February 22, 2001

RICHARD J. STRASSER, JR.
CHIEF FINANCIAL OFFICER AND
EXECUTIVE VICE PRESIDENT

SUBJECT: Audit of the Postal Service's FY 2000 Budget Formulation Process (Audit Report Number FT-AR-01-006)

This report presents the results of our audit of the Postal Service's fiscal year (FY) 2000 budget formulation process (Project Number 00PA011FR000). Our initial objective was to evaluate the effectiveness of the Postal Service Headquarters FY 2001 budget formulation process and how the process supports and integrates cost containment and revenue growth in operational plans and goals. However, because the FY 2001 budget process was not complete at the time of our audit, we audited the FY 2000 budget formulation process.

We found that the Postal Service's budget formulation process was generally effective in allocating funds for functional area programs and operations. However, budget allocations were not based on current and complete analyses and may not have been sufficient to support the Postal Service's strategic goals, including those for reducing costs and increasing revenue. In addition, program budget officials did not have complete financial information to effectively evaluate and manage their programs.

Overall, management disagreed with the conclusion of our report, and with recommendation four. Further, while management agreed with the remaining recommendations, their comments were not responsive to recommendations two, three, and five. Therefore, we consider recommendations two, three, four and five to be *unresolved and plan to pursue them through the formal resolution process. To resolve* these recommendations, we request that management provide an action plan detailing corrective actions, planned milestones for completing them, and the responsible parties.

We appreciate the cooperation and courtesies provided by your staff during the audit. If you have any further questions or would like to schedule another meeting, please contact Lorie K. Siewert, acting director, Financial Statements, or me at (703) 248-2300.

Debra S. Ritt
Assistant Inspector General
for Business Operations

Attachment

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EXECUTIVE SUMMARY

Introduction

This report presents the results of our audit of the Postal Service Headquarters fiscal year (FY) 2000 budget formulation process. Our audit objective was to evaluate the effectiveness of the headquarters FY 2001 budget formulation process and how the process supports and integrates cost containment and revenue growth in operational plans and goals.

Results in Brief

The Postal Service's FY 2000 budget formulation process was generally effective in allocating funds for the six functional area programs and operations reviewed. However, program budget officials[1] focused on reducing costs and did not always prepare budget justifications based on current and complete analyses. Specifically, 50 of the 100 program budgets we reviewed were not based on current or complete studies and analyses. Further, a comprehensive staffing study had not been performed since 1992 to justify the number of personnel authorized and on board. Thus, program budget officials may not have allocated organizational resources to most effectively support the Postal Service's strategic goals, including those for reducing costs and increasing revenue.

In addition, program vice presidents expressed concerns regarding the absence of complete financial information needed to effectively develop, justify, and defend program budgets. Specifically, they stated that there were a large number of programs and no mechanism to efficiently consolidate information on related programs for consideration during the budget formulation process. They also stated that there was no accrual accounting system that recognized revenues paid, but not yet earned, and costs incurred, but not yet paid. Further, there was no costing methodology, such as activity-based costing, that could provide information to better evaluate the cost and benefits of programs and operations.

Summary of Recommendations

For future budget formulations, we recommend program budget officials base estimates on updated studies and analyses, and develop a method to efficiently identify and consolidate financial information on related programs.

[1] Program budget officials include functional vice presidents, program managers, and budget coordinators.

We also recommend that program budget officials evaluate the benefits of implementing both accrual accounting and cost accounting systems at the program and functional levels.

Summary of Management's Comments

Management disagreed with the overall conclusion of our report, but concurred with all but one recommendation. With respect to recommendation four, management stated it does not believe a finance rollup number needs to be developed because the Postal Service's Corporate Information System is capable of consolidating financial information from multiple finance numbers. Further, although management was in agreement with the remaining recommendations, they indicated they would not develop or enforce specific requirements for managing budgets, and that program managers would remain responsible for providing complete program information in the Budget Planning System. In addition, while management agreed to consider accrual and cost accounting systems, they stated current financial challenges limit the upgrades to be implemented in the near future.

Overall Evaluation of Management's Comments

Based on management's comments, we consider recommendations two, three, four, and five to be unresolved, and plan to pursue them through the formal audit resolution process. Although management stated that managing budgets and ensuring completeness of budget information is the responsibility of individual program managers rather than Finance, we believe Finance is responsible for the accuracy of the overall budget and for ensuring the completeness of budget submissions. Further, although management believes budgets can be rolled up under one finance number, vice presidents interviewed told us they did not have such access to consolidated financial information. Finally, while management agreed to consider accrual and cost accounting systems, they did not indicate when or how they would implement this recommendation.

INTRODUCTION

Background

In fiscal year (FY) 2000, the Postal Service's total operating budget was $65.3 billion, of which $4.1 billion was budgeted for expenses, and $2.8 billion was for capital. Our audit focused on the headquarters expense and capital budgets.

Budget Formulation

The headquarters budget formulation process is divided primarily between two phases.[2] The first phase of the process is referred to as the "Establish Phase." Under this phase, the Establish Team[3] develops strategies and goals using the CustomerPerfect![4] concept. The goals are:

Corporate Goals

Customer — Customer-related goals to create service excellence and customer value.

Employee — Employee-related goals to improve employee performance and the workplace environment.

Business — Business-related goals to promote revenue growth and aggressively manage costs.

The second phase of the process is referred to as the "Deploy Phase." This phase requires program budget officials to develop budgets for those programs that support the Postal Service's corporate goals. In addition, according to program budget officials, the individual program budgets are often adjusted based on the Establish Team's evaluation of the program's relative importance to meeting strategic objectives, as well as the budgetary impact. Further, during the FY 2000 budget process, the Establish Team met on numerous occasions, including a three-day program review session to review each program budget,

[2]The budget process is comprised of four phases: establish and deploy, which are budget formulation phases and implement and review, which are budget execution phases.
[3]A team comprised primarily of senior vice presidents.
[4]CustomerPerfect! is the Postal Service's customer-focused, process-driven management system, which establishes strategic goals and measures of performance.

query program managers about requested spending levels, establish priorities, and finalize program budgets.

The process generates two budgets—an annual headquarters expense budget of $4.1 billion and a headquarters capital budget of $2.8 billion. The capital and operating expense budgets are further divided between programs and administrative expenses as follows:

Headquarters' Budget
(In billions)

	Programs	Administration	Total
Capital	$2.7	$0.1	$2.8
Expense	2.7	1.4	$4.1

Budget Reductions

The Postal Reorganization Act of 1970 includes a requirement that postal rates be fair and equitable and cover the cost of operating the Postal Service. Since FY 1999, the Postal Service has been in a cost-cutting mode to offset reduced revenues and delays in the postal rate increase. These reductions, which were coordinated through the Establish Team, were made during the "Implement Phase" of the budget process. Consistent with the cost-cutting mode, in FY 2000 the Postal Service established a "zero growth" parameter during the budget formulation process, which required management committee members not to exceed approved budget requirements for FY 1999.

Further, during FY 2000, program budget officials continuously responded to requests to reduce budgeted expenses, in part, because of unexpected increases in costs for fuel, grievance arbitration, and workers' compensation. Finally, the postmaster general launched an initiative, referred to as "Breakthrough Productivity," to reduce the Postal Service's budgeted expenses by $4 billion over the next four years. Using these cost control strategies, Postal Service officials reported reduced budgeted expenses of at least $2.2 billion from October 1999 through June 2000.

Objective, Scope, and Methodology

Our initial objective was to evaluate the effectiveness of the headquarters FY 2001 budget formulation process and how the process supports and integrates cost containment and revenue growth into operational plans and goals. However, because the FY 2001 budget process was not complete at the time of our audit, we evaluated the FY 2000 budget formulation process. To conduct our audit, we:

- Selected all 100 finance numbers related to programs that were greater than $10 million.
- Reviewed approved program budgets for 6 of the 14 functional areas,[5] which comprised about 75 percent of the headquarters capital and expense budgets.
- Examined processes used to develop budget estimates and reduce budgeted expenses.
- Reviewed documents related to budget formulation and budget reductions.
- Interviewed 108 key headquarters personnel involved in formulating the budget as follows:

Number of Key Headquarters Personnel Interviewed

	Interviewed
Management Committee Members	5
Functional Vice Presidents	14
Program and other Managers	58
Budget Coordinators	31
Total:	108

We conducted our audit from December 1999 through February 2001, in accordance with generally accepted government auditing standards and included tests of internal controls, as were considered necessary under the circumstances. We discussed our conclusions and findings with appropriate management officials and included their comments, where appropriate.

Prior Audit Coverage

In December 1999, we completed an audit of the Postal Service's FY 1999 budget reductions, (referred to as the "Management Challenge"), Review of Budget Cost Containment Measures, report number FR-MA-00-001. The audit disclosed the Postal Service had successfully reduced

[5]The six functional areas were judgmentally selected. Areas evaluated comprised the deputy postmaster general, chief marketing officer, chief operating officer, chief financial officer, chief technology officer, and the Postal Inspection Service.

its expenses by $675 million, and according to senior officials, the reduction had little impact on customer service. However, we determined the budget reduction process emphasized cutting costs without fully considering the impact on the Postal Service's strategic goals, including its goal of increasing revenue.

AUDIT RESULTS

Headquarters Budget Formulation Process

The Postal Service's FY 2000 budget formulation process was generally effective in allocating funds for programs and operations for the six functional areas reviewed. However, budget allocations were not based on current and complete analyses and may not have been sufficient to support the Postal Service's strategic goals for reducing costs and increasing revenue. In addition, program budget officials did not have complete financial information to effectively evaluate and manage their programs.

Program Budget Analyses

Approved program budgets often were not based on current analyses and thus, may not have been sufficient to meet program funding requirements. Program budget officials advised us they often did not update program analyses because the Postal Service had been in a cost-cutting mode since FY 1999. In addition, the Postal Service had established "zero growth parameters" during the FY 2000 budget formulation process, which required program officials not to exceed approved funding requirements for FY 1999. For these reasons, program officials stated they placed little emphasis on conducting data analyses to update and support budget estimates.

Of the 100 finance numbers and related programs we evaluated, 61 were affected by the Postal Service's cost-cutting mode and zero growth parameter. Following are examples of how programs and strategic goals were affected by decisions for cost-cutting and zero growth:

- *A program to measure the delivery of First-Class Mail* was implemented to provide timely, accurate, and consistent customer service in support of the Postal Service's strategic "Voice of the Customer" goals. The program had an initial budget request of $44.4 million for FY 2000, of which $35.9 million was initially approved. The budget was later revised to $34.8 million based on the zero growth parameter. Because of the reduced budget, program budget officials said they were not able to effectively measure delivery of remittance mail or develop a better method for measuring Standard Mail (A). As a result, the diagnostic sampling for measuring Priority Mail was reduced. Thus, the reduced budget increased the risk that funding may not be sufficient to fully implement the "Voice of Customer" goal of improving customer service. An updated study and analysis may have provided program budget officials with the pros and cons of various funding levels.

- A program designed to provide more effective alternatives to dispute resolution processes and improve the quality of the workplace environment for postal employees had an initial budget request of $12.9 million. This program supported the Postal Service's strategic "Voice of Employee" goals. However, because of the zero growth parameter, the program budget was established at $10.9 million. Management later reduced the program by an additional $2.5 million, but had to restore the funds to ensure the program could operate for the entire year. Despite management's decision to restore funds, without a current study and analysis of the program, there was an increased risk that the program may not have been funded at the level necessary to fully implement the "Voice of Employee" strategy for improving the workplace environment.

- A third program established to market awareness, consideration, and choice of postal products and services to increase revenue, had an initial budget request of $270 million. This program supported the Postal Service's "Voice of Business" goals. However, due to the zero growth parameter, the program budget estimate was initially reduced to $242 million and, according to the program budget official, was reduced again to $154 million. Program budget officials used the corporate goals of revenue growth and positive net income to justify this program. The reduced budget may have increased the risk that funding was not sufficient to promote awareness of postal products and services in a way that would fully achieve the "Voice of Business" goals of revenue growth and positive net income.

If program budget officials continue to use zero growth parameters and request budget reductions, they should use current studies and analyses to fully consider the long-term impact on programs and related strategic goals. In addition, program budget officials should prepare flexible or incremental budgets to determine levels of products or services that can be provided at various funding levels.

We also noted that program budget officials did not always maintain supporting documentation to explain how budget estimates were developed for 42 of the 100 finance numbers we reviewed. We discussed the issue of supporting documentation in our December 1999 Review of the Budget Cost Containment Measures report, number FR-MA-00-001. Because the FY 2000 budget was developed during our review of the "Management Challenge," Postal Service officials may not have had sufficient time to implement the suggested corrective actions related to our findings.

Current Program Benefits

Program benefits were not always updated and projected revenues often were not included in the "program narrative" form used to prepare budget justifications. Program benefits included improving customer service, workplace environment, reducing costs, or increasing revenue. This occurred, in part, because program budget officials did not always conduct studies and analyses to update program benefits. As a result, there was no assurance that program benefits were accurate, valid, and attainable. Also, it had become an accepted practice for program budget officials to exclude projected revenue amounts in the financial section of the "program narrative" form. Further, the Postal Service's Budget Planning System did not always have complete information to justify programs and report program benefits.

Of the 100 finance numbers related to Postal Service programs that we reviewed, 68 (56 nonrevenue-generating and 12 revenue-generating) were not supported by current studies and analyses to ensure program benefits were still valid and attainable.

Previous Office of Inspector General audits illustrate the risks associated with not performing updated analyses for specific nonrevenue generating programs. For example:

- The September 24, 1999, Priority Mail Processing Center Network report, number DA-AR-99-001, disclosed end-to-end processing of Priority Mail through the Network cost [redacted] more than Priority Mail processed in-house by the Postal Service without a network. Also, the Priority Mail Processing Center Network [redacted] referenced in the contract. Updated studies and analyses of program benefits and funding needs had not been performed for this program since April 1997. Thus, until our audit, program budget officials may not have been fully aware of the costs versus the benefits of the program.

In addition, program budget officials did not enter program information into the Budget Planning System using the program narrative form as required. The form allowed program budget officials to capture the funding, program benefits, and information on how the program supported the Postal Service's overall corporate goals. Of the 15 finance numbers we reviewed related to revenue-generating programs, 12 included program benefits that were not updated or revalidated to ensure projected revenue was based on current assumptions and projections. Further, none of the revenue-generating programs included projected revenue in the financial information section of the form to illustrate program costs versus benefits. For example:

- A program designed to reduce costs and increase the value of accountable mail by improving access to delivery information and inquiry response times had an approved budget of $73 million. The program narrative form included a statement that the program would increase revenue. However, program budget officials did not include the amount of increased revenue expected from the program in the financial information section of the form and had not updated the market research study that initially established the baseline and projected benefits of the program since 1996. Program budget officials said they did not update the study because technology related to this program had changed too rapidly to track and analyze the information. Thus, it was not possible to fully determine whether projected revenue and cost reductions justified the budget of $73 million.

- A program designed to generate revenue from the sale and development of postal real property had an approved budget of $59 million. Projected revenue reported in the program benefits section of the form was $125 million for FY 2000. This projection was a FY 1998 estimate and was not shown in the financial information section of the program narrative form. According to program budget officials, projected revenue for FY 2000 was only between $50 million and $70 million. As a result, program budget officials may not have had accurate information to effectively make funding decisions.

Because the Postal Service is striving to increase revenue and reduce costs to meet its financial challenges, current studies and analyses would help ensure funds are spent on programs that produce net benefits to the Postal Service.

Completeness of Program Information

Program budget officials did not have complete financial information to effectively evaluate and manage their programs. This occurred because there were a large number of finance numbers and no mechanism to efficiently consolidate information for related programs. In addition, there was no accrual accounting system at the program level that recognized revenues earned, but not yet received and cost incurred, but not yet paid. Also, there was no cost accounting methodology, such as activity-based costing that facilitated assigning costs to products and services based on cause and effect relationships at the program level. As a result, program budget officials could not make fully informed decisions about the benefits of funding, delaying, or eliminating programs.

Program vice presidents stated additional tools would provide more accurate and complete information to make more effective decisions. Specifically, executives stated they need:

- A finance "rollup" number that provides an aggregate total of expenses for related programs.
- An accrual accounting system at the program and functional levels that provides financial information on obligations for products and services not yet paid.
- A costing methodology, such as activity-based costing, that facilitates an evaluation of program costs versus benefits at the program and functional levels.

Following is a more detailed discussion of the methods and systems that are currently needed.

Finance "Rollup" Number. During both the budget formulation and budget reduction processes, program budget officials were responsible for controlling costs and evaluating about 650 finance numbers and related programs. Both processes required program budget officials to make decisions within short time frames to fund, delay, or eliminate programs.

Of the 17 program vice presidents[6] we interviewed, 12 stated they could not easily access information on related programs in other functional areas. Program vice presidents indicated this occurred because no mechanism, such as a finance rollup number, existed that could consolidate budget, expense, and revenue information on related programs within and outside of their functional areas.

As a result, program vice presidents found it challenging to identify and assess the impact of budget decisions on related programs during both the budget reduction and formulation processes. A finance rollup number or another method to consolidate related program financial information would facilitate more effective program and budget decisions.

Accrual Accounting System. Of the 17 program vice presidents we interviewed, 13 stated they maintained informal checkbook systems to track outstanding obligations for products and services that have been received but for which payments had not yet been made. Program budget officials stated they maintained informal systems because the Postal Service did not have an accrual accounting system at the program level that provided information on obligations. They further stated that the informal checkbook allowed them to better manage and defend their budgets during the budget reduction process. Without an accrual accounting system, finance officials only had information on expenses paid by programs, which did not include obligations and gave the impression that programs had more funding available for reductions or reprogramming than they actually did.

To illustrate, during the budget reduction process, finance personnel periodically conducted reviews to assess the relationship between expenses and revenues and to ensure the Postal Service was on target for meeting its financial

[6] Program vice presidents included functional vice presidents and members of the management committee.

goals. As part of these reviews, they determined whether programs were under or over budget. If programs were under budget, program budget officials were asked to return funds for reprogramming or cost reductions. The 13 program vice presidents stated that in the instances where they were asked to return funds, their programs appeared to be under budget. However, they actually were not under budget because obligated funds were not reflected in the Postal Service's accounting system. Instead, program vice presidents showed, in their informal checkbooks, that their programs had already obligated funds for products and services not yet paid.

Postal Service officials recognized the importance of using accrual accounting at the corporate or summary level for selected expenses, liabilities, and revenue—such as employees' salaries and benefits, which is a significant portion of the Postal Service's costs. These transactions, known as "Major Servicewide Accruals," were computed each accounting period at the corporate level. However, accruals were not performed at the program and functional levels to assist Postal Service officials with making budget and operational decisions.

As a result, program budget officials spent additional time and resources to maintain commitment information in informal "checkbooks." If the Postal Service had an accrual accounting system at the program level, it would eliminate the additional time spent by program budget officials to maintain informal checkbook systems. Also, it would provide more timely, complete, and accurate information for decisions at the program level.

Under accrual accounting, costs and revenues are recognized when they are incurred and realized, respectively, and in the time frame related to the economic environment in which they occurred. Thus, trends in revenues and expenses could be more accurately projected. In addition, accrual accounting provides relevant and important financial information showing relationships that are likely to be important in predicting future operating results.

Cost Accounting Methodology. Program budget officials did not have adequate cost information to conduct analyses during the budget formulation process. This occurred, in part, because the Postal Service did not have a costing methodology, such as activity-based costing at the program level, to fully assess programs and core business processes. As a result, program budget officials had no assurance that program benefits exceeded the cost of the program.

Activity-based costing is a cost accounting methodology that facilitates the assignment of costs to products and services based on a cause and effect relationship. The cost accumulated for a given activity is assigned only to the products or services that created a demand for that activity. Therefore, a number of experts deem that activity-based costing provides better information about the true cost of a product or service than other accounting methods, where costs are accumulated centrally and allocated to the products and services using some basis other than a causal relationship.

In addition, activity-based costing methods provide historical information about costs that can then be used in predictive models for budget formulation, improving performance and aligning available resources to meet strategic goals and objectives. Of the 17 program vice presidents we interviewed, 12 stated they could make more informed decisions to manage programs and develop budgets if they had a costing methodology, such as activity-based costing. Prior Office of Inspector General audits of specific programs also validated the importance of the Postal Service using a costing methodology, such as activity-based costing. For example:

- Our December 3, 1999, Cost and Benefit of the International Collection Program report, number RG-MA-00-001, disclosed costs for the International Collection Program exceeded commissions earned under the program by [redacted] during the period January 1997[7] through September 1999. Also, 98 percent of the marketing and administrative costs of selling international stamps (the majority of the costs for the program) had not been charged directly to the program. Thus, until our review, Postal Service officials were not fully aware the program was losing money. After our review the Postal Service discontinued the program.

[7] The inception of the program.

- Our March 31, 2000, Breast Cancer Research Stamp Program report, number RG-AR-00-002, disclosed, in part, that the Postal Service was required to capture and report costs incurred to support the program. In order to do so, the Postal Service developed Excel spreadsheets to accumulate the costs, because their existing accounting system did not separately track costs or revenues for different types of stamps. The reported cost for this program was $5.1 million. However, even with these special procedures in place, $836,000 of program costs were either inconsistently tracked or not tracked at all.

With a costing methodology, such as activity-based costing, the Postal Service can track incurred costs against the revenue for a program to enable a more timely and accurate assessment of programs. More importantly, the Postal Reorganization Act of 1970 includes a requirement that postal rates be fair and equitable and cover the cost of operating the Postal Service.

During the audit we noted the Postal Service is establishing an information platform that has a stated goal of implementing an activity-based costing system.

Personnel

Program budget officials did not ensure budget estimates for the number of personnel authorized and on board were based on current requirements. Budget estimates for personnel were not current because Postal Service officials had not performed a comprehensive staffing study since 1992. As a result, there was no assurance the Postal Service had the optimal number or composition of personnel.

The headquarters administration expense budget of $1.4 billion was generally comprised of salaries, wages, and benefits. Postal Service officials had not performed a comprehensive staffing study, but made various personnel requests within the last two years. The requests were primarily for staffing, general information, and grade determination.

We noted during the audit that the Postal Service established a "Breakthrough Productivity" initiative, which is a comprehensive and integrated method for accomplishing productivity improvements. Included in this initiative is a requirement for ongoing assessments to determine whether the Postal Service has excess personnel and personnel in suitable positions to achieve business efficiencies.

Recommendation

The chief financial officer and executive vice president should coordinate with management committee members to:

1. Reinforce the requirement for program budget officials to update and fully document studies and analyses to ensure budget cost estimates for programs, related benefits, and staffing are based on current goals and strategies.

Management's Comments

Management agreed that documentation can be improved, and has reminded program managers of the need for current and complete documentation during the current planning cycle. Management added, that for ongoing corporate activities (i.e., printing stamps and money orders), they expect program managers to exercise judgment to update studies and analyses only when the benefits of updated information are likely to exceed the costs of obtaining it.

Evaluation of Management's Comments

Management's comments were responsive to our recommendation and should address the issues raised in this report.

Recommendation

The chief financial officer and executive vice president should coordinate with management committee members to:

2. Develop methodologies to prepare flexible or incremental budgets to reduce the need to continuously respond to budget reductions.

Management's Comments

Management agreed that program budget officials should develop flexible budgets capable of responding to a variety of budgetary contingencies, and indicated that flexible budgets are prepared at the direction of senior management. Therefore, Finance will not develop or enforce specific requirements for managing budgets.

Evaluation of Management's Comments

Management's comments were not responsive to our recommendation. With the financial challenges facing the Postal Service, we believe that Finance should require program managers to develop flexible budgets to help them better manage and respond to future budget reductions. Thus, we consider this recommendation as unresolved and plan to pursue it through the audit resolution process.

Recommendation

The chief financial officer and executive vice president should coordinate with management committee members to:

3. Ensure program budget officials include updated potential revenue amounts in the financial information section of the "program narrative" to provide complete program information in the Budget Planning System.

Management's Comments

Management agreed that documentation of potential program benefits can be improved and emphasized this requirement in the instructions for the current planning cycle. Management added that it remains the program manager's responsibility to summarize completely and accurately both the costs and benefits of his/her program in the budget planning system. Failure to do so may result in the program not being funded or funded at a reduced level, meaning the system works. Further, program narratives in the system are only a starting point for the Establish Team's review.

Evaluation of Management's Comments

Management's comments were not responsive to our recommendation because they did not indicate how they would ensure program benefits would be captured. Although program managers are responsible for updating program benefits in the Budget Planning System, this system is maintained by Finance, who is responsible for the completeness and accuracy of the official budget. Also, management should be able to rely on having accurate and complete information in the system to make pertinent program decisions. We view this recommendation to be unresolved and plan to pursue it through the audit resolution process. Accordingly, we request that management provide an action plan, including projected milestones, to show how and when they plan to address this recommendation.

Recommendation

The chief financial officer and executive vice president should coordinate with management committee members to:

4. Develop a finance "rollup" number or another method to consolidate program information and provide program budget officials with related financial program information.

Management's Comments

Management did not agree that a finance "rollup" number should be developed and stated that although some technical expertise was required, the capability exists and budget coordinators should be able to provide consolidated financial information to program budget officials.

Evaluation of Management's Comments

We do not agree with management's comments because the vice presidents interviewed did not have access to financial information that would allow them to quickly assess the impact of their decisions on interrelated programs. Further, management has not demonstrated that this capability exists or that budget coordinators have the technical expertise required to consolidate financial information. Therefore, we view this recommendation as unresolved and plan to pursue it through the formal audit resolution process. To resolve this issue, we request that management provide an action plan, to include timeframes for completion, confirming that the system is capable of providing consolidated financial information on interrelated programs.

Recommendation

The chief financial officer and executive vice president should coordinate with management committee members to:

5. Evaluate the benefits of implementing accrual and cost accounting systems at the program and functional levels to more effectively provide program budget officials with related program information.

Management's Comments

Management agreed to consider the costs and potential benefits of accrual and cost accounting systems when they begin formally evaluating substantial system upgrades. However, current financial challenges limit the upgrades to be implemented in the near future.

Evaluation of Management's Comments

Management's comments were not responsive to our recommendation because they did not indicate when they would implement the recommendation or how they would correct the problem. We believe, as the Postal Service continues to face financial challenges, accrual and cost accounting systems at the program level are necessary to allow program budget officials to make more effective program budget and funding decisions. Therefore, we consider this recommendation as unresolved and plan to pursue it through the audit resolution process.

APPENDIX. MANAGEMENT'S COMMENTS

DONNA M. PEAK
VICE PRESIDENT
FINANCE, CONTROLLER

UNITED STATES
POSTAL SERVICE

January 18, 2001

MS. KARLA CORCORAN

SUBJECT: Draft Audit Report – Audit of the Postal Service's Fiscal Year 2000
Budget Formulation Process

We have reviewed the draft report on the Postal Service's fiscal year (FY) 2000 budget process. We see nothing in this report, or management's response, which contains proprietary or other business information that may be exempt from disclosure under the Freedom of Information Act (FOIA).

The report summarizes the information obtained during your examination and raises points regarding the completeness of program documentation and effectiveness of our information systems. It concludes that the Postal Service may not have effectively planned, controlled, and allocated organizational resources to invest in and support its strategic goals. As explained in our response dated September 19, 2000, we disagree with this conclusion. A basic premise of the report appears to be that failure to fund a program at the level requested jeopardizes achievement of Postal Service strategic goals. This is not realistic. The Establish Team is responsible for the allocation of limited resources and fully considers the impact of budgetary decisions on strategic goals. The report also fails to note that each strategic goal is often supported by more than one program. Funding any single program at the requested level does not ensure achievement of a specified goal. Likewise, it is unrealistic to assume that a lower level of spending will prevent achievement of a goal.

Following are responses to the specific recommendations contained in the report.

1. **Reinforce the requirement for program budget officials to update and fully document studies and analyses to ensure budget cost estimates for programs, related benefits, and staffing are based on current goals and strategies.**

   The draft report noted that many program descriptions in the Budget Planning System (BPS) were not complete or current and recommended that we reinforce the requirement for current studies and analyses of costs, benefit, and staffing estimates. We agree that documentation can be improved, and have reminded program managers of the need for current and complete documentation during our current planning cycle. However, it must be noted that many of the programs included in annual expense budgets are for ongoing corporate activities such as printing stamps and money orders, maintaining the telecommunications systems, etc. It is unnecessary and costly to update cost studies or analyses of such activities on an annual basis, as recommended in the report. As such, we expect that program managers will exercise judgment and update studies and analyses only when the benefits of updated information are likely to exceed the costs of obtaining it.

2. **Require program officials to prepare flexible or incremental budgets to reduce the need to continuously respond to budget reductions.**

   We agree that program managers should develop flexible plans capable of responding to a variety of budgetary contingencies. It is the responsibility of individual program managers to

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adjust their spending in accordance with the general or specific direction of senior management. Finance will not develop or enforce specific requirements as to how program managers prepare or manage their budgets; that is left to the professional discretion of each program manager.

3. **Ensure program budget officials include updated potential revenue amounts in the financial information section of the "program narrative" to provide complete program information in the Budget Planning System.**

   We agree that documentation of potential program benefits can be improved. We have emphasized this requirement in the instructions for the current planning cycle. However, it remains the program manager's responsibility to summarize completely and accurately both the costs and benefits of his/her program in the budget planning system. Failure to do so can, and often does, result in the program not being funded, or funded at a reduced level. This means the system works. Further, it should be noted that the program narratives in the system provide only a starting point for the review process. The Establish Team's reviews of the program often include additional information not included in the program narratives.

4. **Develop a finance "rollup" number or another method to consolidate program information and provide program budget officials with related financial program information.**

   With respect to the concern voiced that it is not possible to consolidate financial information on multiple, related programs, we must disagree. The Postal Service's Corporate Information System allows users to consolidate financial data from multiple finance numbers and manipulate that data as required. Although the system requires some technical expertise, the capacity exists and should be within the capability of budget coordinators. Currently, there are very few programs with multiple finance numbers. Consolidated reports are routinely prepared for these.

5. **Evaluate the benefits of implementing accrual and cost accounting systems at the program and functional levels to more effectively provide program budget officials with related program information.**

   In reviewing the recommendation, we determined that program managers and vice presidents are primarily concerned with tracking commitments. Further, in informally surveying headquarters budget coordinators, we found that many are satisfied with their current, informal "checkbook" systems. We are continually considering new and enhanced accounting and financial planning systems; however, our current financial challenges limit the upgrades we can expect to implement in the near future. When we do begin formally evaluating substantially upgraded systems, we will consider the costs and potential benefits.

Joyce Johnson
for Donna M. Peak