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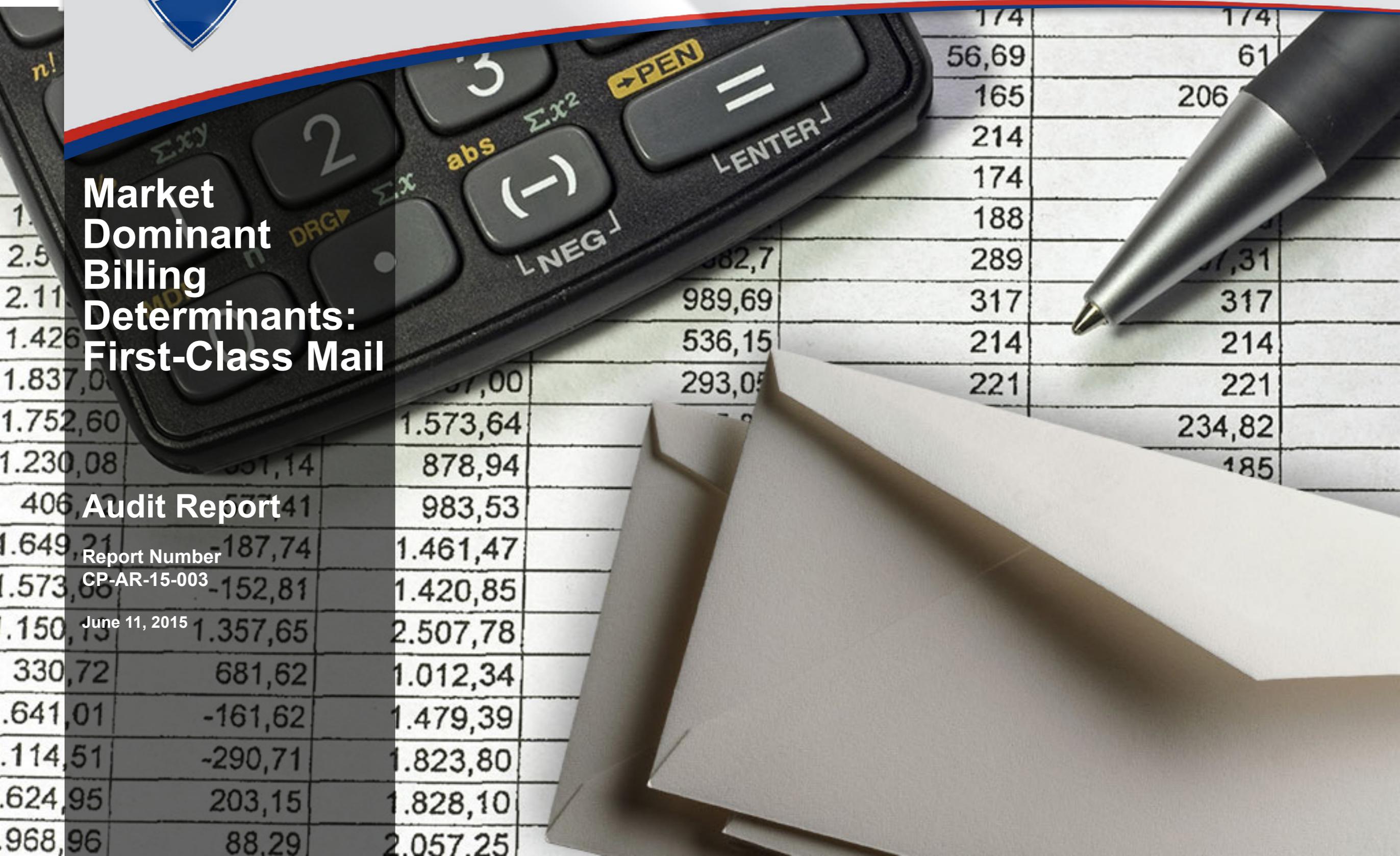
UNITED STATES POSTAL SERVICE

Market Dominant Billing Determinants: First-Class Mail

Audit Report

Report Number
CP-AR-15-003

June 11, 2015





OFFICE OF INSPECTOR GENERAL

UNITED STATES POSTAL SERVICE

Highlights

The Postal Service uses billing determinants to ensure price adjustments do not exceed the price cap for each market dominant class of mail.

Background

Billing determinants are spreadsheets that U.S. Postal Service employees manually produce to report volume and revenue for each price in the five market dominant classes of mail, including First-Class Mail. The Postal Service primarily obtains this data from its published price list and the Revenue, Pieces, and Weight codes.

The Postal Accountability and Enhancement Act requires the Postal Service to produce an Annual Compliance Report within 90 days of the end of each fiscal year. The report analyzes costs, revenue, pricing, and quality of service for all products. The Postal Service uses billing determinants to ensure price adjustments do not exceed the price cap for each market dominant class of mail. Given the manual preparation and complexity of the spreadsheets, there is a risk of data entry errors. Our objective was to assess the completeness and accuracy of the data used in market dominant billing determinants for First-Class Mail.

What The OIG Found

We did not find any issues with the completeness of billing determinants but opportunities exist to improve the accuracy of the Postal Service's billing determinant calculations. Specifically, there were errors in fiscal year (FY) 2013 and FY 2014 First-Class Mail® billing determinants resulting from inconsistent accounting of mail volume due to reclassifications

and calculations we could not verify. As a result, the Postal Service incorrectly calculated a combined \$156.8 million in revenue for FYs 2013 and 2014. Although these errors did not impact compliance with 2015 price cap requirements, there is a risk that future billing determinant calculation errors could.

Overall, these errors occurred because the Postal Service did not establish strong controls over the billing determinant calculation process. Specifically, the Postal Service did not have documented repeatable processes to guide in the preparation of billing determinant spreadsheets and did not conduct quality reviews of billing determinants prior to publication. Recently, the vice president, Pricing, stated that Finance employees have begun reviewing billing determinant calculations for accuracy.

What The OIG Recommended

We recommended the vice president, Pricing, file corrected FY 2013 and FY 2014 billing determinants with the Postal Regulatory Commission; develop procedures to ensure billing determinants are produced using documented, repeatable processes; and establish a quality review process. The current process, with the amount of judgement required and the tight timeframes, would be difficult to automate; however, as business processes change, opportunities for automation may increase and should be pursued.

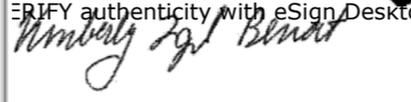
Transmittal Letter



OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

June 11, 2015

MEMORANDUM FOR: CYNTHIA SANCHEZ-HERNANDEZ
VICE PRESIDENT, PRICING

E-Signed by Kimberly Benoit
VERIFY authenticity with eSign Desktop


FROM: Kimberly F. Benoit
Deputy Assistant Inspector General
for Technology Investment and Cost

SUBJECT: Audit Report – Market Dominant Billing Determinants:
First-Class Mail (Report Number CP-AR-15-003)

This report presents the results of our audit of Market Dominant Billing Determinants:
First-Class Mail (Project Number 15TG005CP000).

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

Attachment

cc: Corporate Audit and Response Management

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Findings

Opportunities exist to improve the accuracy of the Postal Service's billing determinant calculations for First-Class Mail.

Introduction

This report presents the results of our self-initiated audit of the U.S. Postal Service's Market Dominant Billing Determinants for First-Class Mail (Project Number 15TG005CP000). The objective was to assess the completeness and accuracy of market dominant billing determinants for First-Class Mail. See [Appendix A](#) for additional information about this audit.

Billing determinants are spreadsheets that Postal Service employees manually produce to report volume and calculated revenue¹ for every price in the five market dominant classes of mail: First-Class Mail, Periodicals, Standard Mail, Package Services, and Special Services.

The Postal Service and the Postal Regulatory Commission (PRC) use the billing determinants to ensure price adjustments do not exceed the price cap for each market dominant class of mail. The Postal Service also uses billing determinants in the Annual Compliance Report (ACR) as a limited portion of the process to develop avoided cost estimates, which the Postal Service uses to set works

Conclusion

While we did not find any issues with the completeness of billing determinants, opportunities exist to improve the accuracy of the Postal Service's billing determinant calculations for First-Class Mail. Specifically, we identified errors resulting from an inconsistent accounting of mail volume and calculations that could not be verified. The combined effect of these errors resulted in the Postal Service incorrectly reporting \$156.8 million² in calculated revenue for fiscal year (FY) 2013 and FY 2014. Although these errors did not result in the Postal Service having to adjust prices, there is a risk that future billing determinant calculation errors could result in prices that exceed the price cap.³

Billing Determinant Accuracy

Opportunities exist to improve the accuracy of billing determinant calculations for First-Class Mail. We noted three types of errors: inconsistent accounting of mail volumes due to product reclassifications, data anomalies, and other calculation errors.

Overall, these errors occurred because the Postal Service did not establish strong controls over the billing determinant process for First-Class Mail.

Specifically, the Postal Service did not have documented, repeatable processes for preparing billing determinant spreadsheets and did not conduct quality reviews of billing determinants prior to publication. The errors described above resulted in the Postal Service incorrectly reporting \$200,000 in calculated revenue for FY 2013 and \$156.6 million for FY 2014 on the billing determinants spreadsheet. Although these errors did not result in the Postal Service having to adjust prices, there is a risk that future billing determinant calculation errors for First-Class Mail could result in prices that exceed the price cap. Since the beginning of this review, the vice president, Pricing, stated that Finance employees have begun reviewing billing determinant calculations for accuracy.

¹ Calculated revenue equals volume multiplied by price, as opposed to actual revenue, which is revenue the Postal Service receives.

² The amount cited is the absolute value of our calculations which is the sum of the figures regardless of whether they are positive or negative. The net value is \$37,946,810.

³ The price cap is the inflation-based limit on Postal Service prices as described in the Postal Accountability and Enhancement Act (PAEA).

Inconsistent Accounting of Mail Volumes

Mail classification changes can cause errors on billing determinant spreadsheets. These changes occur when the Postal Service adds, removes, or transfers price categories in the mail classification schedule.⁴ In FY 2014 the Postal Service added a separate price for metered mail⁵ to the First-Class Mail® category. As a result, all metered mail price category codes were transferred from single-piece letters into the new metered mail group. Before the Postal Service introduced metered mail, billing determinant volume for single-piece letters included seven Revenue, Pieces and Weight (RPW) category codes.⁶

Following the creation of the metered mail category, four categories remained as single piece letters and three categories moved to metered mail. In Quarter (Q) 2 of FY 2014, the Postal Service included a category reclassified to metered letters in its single-piece letters calculations. The impact of the error in Q2 was \$96.2 million in calculated revenue.

Click the envelopes to reveal the classification breakdown

Revenue, Pieces and Weight (RPW) Category Codes

Data Anomalies

Inaccuracies occurred because subjective judgment is necessary to resolve data anomalies. Data anomalies generally result when source data report volume in weight increments with no associated price. Because there are no written procedures governing how to handle data anomalies, Postal Service employees make judgments based on their experience and knowledge to address each occurrence.

4 The PRC maintains the mail classification schedule, which shows all Postal Service prices.

5 Mail that has indicia imprinted by a meter machine (non-metered mail is typically stamped mail). Indicia are an imprinted designation and marking on mail that denote postage payment (e.g., permit imprint, metered postage, and PC Postage products). Broadly, the term can include postage stamps. In many instances, mailpieces do not display the amount of postage paid.

6 The RPW extract file has distinct category codes for each line of data. Typically, multiple RPW category codes are summed to equal one volume reported in the billing determinants.

Data anomalies occurred in the following First-Class Mail price categories:

Click the envelopes to reveal category definition

**Qualified
Business Reply
Mail (QBRM)**

**Alternate
Postage**

**Round-Trip
DVD**

**Election
Mail**

For instance, the Postal Service used subjective judgment to address data anomalies that occurred with QBRM and Round-Trip DVDs. The Postal Service assumed mailers of QBRM pieces weighing over 2 ounces paid the maximum 2-ounce price, regardless of recorded weight. Alternatively, it assumed that mailers of Round-Trip DVDs weighing more than 2 ounces were paying higher prices that reflected the DVDs' actual weight. The conflicting methodology for these assumptions highlights the subjectivity of the Postal Service's process for compiling billing determinants. The total impact on calculated revenue related to data anomalies in FY 2013 was \$200,000 and for FY 2014 was \$107,000. The Postal Service could eliminate future conflicts by developing documented policies.

Other Calculation Errors

We found five other general calculation errors on the billing determinant spreadsheets in Qs 2, 3, and 4 of FY 2014 for First-Class Mail volume, price, and revenue. We identified calculated revenue errors for the following price categories:

Click the envelopes to reveal price categories

**Retail Parcels
Additional
Ounces**

**Residual
Weight***
(1 ounce or less)

**Residual
Mixed Weight**

**Residual
Over**

**Alternate
Postage**

Billing Determinant Controls

Enhanced controls over the billing determinant process may have prevented errors. Currently, the Postal Service does not have a documented, repeatable process for preparing billing determinant spreadsheets and it does not conduct quality reviews of billing determinant calculations prior to publication. The Postal Service only validates its billing determinants by comparing the actual revenue reported in the RPW report to the billing determinants' calculated revenue.⁷ While this technique identifies large errors resulting from manually calculating billing determinants, it did not identify the types of errors we found in our review. Further, the Pricing department has only 10 calendar days to compile billing determinant spreadsheets because of PRC⁸ filing requirements and the timing of receipt of billing determinant source data.⁹

Source data availability and mail classification changes are constraints that, when combined with a compressed timeline, greatly increase the risk of errors. These constraints also impact the Postal Service's ability to effectively automate production of billing determinants. The current manual process allows the preparer of billing determinants, who is an expert in First-Class Mail prices and mail classifications, to visually verify that the correct source data is used, rather than inspecting computer code for accuracy. The current process, with the amount of judgement required and the tight timeframes, would be difficult to automate; however, as business processes change, opportunities for automation may increase and should be pursued.

Improved controls for billing determinants could be an internal system of written procedures and practices to assess the accuracy and completeness of the volume, price, and revenue data reported in First-Class Mail billing determinants. Additionally, the Postal Service could incorporate Microsoft Excel tools to identify data changes and adopt a review process for billing determinant spreadsheets.

⁷ Volume multiplied by price (as opposed to actual revenue the Postal Service receives).

⁸ 39 *Code of Federal Regulations*, Part 3050.25(e).

⁹ The source data for billing determinants include the RPW extract file, the Special Weight Report, and the Postal Service's published price list (Notice 123).

Recommendations

We recommend management file corrected FY 2013 and FY 2014 billing determinants with the Postal Regulatory Commission; and establish controls that result in the preparation of billing determinants using a documented, repeatable process that includes a quality review process.

We recommend the vice president, Pricing:

1. File necessary corrections to fiscal year 2013 and 2014 First-Class Mail® billing determinants with the Postal Regulatory Commission.
2. Establish controls that result in the preparation of billing determinants using a documented, repeatable process that includes a quality review process.

Management's Comments

Management agreed that there are opportunities to strengthen the billing determinants process. However, while management understands the absolute value method to calculate the \$156.8 million of other impact, they believe the net value of \$37.9 million is a more accurate depiction of the results.

In response to recommendation 1, management stated they will file a corrected version of FY 2014 First-Class Mail billing determinants with the PRC by the end of Q3, FY 2015. Management does not believe that changes are needed to FY 2013 billing determinants.

In response to recommendation 2, management agreed. Management stated that documentation of the processes and establishment of a quality review process is one of the FY 2015 goals for pricing managers and analysts.

See [Appendix B](#) for managements comments in their entirety

Evaluation of Management's Comments

The U.S. Postal Service Office of Inspector General (OIG) considers management's comments responsive to the recommendations and corrective actions should resolve the issues identified in the report. While we understand the Postal Service's perspective on net value, we believe absolute value is a more appropriate measurement. Net value understates the total financial impact of each exception on the billing determinant calculations. While we believe that the FY 2013 billing determinants correction should be filed to ensure accuracy, we understand that the amount is minimal and, therefore, accept the Postal Service's decision not to revise FY 2013 billing determinants. In addition, the Postal Service has taken the initiative to proactively begin documenting the process for preparing billing determinants. We will evaluate this process in future audits.

Appendices

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Appendix A: Additional Information

Background

Billing determinants are spreadsheets that Postal Service employees manually produce to report volume and revenue for every Postal Service price within each class of market dominant mail. Volume and price data used in the spreadsheets are primarily derived from RPW data and the Postal Service's Notice 123. Billing determinants are produced for five market dominant classes of mail: First-Class Mail, Periodicals, Standard Mail, Package Services, and Special Services. This review focused on First-Class Mail billing determinants.

The Postal Service uses billing determinants to ensure that price adjustments do not exceed the price cap for each market dominant class of mail and to employ economic forecasting to produce price indices. Further, it uses billing determinants in the ACR as a part of the process to develop avoided cost estimates, which the Postal Service uses to set workshare discounts. The PAEA requires the OIG to regularly audit data collection systems and procedures the Postal Service uses to collect information and prepare the ACR.

Inaccurate billing determinants create the risk of incorrect annual price adjustments. Billing determinant calculation errors could cause proposed prices to exceed the price cap and cause the Postal Service to be in violation of the PAEA. Alternatively, inaccurate billing determinants could prevent the Postal Service from increasing prices as much as the law permits.

The PAEA requires the OIG to regularly audit the data collection systems and procedures the Postal Service uses to collect information and prepare the ACR. The ACR is due within 90 days after the end of each fiscal year and analyzes costs, revenue, pricing, and quality of service for all products. Billing determinants are presented in the ACR as a part of the process to develop avoided cost estimates, which the Postal Service uses to set workshare discounts.

Objective, Scope, and Methodology

Our objective was to assess the completeness and accuracy of the data used in market dominant billing determinants for First-Class Mail. To accomplish our objective we:

- Identified FY 2013 and FY 2014 First-Class Mail billing determinant files.
- Identified support files and data inputs to First-Class Mail billing determinants, including the shape weight indicia, card, and move update file.
- Analyzed data inputs in order to determine their adequacy.
- Reviewed and recalculated volume revenue and prices to identify errors and ensure completeness.
- Interviewed Postal Service subject matter experts to evaluate data handling and processing procedures.
- Interviewed PRC employees who use First-Class Mail billing determinants for their perspective on billing determinants and the existence of any inadequacies.
- Analyzed price adjustment calculations to determine whether identified errors impacted a percentage change in First-Class Mail rates.

The scope of this project included a review of the data and processing used in calculating billing determinant information that included domestic market dominant First-Class Mail.

We conducted this performance audit from October 2014 through June 2015, in accordance with generally accepted government auditing standards and included such tests of internal controls as we considered necessary under the circumstances. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. We discussed our observations and conclusions with management on April 28, 2015, and included their comments where appropriate.

We did not assess the reliability of any computer-generated data for the purposes of this report.

Prior Audit Coverage

The OIG did not identify any prior audits or reviews related to the objective of this audit.

Appendix B: Management's Comments

CYNTHIA SANCHEZ-HERNANDEZ
VICE PRESIDENT, PRICING



5/26/2015

Lori Lau Dillard
Director, Audit Operations

**SUBJECT: Market Dominant Billing Determinants: First-Class Mail
(Report Number CP-AR-15-DRAFT)**

Management agrees that there are opportunities to strengthen the billing determinants process and appreciates the thorough review by the USPS Office of Inspector General (OIG). Although management understands the "absolute value" method used by the OIG to calculate the \$156.8 million value in potential inconsistencies in the 2013 and 2014 billing determinants revenue, management believes that the net value of \$37.9 million is a more accurate depiction of the revenue impact from the anomalies identified by the OIG¹. Management would also like to point out that we had already started down the path of documenting our processes prior to this audit, including the establishment of quality reviews. These activities are scheduled to be completed by the end of fiscal year 2015.

Recommendation 1:

File Necessary corrections to fiscal year 2013 and 2014 First-Class Mail billing determinants with the Postal Regulatory Commission.

Management Response:

Management will file a corrected version of the fiscal year 2014 First-Class Mail billing determinants addressing corrections pointed out by the OIG. However, management does not believe that corrections are needed to the fiscal year 2013 billing determinants for the reasons discussed below.

Fiscal Year 2013 Billing Determinants:

There are two issues pointed out in the fiscal year 2013 First-Class Mail billing determinants. They both relate to data anomalies and the calculation of additional ounces for QBRM (Qualified Business Reply Mail) and Alternate Postage.

The first issue relates to QBRM letters. QBRM letters can only weigh up to two ounces. However, our source data showed a few mail pieces weighing more than this weight limit due to a data collection error. Realizing the anomaly, the Postal Service did not reflect in its billing determinants volume weighing more than two ounces. This data collection error has been corrected in fiscal year 2014.

The second issue relates to the Alternate Postage product. These letter shaped pieces are sold to consumers to be one ounce or less. The Postal Service has no way of collecting for the additional ounces for heavier Alternate Postage pieces. However, similar to QBRM, our data source showed volume in the additional ounce category, but the Postal Service did not reflect them in the billing determinants.

Fiscal Year 2014 Billing Determinants:

¹ Please note that total First-Class Mail Revenue for fiscal years 2013 and 2014 add to approximately \$59 billion.

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In terms of fiscal year 2014, the Postal Service plans to file a corrected version of the fiscal year 2014 First-Class Mail billing determinants with the PRC.

The Postal Service will correct the inconsistent accounting of mail volumes for fiscal year 2014 Quarter 2, the net impact of this correction will be approximately \$1 million. Some of the pieces in Quarter 2 shift from Stamped to Metered Letters and there is a small difference in price for these categories which accounts for the small net change in revenue.

The Postal Service also plans to correct all the calculation errors identified by the OIG audit team for fiscal year 2014. Most of these errors were in the area of calculated revenue and the net impact of these corrections will be approximately \$37 million. It should be noted that calculated revenue is not used in the price change filing.

However, the one fiscal year 2014 issue that the Postal Service is not planning to correct is the treatment of the Round-Trip DVD pieces. Flat Shaped Round Trip DVD pieces weighing up to two ounces are eligible for one ounce letter shaped prices based on their presort level and the presence of Intelligent Mail Barcode. Pieces exceeding the two ounce threshold pay the regular flats prices based on their sort level and the presence of barcode. We reported the Round-Trip DVD pieces consistent with this requirement in fiscal year 2014. The net impact of this issue is approximately \$40 thousand.

Target Implementation Date:

Management will make the appropriate corrections to the fiscal year 2014 billing determinants and file the changes with the Postal Regulatory Commission by the end of Quarter 3 of fiscal year 2015.

Responsible Management Official:

Steve Monteith, Manager Pricing

Recommendation 2:

Establish controls that result in the preparation of billing determinants using a documented, repeatable process that includes a quality review process.

Management Response:

Management concurs with this finding. In fact, management had already started down this path prior to the start of the audit. Documentation of processes and the establishment of a quality review process are one of the fiscal year 2015 goals for pricing managers and analysts. Management also initiated a high level review of billing determinants and exigent surcharge reporting with the Quarter 4 fiscal year 2014 reporting cycle. This review process has been enhanced with additional layers of review with each successive reporting cycle. The review process will be part of the documented process when completed.

Target Implementation Date:

Management will document a repeatable process that includes a quality review process for billing determinants preparation by the end of fiscal year 2015 Quarter 4.

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Responsible Management Official:

Steve Monteith, Manager Pricing



Cynthia Sanchez-Hernandez
Vice President, Pricing

cc: Manager, Corporate Audit Response Management

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