



July 16, 2010

SUSAN M. PLONKEY  
ACTING PRESIDENT, MAILING AND SHIPPING SERVICES

SUBJECT: Audit Report – Fiscal Year 2009 Standard Mail Volume Incentive Program (Report Number FF-AR-10-196)

This report presents the results of our audit of the fiscal year (FY) 2009 Standard Mail® Volume Incentive Program (Project Number 10BO008FF000). The report responds to a request from the Postal Regulatory Commission (PRC). Our objectives were to evaluate the Standard Mail Volume Incentive Program (Summer Sale) to determine whether the Postal Service achieved its objective of increasing volume and revenue and whether the process used to establish customers' mailing history was valid and accurate. This audit addresses financial risk. See [Appendix A](#) for additional information about this audit.

The U.S. Postal Service intended its Summer Sale to increase volume during a typically light mail volume period and increase revenue. The program ran from July 1 through September 30, 2009. At the end of this period, the Summer Sale provided a 30 percent credit to customers for additional volume mailed over a specified threshold.

## Conclusion

The Postal Service reported both volume and revenue increases resulting from the FY 2009 Summer Sale.<sup>1</sup> However, the processes used to calculate the reported increases may result in misleading reported revenue and volume impacts. While the Postal Service used actual, verifiable mailing data in many cases, the additional data essential to calculations supporting the reported increases is less precise. These data included various assumptions related to mail thresholds,<sup>2</sup> negotiated mail volumes based on customer input, and incomplete or unconsidered employee cost data. Postal Service outsiders — including the PRC's public representatives<sup>3</sup> — have also questioned the Postal Service's methods for calculating reported revenue and volume increases. The public representatives found that using methods more closely aligned

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<sup>1</sup> The Postal Service reported that its FY 2009 Summer Sale increased net revenue by \$24.1 million in its report to the Postal Regulatory Commission, *FY 2009 Summer Sale Data Collection Report*, Docket Number R2009-3, February 26, 2010.

<sup>2</sup> Volume of mail a customer must send before being eligible for a rebate. The threshold volume is determined using a formula based on volume amounts for standard mail that customers mailed from October 2008 through March 2009 compared to what they mailed from October 2007 through March 2008.

<sup>3</sup> Comments of the public representatives, Docket No. R2010-3, March 22, 2010 signed by three representatives.

with those initially considered by the PRC in approving the Summer Sale suggests the Postal Service may actually have lost money on the FY 2009 program.

A Postal Service official stated that the benefits gained from conducting incentive programs like the Summer Sale outweigh their potential financial uncertainties. The official said the Summer Sale program should be viewed as an investment in the future of the Postal Service, creating long-term customer satisfaction and building its reputation. While these goals are commendable, a stated objective of the FY 2009 Summer Sale was to increase revenue and volume. It is uncertain whether the Postal Service achieved that objective. We believe the Postal Service needs solid data and complete cost information in order to make well-informed decisions on the programs it initiates or conducts, particularly considering the critical financial predicament it is currently facing.

### **Revenue and Volume Increases Reported for Summer Sale May be Misleading**

Overall, the Postal Service did not always have independent, reliable, and complete data upon which to calculate the \$24.1 million in net revenue contribution and increased volume resulting from the FY 2009 Summer Sale. This occurred because the Postal Service relied on certain customer-provided data to determine customer thresholds and this data was a key component in evaluating revenue and volume increases. In addition, the method the Postal Service used to determine customer mail volume without a Summer Sale — commonly referred to as “loyalty growth” — differs from the PRC-approved method.<sup>4</sup> The Postal Service’s calculation of “loyalty growth” considered trends in volume, whereas the PRC’s public representatives applied a measure of price sensitivity to volumes actually mailed during the Summer Sale to calculate “loyalty growth.” As a result, the Postal Service provided \$67.8 million in rebates to customers who exceeded the established threshold volumes<sup>5</sup> that may have been inaccurate. We consider the \$67.8 million to be assets at risk. See [Appendix B](#) for a breakdown of the monetary impact.

A key component in calculating net revenue and volume increases was determining customers’ mail volume thresholds. To determine thresholds, the Postal Service provided mailing data that established a threshold for all its customers who were eligible to participate in the Summer Sale. While 324 customers agreed with this threshold figure, 129 others did not. Customers who disagreed with the threshold met with a Postal Service analyst from the Business Customer Intelligence (BCI) Department to

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<sup>4</sup> According to a Postal Service official, determining “loyalty growth” is an exercise that uses historical customer data and program rules in which a reasonable set of assumptions is made on what mail volume will be. On the other hand, the public representative’s report states that using this method for estimating “loyalty growth” as approved by the PRC (which is different from what the Postal Service uses) produces a considerable loss.

<sup>5</sup> To establish threshold volumes, the Postal Service used a formula to determine a number based on volume amounts for standard mail that customers mailed during October 2008 through March 2009 compared to what the customers mailed from October 2007 through March 2008.

discuss and negotiate the changes.<sup>6</sup> Postal Service officials stated that BCI analysts researched the requested changes; however, they were not able to provide documentation to support the changes made or the validation process.

When determining threshold figures, customers requested that the Postal Service:

- Remove and/or add accounts that were incorrectly included (or omitted) in its data.
- Add volume from mail service providers (MSPs)<sup>7</sup> for customers who used this method of entering mail. In some instances, volume of this type is not visible or transparent through the current system the Postal Service uses.
- Separate or consolidate accounts for customers with numerous departments or subsidiaries. This information was not identifiable in the Postal Service data.

Determining customer threshold figures presented challenges to both the Postal Service and customers participating in the Summer Sale program.

- One customer stated that mail volume figures the Postal Service presented during the negotiation process were “close enough.”
- While working with a customer disputing his threshold, a Postal Service BCI analyst explained that mail volumes MSPs entered were not accessible through Postal Service systems, so the customer needed to obtain those amounts from the mail preparer. Data on individual customer mail volume is not available through Postal Service systems when MSPs combine mailings from multiple customers or submit mailings using their own accounts rather than using the individual mailer’s account.

Another key component in calculating revenue and volume increases was the mail that customers would have sent if there were no sale, commonly called “loyalty growth.” The Postal Service used “loyalty growth” in the formula to calculate overall volume increases, estimating that customers would have sent 38 percent of the volume qualifying for reduced Summer Sale rates without the incentive. This calculation was not a precise figure, but rather one based on a series of assumptions. Further complicating the calculation was the fact that the Postal Service had seen declines in mail volume due to the United States’ economic recession. At the time of the FY 2009 Summer Sale, some customer volume had begun to rebound.

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<sup>6</sup> BCI analysts work with customers to resolve permit account and mail volume disputes. The BCI staff has the authority, as part of the Summer Sale process, to make adjustments that will result in an agreement with the customer.

<sup>7</sup> Companies that prepare and enter mail for customers using the customers’ accounts and/or entering mail using MSP accounts.

Furthermore, Postal Service outsiders have questioned the validity of the calculation of the “loyalty growth.” The PRC’s public representatives<sup>8</sup> found that using the PRC’s method for “loyalty growth,” the Summer Sale lost \$39.6 million of revenue. This is in contrast to the Postal Service’s reported \$24.1 million net revenue growth. These varying calculations illustrate the difficulty in determining the results and effect of the Summer Sale.

### Some Expenses Not Tracked

The Postal Service did not include all expenses associated with employees who worked on the FY 2009 Summer Sale project, primarily because they did not have a process in place to track those employees’ work hours. The Postal Service attributed \$530,000<sup>9</sup> to the cost of having six full-time and 10 part-time employees working on the project for 4 months. However, the actual amount of time these employees spent on the project far exceeded those estimates. Specifically, the full-time employees began working on the project in April 2009 and were still resolving issues as of March 2010 — 8 months longer than anticipated. We also found that the Postal Service used 11 more part-time employees to work on the project than it initially planned. Some of the additional employees estimated they spent from 1 to 8 hours per day working with customers. Others estimated they spent up to 200 hours working on the project.

We recommend the acting president, Mailing and Shipping Services:

1. Develop a process to obtain accurate and verifiable customer mailing data that dependably measures and reports on the effect of future customer incentive programs designed to increase volume and improve revenue.
2. Develop a method to track the time employees spend working on projects so management can document and report accurate administrative costs.

### Management’s Comments

Management generally agreed with the findings and recommendations but did not feel the report reflected the intangible benefits of the Summer Sale. Those benefits included promoting customer business, retaining customers, and rewarding loyal customers. Management also expressed a concern regarding the \$67.8 million revenue at risk, and reiterated the differing methods for calculating “loyalty growth.” Management stated they will be participating in the PRC’s rulemaking proceeding regarding “loyalty growth” and will reflect conclusions in future analyses as appropriate.

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<sup>8</sup> PRC officers designated to represent the interests of the public in proceedings that come before the PRC.

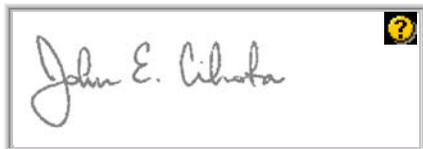
<sup>9</sup> The Postal Service’s dedicated personnel accounted for 54 percent of the total administrative costs associated with the Summer Sale.

Having learned lessons from the 2009 Summer Sale, management stated they implemented processes in June 2010<sup>10</sup> to better document changes made to customer permit configurations and to lessen reliance on customer data. Management is also developing a tiered technology enhancement, which will provide more accurate customer data. The estimated implementation date for phase 1 of the enhancement is Quarter 3, FY 2011.<sup>10</sup> Further, management implemented a process in June 2010<sup>10</sup> that will track employee and contractor costs for the 2010 Summer Sale. See [Appendix C](#) 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 responsive to the recommendations and management's corrective actions should resolve the issues identified in the report. We recognize and agree that there are intangible benefits that can be realized from incentive sales and have noted these in our report. Regarding the reported revenue at risk, while the Postal Service expressed a concern over the \$67.8 million revenue amount, they did not present a basis for their disagreement or different methodologies for calculating the revenue at risk. We consider the calculated amount of \$67.8 million revenue at risk as valid.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact John Wiethop, director, Field Financial – Central, or me at 703-248-2100.



John E. Cihota  
Deputy Assistant Inspector General  
for Financial Accountability

### Attachments

cc: Thomas J. Foti  
Mary E. Savino  
Corporate Audit and Response Management

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<sup>10</sup> Management informed us of this date subsequent to our receipt of the comments.

## APPENDIX A: ADDITIONAL INFORMATION

### BACKGROUND

The FY 2009 Summer Sale program ran from July 1 through September 30, 2009. The Postal Service intended the program to increase mail volume during a typically light mail volume period and increase revenue. Participation in the Summer Sale required the Postal Service and its customers to determine and agree upon a threshold volume.<sup>4</sup> Additionally, to be eligible for the FY 2009 Summer Sale, participating customers must have been:

- Permit holders/owners of a permit imprint advance deposit account(s).
- Able to demonstrate a volume of at least one million Standard Mail letters and flats between October 1, 2007, and March 31, 2008, for one or more permit imprint advance deposit account(s), precanceled stamp permit(s) or postage meter permit(s).
- Qualified for the program with volume mailed through an account(s) owned by a mail service provider, but only with adequate documentation specifying the applicant is the owner of the mail.

At the end of the sale period, the Summer Sale program provided a 30 percent rebate for qualifying customers for the average per-piece price of the incremental volume of Standard Mail letters and flats over a specified threshold recorded during the established program period.

Chart 1 illustrates the breakdown of customers registered for participation in the FY 2009 Summer Sale and those who ultimately participated and received rebates.

Chart 1



## OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives were to evaluate the Summer Sale to determine whether the Postal Service achieved its objective to increase mail volume and revenue and whether the process used to establish the customers' mailing history was valid and accurate.

We traced recorded financial transactions to and from supporting documentation; and used Postal Service instructions, manuals, policies, and procedures as criteria to evaluate internal controls and data reliability. We interviewed sales analysts and other headquarters personnel assigned to the program. Of the 453 customers receiving rebates, we judgmentally selected 14 and reviewed supporting documentation related to mail volume and rebates. We did not review additional customer documentation to validate mail volume. To do so would have been time-consuming and complex – for us as well as for the Postal Service – with little likelihood of producing different results. We reviewed all requisitions and invoices related to the administrative costs of the program.

To assess the reliability of the data elements needed to answer the objectives, we (1) electronically verified relevant calculations, (2) reviewed related documentation, and (3) interviewed agency officials knowledgeable about the data. The results of our audit showed that key data elements were not completely independent, verifiable, and reliable, as disclosed in our report.

We conducted this performance audit from November 2009 through July 2010 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 officials on May 27, 2010, and included their comments where appropriate.

### **PRIOR AUDIT COVERAGE**

The OIG did not identify any prior audits or reviews related to the objective of this audit. In a recent report, the Government Accountability Office (GAO) noted that the FY 2009 Summer Sale had little effect on the Postal Service's overall financial results for the fiscal year.<sup>11</sup>

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<sup>11</sup> The GAO Report, *U.S. Postal Service: Strategies and Options to Facilitate Progress toward Financial Viability* (Report Number 10-455, dated April 12, 2010).

**APPENDIX B: NONMONETARY IMPACT**

<b>Finding</b>	<b>Impact Category</b>	<b>Amount</b>
1	Assets at Risk <sup>12</sup>	\$67.8 million

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<sup>12</sup> Assets or accountable items (for example, cash, stamps, and money orders) that are at risk of loss because of inadequate internal controls.

## APPENDIX C: MANAGEMENT'S COMMENTS



July 6, 2010

LUCINE M. WILLIS  
DIRECTOR, AUDIT OPERATIONS

SUBJECT: The Transmittal of Draft Audit Report – Fiscal Year 2009 Standard Mail  
Volume Incentive Program (Report Number FF-AR-10-DRAFT)

This provides management's response to the subject audit report. We appreciate the opportunity to review and provide comments.

The Postal Service agrees with the audit team that the more precise and exact the data used in processing and measuring its sales incentives, the stronger the programs will be. As such, the Postal Service continues to make improvements to our incentive processes and implement best practices learned from the 2009 Standard Mail Summer Sale.

Prior to addressing the findings in the Fiscal Year 2009 Standard Mail Volume Incentive Program audit, it is important to note that the audit does not take into account more intangible benefits of the Summer Sale, which, although cannot be quantified as easily, have a real benefit to the Postal Service. This incentive program is not only designed to increase mail volume and incremental profit, it is also intended to send a signal to the mailing community that the Postal Service is willing to invest to promote the health of their businesses and reward its loyal customers. Mailers benefit by having the ability to acquire new customers with limited additional investment. Another intangible benefit is retention; the Sale may have bolstered some mailers' use of the mail in a way that fosters their growth or keeps them in business for the longer term. As mailers acquire more customers, both the mailers' companies and the Postal Service's business will grow. This is also evidenced by the strong indications that the rebate money earned by companies is very often invested in future mailings with the Postal Service. In a survey taken at the close of the Summer Sale period participants were asked how they would use any earned rebate credits. Of those respondents who knew how they planned to use the rebate, 88 percent said the money would be used for mailings and mail-related expenses.

We are concerned by the conclusion that the entire \$67 million in rebates was revenue at risk based on the audit findings that not all processes were completely auditable, that, in some instances, customer provided information was used to measure performance, and there was not agreement on how loyalty volume calculations were determined.

Although not specifically discussed in its recommendations, one of the areas of concern in the audit report that influenced the audit team's evaluation of revenue at risk was the determination of loyalty growth (i.e., mail volume that customers would have mailed if there had not been a Summer Sale). According to the report, the methodology the Postal

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Service used in determining "loyalty growth," was based on a series of assumptions and was not a precise figure. Specific to this "loyalty growth" analysis, there are specific points to be considered:

- There is no precise number regardless of the methodology used, as the calculation of loyalty growth is an attempt to quantify something that would have happened under other conditions and cannot be precisely measured. The more appropriate question to ask is whether or not the assumptions and data used by the Postal Service were reasonable, accurate, and made in good faith. We are confident that our assumptions, which were based on actual customer mailing histories, met these expectations.
- Two other methodologies were employed: one by the Postal Regulatory Commission (PRC), and another by the Public Representative for the PRC. Both arrived at different conclusions. The basis for both methodologies was long-term price elasticities that were developed by measuring small, incremental increases in postage. We believe these elasticities are not ideal to measure anyhow volume in the Summer Sale which is a short-term program with a price decrease. We will participate in the rulemaking proceeding (PRC Docket RM2010-9) to address the anyhow calculations and reflect any conclusions in our future analyses as appropriate.
- Finally, the OIG asserted that using the PRC's methodology for loyalty growth, the Postal Service would have "a considerable loss of \$39.6 million." This statement is potentially misleading in that the reader might be led to believe that Standard Mail had a negative contribution. Even if this methodology were deemed to be the best way to estimate anyhow volume, Standard Mail would not have had a loss, although it would have generated less contribution than if there had been no Summer Sale.

In concluding its report, the audit team made two recommendations to the Acting President, Mailing and Shipping Services. The Postal Service gave careful consideration to these recommendations and our responses are described below.

**Recommendation:**

1. **Develop a process to obtain accurate and verifiable customer mailing data, upon which it can dependably measure and report on the success or failure of future customer incentive programs designed to increase volume and improve revenue.**

**Response:**

The Postal Service agrees that accurate and verifiable customer data is important in measuring the success or failure of any customer incentive program. Although not described in the audit report, there were documented processes in place for the 2009 Summer Sale that were designed to get the most accurate customer information possible with our existing infrastructure. We relied on our internal Postal Service's customer data system as the foundation for measuring performance. However, recognizing the complexity of how our customers use mail within their large corporate organizations, how they enter mail into the Postal Service delivery network and how they interact with postal accounting systems, the Postal Service developed a process to improve the quality of

customer data used in the Summer Sale. This highlighted an opportunity to improve accuracy of the customer data used for the Summer Sale. By collecting more information from customers on their use of mail and, when necessary, comparing the results against our own data, we improved the accuracy of customer data, and made it more relevant for purposes of the Summer Sale. This was validated when our own internal accounting group concluded that "those companies that have worked with the USPS to reconcile their volumes pose a lower risk to the USPS than those who have accepted our data."

As the audit report states, 129 customers whose permit configurations and thresholds were adjusted fell into three different categories. The report draws a sweeping conclusion that all of these changes were made based on customer provided data and 100 percent of these customers' volumes relied on this data. In fact, the only type of customer data we received was qualified documentation for volumes sent through a permit that was owned by a mail service provider and was not captured by a ghost permit. In our most recent analysis, only 12 percent of those customers who were eligible for rebates had some volumes that were sent through mail service provider permits. As a result, only 14 percent of the total rebate dollars were attributable to volume associated with mail service provider data.

The audit report also omits another safeguard that was put in place to reduce the risk of using inaccurate customer data. All sale participants were required to sign a certification form certifying that the volumes used in the threshold revenues were accurate and represented all the eligible mail volume that was sent during the threshold period.

The Postal Service has learned lessons from the 2009 Summer Sale and has improved its standard processes for the 2010 Summers Sale in order to better document changes that are made to customer permit configurations and rely less on customer provided data. In addition, the Postal Service is developing longer-term technology enhancements to existing source data systems which will provide improved customer data accuracy.

**Recommendation:**

2. **Develop a method to track the time spent by employees assigned to projects so accurate administrative costs can be documented and reported.**

**Response:**

The Postal Service has implemented a process to track the number of employees engaged on a part-time and full-time basis each month for the 2010 Summer Sale which should result in a clearer picture of the amount of resources spent on this project. Such information may help the Postal Service make more informed decisions about how to employ its Headquarters-based staff on corporate endeavors. Certainly, the administrative resources that are procured for the sole purpose of handling a particular program should be included in the evaluation of the program.

  
Susan M. Plonkey  
A/President  
Mailing and Shipping Services

cc: Sally Haring  
Thomas Foti  
Mary Savino