

October 29, 2002

RALPH J. MODEN
VICE PRESIDENT, STRATEGIC PLANNING

SUBJECT: Management Advisory – Postal Service Transformation Plan
(Report Number OE-MA-03-001)

This management advisory presents the results of our review of the Postal Service Transformation Plan (Project Number 02BG015EM000). We initiated this project to evaluate the Transformation Plan (the plan) and determine whether key elements¹ were included in the planning process.

We found the plan is a good first step toward identifying challenges facing the Postal Service and helpful in developing plans to address these challenges. However, the Postal Service needs to determine the impact of unsuccessful reform legislation and address the universal service, organizational issues, and human capital fixed costs. In addition, the Postal Service has not finalized a comprehensive transformation implementation plan, which should include prioritization of strategies, allocation of resources, and completed project plans, and ensured transformation issues are effectively communicated.

This report made six recommendations addressing these issues. Management agreed with the intent of five of our recommendations and has taken or planned corrective actions addressing those issues identified in this report. Management's response to recommendation 2 did not directly address the recommendation. However, we plan to address this recommendation in future reviews. Thus, we do not plan to pursue it through the formal audit resolution process. Management's comments and our evaluation of these comments are included in this report.

¹The key elements we reviewed were: (1) prioritization of the plan's strategies; (2) availability of implementation plans to achieve these strategies; (3) availability of project plans which correspond to the plan; (4) allocation of resources to accomplish the strategies; and (5) the methodology for communicating the plan's strategies to Postal Service stakeholders.

Background

In April 2002, the Postal Service published the plan. The purpose of the plan was to inform Postal Service stakeholders about the short and long-term challenges facing the Postal Service, provide a source of these challenges, and recommend actions to mitigate these challenges.

According to the plan, the Postal Service's institutional model, adopted in 1971, is no longer effective in dealing with fundamental changes currently reshaping the delivery services marketplace. These changes include: changing customer needs, eroding mail volumes, rising costs, fixed costs, the merging of public and private operators into global networks, and increasing security concerns. These changes could potentially be factors in the continued decline of the Postal Service customer base and revenue.

In addition, according to the Postal Service, the plan is a roadmap of the Postal Service's envisioned plans, which it deems necessary to maintain financial viability while fulfilling its mission of providing universal service. Thus, for the Postal Service to survive its near term challenges, it must find the means and act quickly to foster growth by increasing the value of Postal Service products and services to Postal Service customers, improve operational efficiency, and enhance the performance-based culture.

Objective, Scope, and Methodology

The objective of our review was to evaluate the plan and determine whether key elements were included in the planning process. The key elements were: (1) prioritization of the plan's strategies; (2) availability of implementation plans to achieve these strategies; (3) availability of project plans which correspond to the plan; (4) allocation of resources to accomplish the strategies; and (5) the methodology for communicating the strategies to Postal Service stakeholders.

To accomplish our objective, we reviewed the plan, the Transformation Communication Plan, and documents relative to the plan. We reviewed pertinent General Accounting Office (GAO) reports and related news articles. We also reviewed and relied on workpapers from an ongoing OIG audit² addressing transformation issues. In addition, we interviewed officials from the Postal Service Offices of Strategic Planning and Transformation.

Our fieldwork was conducted from July 25 through August 9, 2002. This review was conducted from July through October 2002, in accordance with the President's Council on Integrity and Efficiency, Quality Standards for Inspections. We discussed our

²Review of Government Performance and Results Act Implementation at Postal Service, Project Number 02XG005FT000.

observations and conclusions with Postal Service management officials and included their comments, where appropriate.

Prior Audit Coverage

The GAO issued one report³ and three congressional testimonies⁴ on the Postal Service's plan. The report disclosed that the Postal Service's financial outlook is growing increasingly dire and recommended that the Postal Service provide monthly and quarterly financial reports to the public.

In transformation-related testimonies, the GAO discussed reasons why the Postal Service was added to its high-risk list, the need for a plan, the Postal Service's financial outlook, actions the Postal Service has taken or planned, and transformation issues that need to be addressed.

Results

The plan is a good first step toward identifying the challenges facing the Postal Service and helpful in developing plans to address these challenges. In addition, the plan provides a vision of a new and modern business model embraced by Postal Service executive officials. The Postal Service has established the Office of Transformation to: coordinate the development of the plan; consolidate all of the project plans; as well as track and report progress. The postmaster general and chief executive officer have held and continue to hold meetings with senior Postal Service officials on implementation of the plan. The Postal Service took positive steps to implement its short-term strategies, but could improve implementation by addressing several issues. Specifically, we observed the following:

Transformation Plan Challenges

The plan provides a forum for legislative issues but does not provide alternative long-term strategies for successful implementation if proposed legislative initiatives are not successful. The long-term strategies set forth in the plan, such as defining universal service and creating a new organizational structure, will require significant stakeholder and congressional action. However, in recent years, attempts to pass comprehensive Postal Service reform legislation have not been successful. As recently as June 2002, a bill⁵ containing many of the proposals included in the plan was defeated in the House Committee on Government Reform. Postal Service officials stated that this had no

³Deteriorating Financial Outlook Increases Need for Transformation (Report Number GAO-02-355), February 28, 2002.

⁴Transformation Challenges Present Significant Risks (Report Number GAO-01-598T), April 4, 2001; Financial Outlook and Transformation Challenges (Report Number GAO-01-733T), May 15, 2001; and Moving Forward on Financial and Transformation Challenges (Report Number GAO-02-694T), May 13, 2002.

⁵ The Postal Accountability and Enhancement Act, H.R. 4970.

impact on the current progress of the plan because they are working on the short-term strategies, but in our view, the defeat of this legislation will delay successful implementation of the plan.

In addition, the plan did not adequately address some key issues. For example, almost one-half of current Postal Service costs are spent on fixed costs. Although, the plan has strategies for addressing some of these fixed costs, other costs such as annuitant health benefits, cost of living adjustments, and retirement liabilities were not adequately addressed. Since the future rate of increases relating to these costs are beyond the Postal Service control, we believe that the Postal Service should plan and address these challenges.

Transformation Implementation Strategy

At the time of our review, the Postal Service did not have a finalized comprehensive transformation implementation plan. It has not clearly prioritized its' strategies, finalized an overall implementation plan, allocated resources to implement the plan, completed some project plans, tied the plan to the budget, and determined if communication of transformation issues is effective. Specifically:

- Prioritization of plan strategies not completed: Prioritization is essential to assure that strategies are evaluated and implemented based on how critical they are to the Postal Service's survival. According to a Postal Service official, plan strategies were not fully prioritized because the Postal Service executive committee reviews plans as they are presented by each functional area. By not considering all strategies together, and prioritizing them on an annual basis upon submission of the plan, the Postal Service may not be able to fund the most critical projects in a timely manner.
- No overall implementation plan finalized: At the time of our review, the Postal Service did not have an overall transformation implementation plan finalized. An implementation plan was being developed and is expected to be issued in early fiscal year (FY) 2003. Development of an implementation plan and roadmap would help to maintain the delicate balance between current and future requirements as the Postal Service transforms. It would also provide the necessary guidance to better focus and direct the Postal Service's transformation activities and tools to guide and oversee progress toward achievement of goals and objectives. In addition, it would provide an effective means for evaluating potential conflicts, interdependencies, and project feasibility. Based on information obtained from Postal Service officials, a comprehensive implementation plan had not been completed because of the Postal Service executive committee's ongoing review of strategies. Without such a plan, it can be difficult for senior leaders and others to provide the necessary support and make optimal decisions on priorities and the effective use of resources to successfully transform the Postal Service.

- All resources to implement strategies have not been allocated: Because plan strategies are in development, the Postal Service has not determined the estimated cost of all the strategies or allocated resources as necessary. In addition, we were told some strategies overlap and the cost of the strategies would be easier to determine after preparation of the FY 2003 budget because it will contain funding for transformation issues. We are concerned that given the projected decline in Postal Service resources, further delay in identifying and committing resources to the critical short-term strategies may hinder implementation and reduce the plan's overall effectiveness.
- Some project plans are not completed: Well developed project plans will benefit the Postal Service's transformation efforts because they will require detailed action plans including schedules, commitments, and resources for implementing strategies. Action plans will also highlight plan deficiencies and provide early remedies. According to a Postal Service official, project plans and concepts corresponding to the postmaster general and chief executive officer's transformation vision are in place for many of the near-term strategies and some of the moderate reform items. However, project plans for capital and long-term reforms are in varying levels of development or in the concept phase. A Postal Service official told us that they will not provide comprehensive project plans until the Postal Service executive committee has finished reviewing and approving the plan's strategies.
- Plans not tied to the budget: The Postal Service has not budgeted for the plan strategies. Based on information obtained from Postal Service officials, the Postal Service has no plan to align the budget to the individual plan goals or subgoals. However, the Postal Service's functional areas will submit budgets that include transformation issues, for review by the postmaster general and chief executive officer. Postal Service officials told us that they anticipate the budget would probably remain close to the previous year's level. As a result, functional areas need to determine how to accomplish plan initiatives with a similar budget level as the previous year.
- Communication effectiveness is not measured: The Postal Service developed a communication action plan to inform the public and stakeholders about the plan. The communication action plan includes briefing materials and news articles to provide information to employees, stakeholders, and the business community. The Postal Service placed transformation-related information on the Postal Service website, and in trade and business journals. Further, Postal Service executives were instructed to brief civic and business organizations on transformation issues. Although the website allows Postal Service managers to track briefings, there are no established milestones or metrics for continuously evaluating the communication action plan's effectiveness. A Gallop poll was conducted at the time the plan was issued to determine the public awareness of

the Postal Service transformation. Without active follow up or a measurement system to determine the effectiveness of the communication plan, the Postal Service may not be able to determine if the plan's message reached key stakeholders.

Conclusion

The Postal Service's plan is a good starting point on building a viable Postal Service system for the twenty-first century. The plan provides information about the Postal Service's challenges, identifies numerous short-term actions the Postal Service plans to take under its existing authority, and outlines long-term strategies that would require congressional action. However, the Postal Service needs to determine the impact of unsuccessful reform legislation and address the universal service, organizational issues, and human capital fixed costs. In addition, the Postal Service needs to finalize an overall implementation plan, which should include prioritization, resource allocation, project plans, and ensure communication of transformation issues.

Recommendation

We recommend the vice president, Strategic Planning:

1. Continue to coordinate legislative Postal Service reform, including the universal service challenge, organizational change, and other fixed costs with Congress and other stakeholders.

Management's Comments

Management agreed with the intent of our recommendation and stated the Postal Service has been coordinating and will continue to coordinate Postal Service legislative reform efforts through the vice president, Strategic Planning, and the Office of Government Relations. Management added the Postal Service committed to active participation with policymakers, mailers, other stakeholders and the general public regarding its transformation. Furthermore, management stated it does not believe there are viable approaches that would guarantee continuation of universal service other than those already proposed in the plan. However, management also stated the plan makes clear the Postal Service believes universal service as now delivered is at risk without structural change.

Management's comments, in their entirety, are included in the appendix of this report.

Evaluation of Management's Comments

Management's actions taken or planned should correct the problem or resolve the issues identified in the report.

Recommendation

We recommend the vice president, Strategic Planning:

2. Ensure that plan strategies are prioritized in a timely manner prior to the fiscal year.

Management's Comments

Management stated the Postal Service started prioritizing its strategies during the creation of the plan. Management added the Postal Service Executive Committee reviewed numerous possible strategies and selected those published in the plan as the organization's priorities. Furthermore, management stated the Postal Service's FY 2003 budget process included criteria to assure that proposed programs supported the transformation process in order to receive funding approval.

Evaluation of Management's Comments

While we agree that the Postal Service prioritized its strategies in creating the plan and has ensured that the budget process has criteria to fund programs supporting the transformation process, we see no evidence that the individual strategies are ranked and/or prioritized to determine the most important strategies and programs within the plan. We plan to revisit this recommendation in future reviews. Thus, we do not plan to pursue it through the formal audit resolution process.

Recommendation

3. Finalize an overall implementation plan covering transformation strategies.

Management's Comments

Management agreed with the intent of our recommendation and stated the Postal Service has worked on developing detailed project plans to ensure all strategies are integrated with the Postal Service's overarching transformation goals. Management added the Postal Service's Executive Committee reviewed the project plans, which comprised the details of how the Postal Service would pursue its transformation objectives. Furthermore, management stated the Office of Strategic Planning would assist the Executive Committee in monitoring progress to ensure all strategies are completed as scheduled or adjusted as necessary to reflect changing circumstances and priorities.

Evaluation of Management's Comments

Management's actions taken or planned should correct the problem or resolve the issues identified in the report.

Recommendation

We recommend the vice president, Strategic Planning:

4. Ensure cost estimates are prepared for strategies and funds are allocated accordingly to implement plan strategies.

Management's Comments

Management agreed with the intent of our recommendation and stated the Postal Service follows a rigorous evaluation process to determine funding for all programs, which are prioritized against the organization's goals. Management added Postal Service funding is authorized according to parameters established by the Executive Committee, which now include relevance to the plan. In addition, management stated the budget process for FY 2003, which included the review of the plan strategies, has been completed. Furthermore, management stated future plan strategies will be funded this way in subsequent years.

Evaluation of Management's Comments

Management's actions taken or planned should correct the problem or resolve the issues identified in the report.

Recommendation

5. Oversee the development of specific project plans on transformation strategies and tie these strategies to the budget.

Management's Comments

Management agreed with the intent of our recommendation and stated the Postal Service has developed detailed project plans for each transformation strategy and would tie each strategy to the Postal Service budgeting process as appropriate. Management also stated the Postal Service began oversight of Transformation Plan strategies when it was delivered to Congress in early April. Furthermore, management stated the Executive Committee has and will continue to monitor progress.

Evaluation of Management's Comments

Management's actions taken or planned should correct the problem or resolve the issues identified in the report.

Recommendation

We recommend the vice president, Strategic Planning:

6. Develop a measurement tool to track milestones and metrics to ensure consistent, effective, and timely dissemination of transformation information to stakeholders.

Management's Comments

Management agreed with the intent of our recommendation and stated the Postal Service has products that will support the measurement tools necessary to track project milestones and metrics. Management also stated the Postal Service started in spring 2002 to communicate its transformation efforts throughout the organization and to stakeholders. Furthermore, management stated the Postal Service would continue to compile a database of stakeholders, and would conduct follow-up surveys to ensure that the transformation messages are being effectively communicated.

Evaluation of Management's Comments

Management's actions taken or planned should correct the problem or resolve the issues identified in the report.

The OIG considers recommendations 1 through 5 significant and, therefore, requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective action(s) are completed. These recommendations should not be closed in the 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 during the review. If you have any questions or need additional information, please contact Robert J. Batta, director, eCommerce and Marketing, at (703) 248-2100, or me at (703) 248-2300.

Ronald D. Merryman
Acting Assistant Inspector General
for eBusiness

Attachment

cc: John E. Potter
John M. Nolan
Julie S. Moore
Susan M. Duchek

APPENDIX. MANAGEMENT'S COMMENTS

RALPH J. MODEN
VICE PRESIDENT, STRATEGIC PLANNING



October 4, 2002

KIM STROUD
DIRECTOR, AUDIT OPERATIONS AND QUICK RESPONSE
OFFICE OF THE INSPECTOR GENERAL

SUBJECT: Response to draft Management Advisory-Postal Transformation Plan
(Report Number EM-MA-02-DRAFT)

We have reviewed the subject draft report with the Executive Committee, and our responses to the six recommendations are listed below.

We appreciate the cooperation and responsiveness of your staff while performing your audit, as well as during the preparation of your draft report. We believe that the discussions between our staffs have helped to create a report that is more reflective of the current status of our transformation planning efforts than were the earlier drafts. Those discussions also provided us with a better understanding of the Office of the Inspector General's concerns.

Before responding to each recommendation, however, we would like to address some specific findings in your report.

- *The report stated that the Postal Service plan did not detail alternative actions planned if proposed legislative changes were defeated.*

This is not the case. As discussed during meetings of our respective staffs, the *Transformation Plan* has three major components. The first details those actions we are taking now and plan to take in the future that are completely within the authority of the Postal Service to pursue. The second component identifies specific improvement strategies that can be implemented with only moderate changes to existing regulations and laws. The third component outlines specific structural changes that require legislation. The *Plan* recognizes that fundamental structural transformation of an institution as large as the Postal Service will likely take years to complete, and in the absence of significant legislative "changes," we will continue to aggressively pursue the strategies of the other two elements of the *Plan*.

- *The report stated that the Plan did not adequately address some fixed costs such as annuitant health benefits, cost-of-living adjustments and retirement liabilities.*

This is not the case. The *Plan* does discuss options for addressing the *cost-of-living* and *retirement issues* in Appendix D. In addition, the *Plan* addresses changes in the rate setting process that would enable the Postal Service to generate earnings that would be available to fund future expenses, if necessary. Although the annuitant health benefits are not specifically

-2-

addressed in the *Plan* because of the complexity of the issue, the Postal Service's current rates provide for full funding of these costs. For fiscal year (FY) 2003, \$4 billion will be paid on retirement liabilities and \$1.1 billion will be paid for annuitant health benefits.

The Postal Service pays for all retiree health benefit costs on a pay-as-you go basis. From Postal Reorganization through FY2001, \$7.6 billion has been paid for these obligations. Current postal rates include more than \$1 billion per year for the payment of these costs.

The Postal Service's treatment of these costs on a pay-as-you go basis is in accordance with accounting requirements of multi-employer plans.

Responses to specific recommendations contained in the draft report follow.

Recommendation 1: Continue to coordinate legislative Postal Service reform, including the universal service challenge, and organizational change with Congress and other stakeholders.

Response 1: As the Postal Service advised representatives of the Office of the Inspector General, the Postal Service has been coordinating and will continue to coordinate Postal legislative reform efforts through the Vice President, Strategic Planning, and the Office of Government Relations. Both in the *Outline for Discussion* and the *Plan* the Postal Service committed to active participation with policymakers, mailers, other stakeholders and the general public on all issues regarding Postal transformation. As for the universal service challenge, if the Postal Service believed there were other viable approaches that would guarantee the continuation of universal service other than those proposed in the *Plan*, those approaches would have been discussed and analyzed. The *Plan*, instead, makes clear that without structural change, the Postal Service believes that universal service as now delivered is at risk.

Recommendation 2: Ensure that *Plan* strategies are prioritized in a timely manner prior to the fiscal year.

Response 2: The prioritization of strategies began during creation of the *Plan*, the full developmental process of which has been shared with the OIG staff. In preparing the *Plan*, the Postal Service Executive Committee reviewed numerous possible strategies and selected those published in the *Plan* as the organization's priorities. In addition, the Postal Service FY2003 budget process included criteria to assure that proposed programs supported the transformation process in order to receive funding approval. (See also our response to recommendation 4.)

Recommendation 3: Finalize an overall implementation plan covering transformation strategies.

Response 3: During discussions with the OIG staff, the Postal Service explained that since late spring it has worked on developing detailed project plans which have been prepared cross functionally to ensure that all strategies are integrated with the Postal Service's overarching transformation goals. Reviewed in detail by the Postal Service's Executive Committee, these project plans comprise the details of how the Postal Service will pursue its transformation objectives. The Office of Strategic Planning will assist the Executive Committee in monitoring progress to ensure that all strategies are completed as scheduled or adjusted as necessary to reflect changing circumstances and priorities.

-3-

Recommendation 4: Ensure cost estimates are prepared for strategies and funds are allocated accordingly to implementation plan strategies.

Response 4: The Postal Service follows a rigorous evaluation process in determining funding for all programs, each of which is prioritized against the organization's goals. In meetings this summer with the OIG staff, the Postal Service explained the process through which Postal Service funding is authorized according to parameters established by the Executive Committee. These parameters now include relevance to the *Transformation Plan*. The budget process, during which *Transformation Plan* strategies were reviewed, has been completed for FY2003. Future *Plan* strategies will be funded this way in subsequent years. (See also responses to recommendations 2 and 5.)

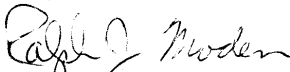
Recommendation 5: Oversee the development of specific project plans on transformation strategies and tie these strategies to the budget.

Response 5: As noted in the responses to recommendations 2, 3, and 4, all of which were discussed with the OIG staff, the Postal Service has developed detailed project plans for each transformation strategy and will tie each strategy to the postal budgeting process as appropriate. The Postal Service commenced oversight of *Plan* strategies when the *Plan* was delivered to Congress in early April, and, as stated in the response to recommendation 3, the Executive Committee has and will continue to monitor progress.

Recommendation 6: Develop a measurement tool to track milestones and metrics to ensure consistent, effective, and timely dissemination of transformation information to stakeholders.

Response 6: In discussions with the OIG staff, the Postal Service shared the massive work products behind the project plans that will support the measurement tools necessary to track milestones and metrics. The Postal Service also outlined to the OIG staff the efforts started in spring 2002 to communicate its transformation efforts throughout the organization and to stakeholders. The Postal Service will continue to compile a data base of stakeholders to whom the *Plan* has been communicated, and will conduct follow-up surveys similar to those conducted after release of the *Plan* to ensure that the transformation messages are being effectively communicated.

In response to your offer, we would like to schedule an exit conference after you receive this response to your draft report. An exit conference should allow both the OIG and the Postal Service to iron out any remaining issues. Please contact Ms. Julie Moore, Executive Program Director, Postal Transformation, (202) 268-2873.


Ralph J. Moden