.
 - Overnight Service.
 - 3-Day Service.

¹³ *USPS News Link*. November 29, 2010, “[Anything but Flat, Flat Rate Box Enjoys a Record-Setting October.](#)”

- Special Services include, but are not limited to:
 - Sunday/Holiday Delivery.
 - Certified Mail.
 - Restricted Delivery.
 - Signature Confirmation.
 - Return Receipt.

Appendix D: OIG Pricing Blog “Reducing the Number of Prices”

The OIG uses blogs to gather ideas from Postal Service employees and customers, colleagues in the Inspector General community, colleagues from other national Postal Service audit and investigative organizations, and the general public. We do this to make our audits as open and transparent as possible and encourage stakeholders to participate on our audits whenever possible.

Our blog was titled "Reducing the Number of Prices." In total, the blog had 128 respondents, with 89 percent indicating the Postal Service should streamline the DMM and pricing.

Which of the following options should the Postal Service consider?	Number of “YES” Votes	Percentage of Total Votes
Keep the DMM pricing as is	4	3%
Streamline the DMM and its pricing	114	89
Include more information in the DMM and offer more pricing opportunities	10	8
Total	128	100%

Further, one blogger commented that the Postal Service’s price structure was mimicking the U.S. Tax Code. Also, mailers, employees, and the public do not understand all of the prices the Postal Service offers. Another blogger commented that proponents of rate simplification should know that complex rates aren’t necessarily a bad thing for mailers and that most large mailers calculate their postage with a computer rather than paper and pencil.

Appendix E: Management's Comments

MAURA ROBINSON
VICE PRESIDENT, PRICING



November 18, 2011

SHIRIAN B. HOLLAND
ACTING DIRECTOR, AUDIT OPERATIONS

SUBJECT: Draft Audit Report—U.S. Postal Service's Pricing Strategy (Report Number CI-AR-12-DRAFT)

In general, the Postal Service agrees that unnecessary complexity in pricing is undesirable, and should be eliminated, consistent with Postal Service strategic priorities including reducing cost, encouraging volume growth and retention, and improving efficiency. In particular, there may be room for simplification of price tables in products heavily used by consumers.

The Postal Service is actively implementing programs to simplify and streamline our product offerings. Current programs and recent actions, such as the Every Door Direct Mail market test and the expansion of simplified addressing for Saturation Mail to all route types provide simpler options for customers not currently using the mail. In addition, beginning in January 2012, the Postal Service will additionally simplify its products by offering

- One price for pieces weighing up to two ounces for First-Class Mail customers sending presorted mail;
- The same price for First-Class Mail sorted to the 3-digit and AADC levels;
- Free permit fees for customer mailings that maintain a 90 percent eligibility for full service Intelligent Mail discounts;
- Free Delivery Confirmation for certain commercial parcels.

However, the Postal Service believes there is value in maintaining options for customers—specifically large commercial mailers—who are willing and able to manage mailing logistics. These options help us to cooperatively manage mailing costs.

The Postal Service also recognizes that, at least in some cases, its data systems do not provide the maximum potential level of data granularity and that increased

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granularity could be used to support pricing and cost analysis. While improving the quality of the information we use is important, as with all such efforts, the additional benefit derived from the additional data must be weighed against the additional cost we will incur to collect it.

Recommendation 1:

Develop a strategic plan to simplify pricing that is supported by real-time volume and revenue data as envisioned by the Postal Act of 2006 to allow management to make competitive decisions in the market place.

Management Response/Action Plan:

As discussed above, the Postal Service agrees that it should strive to eliminate unnecessary complexity and has plans to implement simpler pricing options in January 2012. In addition, the Postal Service is currently reviewing its costing systems and revenue and volume reporting and has chartered an initiative to optimize pricing. It is expected that these reviews and initiatives will lead to programs that identify additional simplification opportunities.

Target Implementation Date:

January 2012 and in subsequent annual price changes.

Responsible Official:

Maura Robinson, Vice President, Pricing

Recommendation 2:

Using a simplified cost pricing system and real-time data, develop and implement an optimized, modern pricing structure as part of an overall methodology to reduce barriers to new market entrants and promote ease of use by existing customers and Postal Service employees.

Management Response/Action Plan:

As noted, the Postal Service is currently reviewing its costing systems and revenue and volume reporting and has chartered an initiative to optimize pricing. It is expected that these reviews and initiatives will lead to programs that address the concerns of this recommendation within the framework of the strategic priorities mentioned above. Postal Service management believes that current programs and recent actions, described above also address the ease-of-use issues raised here.

Target Implementation Date:

January 2012 and in subsequent annual price changes.

Responsible Official:

Maura Robinson, Vice President, Pricing

This report and management's response do not contain information that may be exempt from disclosure under the FOIA.

A handwritten signature in cursive script that reads "Maura Robinson".

Maura Robinson
Vice President Pricing

cc: Paul Vogel
Jamie Gallager