



# OFFICE OF INSPECTOR GENERAL

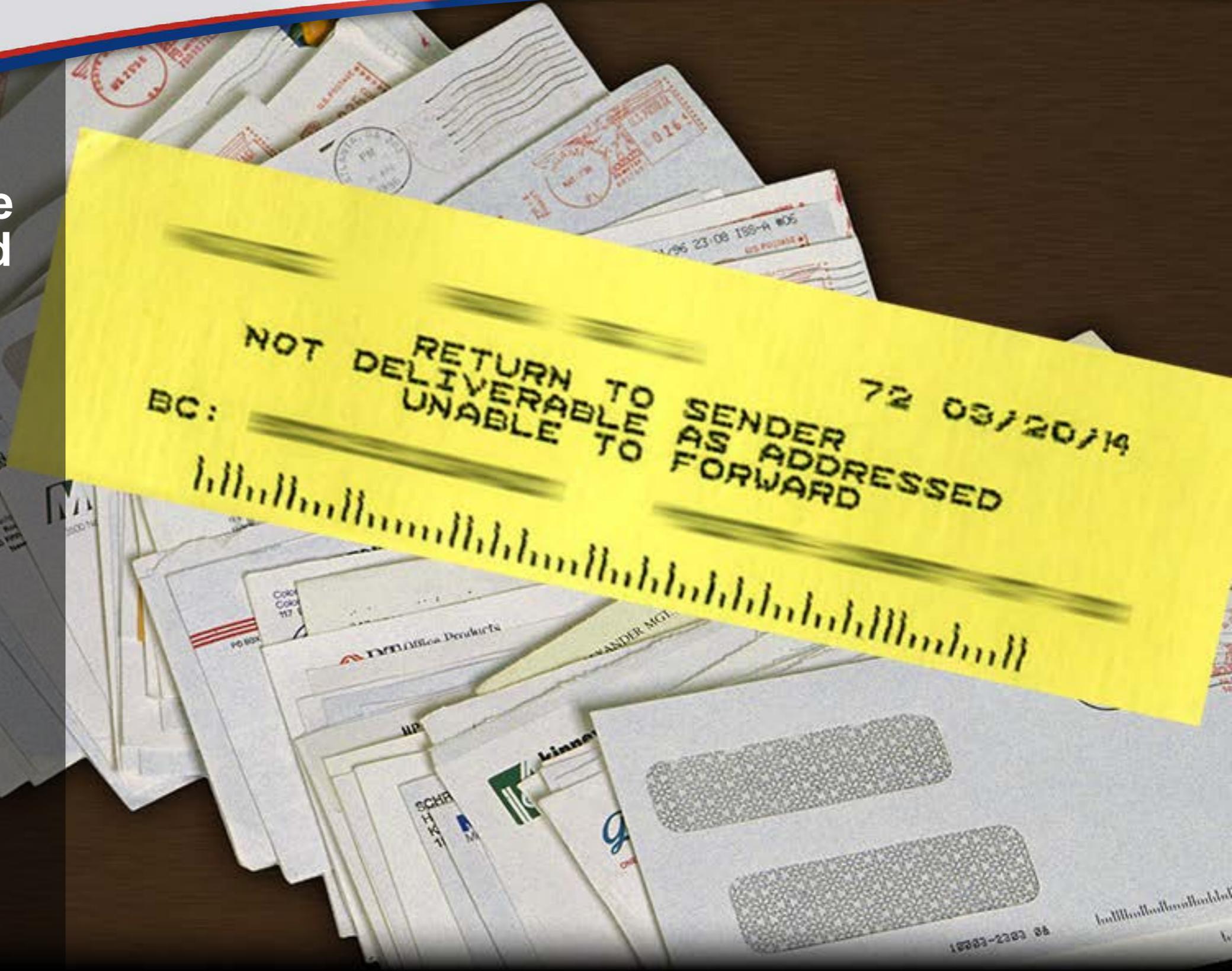
UNITED STATES POSTAL SERVICE

## Undeliverable as Addressed Mail

### Audit Report

Report Number  
MS-AR-14-006

July 14, 2014





# OFFICE OF INSPECTOR GENERAL

## UNITED STATES POSTAL SERVICE

### Highlights

*The Postal Service has taken action to reduce and recover UAA mail costs by testing whether business mailers update their mailing lists regularly and assessing surcharges when mailings fail to meet an address accuracy threshold.*

### Background

The U.S. Postal Service processed more than 158 billion mailpieces in fiscal year (FY) 2013. Of those, it identified almost 6.8 billion pieces (4.3 percent) as undeliverable as addressed (UAA) — mail that could not be delivered to the address on the mailpiece. Causes for UAA mail include individuals or businesses moving, illegible addresses, or deceased addressees. Depending on the mail class, UAA mail is forwarded, returned to sender, or treated as waste.

The Postal Service estimated it cost \$1.5 billion in FY 2013 to process UAA mail. Reducing UAA mail is important to the Postal Service, which faces sizeable cost pressures, and to mailers who want to ensure their mailings reach their intended recipients. Our objective was to identify opportunities to reduce and recover costs associated with UAA mail.

### What the OIG Found

The Postal Service has taken action to reduce and recover UAA mail costs by testing whether business mailers update their mailing lists regularly and assessing surcharges when mailings fail to meet an address accuracy threshold. The Postal Service, however, does not effectively or equitably determine surcharge amounts and does not always assess them. The Postal Service also automatically tests only 3 percent of mail for address accuracy and does not track UAA mail volume by mailer.

The Postal Service could reduce and recover UAA mail costs by updating the amount and assessment of surcharges, increasing the address accuracy threshold, expanding mail verification, and tracking UAA volume by mailer.

### How much did it cost to process undeliverable as addressed mail in FY 2013?





# OFFICE OF INSPECTOR GENERAL

## UNITED STATES POSTAL SERVICE

We estimate these actions could have multiple benefits. First, they could generate additional revenue. Use of these strategies would have increased revenue by \$11.9 million in FY 2013. Second, the Postal Service would more equitably recover costs from those mailers responsible for UAA mail. Third, such incentives would be consistent with legal requirements that the Postal Service maximize incentives to reduce costs and increase efficiency.

### **What the OIG Recommended**

We recommended the Postal Service develop strategies to improve pricing and recover costs associated with UAA mail to include enhancing the methodology used to determine surcharge amounts and increasing the address accuracy threshold. We also recommended enhancing the assessment of surcharges, expanding mail verification by increasing the number of mailings tested using automated address verification, and tracking UAA mail volume by mailer.

# Transmittal Letter



OFFICE OF INSPECTOR GENERAL  
UNITED STATES POSTAL SERVICE

July 14, 2014

**MEMORANDUM FOR:** CYNTHIA SANCHEZ-HERNANDEZ  
VICE PRESIDENT, PRICING

PRITHA N. MEHRA  
VICE PRESIDENT, MAIL ENTRY  
AND PAYMENT TECHNOLOGY

E-Signed by Janet Sorensen  
VERIFY authenticity with eSign Desktop  


**FROM:** Janet M. Sorensen  
Deputy Assistant Inspector General  
for Revenue and Resources

**SUBJECT:** Audit Report – Undeliverable as Addressed Mail  
(Report Number MS-AR-14-006)

This report presents the results of our audit of Undeliverable as Addressed Mail (Project Number 13RG026MS000).

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Joe Wolski, director, Sales and Marketing, or me at 703-248-2100.

Attachment

cc: Corporate Audit and Response Management

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# Findings

***Given the magnitude of UAA mail-related costs and the other sizeable cost pressures throughout Postal Service operations, it is crucial for the Postal Service to continue finding ways to reduce UAA mail costs.***

## Introduction

This report presents the results of our self-initiated audit of Undeliverable as Addressed (UAA) Mail (Project Number 13RG026MS000). Our objective was to identify opportunities to reduce and recover costs associated with UAA mail. See [Appendix A](#) for additional information about this audit.

The U.S. Postal Service processed more than 158 billion mailpieces in fiscal year (FY) 2013. Of those, it identified almost 6.8 billion pieces (4.3 percent) as UAA — mail the Postal Service could not deliver to the address on the mailpiece. People moving (40 million Americans move each year) and incorrect or illegible addresses are key causes of UAA mail. The Postal Service spent \$1.5 billion<sup>1</sup> in FY 2013 to process UAA mail that was forwarded, returned, or treated as waste<sup>2</sup> or dead mail. Specific UAA mail-related costs in FY 2013 were:

- \$244 million for forwarded mail.
- \$769 million for returned mail.
- \$258 million for waste.
- \$202 million for administrative costs.

The cost of handling and disposing of UAA mail for any class or product is included in the total cost of that product.<sup>3</sup> These costs are incorporated into postage paid by retail customers and business mailers. Most UAA mail is First-Class Mail (FCM) or Standard Mail. About 2.8 percent of FCM revenue in FY 2013 went to cover the \$828 million in UAA costs from FCM. UAA FCM volume was 2.4 billion pieces (about 3.7 percent of total FCM volume).

UAA mail is not classified as a product or service; therefore, its costs are not directly measured in Postal Service costing systems or itemized in its annual *Cost and Revenue Analysis* (CRA) report.<sup>4</sup> Instead, the Postal Service relies on estimates based on annual updates to a UAA cost model originally developed by a contractor (Christensen Associates) in 2004.

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1 The \$1.5 billion in UAA costs includes \$202 million for administrative costs.

2 Waste mail can include recycled mailpieces.

3 The Postal Accountability and Enhancement Act (PAEA) of 2006, Public Law 109-435, Section 3622, requires each mail class or service to bear the direct and indirect postal costs attributable to that class or service through reliably identified causal relationships plus that portion of all other costs of the Postal Service reasonably assignable to such class or type.

4 The Postal Service prepares the CRA report annually as part of the PAEA reporting requirements. The Postal Regulatory Commission (PRC) uses information in the CRA report to determine whether the Postal Service complied with the statutory requirement that each class or type of mail service bear direct and indirect costs attributable to it.

***The Postal Service has taken action to reduce and recover UAA mail costs by testing whether business mailers update their mailing lists regularly and assessing surcharges for mailers failing an address accuracy threshold of 70 percent.***

The Postal Service has taken pricing- and verification-related actions to reduce UAA mail. For example, recognizing that change-of-address (COA) is a key cause of UAA mail, the Postal Service developed standards to test whether business mailers update their mailing lists regularly. Specifically, if a mailer fails to meet a 70 percent address accuracy threshold, as part of Move Update,<sup>5</sup> the Postal Service assesses the mailer a 7 cent surcharge on the portion of the mail that exceeded the 30 percent tolerance.<sup>6</sup> The Postal Service began assessing the surcharge for both FCM and Standard Mail in January 2010. In November 2010, the Postal Service filed a proposal with the PRC to increase this threshold to 75 percent but tabled the plan after the PRC said it would impact the Postal Service's price adjustment authority.<sup>7</sup>

While the Postal Service has established the Move Update threshold, it has a limited ability to verify mail to determine Move Update compliance. To address this, the Postal Service is developing additional ideas to promote mailer address quality as part of planned mail verification enhancements through its seamless acceptance initiative.<sup>8</sup> Currently, only 3 percent of the mail is examined to verify it is meeting Move Update requirements. In October 2014, the Postal Service plans to transition to a process whereby it will verify all mail that goes through seamless acceptance for Move Update requirements. Doing so would not only help identify more mailings with poor or outdated addresses, but it would also incentivize mailers to update the frequency and accuracy of their mailing lists. Currently, the Postal Service is not charging mailers for Move Update errors in seamless acceptance. Additional information on these actions and other UAA-related information is in [Appendix A](#).

Given the magnitude of UAA mail-related costs and the other sizeable cost pressures throughout Postal Service operations, it is crucial for the Postal Service to continue finding ways to reduce UAA mail costs. These efforts, which will benefit mailers by ensuring mail is reaching intended recipients, should also bring the Postal Service into compliance with the legal requirement that it maximize incentives to reduce costs and increase efficiency.<sup>9</sup>

## **Conclusion**

The Postal Service has taken action to reduce and recover UAA mail costs by testing whether business mailers update their mailing lists regularly and assessing surcharges for mailers failing an address accuracy threshold of 70 percent. The Postal Service, however, does not effectively or equitably determine the amount of surcharges and does not always assess them. The Postal Service also automatically tests only 3 percent of mail for address accuracy and does not track UAA mail volume by mailer. The Postal Service could reduce and recover UAA mail costs by updating the amount and assessment of related surcharges, increasing the address accuracy threshold, expanding mail verification, and tracking UAA volume by mailer.

We estimate these actions could have multiple benefits. First, we estimate the actions could generate additional postal revenue. The Postal Service could have earned \$11.9 million in FY 2013 (see [Appendix B](#) for monetary impact) from these strategies. Second, the Postal Service would more equitably recover costs from those responsible for UAA mail, and third, they would bring the Postal Service into compliance with legal requirements to maximize incentives to reduce costs and increase efficiency.

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5 Move Update is a requirement for presorted and automation FCM service and for all Standard Mail service that helps reduce the number of mailpieces in a mailing that may require forwarding or return due to inaccurate addresses.

6 As part of the Move Update verification process, the Postal Service does not assess a surcharge for all of the mailpieces with addresses that were not updated within the previous 95 days but only for the mailpieces above the 70 percent threshold. For example, if Postal Service testing identified that 65 percent of the addresses within tested mailpieces were updated within the past 95 days, a surcharge would be assessed on 5 percent of all mailpieces in that mailing (the difference between the testing result, 65 percent, and the Postal Service's threshold, 70 percent).

7 Price adjustment authority is the amount the Postal Service can adjust prices in a particular class pursuant to the PAEA.

8 Seamless acceptance enables an automated verification process by comparing systems' data to electronic documentation at the time of induction and as mail is processed on automated postal equipment.

9 Public Law 109-435, 120 Statute 3201, 39 U.S.C., Section 3622 (b)(1).

## Pricing Opportunities

The Postal Service can enhance its pricing to recover and reduce UAA mail-related costs. The Postal Service does not effectively or equitably determine the amount of surcharges and does not always assess those surcharges due to system-related issues. It should also consider raising the Move Update threshold. A higher threshold would encourage mailers to more frequently and accurately update their mailing lists and could help the Postal Service recover more UAA mail-related costs by more equitably assessing surcharges. By improving the amount and assessment of these surcharges and increasing the Move Update threshold, the Postal Service could enhance its ability to recover and reduce UAA mail-related costs and more equitably assign those costs to the mailers that incurred them.

### Surcharge Amount

The Postal Service does not effectively or equitably determine the amount of the surcharge for the mailings that do not meet the Move Update threshold. The current Move Update assessment surcharge of 7 cents (which was established in 2008 based on the difference between the workshare discounted rates and FCM single-piece rates) is applied equally to FCM and Standard Mail. Because there is no single-piece Standard Mail rate, the Postal Service determined the 7 cents assessment should provide a substantial incentive to encourage customers to adopt Move Update processes, while still being reasonable.

Considering postage rates have changed since 2008, the Postal Service should revisit the methodology used to determine the Move Update surcharge. In addition, the Postal Service could consider using a cost-based methodology to establish the surcharge assessment based on the processing costs of UAA mail across mail classes. The Postal Service must forward FCM identified as UAA or returned; however, Standard Mail identified as UAA is typically disposed of as waste.<sup>10</sup> The Postal Service could consider revising the surcharge to more accurately reflect UAA mail costs across mail classes. Making these changes would send more appropriate price signals to recover these costs.

The Postal Service is considering updating the methodology for determining surcharges through seamless acceptance by charging mailers the difference between the single-piece rate and the postage paid for each mailpiece that does not meet move update compliance. Mailers who participate in the seamless acceptance program must use the Full-Service Intelligent Mail barcode (IMb); however, as of the end of February 2014, only 74 percent of all commercial mail was eligible for the Full-Service IMb.

### Assessment of Surcharges

The Postal Service did not assess Move Update surcharges for 1,239 mailings in FYs 2012 and 2013 that failed to meet the 70 percent threshold.<sup>11</sup> Officials stated they likely did not assess these surcharges due to system-related issues. Specifically, these issues were either communication breakdowns among any of the three systems used in this process — Mail Evaluation Readability Lookup Instrument (MERLIN), National Customer Support Center, and PostalOne! — or individual system malfunctions. Correcting system-related issues should enable the Postal Service to collect surcharge revenue more effectively. We estimated the Postal Service lost \$1.82 million in revenue in FYs 2012 and 2013 by not assessing these surcharges. Additional information on this monetary impact calculation is in [Appendix B](#).

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<sup>10</sup> *Domestic Mail Manual* 507, Section 1.4.1, mail that is UAA is forwarded, returned to the sender, or treated as dead mail, as authorized for the particular type of mail. All nonmailable pieces are returned to the sender.

<sup>11</sup> We retrieved this data from the *Enterprise Data Warehouse: Business Mail Acceptance - Mail Acceptance Verification Report - FYs 2012 and 2013*.

## Move Update Standard

The current Move Update threshold is not set at a level that sufficiently deters UAA mail. Nearly all mailings selected for verification passed the 70 percent threshold. For example, in FY 2013, 99.3 percent of verified mailings passed the threshold. The Postal Service identified this issue and, in 2010, submitted a request to the PRC to increase the Move Update assessment threshold to 75 percent. But the Postal Service tabled that proposal after the PRC determined it would impact the Postal Service's price adjustment authority.<sup>12</sup>

The Postal Service should propose a regulatory change to increase the Move Update assessment threshold. A higher threshold would encourage mailers to more frequently and accurately update their mailing lists and could help the Postal Service recover more of its UAA mail-related costs by more equitably assessing surcharges. We estimate that if the Postal Service had increased the threshold to 75, 80, or 85 percent, it would have collected additional revenue of \$383,869, \$904,348, or \$1,598,162, respectively, in FYs 2012 and 2013. Additional information on this monetary impact calculation is in [Appendix B](#).

## Verification Opportunities

The Postal Service can enhance its mail verification process to drive reductions in UAA mail costs. The amount of mail verified is determined by a performance-based verification (PBV) model in PostalOne!. This model generates the verification frequency and sample size for each mail preparer based on its past performance and the mailing size. Currently, only 3 percent of mailings are verified for Move Update requirements.<sup>13</sup> Considering the \$1.5 billion in UAA mail-related costs in FY 2013, this relatively small testing sample is not sufficient to detect UAA mail.

Postal Service officials stated that seamless acceptance will increase the amount of mail that is automatically tested for Move Update compliance and more effectively assess related surcharges. A limited, but growing, number of mailers are currently using seamless acceptance. Expanding mail verification by increasing the number of mailings tested using automated address verification may help identify mailers who are not meeting Move Update standards and enable the Postal Service to collect additional revenue through surcharges.

We estimate the Postal Service could have collected additional postage revenue of \$19.9 million in FY 2012 and \$11.6 million in FY 2013 if it had verified all mailings were meeting Move Update requirements. Additional information on this monetary impact calculation is in [Appendix B](#).



<sup>12</sup> The PRC determined that any change to the Move Update assessment amount or the threshold has price cap implications and requires regulatory approval. See Docket Number R2011-1, Final Order Number 606.

<sup>13</sup> The Postal Service selected about 3 percent of FCM and Standard Mail for MERLIN verification, including Move Update validation.

## Tracking Undeliverable as Addressed Mail

The Postal Service has an opportunity to reduce future UAA mail-related costs by enhancing its ability to track UAA volume by mailer. While the Postal Service has limited ability to track these volumes by mailers using the Full-Service IMb program, there is no system in place to capture this information for some major segments of mail. Also, if mailers subscribe to Address Change Services (ACS),<sup>14</sup> they will know whether their mailpieces have been forwarded and returned, but they will not know whether their mail is disposed of as waste.

Postal Service officials stated that establishing a system to track mail volume by mailer has been, and will likely continue to be, cost-prohibitive, as it would necessitate operational and systems enhancements. We spoke with major mailing organizations about UAA mail-related issues and some mailers indicated they do not know how much of their mail is UAA. In addition, mailers expressed concerns that secondary information such as apartment numbers, while usually known by the Postal Service, is not provided through the ACS program. Having this information would help mailers determine whether they are reaching their intended recipients.

While we recognize the complexities and costs associated with collecting this type of data, there are a number of reasons it might be beneficial to the Postal Service. First, this information would improve the Postal Service's ability to make address corrections and communicate them to those responsible for UAA mail. Second, it would help mailers identify successfully delivered mailpieces and determine the causes of any UAA mail. Third, it may motivate mailers to update their Move Update mailing lists more frequently.

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<sup>14</sup> An electronic enhancement to traditional, manual methods of providing COA information to mailers.

# Recommendations

***Among others, we recommend the Postal Service develop strategies to improve pricing and recover costs associated with UAA mail to include enhancing the methodology used to determine surcharge amounts and increasing the address accuracy threshold.***

We recommend the vice president, Pricing, develop strategies to improve pricing and recover costs associated with undeliverable as addressed mail by:

1. Enhancing the methodology used to determine surcharge amounts.
2. Considering pursuing a regulatory change to increase the Move Update threshold.

We recommend the vice president, Mail Entry and Payment Technology, develop strategies to reduce and recover costs associated with undeliverable as addressed mail by:

3. Enhancing the assessment of surcharges, which may include addressing system-related issues.
4. Expanding mail verification by increasing the number of mailings tested using automated address verification.
5. Tracking undeliverable as addressed mail volume by mailer.

## Management's Comments

Management partially agreed with recommendation 1. However, they noted that in a rate cap environment, the expected return on investment on a price increase for a penalty intended to discourage the volume the price is associated with may be lower than a price increase on a nonpenalty price. When preparing for the next price change, which has not been scheduled, management will evaluate the methodology used to determine the surcharge amounts and provide that analysis by January 2015.

Management partially agreed with recommendation 2 but noted that if they decide to change the threshold, the Postal Service must determine the number of additional mailpieces that would have been assessed the Move Update fee as a result of noncompliant mailings. Effectively, each additional piece assessed a fee will get a 7 cent price increase. This will require the Postal Service to allocate a portion of its limited price change authority to implement any change. Management will evaluate this with its next price change and provide that analysis by January 2015. Management also agreed with the other impact in the report. See [Appendix C](#) for management's comments, in their entirety.

Management did not provide official comments to recommendations 3, 4, and 5.

## Evaluation of Management's Comments

The U.S. Postal Service Office of Inspector General (OIG) considers management's comments responsive to recommendations 1 and 2 and corrective actions should resolve the issues identified. For recommendations 1 and 2, we agree any change to the surcharge amount and threshold will impact the Postal Service's price change authority. We also continue to believe that increasing the surcharge amount and the threshold would encourage mailers to more frequently and accurately update their mailing lists and could help the Postal Service reduce its UAA mail-related costs.

As of July 9, 2014, management has not provided an official response for recommendations 3, 4, and 5. Consequently, we are issuing this report without management's comments for these recommendations.

The OIG considers all the recommendations significant, and therefore requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective actions are completed. These recommendations should not be closed in the Postal Service's follow-up tracking system until the OIG provides written confirmation that the recommendations can be closed.

# Appendices

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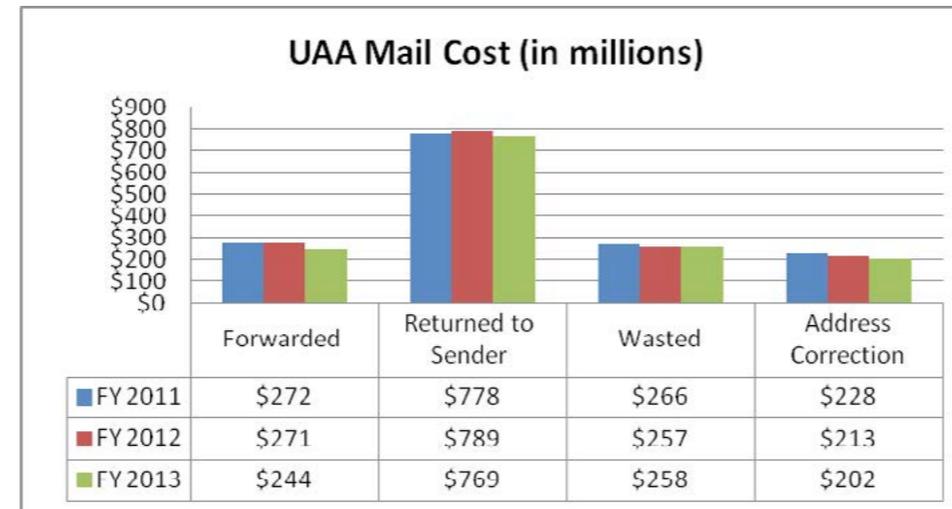
## Appendix A: Additional Information

### Background

The Postal Service identifies 6.8 billion mailpieces as UAA mail annually. There are a number of reasons why mail is undeliverable, such as an individual or business moving, an incomplete address, an illegible or incorrect address, an unknown or deceased addressee, or an addressee who refuses or fails to claim the mail. Unpaid postage or addressees refusing mail before or after delivery are also reasons mail is undeliverable.

The Postal Service estimates processing UAA mail for FY 2013 cost \$1.5 billion — \$244 million for forwarded mail, \$769 million for returned mail, \$258 million for waste, and \$202 million for administrative costs related to COA and address correction activities. Figure 1 shows that, overall, returned mail has been the most costly way of handling UAA mail over the past 3 years.

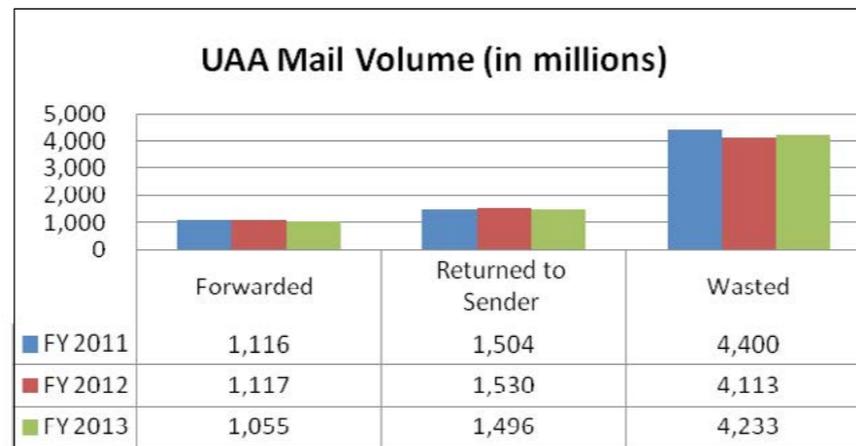
**Figure 1: UAA Mail Costs for FYs 2011 – 2013**



Source: Postal Service and Christensen Associates UAA cost model.

Figure 2 shows that UAA waste mail volume represented the highest amount of UAA mail over the past 3 years.

**Figure 2: UAA Mail Volume for FYs 2011 – 2013**



Source: Postal Service and Christensen Associates UAA cost model.

The Postal Service is considering several initiatives to reduce UAA costs and volume. The Postal Service plans to introduce a Secure Destruction program so UAA mail can be destroyed at a facility rather than returned. This will save the Postal Service the cost of returning mail by converting it to waste mail, which can later be destroyed. Additionally, there are plans to consolidate Postal Automated Redirection System (PARS) and Computerized Forwarding System (CFS) facilities. Another initiative is the use of PARS for flats technology, which will allow UAA flats to be processed in an automated environment to reduce manual handling.

The Postal Service also has taken productive steps in mail verification, such as developing a PBV model to identify mailings that do not comply with Move Update standards<sup>15</sup> and deploying mail verification enhancements through its seamless acceptance initiative.

The Move Update standard is a way to reduce the number of mailpieces in a mailing that must be forwarded or returned. Mailers periodically match their address records with COA orders the Postal Service receives and maintains. Mailers who claim presorted or automation prices for FCM or Standard Mail must demonstrate that they have updated their mailing lists within 95 days before the mailing dates.

The Postal Service offers three preapproved ways to meet Move Update standards — the ACS, the National COA Linkage System, and Ancillary Service endorsements (except for Forwarding Service Requested). The Postal Service also offers alternatives that require separate approval for FCM. Mailers must use one of the preapproved or alternative methods to meet the Move Update standard. Bulk mail entry unit clerks test selected mailpieces with MERLIN to verify whether mailers are meeting the Move Update standards.

<sup>15</sup> PBV generates the verification frequency and sample size for verification for each mail preparer based on its past performance and the mailing size.

## Objective, Scope, and Methodology

Our objective was to identify opportunities to reduce and recover costs associated with UAA mail. To accomplish our objective we reviewed criteria, data, and documentation to identify and evaluate UAA mail-related processes and procedures; and interviewed Postal Service officials and mailer representatives. We also reviewed special studies, policies, procedures, and manuals related to UAA mail to gain further understanding of UAA mail processes and related operations.

To obtain the history behind UAA mail price inclusion in the postage rate, we conducted research and explored current laws and regulations related to UAA mail. We interviewed Postal Service officials to identify related legislation, obtain general background information (including data sources), and discuss tools offered to mailers to reduce UAA mail. We obtained and analyzed UAA mail volume and cost data and conducted site visits to observe UAA processes and procedures for MERLIN, PARS, and CFS to identify the relationship between automated and manual UAA processes and operations. We obtained and analyzed Move Update validation error data reports.

We conducted this performance audit from June 2013 through July 2014, 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 June 4, 2014, and included their comments where appropriate.

We analyzed Move Update validation error data and assessed its reliability by having system owners review our analyses. We compared our methodology to the Move Update surcharge assessment policy and we determined that the data were sufficiently reliable for the purposes of this report.

## Prior Audit Coverage

There were no audit reports issued in the past 3 years that directly relate to this audit.

## Appendix B: Monetary and Other Impacts

### Monetary Impacts

Recommendation	Impact Category	Amount
3	Revenue Loss <sup>1</sup>	\$1,817,308
4	Revenue Loss	31,461,308
Total		\$33,278,616

<sup>1</sup> Amount Postal Service is (or was) entitled to receive but was underpaid or not realized because policies, procedures, agreements, requirements, or good business practices were lacking or not followed. May be recoverable or unrecoverable. May apply to historical events or a future period (in the sense perceived future losses may be prevented by the implementation of a recommendation)

In FYs 2012 and 2013, the Postal Service did not assess Move Update surcharges for 696 and 543 mailings, respectively, which did not pass the 70 percent threshold. This resulted in a revenue loss of \$1,585,296 and \$232,011 in FYs 2012 and 2013, respectively (or \$1.82 million total).

The Postal Service conducts limited MERLIN verification — it only selected about 3 percent of mailings for MERLIN verification during FYs 2012 and 2013. Of that percentage, about 0.7 percent did not comply with Move Update standards. Expanding mail verification by increasing the number of mailings tested using automated address verification may help identify mailers who are not meeting Move Update standards and enable the Postal Service to collect additional revenue through surcharges.

We applied the failed percentage to the remaining mailings that were not verified (97 percent) and estimated the Postal Service could have collected additional postage fees of \$19.9 million and \$11.6 million in FYs 2012 and 2013, respectively (or \$31.5 million total).

### Other Impact

Recommendation	Impact Category	Amount
2	Potential Additional Revenue <sup>1</sup>	\$383,869

<sup>1</sup> Revenue the Postal Service could potentially generate for goods delivered or services rendered based on suggested improvements.

The Postal Service had an opportunity to collect additional revenue if it had not withdrawn its request to modify the Move Update threshold to 75 percent. The Postal Service would have collected additional revenue of \$238,131 and \$145,737 in FYs 2012 and 2013, respectively (or \$383,869 total), for mailings verified through MERLIN that did not meet Move Update standards based on the 75 percent threshold.

## Appendix C: Management's Comments

CYNTHIA SANCHEZ-HERNANDEZ  
VICE PRESIDENT, PRICING



July 1, 2014

TO: LORI DILLARD  
(A) DIRECTOR, AUDIT OPERATIONS

SUBJECT: Undeliverable as Addressed Mail Costs  
(Report Number [MS-AR-14-DRAFT])

Thank you for the opportunity to respond to the Office of Inspector General's self-initiated audit of Undeliverable as Addressed (UAA) Mail Costs (Project Number 13RG026MS000). The Vice President of Pricing provides the following comments to the findings, recommendations and impacts:

In Appendix B, under other impact it is stated that, "The Postal Service had an opportunity to collect additional revenue if it had not withdrawn its request to modify the Move Update threshold to 75 percent..." It cites a total of \$383,869 in additional revenue for mailing verified through MERLIN in FY's 2012 and 2013. The Postal Service agrees with this number from a regulatory point of view. However, in order to raise the threshold the Postal Service would have had to use cap authority in a regulatory filing to make this change. By its nature the surcharge for this volume is designed to change addressing behavior. This analysis presupposes that even with the higher threshold, the mailers would make no changes to their process in order to avoid paying the surcharge. If they did make those changes and brought their mailings in compliance the Postal Service would have spent cap authority on potential revenues that never materialized. For that reason the Postal Service chose to use the cap in other areas where revenue could be realized.

#### **Recommendation 1:**

##### **Enhance the methodology used to determine surcharge amounts.**

**Conditionally Agree.** As noted in the report, the Move Update fees were originally based on the difference between work shared and Single Piece FCM. *For instance, if there were no cap impact we could increase the fee to result in the differential being closer to the differential between Single Piece and 3-digit/AADC.* However, in a cap environment, the expected ROI on a price increase for a penalty which is intended to discourage the volume the price is associated with is likely to be lower than the ROI of a price increase on a non-penalty price. The Postal Service will evaluate it with our next price change which is not yet scheduled. We will provide the analysis when we prepare the next price change.

Target Implementation Date: January 2015 we will report out. The final analysis will not be completed until a decision is made on the next price change and we know how much cap authority is available.

Responsible Manager: Steve Monteith, Manager Pricing

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**Recommendation 2:**

**Consider pursuing regulatory change to increase the move update threshold.**

**Conditionally Agree.** The Postal Service will evaluate it with our next price change which is not yet scheduled. We will provide the analysis when we prepare the next price change. It should be noted however that if the decision is made to change the threshold, the Postal Service will need to derive the number of additional mailpieces that would have been assessed the Move Update fee as a result of mailings being out of compliance. Effectively each additional piece assessed a fee, will get a 7 cent price increase. This will require the Postal Service to allocate a portion of its limited price change authority in order to implement any change. The inflation estimate released on June 17, 2014 shows that the current cap authority available to the USPS is 1.097%. The Postal Service is concerned about using precious CPI-based price change authority on volume that it intends to discourage and for which it may never receive revenue.

The expected ROI on a price increase for a penalty which is intended to discourage volume the price is associated with is likely to be lower than the ROI of a price increase on a non-penalty price.

Target Implementation Date: January 2015 we will report out. The final analysis will not be completed until a decision is made on the next price change and we know how much cap authority is available.

Responsible Manager: Steve Monteith, Manager Pricing

This report and management's response to Recommendations 1 and 2 do not contain information that may be exempt from disclosure under the FOIA.



Cynthia Sanchez-Hernandez

cc: Corporate Audit and Response Management



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