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SUBJECT: Audit Report – Periodicals Mail Costs  
(Report Number CRR-AR-11-001)

This report presents the results of our audit of the U.S. Postal Service's Periodicals mail costs (Project Number 10RG008CRR000). Our objectives were to (1) determine whether Postal Service data collection systems and procedures accurately attribute costs to Periodicals and (2) review Postal Service operations that affect manual processing of Periodicals. This self-initiated audit addresses financial and operational risk. See [Appendix A](#) for additional information about this audit.

The Periodicals mail class consists of magazines, newspapers or other publications that meet specific eligibility criteria.<sup>1</sup> Periodicals are considered a preferred mail class because of their educational, cultural, scientific, and informational value. There are two categories of Periodicals: Outside County and Within County.<sup>2</sup> Approximately 90 percent of Periodicals qualify for Outside County pricing. The remaining 10 percent of Periodicals publications are generally delivered to local Postal Service facilities for distribution within the same county and qualify for Within County pricing.

The Postal Accountability and Enhancement Act (the Act) of 2006 directed the Postal Service and the Postal Regulatory Commission (PRC) to study and submit to the president and Congress a report on the quality, accuracy, and completeness of the information the Postal Service uses to attribute costs to Periodicals and any opportunities to improve the transport and processing of Periodicals. That study is in progress, but the PRC has not yet completed it yet.

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<sup>1</sup> Approximately 90 percent of Periodicals are classified as flat-sized mail, which are mailpieces that exceed the dimensions for letter-size mail but do not exceed the maximum dimension for the mail-processing category. Other types of flat-size mail include Express Mail, Priority Mail, First-Class Mail, Standard Mail, and three Package Services Products (Media Mail, Bound Printed Matter, and Library Mail).

<sup>2</sup> Outside County charges are based on entry point, destination, and depth of sortation, with separate bundle and container charges. Bundle and container charges do not apply to Within County publications, which must, in general, have a circulation of less than 10,000 copies or 50 percent of the circulation distributed within the county of publication.

## Conclusion

Even though Periodicals volume has decreased and automation and mailer preparation efforts have increased, manual costs attributed to Periodicals continue to rise. We identified several reasons for these increases in manual processing costs, including:

- The “Hot 2C”<sup>3</sup> program management instituted to provide expedited processing.
- Missed Critical Entry Times (CETs) by the mailers.
- Bundle breakage and preparation problems.
- Mailpiece characteristics that make them non-machinable.

Additionally, we found that Processing and Distribution Center (P&DC) personnel do not consistently report these issues in the Electronic Mail Improvement Reporting (eMIR) system<sup>4</sup> so management can take corrective action. Management is taking some action to address these issues, including revising mailing standards and price eligibility for commercial flats that fail to meet deflection<sup>5</sup> standards and are, therefore, non-machinable. In addition, management has initiated a Lean Six Sigma<sup>6</sup> review of the Periodicals process.

Finally, we found that Postal Service data collection systems and procedures accurately attribute costs to Periodicals based on the existing cost attribution models. Specifically, the costs used in this process are reconciled to the financial statements, the data obtained from the In-Office Cost System (IOCS)<sup>7</sup> is consistent with prior year results, and the data and any system changes are submitted to the PRC for review and approval.

## Manual Processing

Increases in manual processing costs attributed to Periodicals require further investigation. For example, manual processing costs attributed to Periodicals increased by 4.5 percent (\$10.4 million) and 3.6 percent (\$8.6 million) in fiscal years (FYs) 2008 and 2009, respectively, even though Periodicals Outside County flats volume declined by 3.6 percent and 8.6 percent in FYs 2008 and 2009, respectively. In addition, Periodicals mail is now being prepared more efficiently (co-mailing, co-binding, co-palletization, and sack reduction) and mailers have increased the percentage of pre-sorted Periodicals volume to levels that should require little to no automated or manual processing. Interested parties have attributed the increase in manual processing to an

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<sup>3</sup> “2C” is a reference to Periodicals’ former classification as Second-Class (2C) Mail.

<sup>4</sup> A *PostalOne!* System application that provides a process for operations to notify mailers, bulk mail entry units, and Business Service Network representatives of irregularities in the preparation of mail.

<sup>5</sup> Minimum flexibility standards for a mailpiece to qualify as a flat; in general, the piece must bend (deflect) 1 inch without breaking.

<sup>6</sup> A continuous improvement methodology that combines Lean methodologies and tools to identify waste with Six Sigma methodologies and tools to improve business processes.

<sup>7</sup> IOCS is the primary data collection system; other data collection systems include the City Carrier Cost System, the Transportation Cost System, and the Management Operating Data Collection System (MODS).

operational condition referred to as “automation refugees.” They allege this includes “idle” mail processing employees who are assigned to manually process Periodicals even though automated processing is available. While we did not observe this condition at the six locations we visited, nor did our review of applicable data conclusively identify this situation, we believe this warrants further investigation by management.

We did see evidence of operational activities that likely result in increased manual processing of Periodicals. The “Hot 2C” program, which was established to expedite processing, and issues with mail preparation could both be resulting in increased manual processing within the plants. Other mail preparation and processing issues could also be resulting in increased manual processing.

### “Hot 2C” Program

There was an unofficial “Hot 2C” or “Hot Periodicals” program at each of the six facilities we visited, which provided selected publications with expedited mail processing treatment. The unofficial “Hot 2C” program is intended to highlight the guaranteed delivery day for various Periodicals, but managers have expanded it to expedite processing (including manual processing) for certain publications.

Each facility uses slightly different procedures to maintain and update the “Hot 2C” lists but, in general, publications are placed on the list based on requested delivery days because:

- Local or national Business Service Network (BSN) personnel requested the inclusion in response to frequent missed delivery complaints from customers or mailers; or
- External measurement services<sup>8</sup> monitor selected publications for service performance.

Based on our discussions with management, we believe this unofficial program exists at the majority of Postal Service processing facilities. These informal procedures increase mail processing costs and may distort service performance measurements for Periodicals.

Increased manual processing can occur due to management’s emphasis on meeting guaranteed delivery days and service performance goals. Additionally, including Red Tag Monitoring Service and Del-Trak System publications on “Hot 2C” lists can result in misleading Periodicals service performance results.

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<sup>8</sup> Service performance is measured using two external measurement systems. A not-for-profit association operates the Red Tag Monitoring Service to monitor service for its association members, while Time, Incorporated operates the Del-Trak System to monitor service for several of its publications.

### Other Processing Issues

Management identified missed CETs, bundle integrity issues, and mailpiece characteristics as operational conditions that can lead to increased manual processing of Periodicals. However, these operational issues were not always reported in the eMIR system, which would allow management to identify and address systemic mail preparation issues.

**Missed CETs** — One facility identified missed CETs as a factor that increased manual processing of Periodicals at the facility. At the destination processing facilities the CET is the latest time a Periodicals mailing can arrive and meet service standards for mail processing, dispatch, and final delivery. When a Periodical mailing misses a CET, the facility may be unable to process the mailing with the Automated Package Processing System (APPS) or Small Parcel Bundle Sorter (SPBS) and the mailing is processed manually at the P&DC or sent to delivery units for manual sortation. As a part of a Postal Service Periodicals Lean Six Sigma review, management will evaluate establishing a national CET for Periodicals (as opposed to the current practice of locally established CETs).

**Bundle Packaging Problems** — Bundle integrity issues also contribute to increased manual processing of Periodicals. Current mailing standards state that bundles can be secured with plastic bands, rubber bands, twine, string or shrink-wrap. However secured, the bundles must withstand normal transit and handling without breaking.<sup>9</sup> Four of the six facilities identified problems with bundle breakage or shrink-wrapped bundles. The four facilities identified Periodicals publications whose bundles they routinely process manually because they either break during APPS or SPBS processing or the shrink-wrapped bundles obscure the delivery address or bundle labels. Figures 1 through 4 depict bundle preparation and manual bundle processing issues we observed at the Baltimore and Atlanta P&DCs.

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<sup>9</sup>*Domestic Mail Manual*, Chapter 7, Periodicals, Section 19, Bundles.

**Figure 1. String from Broken Bundles Entangled in APPS Machine**



**Figure 2. Shrink-wrap Obscures Address and Barcode**



**Figure 3. Broken Bundles Manually Processed**



**Figure 4. Broken Bundles Manually Processed**



**Mailpiece Characteristics** — The six P&DCs also identified mailpiece characteristics — such as the size, shape or material — as factors that contribute to the need to manually process Periodicals. Management identified certain publications that, from prior experience, they are unable to process on automated equipment, such as the Automated Flat Sorter Machine (AFSM) 100 or the Upgraded Flat Sorter Machine (UFSM) 1000. These mailpieces, frequently newspaper-shaped publications, are processed in manual flats operations. Based on FY 2009 IOCS statistical testing results, about 39 percent of the manual handling costs at P&DCs were associated with newspaper-shaped publications.



We examined postage statements for nine national publications the facilities routinely process manually. We estimate the national publications mailed about 34.8 million flats mailpieces a year. Over a 1-year period, we estimate the difference in postage between the machinable and non-machinable flats rates totaled approximately \$1 million for these nine publications. If this condition exists in 5 percent of the universe of the 7.2 billion Periodicals flats mailpieces processed in FY 2009, the difference between the machinable and non-machinable flats rates could total as much as \$28.3 million.<sup>10</sup>

The Postal Service, due to the difficulties in processing certain flats, revised its mailing standards and price eligibility on June 7, 2010, for commercial flats that fail to meet the new deflection standards. However, the Postal Service delayed implementation of the revised price eligibility to October 3, 2010, as it worked with mailers to ensure flats preparation that is compatible with Postal Service processing and handling procedures. While the new deflection standards may alleviate some of these issues, it will be difficult for some publications, such as newspapers, to fully comply with them; therefore, the new standards will not resolve many of the issues noted in this report. See [Appendix B](#) for our detailed analysis of this topic.

We recommend the manager, Regulatory Reporting and Cost Analysis, direct the manager, Cost Attribution, to coordinate with Operations to:

1. Determine the extent of changes in operational conditions associated with Periodicals and their impact on Periodicals cost attributions.

We recommend the vice president, Network Operations, direct the manager, Processing Operations, to:

2. Issue guidance to processing facilities that emphasizes managing the expected delivery dates and eliminates using the “Hot 2C” program to provide expedited processing or manual processing for select publications.

### **Inconsistent eMIR System Reporting**

Although each facility manager identified publications that they routinely process manually because of mail preparation, mail characteristics or missed CETs, they did not document these discrepancies in the eMIR system. The six facilities we visited entered only 91 eMIR system reports during a recent 6-month period. The 91 reports consisted of 5 missed CETs, 15 bundle preparation issues, and 71 shipment discrepancies. No reports were put into the eMIR system regarding flats with mailpiece characteristics that resulted in them being non-machinable.

The Postal Service and the mailing industry developed the eMIR system to identify issues impacting efficient mail processing and inform process owners of identified

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<sup>10</sup> 7.2 billion Periodicals flats mailpieces x 5 percent x \$.0785 cents (the average difference between the eight machinable and non-machinable postage rates).

deficiencies. Postal Service procedures state that the Postal Service should use the eMIR system to report quality issues and other recurring problems with Periodicals, such as broken bundles. Employees should use the process when there is a quantity of improperly prepared mail that could impact the efficient processing or delivery of the mail.<sup>11</sup> These reports help ensure that bulk mail entry unit (BMEU) personnel (who determine whether bundles meet mail preparation standards) are informed of mail preparation issues. BMEU acceptance employees are responsible for verifying that Periodicals mailers have submitted mailings prepared according to the appropriate standards. As part of this verification, the mailer's account is examined and eMIR system reports are displayed. BMEU personnel then must examine the submitted mailing for errors similar to those previously reported in the eMIR system. During an examination of the mailpieces, personnel verify, among other things, barcode visibility requirements, machinable criteria, and proper bundle preparation. If employees identify errors, they hold the mail until the issue is resolved. The employees must inform the mailer of the errors, provide feedback on cause of errors and corrective measures, and obtain disposition. The mailer may either rework the mailing or pay additional postage.

The goal of the eMIR system is to link all process owners (BMEU, Operations, the BSN, and mailers) and correct identified deficiencies. For example, for the new flats deflection standards the Postal Service stated they would provide feedback to mailers through the eMIR system so they could correct mailpieces that fail the new deflection standards. During our visits, we observed routine manual processing of Periodicals bundles at two facilities.

Management at the facilities stated they did not use the eMIR system for a variety of reasons, such as:

- It is easier and they receive quicker feedback if they contact the BSN or mailer directly; and
- They were reluctant to report problems because eMIR system guidance states that employees should report important/serious problems or issues and the facilities did not always consider the bundle preparation, bundle breakage, and mail characteristics as important/serious problems.

In addition to the problems that occur when employees do not use the eMIR system, we also found that the system currently has very limited search and reporting capabilities, making it difficult to quantify the issues we identified nationwide. The Postal Service is currently redesigning the eMIR system and it will have significantly improved search and reporting capabilities in the future.

The eMIR system is an important tool for correcting missed CETs, bundle preparation and breakage issues, and mailpiece characteristic problems. Using the eMIR system

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<sup>11</sup> *Standard Operating Procedures for Periodicals Processing*, April 24, 2006.

provides documented corrective feedback to mailers and assists in reduced processing costs by identifying systemic processing issues. The Postal Service and mailers can then address these issues. Other processing facilities may have similar issues with specific publications and reporting the issues in the eMIR system would help identify nationwide systemic issues that need to be resolved. Additionally, by directly contacting the BSN or mailer, facilities may be bypassing the BMEU accepting the mailings. If the bundles or mailpieces cannot be processed on mechanical or automated equipment, BMEU personnel should be alerted to ensure that bundles and mailpieces meet Postal Service standards and that mailers are paying the correct machinable or non-machinable rates.

The previously mentioned Lean Six Sigma review and the revised deflection standards are two Postal Service initiatives that should address some of these operational conditions.

We recommend the vice president, Network Operations, direct the manager, Processing Operations, to:

3. Re-emphasize use of the Electronic Mail Improvement Reporting System to processing facility personnel and define the types of issues that should be reported.

### **Cost Attribution**

Postal Service data collection systems and procedures accurately attribute costs to Periodicals based on the existing cost attribution models. Specifically, the costs used in this process are reconciled to the financial statements and the data obtained from the IOCS is consistent with prior year results. Additionally, the data and any system changes are submitted to the PRC for review and approval.

### **Management's Comments**

Management agreed with the recommendations and stated there were ongoing efforts to analyze operational conditions and their impact on cost attribution. Management also stated that they do not endorse practices that force Periodicals handling out of the automated processing stream and into less efficient manual processes. The target date for issuing "Hot 2C" guidance is April 2011. Management further stated they will develop eMIR system training guidance, in conjunction with the eMIR system redesign, by May 2011. See [Appendix C](#) for management's comments in their entirety.

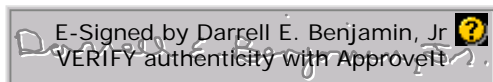
### **Evaluation of Management's Comments**

We consider management's comments responsive to the recommendations and the actions taken should correct the issues identified in the report.



The OIG considers recommendations 2 and 3 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.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Paul Kuennen, director, Cost, Revenue, Rates, or me at 703-248-2100.



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Attachments

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## APPENDIX A: ADDITIONAL INFORMATION

### BACKGROUND

Beginning in 1792, Congress provided Periodicals mailers with preferred mailing rates that were lower than their delivery costs. Initially, Congress funded these postage subsidies through annual appropriations. Between 1792 and 1969, Congress enacted legislation that focused on developing criteria that would define the differences between Periodicals and non-Periodicals for the purpose of these subsidies. Congress enacted the Postal Reorganization Act (PRA) of 1970 which resulted in major changes, including abolishing the Post Office Department and replacing it with the U.S. Postal Service. Under the PRA, Periodicals — along with all mail classes — were to “bear the direct and indirect postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type.” The PRA established timetables for phasing out Periodicals subsidies, initially a 5-year period but later extended to an 8-year period. In 1976, Congress amended the PRA and required the PRC to consider additional criteria when setting postage rates — “the educational, cultural, scientific, and informational (ECSI) value to the recipient of mail matter.” The PAEA of 2006 also included the ECSI provisions.

Since FY 2000, Periodicals’ revenue has not covered its attributable costs.<sup>12</sup> In FY 2000, Periodicals’ revenue covered about 89.2 percent of attributable costs. Cost coverage rose to 98.7 percent in FY 2003 and declined to 76.1 percent in FY 2009, resulting in a cumulative loss of over \$2.2 billion from FY 2000 through FY 2009. Contributing to this decline in cost coverage was a 23 percent decline in Periodicals volume, from 10.4 billion pieces in FY 2000 to 8 billion pieces in FY 2009. Table 1 illustrates Periodicals revenue, costs, cost coverage, and volume for FYs 2000 through 2009.

**Table 1. Periodicals Revenue, Costs, and Volume (billions)  
and Cost Coverage<sup>13</sup>**

	Fiscal Year									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
<b>Revenue</b>	\$2.17	\$2.21	\$2.16	\$2.23	\$2.19	\$2.16	\$2.22	\$2.19	\$2.29	\$2.04
<b>Costs</b>	\$2.28	\$2.43	\$2.36	\$2.26	\$2.39	\$2.51	\$2.57	\$2.64	\$2.73	\$2.68
<b>Volume (Pieces)</b>	10.4	10.1	9.7	9.3	9.1	9.1	9.0	8.8	8.6	8.0
<b>Cost Coverage Percentage</b>	89.2%	90.3%	91.8%	98.7%	91.7%	85.9%	86.2%	83.0%	84.0%	76.1%

<sup>12</sup> Postal Service costs directly associated with a product including volume variable costs (which vary directly with volume changes) and product-specific costs (which do not vary with volume changes).

<sup>13</sup> PRC methodologies used for all years.

Service commitments for Periodicals delivery range from 1 to 7 days depending on the origin and destination ZIP Codes. The Postal Service measures service performance using two external measurement systems. A not-for-profit association operates the Red Tag Monitoring Service to monitor service for its association members while Time, Incorporated operates the Del-Trak System to monitor service for several of its publications.

Recent economic and technology-driven changes have affected the Periodicals mailing industry, causing significant drops in Periodicals advertisements, less weight per piece, and a corresponding reduction in postage revenue for the Postal Service. In FY 2009, mailers sorted about 56 percent of Periodicals mail to carrier routes that require little to no mechanical or automated processing. In July 2007, the Postal Service implemented new prices and mailing standards for Periodicals mail that increased the complexity of the pricing structure. In addition to the existing piece and pounds rates, new bundle and container rates were implemented. The bundle and container rates varied based on presort level and point of entry and were designed to recognize the cost difference between handling various types of containers and bundles. The rate increase averaged 11 percent for the entire Periodicals mail class.

Despite collaborative efforts with the mailing industry to reduce mail preparation and processing costs, the Postal Service lost \$642 million during FY 2009 in handling Periodicals mail.

P&DCs can receive Periodicals directly from mailers (drop-shipped) or from other Postal Service facilities (primarily Network Distribution Centers and other PDCs) for distribution to the ZIP Codes designated for their local delivery. Periodicals arriving on pallets or in sacks, bundles<sup>14</sup> or trays can be sorted to area distribution centers, 3-digit Zip Code areas,<sup>15</sup> sectional center facilities, or 5-digit ZIP Code areas,<sup>16</sup> and Firm<sup>17</sup> and carrier route<sup>18</sup> destinations. Carrier route, Firm, and direct 5-digit bundles that require no additional mechanical or automated sortation are dispatched directly to delivery units.

Flat mail bundles arriving on pallets are generally processed in a primary sort in an APPS or a SPBS bundle sorting operation. Once separated, incoming Periodicals that qualify as automated flats should be processed on the AFSM 100 or, because of size or weight limitations, on the USFM 1000. Non-automated mailpieces, such as culls, mail outside the AFSM 100 or USFM 1000 specifications, and rejects from AFSM 100s or USFM 1000s are processed in manual flat operations.

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<sup>14</sup> A group of addressed pieces secured together as a unit. Bundle preparation standards allow bundles to be secured with plastic or rubber bands, twine, string, and similar material. The bundles must withstand normal transit and handling without breaking and without causing injury to Postal Service employees or damage to equipment.

<sup>15</sup> The ZIP Code in the delivery address on all pieces begins with the same three digits.

<sup>16</sup> The ZIP Code in the delivery address on all pieces includes the same five-digit ZIP Code.

<sup>17</sup> Two or more copies for the same business address placed in one bundle, all pieces within a "firm" bundle are for delivery to the address shown on the top piece.

<sup>18</sup> Sorted by carrier route and requires no primary or secondary distribution.

The Postal Service is deploying the Flats Sequencing System (FSS), a new technology intended to increase efficiencies in the processing, distribution, and delivery of flats. The FSS will automatically sort flat-shaped mail into delivery point sequence at high speeds. The Postal Service is currently installing 100 FSS machines at 47 sites. Periodicals that meet new addressing standards and standards for Periodicals automated processing can be processed on FSS machines.

Most Postal Service mail processing plants report operational data through MODS, which is used in apportioning costs to various cost pools<sup>19</sup> and classes of mail. MODS is used to gather, report, and store data on workload, workhours, and machine use. Workhours are taken from the Time and Attendance Collection System while mail volume is obtained from the Web End of Run application.

The web-based eMIR system is a process for notifying business mailers of irregularities in the preparation of mail they present to the Postal Service. When processing operations identifies a problem in the preparation of a mailing, they enter the information into the eMIR system module in the *PostalOne!* System. Reports for managed accounts are routed to the BSN and are also visible to the BMEU where the mailing was entered. Reports for non-managed accounts are routed to the BMEU where the mailing was entered. BMEU personnel enter the results of their actions regarding the eMIR system report into the eMIR system.

## **OBJECTIVES, SCOPE, AND METHODOLOGY**

Our objectives were to (1) determine whether Postal Service data collection systems and procedures accurately attribute costs to Periodicals and (2) review Postal Service operations that affect the manual processing of Periodicals.

To determine whether Postal Service data collection systems and procedures accurately attribute costs to Periodicals we interviewed management, assessed controls over the data collection systems, and examined the methodologies and procedures used to attribute costs to Periodicals.

To assess controls over the data collection systems, we reviewed the available policies and procedures for the major data collection systems. In addition, we examined FY 2008 and FY 2009 IOCS proportions and FY 2009 IOCS test results.

To determine the reliability of product estimates produced by the data collection systems, we reviewed the FY 2008 and FY 2009 coefficients of variation.

To examine how Periodicals costs are attributed we reviewed the Cost Segment and Component Reconciliation to Financial Statements and Account Reallocation for FY 2009, identified the general ledger accounts, and reconciled the account/subaccount

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<sup>19</sup> Groups of operations or activities that are similar in terms of type of work being performed and characteristics of the mail being processed.

from an Enterprise Data Warehouse extract report of FY 2009 to the reconciliation worksheet of the cost segment. Specifically, we traced costs attributed to cost segments 3, 6, and 14 by segment or component from the Cost and Revenue Analysis "B" workpapers<sup>20</sup> and matched their respective attributable cost as identified in the source general ledger accounts.

To analyze the cost pools we performed a comparative analysis on selected pools to determine their shares relative to the Postal Service's total volume variable cost for each pool. In addition, we performed a comparative analysis on selected cost pool volume variable costs and their percentage changes in FY 2008 and FY 2009. Furthermore, to account for volume decline and determine the magnitude of the changes in a cost pool, we examined flats unit costs for Outside County Periodicals reported in the Cost and Revenue Analysis Reports for FYs 2007 through 2009.

To review Postal Service operations that affect the manual processing of Periodicals, we conducted site visits at the Atlanta, Baltimore, Columbus, Dominick V. Daniels, New York Morgan, and Minneapolis PDCs. We judgmentally selected the six PDCs based on the relatively high number of IOCS tests conducted at those facilities in FY 2009 and the high volume of Periodicals processed at those facilities. At each facility, we analyzed FY 2009 MODS and IOCS test results, observed Periodicals processing, and interviewed management.

To determine the extent to which mailers received automation (discounted) rates for manually processed mail, we identified national publications that were routinely processed manually at one or more of the facilities. For the nine national publications, we extracted four FY 2010 postage statements<sup>21</sup> (one each quarter) from the *PostalOne!* System and calculated the difference between the machinable and non-machinable flats rates for mailpieces that received the lower machinable flats postage rates. To determine the extent that facilities use the eMIR system, we reviewed Periodicals eMIR system reports for a 6-month period January 1 through June 30, 2010.

We conducted this performance audit from January through December 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 performed analytical and comparative tests on automated data we received. 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 November 10, 2010, and included their comments where appropriate.

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<sup>20</sup> The CRA "B" workpapers produce some product attributable costs for 13 of the 18 cost segments, including Postmasters, Supervisors, Clerks and Mail Handlers, In-Office City Carrier Activities, City Carrier and Rural Carrier Street Costs, Purchased Transportation.

<sup>21</sup> Postal Service Form 3541.

**PRIOR AUDIT COVERAGE**

We did not identify any prior audits of Periodicals mail costs.



## APPENDIX B: DETAILED ANALYSIS

### Manual Processing

There are increases in Periodicals manual processing costs, which may be the result of changes in operational conditions that requires further investigation. Costs attributed to Periodicals manual flats processing have been increasing despite the Postal Service's and mailers' efforts to increase the automated processing of flats. The Postal Service's efforts include deployment of additional FSS machines that will automatically sort flat-sized mail into delivery point sequence at high speeds. In addition, more mailers are participating in efforts to reduce processing costs through co-mailings, co-palletizations, sacks reductions, drop shipment, and preparation of carrier-route sequenced mail that should require little to no automated or manual processing.

In FY 2009, mail-processing costs accounted for 55 percent of all Outside County Periodicals costs. In FY 2009, costs attributed to the manual processing of Periodicals flats were estimated at \$250.4 million. Almost all manual processing costs are captured in three cost pools: MODS manual flats, non-MODS manual flats, and manual distribution activities. While two of the cost pools are increasing, the third cost pool has remained constant. Table 2 illustrates the share of manual flats processing costs attributed to Periodicals and the portion of each cost pool attributed to Periodicals in FYs 2007 through 2009.

**Table 2. Periodicals Share of Manual Flats Cost Pools**

Cost Pool	FY 2007		FY 2008		FY 2009	
	Costs (millions)	Periodicals Share of Cost Pool	Costs (millions)	Periodicals Share of Cost Pool	Costs (millions)	Periodicals Share of Cost Pool
MODS Manual flats	\$50,742	22.71%	\$48,479	22.61%	\$57,626	27.54%
Non-MODS Manual flats	122,947	21.38%	133,056	23.67%	139,127	27.42%
Manual Distribution Activities (LDC 43)	57,718	8.11%	60,259	8.99%	53,674	8.89%
<b>Manual Processing Totals</b>	<b>\$231,407</b>		<b>\$241,794</b>		<b>\$250,427</b>	

The first cost pool, MODS manual flats, represents all manual flat sorting performed at mail processing plants.<sup>22</sup> In FY 2007, 22.7 percent of the manual flats costs at these facilities were attributed to Periodicals. That percentage decreased slightly to 22.61 percent in FY 2008 and increased again in FY 2009 to 27.54 percent. Periodicals' share of manual flats sorting has been increasing, even though Periodicals mail volume declined and a higher percentage of Periodicals were prepared by mailers at a level that should require a minimum level of manual processing.

<sup>22</sup> MODS 1 and 2 facilities.

The second cost pool, non-MODS manual, consists of manual flats distribution activities at post offices, stations, and branches not associated with mail processing plants.<sup>23</sup> These are generally small facilities that primarily perform manual mail processing activities. Manual mail processing activities at these facilities that are attributed to Periodicals have been increasing. In FY 2007, about 21.38 percent of manual flats distribution at those facilities was attributed to Periodicals. The manual flats Periodical distribution increased to 23.67 percent in FY 2008 and increased again in FY 2009 to 27.42 percent.

The third manual processing cost pool (LDC43) — manual distribution activities at post offices, stations, and branches associated with mail processing plants — has remained relatively constant. In FY 2007, about 8.11 percent of those costs were attributed to Periodicals. That increased slightly to 8.99 percent in FY 2008 and declined slightly to 8.89 percent in FY 2009.<sup>24</sup>

Management stated that there may be operational or other conditions causing these increases in Periodicals manual flats processing. For example, removing FSM 1000 machines and replacing them with higher speed AFSM 100 machines may have led to an increase in flats volumes needing a manual sort<sup>25</sup> or the share of pieces that are AFSM 100 machinable may have declined. Over a 2-year period, (FYs 2007 to 2009) management removed about half of the FSM 1000s from Postal Service facilities.

The Act directed the Postal Service and the PRC to jointly examine the rates for Periodicals and to report on, among other things, the quality, accuracy, and completeness of the information the Postal Service used in determining direct and indirect postal costs attributable to periodicals; and identify opportunities to improve efficiencies in the collection, processing, transportation, and delivery of Periodicals. This review is ongoing.

The Postal Service should determine whether changing operational conditions cause increases in manual processing costs attributed to Periodicals.

### **“Hot 2C” or “Hot Publications” Programs**

While there is no authorized national “Hot 2C” program, it exists unofficially at many sites and the publication titles, their treatment, and other activities vary by site and are not reported at the headquarters level. Postal Service personnel estimate that there are over 90 publications on the “Hot 2C” lists and the lists vary by site and have grown over time.

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<sup>23</sup> This cost pool also contains activities not classified as manual, primarily allied operations.

<sup>24</sup> This cost pool also contains activities not classified as manual, primarily allied operations.

<sup>25</sup> There is a small percentage of flat mail that is machinable on the FSM 1000 and not machinable on AFSM 100s.

Examples they provided of expedited treatment include:

- Dedicated staging, sort areas, and employees;
- Special placarding to prevent comingling;
- Manual sortation of machinable mailings;
- Separate bundle sort programs if automated;
- Bundles that should be sorted to the carrier route level instead being sent directly to delivery units for sorting; and
- Late arrivals that miss automated incoming secondary operations.

Each of the facilities we visited had some version of a “Hot 2C” program and the number of publications on the lists ranged from seven to 131. Four of the facilities used the lists to manage the in-home delivery dates for time-sensitive publications. Additionally, four of the facilities used the “Hot 2C” program to monitor the delivery performance of publications being monitored by the Red Tag Monitoring Service or Del-Trak System.

At four of the six facilities, the “Hot 2C” lists are prominently displayed in the plants. Figure 5 shows two “Hot 2C” lists at PDCs.

**Figure 5. “Hot 2C” Signs at Two PDCs**



## APPENDIX C: MANAGEMENT'S COMMENTS



December 3, 2010

LUCINE WILLIS  
DIRECTOR, AUDIT OPERATIONS

SUBJECT: Periodicals Mail Costs (Report Number CRR-AR-11-DRAFT)

We have reviewed the subject Draft Audit Report Periodicals Mail Costs (Report Number CRR-AR-11-DRAFT) and provide the following response.

**Recommendation 1:**

Determine the extent of changes in operational conditions associated with Periodicals and their impact on Periodicals cost attributions.

**Management Response/Action Plan:**

Management agrees with this recommendation.

This effort is ongoing. In particular, Section 708 of the Postal Accountability and Enhancement Act (PAEA) requires the Postal Service and the Postal Regulatory Commission to jointly report to the President and Congress on Periodicals costs, operations, and pricing. The PAEA requires that this report examine "the quality, accuracy, and completeness of the information used by the Postal Service in determining the direct and indirect postal costs attributable to Periodicals."

**Target Implementation Date:** Ongoing

**Responsible Official:** Manager, Regulatory Reporting and Cost Analysis

**Recommendation 2:**

Issue guidance to processing facilities that emphasizes managing the expected delivery dates and eliminates using the "Hot 2C" program to provide expedited processing or manual processing for select publications.

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**Management Response/Action Plan:**

Management agrees with this recommendation. Hot 2-C practices that force Periodicals (bundle or piece distribution) outside of the automated processing stream and into less efficient manual processes are not endorsed procedures.

**Target Implementation Date:** April 2011

**Responsible Official:** Vice President, Network Operations

**Recommendation 3:**

Re-emphasize use of the Electronic Mail Improvement Reporting System to processing facility personnel and define the types of issues that should be reported.

**Management Response/Action Plan:**

Management agrees with this recommendation and the need for an effective feedback mechanism for reporting specific flats preparation or packaging discrepancies such as flat bundle breakage due to ineffective packaging, non-conforming shrink wrap, excessive selvage or standard addressing format and placement issues.

The Postal Service collaborated with our industry partners through the Mailers' Technical Advisory Committee Package Integrity Workgroup and Mail Irregularity Reporting Workgroup to create an electronic solution. In 2003, the Electronic Mail Improvement Reporting (eMIR) process was successfully tested as part of the PostalOne! System; and in 2004, a national rollout began. While eMIR proved far more effective than the hardcopy process it replaced, opportunities for additional improvements were identified.

A redesign of the eMIR program began in fiscal year 2010 to include the following upgrades:

- Move from PostalOne! to a stand-alone intranet-based process
- Accessible to a greater number of mail processing employees through the Postal Blue Web site
- Expanded checklist of commonly identified issues to minimize time required for data input and the need for employee comments
- Greater reporting capabilities to identify trends

The rollout of the new eMIR process will include retraining of employees currently using the system and will provide an opportunity to introduce the process to additional processing employees. A comprehensive training toolkit is being developed and will be implemented in the field to coincide with the release of the upgraded eMIRs system. In parallel, Processing Operations is developing a training module specific to understanding and reporting flat mail discrepancies.

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**Target Implementation Date:** May 2011

**Responsible Officials:** Manager, Processing Operations  
Manager, Business Mail Acceptance

This report and management's response do not contain information that may be exempt from disclosure under the Freedom of Information Act. If you have any questions, please contact Frank Neri, Manager, Processing Operations, at 202-268-5556.



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