December 22, 1999

M. RICHARD PORRAS
CHIEF FINANCIAL OFFICER AND
SENIOR VICE PRESIDENT

SUBJECT: Review of Budget Cost Containment Measures
(Report Number FR-MA-00-001)

This management advisory report presents the results of our review of budget cost containment measures (Project Number 99PA027FR000). In September 1998, the postmaster general asked his officers to reduce headquarters expenses to preserve fiscal year (FY) 1999 financial goals. To meet this financial challenge, headquarters management assessed their budgets for potential reductions for FY 1999 and FY 2000. We conducted the review to identify: (1) key factors responsible for successfully implementing the FY 1999 "Management Challenge" and (2) opportunities to improve future budget reductions.

## Results in Brief

The Postal Service surpassed its "Management Challenge" through reductions in headquarters programs to preserve financial goals for FY 1999. The "Management Challenge" process was accomplished through functional coordination that yielded reductions in budgeted expenses and more efficient operations. As a result, the Postal Service reduced its expenses for FY 1999 by about $675 million with little impact on customer service.[1]

In addition, opportunities exist to improve the process in the event future budget reductions are required. Specifically, 32 of the 50 personnel we interviewed stated that guidelines and criteria were not disseminated to all levels of the organization and 20 personnel stated they should have focused more on strategic goals to fully optimize the

[1] According to senior postal officials.

outcome of the "Management Challenge." Further, 48 of the 50 personnel we interviewed expressed concerns regarding not having a method for evaluating the impact on programs after budget reductions.

We suggested that in the event of future initiatives for budget reductions, the Postal Service should: (1) issue written guidelines and criteria, (2) communicate the strategic approach to all levels of the organization, and (3) require program managers to maintain documentation to reflect the impact of budget reductions. Management agreed with and has planned actions that are responsive to our suggestions. Management's comments are included, in their entirety, in Appendix B.

## Other Pertinent Matters

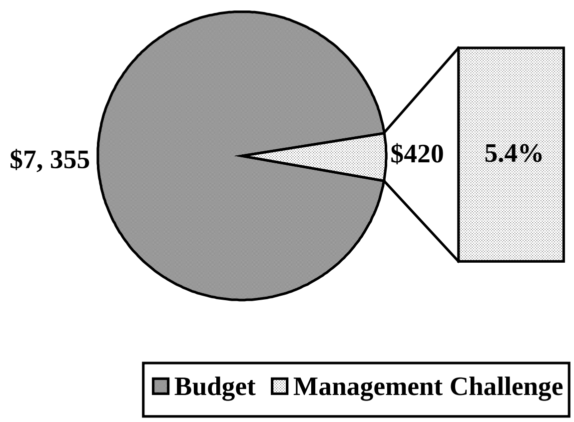
Of the 16 vice presidents we interviewed, 13 stated they should have focused more on strategic instead of tactical goals. We agree with their assessment and are concerned that the program plans may not appropriately document expected outcomes and their impact on generating revenue. In addition, as previously stated in the report, headquarters reduced expenses by about $675 million with little impact on customer service. The lack of measurable impact may have resulted from not having data and documentation to evaluate the immediate and long-term impact of budget reductions, or not linking budgeted amounts to anticipated levels of performance during program planning. For these reasons, we are initiating an audit to assess the Postal Service's budget formulation process.

## Background

Due to delays in the rate increase and a decrease in projected revenues, the postmaster general requested headquarters personnel to reduce their budgeted expenses by $400 million during FY 1999. This request was referred to as the "Management Challenge." To meet this financial challenge, headquarters personnel focused on cost containment measures and began taking aggressive management actions to meet the challenge and preserve the $200 million net income planned.

As of December 4, 1998, revenues were about $176 million below projections. Therefore, to achieve original net income projections, officials reduced headquarters budgeted expenses from $7.8 to $7.4 billion, resulting in reductions to budgeted expenses of about $420 million[2] (5.4 percent). The following chart depicts this reduction.

**Postal Service Headquarters FY 1999 Budget (In Millions)**




In addition to reductions taken at headquarters, the Postal Service was able to significantly reduce its expenses in the field during FY 1999. These reductions were not achieved through the formal "Management Challenge" process and were not specifically addressed during this review. Budget formulation and execution for field operations will be addressed in future Office of the Inspector General's audit coverage.

## Objective, Scope, and Methodology

Our objectives were to identify: (1) key factors responsible for successfully implementing the FY 1999 "Management Challenge" and (2) opportunities to improve future budget reductions. To conduct our review, we:

- Reviewed 5 of the 14 headquarters functional areas,[3] which comprised about 94 percent of the budget reduction dollars.
- Interviewed 16 vice presidents, 21 program managers, and 13 budget coordinators and consolidated their views to provide lessons learned.
- Examined processes used to identify budget reductions.

[2] Rounding. The actual number is $416 million.
[3] Areas evaluated are comprised of deputy postmaster general, chief marketing officer, chief operating officer, chief technology officer, and corporate transportation.

- Reviewed applicable documentation regarding the process.

This review was conducted from August through November 1999, in accordance with the President's Council on Integrity and Efficiency, Quality Standards for Inspections.

Audit field work was completed, and the draft results of this audit published, prior to approval and publication of the FY 1999 audited financial statements of the Postal Service. In the interest of consistency between the draft and final reports, we did not revise the financial information contained in the report. However, differences were not material and had no overall effect on the results of our review.

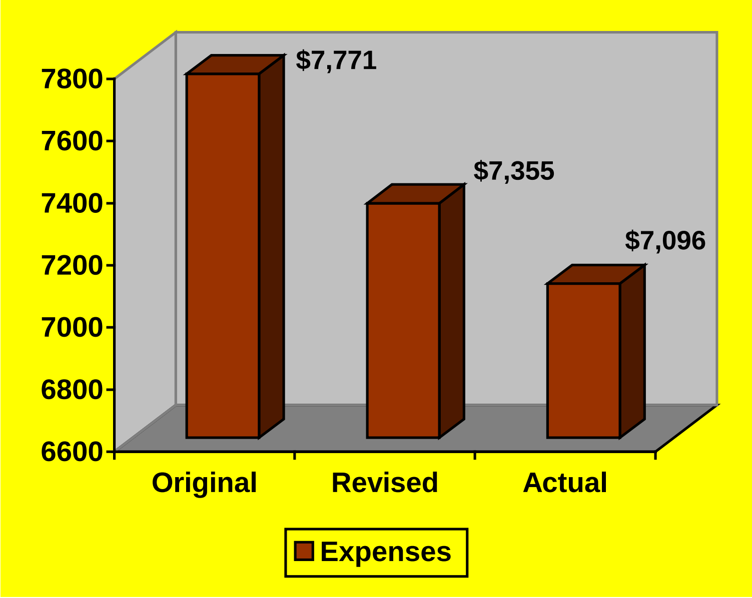
We discussed our conclusions and observations with appropriate management officials and included their comments, where appropriate.

## Management Challenge

The Postal Service surpassed its "Management Challenge" through reductions in headquarters programs to preserve financial goals for FY 1999. As a result, headquarters reduced its expenses by about $675 million with little impact on customer service.

Headquarters revised its original FY 1999 budget from about $7.8 billion to $7.4 billion, resulting in reductions of about $420 million. Further, headquarters made additional reductions of $259 million to realize end of the year actual expenses of $7.1 billion. Therefore, the overall effect of implementing the "Management Challenge" and additional reductions was about $675 million as depicted in the following chart.

**FY 1999 Headquarters Budgeted Versus Actual Expenses[4]**
**(In Millions)**




During our audit, we interviewed 50 key headquarters personnel assigned to various functional areas and levels, to assist us with assessing the process used to implement the FY 1999 "Management Challenge." Appendix A provides a summary of the overall interview results regarding the "Management Challenge."

The "Management Challenge" process was accomplished through functional coordination that yielded reductions in budgeted expenses and more efficient operations. The following graph depicts the number of key personnel we interviewed that expressed their views on the process strengths that contributed to accomplishing the "Management Challenge."

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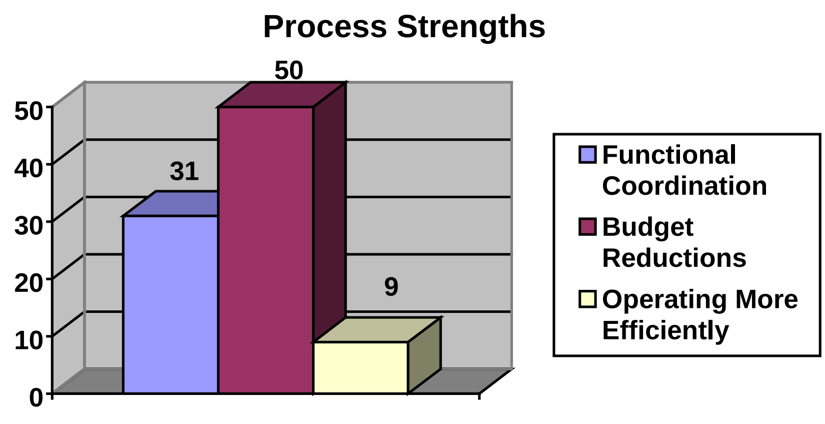
[4] These expenses are based on preliminary (unaudited) accounting period 13 financial results.




In addition, opportunities exist to improve the future budget reduction process.

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**Functional Coordination**

The "Management Challenge" was a coordinated effort and not just the responsibility of the controller or chief financial officer. Of the 50 personnel we interviewed, 31 stated that functional coordination was a key factor in accomplishing the "Management Challenge." The following table depicts the number of key personnel sharing that view by functional level.

**Functional Coordination**

| | Interviewed | Confirmed |
|---|---|---|
| Management Committee Members | 5 | 5 |
| Vice Presidents | 11 | 3 |
| Program Managers | 21 | 14 |
| Budget Coordinators | 13 | 9 |
| Total: | 50 | 31 |

To illustrate, headquarters management committee, in coordination with the Establish Team,[5] held discussions to effectively respond to the "Management Challenge." Our interviews with committee members disclosed that the team used an iterative process to coordinate among functional areas, at the headquarters level. This process was also

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[5] The Establish Team was the team responsible for the initial phase of the budget planning process.

used to determine interdependencies among programs and potential impacts for programs if they were reduced, deferred, or eliminated.

Committee members then met with responsible personnel[6] within their functional areas and collectively made decisions on how to achieve the "Management Challenge." Specifically, management evaluated the consistency between fixed (mandatory) and variable (discretionary) costs for selected programs. Management also prioritized programs and computed return on investment to determine potential cost savings, and then reduced, deferred, or eliminated the programs accordingly. As a result, headquarters personnel reduced their budgeted expenses.

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Budget Reductions

Key headquarters personnel reduced budgeted expenses within their functional areas to achieve the "Management Challenge." Based on our interviews with key personnel, all 50 stated they took budget reductions to achieve the "Management Challenge." Examples of some of the significant reductions taken by the personnel included:

- Selected advertising at the headquarters level was reduced by about $58 million. Reductions were taken in Field Sponsorship, Research and Development, and Special Service Advertising.

- Budgeted expenses for the Corporate Call Management program were reduced by $53 million. The reductions were achieved by pursuing a slower implementation schedule.[7]

- Transportation costs were reduced by $50 million by using space more efficiently on dedicated aircraft.

- The Point of Service program was reduced by $15 million. The reductions were accomplished by delaying program implementation.

These reductions comprised about $176 million (40 percent) of the $420 million in the reductions headquarters initially took with regard to the "Management Challenge."

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[6] Management, program managers, and budget coordinators
[7] According to postal officials, the full board was notified of the decisions regarding the Corporate Call Management and Point of Service programs.

Operating More Efficiently

Senior management in coordination with key personnel reassessed many business processes to identify opportunities for increased efficiency. The following table depicts the number of personnel we interviewed by functional level that stated operating more efficiently was key in implementing the "Management Challenge."

**Operating More Efficiently**

| | Interviewed | Confirmed |
|---|---|---|
| Management Committee Members | 5 | 2 |
| Vice Presidents | 11 | 5 |
| Total: | 16 | 7[8] |

Specifically, officials stated they:

- Questioned the validity and accuracy of support service costs provided by other headquarters functional areas.
- Reduced the timeframes and costs for training, conferences, and seminars by having teleconferences and changing locations for training to be near an airport.
- Developed intranet training systems and thus, reduced printing and mailing costs.
- Discontinued payment for research and development of selected logistics systems and opted to use technology that was available commercially (off-the-shelf).

Thus, according to postal officials, their decisions resulted in business efficiencies that contributed to the successful execution of the "Management Challenge."

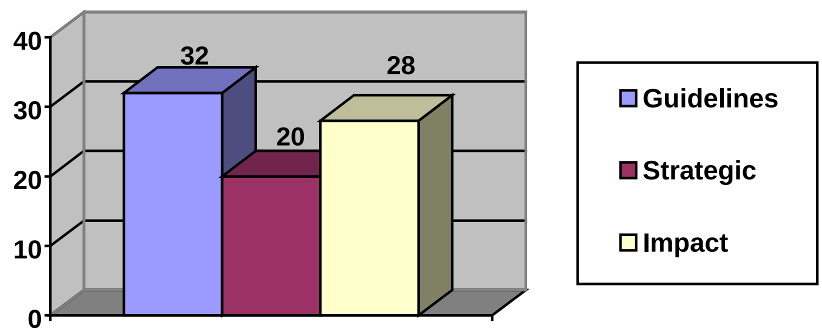
**Process Improvements**

Based on our review, opportunities exist to improve the process if future budget reductions are necessary. To improve the process management should: (1) issue written guidelines and criteria, (2) communicate the strategic approach to all levels of the organization, and (3) require program managers to maintain documentation to reflect the

[8] We did not include the program managers and budget coordinators because vice presidents are ultimately responsible for making decisions regarding programs.

impact of budget reductions. The number of key personnel sharing those views is depicted in the following chart.

**Process Improvements**




Guidelines and Criteria

Specific guidelines and criteria could have assisted headquarters personnel with optimizing the outcome of the "Management Challenge." The following table depicts the number of key personnel we interviewed, by functional level, who viewed guidelines and criteria as an area warranting improvement.

**Guidelines and Criteria**

| | Interviewed | Confirmed |
|---|---|---|
| Vice Presidents | 11 | 7 |
| Program Managers | 21 | 15 |
| Budget Coordinators | 13 | 8 |
| Total: | 45 | 30[9] |

Key personnel stated they were told to make reductions, but were not given specific guidance on how to preserve the FY 1999 financial goals of the Postal Service. For instance, the committee members had discussions and provided instructions among committee members to execute the "Management Challenge." However, the results of the discussions, including guidelines and criteria, often were not communicated to functional area personnel.

Overall, there were three phases for requesting budget reductions. During each phase, management was tasked

[9] This number does not include the management committee, shown in the bar graph, because committee members were responsible for establishing and disseminating guidelines and criteria.

with making budget reductions in a short timeframe. Personnel considered the task to be complicated because the targeted amount for reducing expenses changed as the overall expense information changed. In addition, management stated they made reductions but were often concerned about the strategic (long-term) implications.

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Strategic Versus Tactical

Key personnel often did not focus on strategic goals when making budget reductions. Overall, 20 personnel we interviewed stated they took a tactical approach to implement the “Management Challenge.” The following table depicts the number of key personnel, by functional level, who shared this view.

**Strategic Versus Tactical**

| | Interviewed | Confirmed |
|---|---|---|
| Committee Members | 5 | 4 |
| Vice Presidents | 11 | 9 |
| Program Managers | 21 | 3 |
| Budget Coordinators | 13 | 4 |
| Total: | 50 | 20 |

Because the focus was on tactical goals, value-added programs were eliminated or deferred. For example:

- One program implemented to prevent fraudulent submissions of change-of-address orders by sending a move validation letter to customers who are moving was eliminated based on recommendations by the area vice presidents to save $10.6 million. Committee members reestablished this program because of the increased risk for fraud. After the budget was restored, post offices attempted to resend the validation letters, but were unable to recover and process all of the letters. Thus, we believe taking a more strategic approach could have resulted in a decision not to eliminate the program and ensure validation letters were processed and received.

- Alternative Dispute Resolution program, established to assist headquarters with informal, timely resolutions of Equal Employment Opportunity conflicts, was initially reduced by $3.3 million for training, travel, and promotional items. However, officials later reprogrammed $2 million to fund the program because they were concerned that the reduction in expenses would adversely impact this value-added program.

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Impact on Programs

Key personnel did not have a method for evaluating the impact on programs after budget reductions and determining the overall impact of deferring, reducing, or eliminating selected programs. As depicted in the following table, 28 key personnel we interviewed, by functional level, shared this view.

**Program Impact**

| | Interviewed | Confirmed |
|---|---|---|
| Committee Members | 5 | 4 |
| Vice Presidents | 11 | 10 |
| Program Managers | 21 | 10 |
| Budget Coordinators | 13 | 4 |
| Total: | 50 | 28 |

Management stated there was no method to determine the impact because personnel did not maintain documentation to reflect the impact after making budget reductions and most of the reductions were taken from long-term programs with future year benefits. For example, management:

- Reduced advertising for products or campaigns, such as Priority Mail, international mail, and new business initiatives. Thus, the reductions could have an adverse effect on current and future revenues.

- Delayed implementation for capital programs. However, they could not fully assess the long-term impact of the reductions because the full benefit of the program would not be realized until future years.

- Did not renew contracts for hardware upgrades and corporate software licenses agreements. Consequently, headquarters could be operating with outdated and obsolete hardware and software in the future.

Establishing written guidelines and criteria, ensuring strategic as well as tactical goals are appropriately communicated and requiring program managers to maintain documentation after budget reductions will assist headquarters in optimizing benefits derived from budget reductions in future years.

**Suggestions**

We offer the following suggestions.

The chief financial officer and senior vice president should coordinate with the Management Committee to:

1. Provide written guidelines and criteria to ensure strategic and tactical goals are communicated to optimize benefits derived from future budget reductions.

2. Require responsible personnel to document programs, including detailed project plans, to evaluate the impact of budget reductions at both headquarters and functional levels to ensure reductions are in agreement with headquarters goals and strategies.

**Management's Comments**

The chief financial officer and senior vice president concurred with our suggestions and advised that officials would incorporate written guidelines and criteria in subsequent budget activities. Officials will also continue to inform program managers of their responsibility to document programs in the budget development process.

In addition, the chief financial officer and senior vice president requested clarification on the statement in our report, "management did not renew contracts for hardware upgrades and corporate software licenses agreements. Consequently, headquarters could be operating with outdated and obsolete hardware and software in the future."

**Evaluation of Management's Comments**

Management's comments were responsive to our suggestions. In reference to management's request to clarify the statement regarding hardware upgrades and software licenses agreements, we offer the following response. Based on our discussions with management personnel, we reported this issue because, although there was no immediate impact, we had concerns about future impacts on postal operations.

We appreciated the cooperation and courtesies provided by your staff during the review. If you have any questions, please contact me at (703) 248-2300.

Richard F. Chambers
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for Performance

Attachment

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# Appendix A

## SUMMARY OF INTERVIEW RESULTS REGARDING THE PROCESS FOR THE "MANAGEMENT CHALLENGE"

| POSITION | Process Strengths | | | Process Improvements | | |
|---|---|---|---|---|---|---|
| | Functional Coordination | Budget Reductions | Operating More Efficiently | Guidance and Criteria | Strategic vs. Tactical | Program Impacts |
| **MANAGEMENT COMMITTEE[10] *(5)*** | 5 | 5 | 2 | 2 | 4 | 4 |
| **VICE PRESIDENTS *(11)*** | 3 | 11 | 5 | 7 | 9 | 10 |
| **PROGRAM MANAGERS / MANAGERS *(21)*** | 14 | 21 | 1 | 15 | 3 | 10 |
| **BUDGET COORDINATORS *(13)*** | 9 | 13 | 1 | 8 | 4 | 4 |
| **TOTAL *(50)*:** | 31 | 50 | 9 | 32 | 20 | 28 |

[10] Management Committee is comprised of the senior vice presidents.

# APPENDIX B. MANAGEMENT'S COMMENTS

M. RICHARD PORRAS
CHIEF FINANCIAL OFFICER
EXECUTIVE VICE PRESIDENT

UNITED STATES
POSTAL SERVICE

December 16, 1999

RICHARD F. CHAMBERS

SUBJECT: Draft Management Advisory Report – Review of Budget Cost Containment Measures (Report Number FR-MA-00-DRAFT)

We have reviewed the above referenced report, and are in general agreement with its content and findings with one exception. On page 11, under the "Impact on Program" section, the last bullet states that management indicated:

> "Did not renew contracts for hardware upgrades and corporate software licenses agreements. Consequently, headquarters could be operating with outdated and obsolete hardware and software in the future."

Clearly, this statement needs clarification. The actions taken in relation to the Management Challenge related strictly to fiscal year (FY) 1999 budget funds. Decisions made to defer upgrades were predicated on funding availability. If these decisions to delay had impacted postal operations, they would not have been made.

On the two recommendations, we will incorporate written guidelines and criteria in subsequent budget reduction activities. We will continue to inform program managers of their responsibility to document programs in the budget development process. This will be included in our FY 2001 budget process.

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## Major Contributors to This Report

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