



# OFFICE OF INSPECTOR GENERAL UNITED STATES POSTAL SERVICE

## Postmaster Cost Segment

## Audit Report

Report Number  
CP-AR-16-010

September 8, 2016

DATE	BID	ASK	PRO	QUA
JAN	€ 241,00	€ 558,00	€ 104,00	339
FEB	€ 955,00	€ 348,00	€ 374,00	223
MAR	€ 116,00	€ 415,00	€ 930,00	269
APR	€ 262,00	€ 146,00	€ 107,00	437
MAY	€ 339,00	€ 890,00	€ 801,00	934
JUN	€ 706,00	€ 579,00	€ 691,00	933
JUL	€ 627,00	€ 870,00	€ 935,00	641
AUG	€ 557,00	€ 775,00	€ 854,00	641
SEP	€ 50,00	€ 300,00	€ 437,00	107
OCT	€ 817,00	€ 518,00	€ 269,00	930
NOV	€ 173,00	€ 331,00	€ 223,00	374
DEC	€ 608,00	€ 500,00	€ 339,00	104

DATE	BID	ASK	PRO	QUA
JAN	€ 542,00	€ 348,00	€ 820,00	620
FEB	€ 685,00	€ 920,00	€ 784,00	784
MAR	€ 953,00	€ 604,00	€ 934,00	934
APR	€ 228,00	€ 202,00	€ 555,00	555
MAY	€ 468,00	€ 685,00	€ 386,00	386
JUN	€ 609,00	€ 963,00	€ 974,00	974
JUL	€ 517,00	€ 240,00	€ 575,00	575
AUG	€ 950,00	€ 856,00	€ 645,00	645
SEP	€ 659,00	€ 248,00	€ 941,00	941
OCT	€ 911,00	€ 952,00	€ 802,00	802
NOV	€ 629,00	€ 715,00	€ 715,00	715
DEC	€ 248,00	€ 542,00	€ 557,00	557





# OFFICE OF INSPECTOR GENERAL

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## Highlights

***Opportunities exist for the Postal Service to improve the accuracy of Postmaster Cost Segment data.***

### 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 (PRC) within 90 days of each fiscal year end. The report analyzes cost, revenue, pricing, and quality of service for all products and determines whether each product is covering its attributable costs, which are the sum of volume variable plus product-specific costs.

The Postal Service develops the cost segments report as part of the ACR filing. In fiscal year (FY) 2014 there were 18 active cost segments and in FY 2015 there were 17 active cost segments. The Postmaster Cost Segment includes the accrued salaries, benefits, and related costs of postmasters.

Our objective was to assess whether inputs into the Postmaster Cost Segment are accurately calculated and recorded.

### What the OIG Found

Opportunities exist for the Postal Service to improve the accuracy of Postmaster Cost Segment data. In FY 2014 we found seven of 87 accounts incorrectly assigned to the Postmaster Cost Segment, and in FY 2015 we found seven of 88 accounts incorrectly assigned to this cost segment. In addition, two expense accounts had erroneous account descriptions in each fiscal year. These issues occurred because

there is no formal review and reconciliation conducted during the year-end account adjustment process. In addition, the administrative guidelines that address updating and correcting account information are silent on respective roles and responsibilities. During the course of this audit, management took corrective action to update the incorrectly assigned and mislabeled accounts identified.

Additionally, the Postal Service did not follow the stated procedures in the *Summary Description of USPS Development of Costs by Segments and Components* (CSC) report of using money order revenue data from the *Revenue, Pieces, and Weight* report to distribute attributable costs and, instead, used money order revenue data from the *Cost Revenue and Analysis* report, which includes interest earned. This has been a standing practice for management, resulting in using overstated interest revenue to distribute attributable costs.

Lastly, the postmaster variability study used to estimate volume variable costs has not been updated since 1984. In FY 2013, the Postal Service notified the PRC that it would initiate a new study in FY 2014. In November 2015, the PRC postponed the request to update the study pending implementation of the Post Office Structure Plan (POStPlan), which could materially impact the outcome of the study. POStPlan implementation was completed in February 2015, yet the study had not been updated as of June 2016.



# OFFICE OF INSPECTOR GENERAL

## UNITED STATES POSTAL SERVICE

Although the exceptions or overstated revenue did not have a material impact on reporting Postmaster Cost Segment data for FYs 2014 and 2015, ineffective internal controls increase the risk of reporting inaccurate attributable cost data for products.

### What the OIG Recommended

We recommended management conduct an annual review and reconciliation process for expense account assignments and descriptions. We also recommended management follow or revise the procedures in the *Summary Description of USPS Development of Costs by Segments and Components* report related to distribution of volume variable costs, and create a timeline or approach for updating the postmaster variability study.

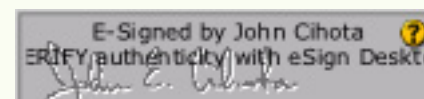
# Transmittal Letter



OFFICE OF INSPECTOR GENERAL  
UNITED STATES POSTAL SERVICE

September 8, 2016

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



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

**SUBJECT:** Draft Audit Report – Postmaster Cost Segment  
(Report Number CP-AR-16-010)

This report presents the results of our audit of the Postmaster Cost Segment  
(Project Number 16TG011CP000)

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

Attachment

cc: Corporate Audit and Response Management

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# Findings

***Postmaster Cost Segment data used to develop accrued postmaster costs for the CSC report contained incorrect or mislabeled expense accounts.***

## Introduction

This report presents the results of our self-initiated audit of the Postmaster Cost Segment (Project Number 16TG011CP000). Our objective was to assess whether the U.S. Postal Service accurately calculated and recorded Postmaster Cost Segment inputs. See [Appendix A](#) for additional information about this audit.

The Postal Accountability and Enhancement Act of 2006 (PAEA) requires the Postal Service to file an *Annual Compliance Report* (ACR)<sup>1</sup> with the Postal Regulatory Commission (PRC) within 90 days of each fiscal year end. The ACR analyzes cost, revenue, pricing, and quality of service for all products and determines whether each product is covering its attributable costs.<sup>2</sup>

The *Summary Description of USPS Development of Costs by Segments and Components* (CSC) report is a summary of the Postal Service's approach to costing. The CSC identifies the total costs attributable to Postal Service products and the results are used to prepare the *Cost and Revenue Analysis* (CRA) report. The CRA compares attributable costs to revenue, by product, to determine if each product's revenue covers its cost.<sup>3</sup> In fiscal year (FY) 2014, the Postal Service reported on 18 active cost segments that aligned with the postal system of accounts.<sup>4</sup> In FY 2015, the PRC approved the combining of Cost Segments 3 and 4, resulting in a total of 17 active cost segments.

The Postmaster Cost Segment (CS 01) reports on the accrued<sup>5</sup> salaries, benefits, and related costs of postmasters. Management estimates the portion of accrued postmaster salaries, benefits, and related costs that are attributable to products using a methodology developed from a special study.<sup>6</sup> The costs are then allocated to individual products based on national *Revenue, Pieces and Weight* (RPW) report data. Attributable postmaster costs accounted for less than 1 percent<sup>7</sup> of all attributable costs in the CSC reports reviewed.

## Summary

Opportunities exist for the Postal Service to improve the accuracy of Postmaster Cost Segment data. In FY 2014 we found seven of 87 accounts incorrectly assigned to the Postmaster Cost Segment, and in FY 2015, we found seven of 88 accounts incorrectly assigned to the Postmaster Cost Segment. In addition, two expense accounts that were properly included in the Postmaster Cost Segment each year had erroneous account descriptions. These issues occurred because there is no formal review and reconciliation conducted during the year-end account adjustment process. In addition, the administrative guidelines that address updating and correcting account information are silent on respective roles and responsibilities.

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

2 The attributable costs of a product is the sum of its volume variable and product-specific costs. There are no product-specific costs reported for the Postmaster Cost Segment. Volume variable costs are those that change proportionally to a change in the volume of a product or activity.

3 PAEA requires each class of mail to cover its attributable costs.

4 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.

5 Accrued costs consists of postmaster costs for Executive and Administrative Service (EAS) -23 and below offices and EAS24 and above offices. EAS is a salary structure that applies to most managerial and administrative employees.

6 The Postmaster Variability Study was completed in 1984. The analysis used FY 1979 postmaster salaries and FY 1978 Workload Service Credit Index data to estimate volume variable costs for the Postmaster Cost Segment.

7 Attributable postmaster costs were 0.87 percent of all attributable costs in the CSC for FY 2014, and 0.73 percent for FY 2015.

Additionally, the Postal Service did not follow procedures<sup>8</sup> stated in the CSC report of using money order revenue data from the RPW report to distribute attributable costs and, instead, used money order revenue data from the CRA report, which includes interest earned. Management has applied this practice for several years, resulting in using overstated interest revenue to distribute attributable costs.

Finally, the postmaster variability study used to estimate volume variable costs has not been updated since 1984. In FY 2013, the Postal Service notified the PRC that it anticipated initiating the update to the study in FY 2014. In November 2015, the PRC postponed its request to update the study pending implementation of the Post Office Structure Plan (POStPlan) because it could materially impact the outcome of the study. The POStPlan implementation was completed in February 2015, yet the study had not been updated as of June 2016.

As a result of our audit, management updated the incorrectly assigned and mislabeled accounts identified. Although these issues did not have a material impact on the reporting of Postmaster Cost Segment data for FYs 2014 and 2015, ineffective internal controls promote an increased risk of reporting inaccurate attributable cost data for products.

### Postmaster Cost Segment Data Input

Postmaster Cost Segment data used to develop accrued postmaster costs for the CSC report contained incorrect or mislabeled expense accounts. In FY 2014, management incorrectly assigned seven of 87 expense accounts to the Postmaster Cost Segment and in FY 2015 incorrectly assigned seven of 88 expense accounts, as shown in Table 1.

**Table 1. Expense Accounts and Associated Dollars Incorrectly Assigned to the Postmaster Cost Segment**

Account Description	FY 2014	FY 2015	Total
51107-114 Personnel Compensation—Straight Time Additional Pay Full Time Employees (Vehicle Drivers)	\$0	\$0	\$0
51107-144 Personnel Compensation—Straight Time Additional Pay Full Time Employees (Accounting Service Center)	\$46	\$2,045,798	\$2,045,844
51107-146 Personnel Compensation—Straight Time Additional Pay Full Time Employees (Facility Service)	\$0	\$0	\$0
51107-159 Personnel Compensation—Straight Time Additional Pay Full Time Employees (Field Sales)	\$0	\$0	\$0
51107-171 Personnel Compensation—Straight Time Additional Pay Full Time Employees (Inspection Service/Inspector General)	\$0	\$0	\$0
51107-172 Personnel Compensation—Straight Time Additional Pay Full Time Employees (Administration)	\$0	\$234	\$234
51216—Social Security Taxes	\$0	\$0	\$0
<b>Total</b>	<b>\$46</b>	<b>\$2,046,032</b>	<b>\$2,046,078</b>

Source: PRC website; FY 2014 and FY 2015 ACR library references.

<sup>8</sup> *Summary Description of USPS Development of Costs by Segments and Components* report, FY 2014 and FY 2015, Cost Segment 1, Postmasters, Section 1.1.4, Distribution of Costs.

Management also mislabeled two accounts, Medicare Tax (IS/IG) and Social Security Taxes Post 1983. These account descriptions should have included “PM” in the title. The expenses<sup>9</sup> associated with these mislabeled account were correctly posted to the Postmaster Cost Segment. These issues occurred because there is no formal review and reconciliation conducted during the account adjustment process. Also, Postal Service guidelines<sup>10</sup> are silent on roles and responsibilities related to initiating account change requests and reconciliations.

As a result of this audit, management updated the incorrectly assigned and mislabeled accounts identified for the Postmaster Cost Segment. We consider the \$2,046,078 in other impact due to data integrity issues<sup>11</sup> for misclassified account balances posted to the Postmaster Cost Segment trial balance.

These issues did not have a material impact on the reporting of Postmaster Cost Segment data for FYs 2014 and 2015; however, ineffective internal controls promote an increased risk of reporting inaccurate attributable cost data for products.

### Allocating Attributable Costs

The Postal Service did not follow procedures in the CSC report regarding the use of money order revenue data from the RPW report to distribute attributable costs and, instead, used money order revenue data from the CRA report, which includes interest earned. For FY 2014 and FY 2015, the difference between the RPW money order revenue and the CRA revenue was \$2,775,000, as shown in Figure 1.

#### Figure 1: Money Order Revenue (in Thousands)

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<sup>9</sup> Account 51217-101, Medicare Tax IS/IG, carried a balance of \$17,550,225 in FY 2014 and \$16,133,472 in FY 2015, totaling \$33,683,697. Account 51218-101, Social Security Taxes Post 1983 Employees AREA, carried a balance of \$596,283 in FY 2014 and \$453,703 in FY 2015, totaling \$1,049,986.

<sup>10</sup> Handbook F-23, *Accounting Policy Reference*, dated January 2015.

<sup>11</sup> Validation of the consistency, accuracy, and completeness of data used by the Postal Service. Data used to support management decisions that are not fully supported or completely accurate. This can be the result of flawed methodology; procedural errors; or missing or unsupported facts, assumptions, or conclusions.



Management stated they used revenue from the CRA report to allocate money order service attributable costs in the Postmaster Cost Segment for at least the previous 5 years. Our analysis found the revenue used to allocate attributable costs for all other products matched revenue in the RPW reports.

This issue did not have a material impact on reporting Postmaster Cost Segment data for FYs 2014 and 2015; however, ineffective internal controls and noncompliance with stated procedures promote an increased risk of reporting inaccurate attributable cost data for products in the ACR.

### **Postmaster Variability Study**

The Postal Service has not updated the postmaster variability study used to estimate volume variable cost since 1984. In FY 2013, the Postal Service notified the PRC that it anticipated initiating the update to the study in FY 2014. In November 2015, the PRC postponed its request for the Postal Service to update the study pending complete implementation of the POSTPlan, believing it could materially impact the outcome of the study. POSTPlan implementation was completed in February 2015 and, as of June 2016, the Postal Service has not taken any further actions to update the study.

# Recommendations

***We recommended management conduct an annual review and reconciliation process for expense account assignments and descriptions. We also recommended management follow or revise the procedures in the Summary Description of USPS Development of Costs by Segments and Components report related to distribution of volume variable costs, and create a timeline or approach for updating the postmaster variability study.***

We recommend the vice president, Pricing and Costing:

1. Conduct an annual review and reconciliation of expense account assignments and descriptions, that includes revising applicable guidance for communicating roles and responsibilities.
2. Follow or revise procedures in the *Summary Description of USPS Development of Costs by Segments and Components* report related to distribution of volume variable costs to mail products and specials services.
3. Communicate to the Postal Regulatory Commission the status of the Post Office Structure Plan and develop a timeline and approach for updating the postmaster variability study.

## Management's Comments

Management generally agreed with the findings and agreed with recommendations 1 and 2; however, management disagreed in part with recommendation 3.

Management agreed with recommendation 1; however, they stated a process is already in place to review any changes in accounts. Management stated the Finance Number Control Master/Account Number Control Master F8 Process, managed by Accounting, alerts postal staff across the organization (including Cost Attribution) of any proposed changes to accounts and their treatment in the cost segments and components – to assure concurrence from pertinent parties. Management also stated that an additional, one-time effort is required to review the trail balance process to assure assignment of current general ledger accounts and subaccounts costs to the correct cost segments and components. Management's target implementation date for this review is October 31, 2016.

Management agrees with recommendation 2 and acknowledged the statement in the Summary Description of the distribution key for attributable costs in Cost Segment 1 for FY 2014 and previous years was not precisely correct. Management asserts that there was no overstatement of revenue, but had the revenue been overstated the impact on the attributable costs of Money Orders would have been less than \$7,500 in FY 2015. Management stated the FY 2015 *Summary Description of USPS Development of Costs by Segments and Components*, filed with the PRC on July 6, 2016, was updated to more accurately specify the distribution key for attributable Cost Segment 1 costs was the CRA revenue.

Management disagreed in part with recommendation 3 and stated the Postal Service has no obligation to provide further information to the PRC regarding POSTPlan. The Postal Service is obligated to provide the PRC with information on access to post offices, but this requirement is not specific to POSTPlan. Management stated if and when the Postal Service completes an update to the postmaster variability study, or any other aspect of postmaster costs, the Postal Service will follow PRC rules and file a proposed change in methodology for PRC review. Management also stated they have already initiated a process and approach for updating the study but the timeline for completing the study has yet to be developed. Management's target implementation date is July 31, 2018.

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

## Evaluation of Management's Comments

The U.S. Postal Service Office of Inspector General (OIG) considers management's comments to recommendation 1, 2, and part of 3 to be responsive and corrective actions should resolve the issues identified in the report. The OIG considers management's comment to part of recommendation 3 to be non-responsive and will not resolve the issue identified in the report.

Management agreed with recommendation 1 but stated a process is already in place to review any changes in accounts with the Finance Number Control Master/Account Number Control Master F8 Process. This process addresses change request and maintenance of accounts during the course of operations but does not address the annual review and reconciliation process stated in the recommendation.

Management agreed with recommendation 2 but stated that the Postal Service and the PRC use and have been using CRA revenue for distribution of Cost Segment 1 costs. We agree with this statement and, as management acknowledged in their response, this process is not consistent with the *Summary of Description of USPS Costs by Segments and Components* report. Management's corrective actions to update the report addresses the recommendation.

Management disagreed in part to recommendation 3 to communicate to the PRC the status of POSTPlan. Management asserts with the closing of Docket No. RM2011-3, the Postal Service is no longer obligated to inform the PRC the status of POSTPlan. The OIG concurs that Docket No. RM2011-3 was closed, which identified postmaster costs as a study area that should be a near-term priority. The Docket also stated the PRC finds that it is prudent to delay consideration of postmaster costs until the Postal Service's POSTPlan is fully implemented, as it may materially impact the elasticity of postmaster labor costs. During the audit, we learned the implementation of POSTPlan was completed in February of 2015, and this information was not communicated to the PRC. We continue to believe the PRC considers this a near-term priority and although not an obligation, the Postal Service should communicate the status accordingly.

The corrective actions for recommendations 1 and 3, with respect to developing a timeline for updating the postmaster variability study, should resolve the issues identified in the report. These recommendations require OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective actions are completed. Recommendations 1 and 3 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.

We consider recommendation 2 closed with the issuance of this report as management's corrective actions have been implemented. We consider management's actions for recommendation 3, with respect to communicating to the PRC the status of POSTPlan, to be nonresponsive; however, we will not pursue audit resolution on this part of recommendation 3, as the intent of the recommendation was satisfied during the course of the audit and issuance of the report.

# Appendices

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## Appendix A: Additional Information

### Background

The Postal Service is required to “analyze costs, revenues, rates, and quality of service” and report to the PRC no later than 90 days after the end of each year. To comply, the Postal Service files the ACR with the PRC<sup>12</sup> within 90 days of each fiscal year end.

The CSC report is a documentation of the processes used to prepare the CRA report. An objective of the CSC report is to report total costs attributable to Postal Service products and services. The costs are then allocated to individual products. Only the attributable portion of costs are assigned to products. The CRA compares attributable costs to revenue to determine whether each product’s revenue covers its cost.<sup>13</sup> Results of this comparison are included in the ACR.

Cost segments correspond to major divisions of the postal system of accounts, such as postmasters, motor vehicle service, and building occupancy. In FY 2014, the Postal Service reported on 18 cost segments<sup>14</sup> and FY 2015 there were 17 active cost segments in the CSC. There are three levels of cost segment reporting: segments, components, and elements. The three levels of the Postmaster Cost Segment are:

- Level 1: Cost Segment Group – Postmasters
- Level 2: Cost Components – Postmasters EAS-23<sup>15</sup> and below and Postmasters EAS-24 and above
- Level 3: Cost Elements<sup>16</sup> – individual products and services

Costs for the Postmaster Cost Segment are summarized by component group in Table 2.

**Table 2. Component Groups in Cost Segment 01**

FY 2014 Costs (in Thousands)			
Component Group	Total Accrued	Attributable	Institutional
Postmasters EAS-23 and Below	\$1,885,628	\$343,750	\$1,541,878
Postmasters EAS-24 and Above	\$53,144	--	\$53,144
<b>Total</b>	<b>\$1,938,772</b>	<b>\$343,750</b>	<b>\$1,595,022</b>

FY 2015 Costs (in Thousands)			
Component Group	Total Accrued	Attributable	Institutional
Postmasters EAS-23 and Below	\$1,625,260	\$296,285	\$1,328,975
Postmasters EAS-24 and Above	\$56,355	--	\$56,355
<b>Total</b>	<b>\$1,681,615</b>	<b>\$296,285</b>	<b>\$1,385,330</b>

Source: Postal Service *Summary Description of USPS Development of Cost by Segments and Components* reports, FY 2014 and FY 2015.

<sup>12</sup> U.S. Code, Title 39, Section 3652. The PRC reviews this report and publishes an annual assessment of Postal Service rates and service within 90 days in the *Annual Compliance Determination* (ACD) report.

<sup>13</sup> PAEA required each class of mail to cover its attributable costs.

<sup>14</sup> The report includes Cost Segments 1 through 20; however, Segments 5 and 9 are no longer used to identify costs.

<sup>15</sup> EAS-24 and above postmasters have duties and responsibilities that are not significantly related to the volume of mail flowing through offices they direct. The work of postmasters EAS23 and below are subject to a functional workload analysis that reflects various associate offices functional activities performed in connection with window, lobby, delivery services, mail processing, distribution/collection, and general administration activities.

<sup>16</sup> The most refined level of cost analysis for that segment and where elasticity with respect to volume is estimated.

The Postal Service develops annual cost reporting for the CSC using methods approved by the PRC. Reporting is accomplished using a variety of operational and statistical information. Data collected and analyzed to prepare the Postmaster Cost Segment worksheet comes from sources such as the general ledger, payroll, and the RPW report. Additional information is obtained from special studies such as the postmaster variability study used to estimate the portion of postmaster salaries, benefits, and related costs that are volume variable. The PRC's FY 2015 ACD report did not mention any outstanding issues or contain any comments concerning the current status of postmaster variability.

Costs are either directly attributable to products or categorized as institutional costs. One objective of cost segment reports is to provide cost data, by product, to the CRA. Comparisons to revenue in the CRA help determine whether each product's revenue covers its attributable costs and is making a contribution to cover institutional costs.

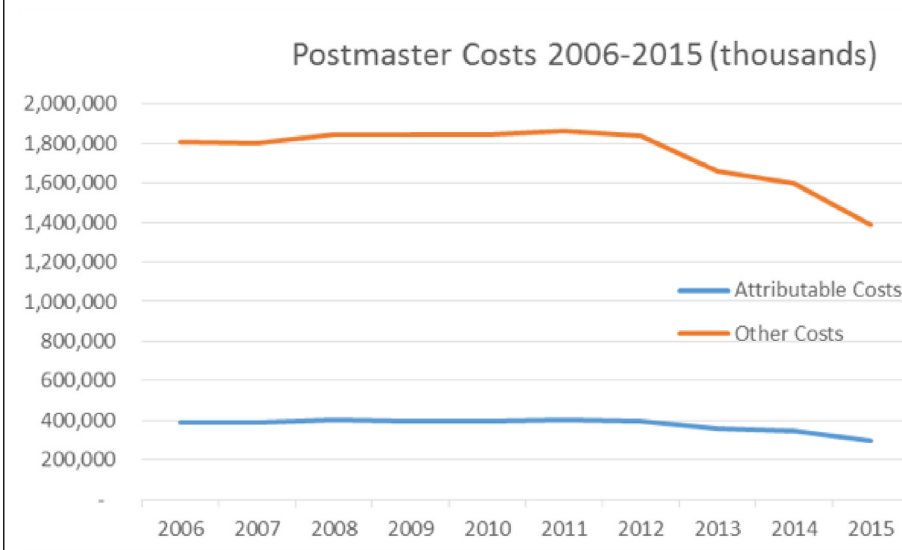
- The attributable cost of a product is the sum of its volume variable and product-specific costs. Costs attributed to products are either “volume variable” or “product-specific.”
  - Volume variable costs are calculated by multiplying the marginal cost by the volume. The marginal cost of a product is the change in costs caused by a change in volume.
  - Product-specific costs are product related, but do not vary with volume.<sup>17</sup> There are no product-specific costs for the Postmaster Cost Segment.
- Costs that are not determined to be attributable to a product are classified as institutional.
  - Institutional costs are the difference between total accrued costs and total attributable costs.

Postmaster attributable and institutional costs have generally followed similar trends over the prior 10 years (see [Figure 2](#)).

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<sup>17</sup> Advertising is an example of a product-specific cost, but the expense does not vary with volume during that period.

**Figure 2: Postmaster Costs Since FY 2006**



Source: Postal Service *Summary Description of USPS Development of Costs by Segments and Components* reports, FYs 2006-2015.

The process for preparing the Postmaster Cost Segment of the CSC report includes the following steps:

- Total accrued costs for postmaster salaries, benefits, and related costs are obtained from general ledger sub-accounts 101 and 102. They are adjusted or re-allocated, as necessary, in a trial balance worksheet of postmaster expenses.
- Accrued costs from sub-account 101 in the trial balance are split between two postmaster component groups, EAS-23 and below and EAS 24 and above, using proportions developed from actual salaries at each EAS grade level.
- Costs from sub- account 102, Postmaster Relief and Replacement, are added to the EAS-23 and below costs to complete the total accrued costs calculations by component.
- Postmaster variability (18.23 percent determined by a 1984 functional workload study) is applied to total accrued costs for EAS-23 and below to determine volume variable costs. All EAS-24 and above cost are considered institutional costs.
- EAS-23 and below costs that are not volume variable are reported as institutional costs.
- There are no product-specific costs for the Postmasters Cost Segment; therefore, EAS-23 and below volume variable costs equal attributable costs for this segment.
- Attributable costs are allocated to mail products and services based on proportions determined from national RPW revenue data and subsequently used to develop the CRA.

## Objective, Scope, and Methodology

Our objective was to assess whether inputs to the Postmaster Cost Segment were accurately calculated and recorded. The scope of this project included a review of the calculations and data used to prepare the Postmaster Cost Segment report for the FY 2014 and 2015 CSC reports.

To accomplish our objective we:

- Reviewed the Postmaster Cost Segment report worksheet in the CSC reports for FYs 2014 and 2015.
- Obtained and reviewed the cost segment summary descriptions preface and Postmaster Cost Segment for FYs 2014 and 2015 to identify the cost segment preparation methodology.
- Met with management at Postal Service Headquarters and the Eagan, MN, Accounting Service Center to discuss processes, procedures, and documentation.
- Obtained and reviewed information for PRC Docket R84-1 and Docket RM2011-3.
- Obtained and reviewed workpapers filed with the PRC that included CRA workpapers, RPW reports, trial balances, payroll reports, and RPW extracts.
- Executed a query and reviewed the ANCM for the Postmaster Cost Segment.
- Compared data inputs to related workpapers to gauge the accuracy of the data inputs and reasonableness of line items.
- Reviewed calculations and proportions in CRA “B” workpapers and the Postmaster Cost Segment worksheets.

We conducted this performance audit from February through September 2016, 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We discussed our observations and conclusions with management on August 1, 2016, and included their comments where appropriate.

We assessed the reliability of costing data by interviewing the Postal Service’s manager, Cost Attribution, and Eagan Accounting Service Center senior payroll accountants to determine how the data was collected and used. Additionally, we obtained the FY 2014 and FY 2015 CSC reports and RPW reports from the Postal Service. Through our evaluation of this information, we assessed the appropriateness of data inputs. We determined that the data were sufficiently reliable for the purposes of this report.



## Prior Audit Coverage

Report Title	Report Number	Final Report Date	Monetary Impact
<i>U.S. Postal Service Building Occupancy Data</i>	<a href="#">CP-AR-16-002</a>	12/8/2015	None

**Report Results:** Our report determined that building occupancy costs reported in the FY 2014 ACR did not accurately reflect current network and operational changes. The latest facility space usage study was completed in 1999 and over 20 percent of facilities surveyed for the study were no longer in use and there was no documented process for annual updates to facility space usage data. In addition, the methodology used to attribute costs to products in cost segment 15 was outdated and included vacant space costs and a portion of utilities and communication costs, which were generally considered institutional. Management agreed, in part, that costs reported in the FY 2014 ACR did not accurately reflect current network and operational changes and that some improvements could be made in collecting building occupancy data. Management disagreed that the methodology used to attribute costs to products is outdated, asserting that because the recognized attributable costs of current market rental value was greater than total actual rent expenses paid, they could attribute total actual rent expenses paid to products.

## Appendix B: Management's Comments

SHARON D. OWENS  
VICE PRESIDENT, PRICING AND COSTING



August 26, 2016

LORI LAU DILLARD  
DIRECTOR, AUDIT OPERATIONS

SUBJECT: Postmaster Cost Segment (CP-AR-16\_DRAFT)

The OIG draft audit report identified erroneous accounts assigned to Postmasters costs and alleged this was due to a lack of formal review or process.<sup>1</sup> The Postal Service acknowledges that in both FYs 2014 and 2015, seven general ledger accounts were incorrectly assigned to the Postmaster Cost Segment, Cost Segment 1, and that two additional accounts were mislabeled but properly assigned to Cost Segment 1. As shown in Table 1 of the draft audit report, six of the seven accounts incorrectly assigned to Cost Segment 1 in FY 2014 had zero balances (with the seventh having a balance of \$46), and in FY 2015, five of the seven incorrectly assigned accounts had zero balances. Thus, the Postal Service agrees with the draft audit report statement that this issue did not have a material impact. The impact of the incorrectly assigned accounts in FY 2015 was the erroneous assignment of less than \$360 thousand to product costs. The Postal Service denies that there is no process for reviewing account names and cost segment designations. The Finance Number Control Master/Account Number Control Master F8 Process requires notification of any addition or subtraction of a general ledger account or finance number and any change in name or other characteristic of an account or subaccount submitted to a cross-functional group, including Cost Attribution in Pricing and Costing, for review. Further, as noted in the draft audit report, additional review was undertaken to correct the errors listed above and additional analysis is being undertaken to identify any shortcomings in our processes.

The OIG draft report indicates that the distribution of attributable costs is not consistent with the method described in the Summary Description. The Postal Service acknowledges that the statement in the Summary Description of the distribution key for attributable costs in Cost Segment 1 for FY 2014 and previous years was not precisely correct. The Summary Descriptions (called the CSC in the draft audit report) prior to FY 2015 stated: "Volume variable costs are distributed among mail products and special services on the basis of revenue relationships determined from national Revenue, Pieces, and Weight (RPW) data." (Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 2014, CS01-14.doc, page 1-2, section 1.1.4.) While the statement was correct, it was incomplete. In fact, the distribution was, and has been, on the basis of RPW revenue with one adjustment to the revenue of Money Orders. The RPW revenue for Money Orders does not include the interest income from float on uncashed Money Orders, whereas the revenue reported for Money Orders in the Cost and Revenue Analysis (CRA) report does. It was the CRA revenue that both the Postal Service and the Postal Regulatory Commission (Commission) had been using for the distribution of the attributable costs of Cost Segment 1.<sup>2</sup> The Summary Description for FY 2015, filed with the Commission on July 6, 2016, contains more precise language, indicating "Volume variable costs are distributed to products based on revenue proportions from the Cost and Revenue Analysis (CRA) report." (Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 2015, CS01-15.doc, page 1-2, section 1.1.4.)

<sup>1</sup> "In FY 2014 we found seven of 87 accounts incorrectly assigned to the Postmaster Cost Segment, and in FY 2015, we found seven of 88 accounts incorrectly assigned to the Postmaster Cost Segment. In addition, two expense accounts that were properly included in the Postmaster Cost Segment each year had erroneous account descriptions. These issues occurred because there is no formal review and reconciliation conducted during the year-end account adjustment process." (OIG audit draft report, at page 2)

<sup>2</sup> See, for example, Annual Compliance Determination, Docket No. ACR2015, PRC-LR1 for the revenue adjustment made in the Commission's work papers.

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The draft audit report stated that the Postal Service did not use the procedures described in the Summary Description, of using the unadjusted RPW revenue, "resulting in using overstated interest revenue to distribute attributable costs." (draft audit report at page 2) The Postal Service submits that both the Postal Service and Commission do use and have been using the CRA revenue for distribution of Cost Segment 1 costs, and that there was no overstatement of revenue, but even had the revenue been overstated as suggested by the report, the impact on the attributable costs of Money Orders would have been less than \$7,500 in FY 2015.

The Postal Service agrees with the draft audit report that "the exceptions or overstated revenue did not have a material impact on reporting Postmaster Cost Segment data for FYs 2014 and 2015." (draft audit report at page 2)

The Postal Service agrees with the draft audit report's finding that

the postmaster variability study used to estimate volume variable costs has not been updated since 1984. In FY 2013, the Postal Service notified the PRC that it anticipated initiating the update to the study in FY 2014. In November 2015, the PRC postponed its request to update the study pending implementation of the Post Office Structure Plan (POStPlan) because it could materially impact the outcome of the study. The POStPlan implementation was completed in February 2015, yet the study had not been updated as of June 2016. (draft audit report at page 2)

The update of the Postmaster study was one of the priorities, along with the updates of the city carrier street time study, the highway transportation variabilities, and window costs, that were identified by the Postal Service and the Commission in Docket No. RM2011-3, the Strategic Rulemaking on changes in analytical principles, a docket closed by the Commission on November 3, 2015. The Postal Service filed proposals for an updated city carrier street study and the first phase of updated highway transportation variabilities and had begun the initial stages of investigating the options for updating the postmasters study when the Strategic Rulemaking docket was closed. Efforts are underway. The Postal Service submits that updating a study of this complexity is not a simple undertaking – else an update, or series of updates, would certainly have been completed between 1984 and the present time. With an analytical undertaking of this nature, it is not enough to establish a timeline and meet that deadline as the availability and quality of the actual data required, as well as the difficulty encountered in obtaining reasonable and defensible results will all necessarily determine the success of the project. The timeline, when developed, will likely shift depending upon available resources, ease of accessing appropriate data, and the intervention of other priorities.

Recommendation 1:

Conduct an annual review and reconciliation of expense account assignment and descriptions, that includes revising applicable guidance for communicating roles and responsibilities.

Management Response/Action Plan:

Management agrees with this recommendation and notes that a process is already in place to review any changes in accounts. The Finance Number Control Master/Account Number Control Master F8 Process, managed by Accounting, alerts postal staff across the organization (including Cost Attribution) of any proposed changes to accounts and their treatment in the cost segments and components -- to assure concurrence from pertinent parties. Cost Attribution staff review these proposals as they occur to provide input and adapt the cost segments and components (trial balance) for any changes. In addition, to address the erroneous accounts identified by the OIG audit team, an additional, one-time effort is required to review the trial balance process to assure assignment of current general ledger accounts and subaccounts costs to the correct cost segments and components.

Target Implementation Date:

October 2016

Responsible Official:

Sharon Owens, Vice President of Pricing and Costing

Recommendation 2:

Follow or revise procedures in the Summary Description of USPS Development of Costs by Segments and Components report related to distribution of volume variable costs to mail products and specials services.

Management Response/Action Plan:

Management agrees. The phrasing in the FY 2015 Summary Description filed with the Commission on July 6, 2016, stated that the distribution key for attributable Cost Segment 1 costs was the CRA revenue. The cost distribution process did not and will not change, per se, but the description in the Summary Description more accurately specifies the distribution key.

Target Implementation Date:

July 2016

Responsible Official:

Sharon Owens, Vice President of Pricing and Costing

Recommendation 3:

Communicate to the Postal Regulatory Commission the status of the Post Office Structure Plan and develop a timeline and approach for updating the postmaster variability study.

Management Response/Action Plan:

Management disagrees in part with this recommendation. The Postal Service is not obligated to provide further information to the Commission regarding POSTPlan. The Postal Service is obligated to report in the Annual Compliance Report on access to post offices, but this requirement is not specific to POSTPlan. With the closing of Docket No. RM2011-3, the Postal Service is no longer obligated to inform the Commission about progress or intent to revise costing methodologies. If and when the Postal Service completes an update to the postmaster variability study, or any other aspect of postmaster costs, the Postal Service will follow Commission rules and file a proposed change in methodology for Commission review. With respect to updating the postmaster variability, work had already begun on the process and approach, as was described in the Postal Service Response to PRC Order No. 1626 in Docket No. RM2011-3, particularly on pages 26 through 28. The timeline for completing the study will be developed, but may shift depending upon available resources, ease of accessing appropriate data, and the intervention of other priorities. As noted, with an analytical undertaking of this nature, it is not a simple matter to establish a timeline and meet that deadline as the availability and quality of the actual data required, as well as the difficulty encountered in obtaining reasonable and defensible results will all necessarily determine the success of such an undertaking.

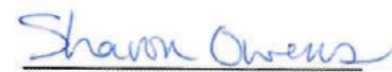
Target Implementation Date:

July 2018



Responsible Official:

Sharon Owens, Vice President of Pricing and Costing

  
Sharon Owens

Sharon Owens

cc: Maura McNerney, Controller  
Virginia Mayes, Manager, Cost Attribution  
Sally Haring, Manager, Corporate Audit Response Management



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