



OFFICE OF INSPECTOR GENERAL

UNITED STATES POSTAL SERVICE

Market Dominant Price Adjustment Filings

Audit Report

Report Number
CP-AR-16-003

January 13, 2016





OFFICE OF INSPECTOR GENERAL

UNITED STATES POSTAL SERVICE

Highlights

The Postal Service delayed the price change to comply with regulatory requirements which resulted in \$108 million in forgone revenue.

Background

The U.S. Postal Service Pricing department is responsible for compiling market dominant price adjustment proposals for the five market dominant classes of mail: First-Class Mail, Periodicals, Standard Mail, Package Services, and Special Services. These proposals are filed with the Postal Regulatory Commission (PRC) for approval.

The Postal Accountability and Enhancement Act (PAEA), enacted in 2006, limits the price increase for each market dominant class of mail to no more than the Consumer Price Index for All Urban Consumers. The PAEA also limits the PRC rate setting process to 45 days. To meet this requirement, the PRC allows 20 days for public comment and 14 days for its own ruling on whether a proposed price adjustment complies with applicable laws and regulations.

Our objective was to evaluate the Postal Service's process for compiling market dominant price adjustment proposals filed with the PRC.

What The OIG Found

Opportunities exist for the Postal Service to improve the price adjustment process. The Pricing department did not have documented and repeatable processes to guide the preparation of price adjustment proposals. According to the Pricing manager, there has not been an opportunity to establish and

document the process because of other priorities. Without a comprehensive, documented process, the Pricing department is at increased risk of making errors, failing to meet PRC regulatory requirements and not gaining approval for price adjustments.

Specifically, the Pricing department did not always perform comprehensive internal reviews of supporting documentation for the January 2015 price adjustment proposal prior to filing it with the PRC. This occurred because of time constraints and no documented process for ensuring an internal review. The Postal Service moved the date for filing proposed price adjustments from February to January 2015 and some of the primary data needed for computing price adjustments were not available until late December 2014. Proposing complex mail classification changes during the short price adjustment period further complicated the preparation of the proposal and PRC's review.

The PRC returned the price adjustment proposal to the Postal Service twice because the regulatory agency could not determine whether the proposal complied with applicable laws and regulations due to its complexity. Because of these two remands the Postal Service delayed implementing the price changes from April 26 to May 31, 2015, to provide 45 days advanced notice to the mailer community as required. Although the PRC approved price adjustments for Competitive Products, First-Class Mail, and Special Services, management also



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postponed price adjustments in favor of a single price change on May 31, 2015 to minimize the impact. As a result, the Postal Service has forgone \$108 million in revenue for all mail products.

The Postal Service could have prevented errors the PRC identified in the proposal if it had performed comprehensive internal reviews prior to filing and limited the complexity of mail classification changes in the proposal.

What The OIG Recommended

We recommended the executive vice president, chief marketing and sales officer, establish a documented and repeatable process to guide the preparation of price adjustment proposals and to ensure comprehensive internal reviews of price adjustment proposals were performed prior to filing with the PRC; and establish and document internal procedures for filing complex mail classification changes separately from price adjustment filings.

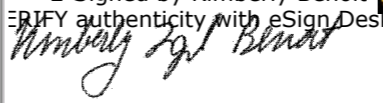
Transmittal Letter



OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

January 13, 2016

MEMORANDUM FOR: JIM COCHRANE
EXECUTIVE VICE PRESIDENT, CHIEF MARKETING
AND SALES OFFICER

E-Signed by Kimberly Benoit
VERIFY authenticity with eSign Desktop


FROM: Kimberly F. Benoit
Deputy Assistant Inspector General
for Technology, Investment and Cost

SUBJECT: Audit Report – Market Dominant Price Adjustment Filings
(Report Number CP-AR-16-003)

This report presents the results of our audit of Market Dominant Price Adjustment Filings (Project Number 15TG039CP000).

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

Attachment

cc: Corporate Audit and Response Management

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Findings

Opportunities exist for the Postal Service to improve the price adjustment process.

Introduction

This report presents the results of our self-initiated audit of Market Dominant Price Adjustment Filings (Project Number 15TG039CP000). Our objective was to evaluate the U.S. Postal Service’s process for compiling market dominant price adjustment proposals filed with the Postal Regulatory Commission (PRC). See [Appendix A](#) for additional information about this audit.

The Postal Service Pricing department compiles proposed market dominant price adjustments for the five market dominant classes of mail: First-Class Mail, Periodicals, Standard Mail, Package Services, and Special Services. These proposals are filed with the PRC for approval. The Postal Accountability and Enhancement Act (PAEA) limits the annual price increase for each market dominant class of mail to no more than the Consumer Price Index (CPI) for All Urban Consumers,¹ a commonly used measure of inflation.

The PAEA also revised the PRC’s lengthy price adjustment review process from 10 months to 45 days. To fulfill this requirement, the PRC developed regulations that allow 20 days for public comment and another 14 days after the comment period ends for its own ruling on whether a proposed price adjustment complies with applicable laws and regulations. In addition, the Postal Service must notify the mailing community at least 45 days before a price adjustment goes into effect.



¹ A measure of the average change over time in the prices urban consumers paid for a market basket of consumer goods and services.

Summary

Opportunities exist to improve the Postal Service's price adjustment process. Specifically, the Pricing department did not have documented and repeatable processes to guide the preparation of price adjustment proposals filed with the PRC. Without a comprehensive, documented process, the Pricing department is at increased risk of making errors or failing to meet PRC regulatory requirements.

In addition, the Pricing department did not always perform comprehensive internal reviews of supporting documentation for the January 2015 price adjustment proposal prior to filing it with the PRC. Further, it included complex mail classification changes, such as new price categories and workshare discounts, in the 2015 proposal. These proposed changes increased the complexity and were noted as the primary reason the PRC remanded² the proposal to the Postal Service twice. Because of these two remands the Postal Service delayed implementing the price changes from April 26 to May 31, 2015, to comply with regulatory requirements.³ Although the PRC approved price adjustments for Competitive Products, First-Class Mail, and Special Services, management postponed price adjustments in favor of a single price change on May 31, 2015. As a result, the Postal Service has forgone \$108 million in revenue for all mail products.⁴

Price Adjustments Process

The Pricing department did not have documented and repeatable processes to guide the preparation of price adjustment proposals filed with the PRC. The Pricing department developed prices based on institutional knowledge and data and economic analyses. Based on their experience and analyses, they understand which products are at risk of a significant decrease in volume when prices increase. In addition, they are aware of regulatory compliance requirements that need to be considered when proposing price adjustments. For example, they are required to justify any difference in discounts for commercial and nonprofit mail.

According to the Pricing manager, who took that position in 2013, there has not been an opportunity to formally establish and document a process because of other priorities. The Pricing manager stated that he is working toward documenting this process as a result of the 2015 remands. Thus far, they have completed a training guide for new Pricing department employees and are documenting the process to prepare billing determinant spreadsheets, which are used as part of the price adjustment process. Although the training guide is not specific to the price adjustment preparation process, it is a useful foundation for new employees. Without a comprehensive, documented process, the Pricing department is at increased risk of making errors or failing to meet PRC regulatory requirements.

Internal Review

Pricing department employees did not always perform comprehensive internal reviews of supporting documentation prior to filing the January 2015 price adjustment with the PRC. In the initial remand of the 2015 price adjustment proposal, the PRC stated the Postal Service's supporting documentation "contained many errors and inconsistencies and lacked information" for the PRC to rule on the proposal. After reviewing the Postal Service's revised supporting documentation, the PRC issued a second remand stating that it needed "further revision, correction, and clarification" to be fully compliant with statutory and regulatory requirements.

² The PRC returns the proposal to the Postal Service because it is unable to determine whether the prices comply with the law and PRC rules.

³ In accordance with 39 CFR, Part 3010, the Postal Service is required to provide at least 45 days advance notice to the mailing community prior to implementing a price adjustment.

⁴ These include market dominant and competitive products.

Examples of issues the PRC identified in the two remands are:

- Data inconsistency in reports and spreadsheets in the price adjustment filing.
- Inadequate justification for certain workshare discount changes.
- Incorrect exigent surcharge data.
- Inaccurate adjustments for certain spreadsheets.

Due to time constraints and no documented internal review process to guide their efforts, the Pricing department did not ensure that a comprehensive internal review of the proposal was performed. In December 2014, senior Postal Service management decided to move the price adjustment filing date from February to January 2015, which required the Pricing department to accelerate completion of its proposal. The primary data inputs (CPI, billing determinants, and product costing data) were not available for the Pricing department until the middle to end of December 2014. In addition, during the month of December, Pricing department employees play a significant role in producing the Postal Service's *Annual Compliance Report*⁵.

Although Pricing department employees did not conduct internal reviews of supporting documentation prior to filing the proposal in January 2015, after the second remand they used employees from other departments to review the documentation before resubmitting the proposal. Pricing managers stated they are working toward creating an internal control process, but have not provided documentation to support these efforts. The Postal Service could have prevented the errors identified in the remands if the Pricing department had performed comprehensive internal reviews prior to filing.

Proposal Complexity

Including additional information in the January 2015 price adjustment proposal increased its complexity. For example, the existence of the exigent surcharge⁶ increased filing requirements because it required the Pricing department to produce two sets of prices (with and without the exigent surcharge).

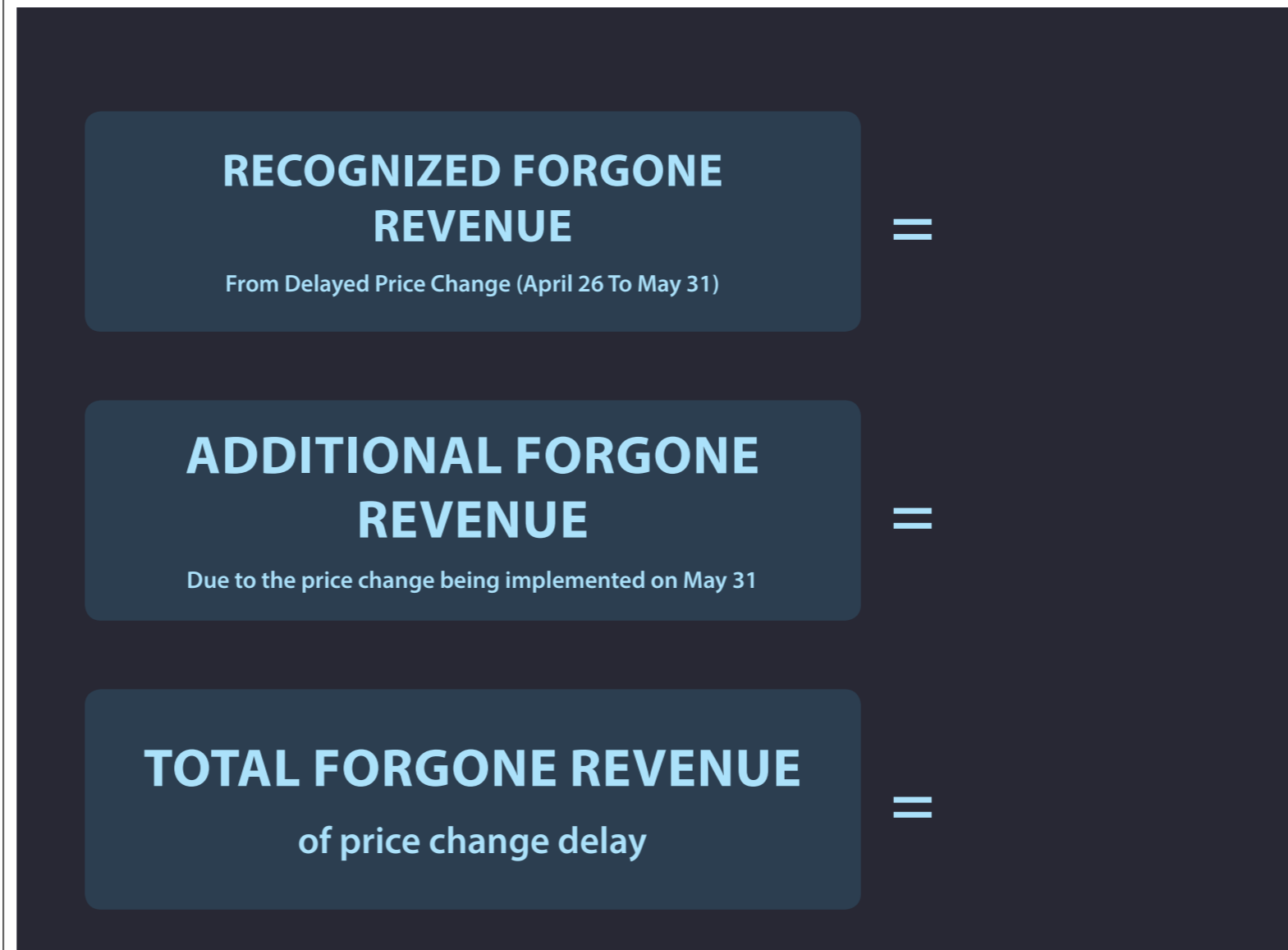
In addition, the inclusion of complex mail classification changes during a short price-adjustments timeframe further complicated the preparation of the proposal and the PRC's review. Specifically, the complexity associated with the creation of new price categories and workshare discounts were extensive. The Postal Service was unable to provide adequate source documentation to support the methodology used to incorporate these mail classification changes into the price adjustment calculations within the PRC's review period. The changes and the inadequate support for them were the primary reasons the PRC remanded the price adjustments to the Postal Service.

There is no requirement that mail classification changes be filed with price adjustment proposals. The Postal Service could have prevented the errors identified in the remands had it limited the complexity of mail classification changes in the filing.

⁵ 39 U.S.C. §3652 requires the Postal Service to file with the PRC within 90 days after the end of each fiscal year, a variety of data on cost, revenue, rates, and quality of service to demonstrate that all products during the fiscal year complied with applicable regulatory requirements.

⁶ The PAEA allowed the Postal Service to seek price adjustments above inflation for extraordinary or exceptional circumstances and this is commonly referred to as an "exigent" price increase.

Because of the remands, the Postal Service delayed the price change from April 26 to May 31, 2015, to comply with regulatory requirements. As a result, the Postal Service has forgone \$108 million in revenue. The Postal Service could have limited forgone revenue to \$27 million by implementing the PRC-approved First-Class Mail, Special Services, and Competitive Products prices on April 26, 2015. However, management decided to delay implementation for all mail products to May 31, 2015, to minimize the impact.



Recommendations

We recommend management establish a documented and repeatable process for price adjustment proposals and ensure comprehensive internal reviews are performed prior to filing with the PRC; and establish and document internal procedures for filing complex mail classification changes separately from price adjustment filings.

We recommend the executive vice president, chief marketing and sales officer:

1. Establish a documented and repeatable process to guide the preparation of price adjustment proposals and to ensure comprehensive internal reviews of price adjustment proposals were performed prior to filing with the Postal Regulatory Commission.
2. Establish and document internal procedures for filing complex mail classification changes separately from price adjustment filings.

Management's Comments

Management agrees that there are opportunities to strengthen the price adjustment process and has agreed to establish documented processes to guide the preparation of price adjustment proposals. They also agree that a more comprehensive review of supporting documentation could have helped mitigate the problems identified in the 2015 filing. However, management stated that certain PRC remand issues were the result of differences in methodology that would not have been resolved through internal reviews. Finally, management understands the methodology used to calculate the \$108 million in forgone revenue, but wanted to re-emphasize that, of this \$108 million, a certain portion was for classes that were approved in time to meet the April 26, 2015, implementation date. However, to minimize the impact on their customers, management decided to postpone all price adjustments until May 31, 2015. See [Appendix B](#) for management's comments in their entirety.

Evaluation of Management's Comments

The U.S. Postal Service Office of Inspector General (OIG) considers management's comments responsive to the recommendations in the report and corrective actions should resolve the issues identified in the report. Management agreed with OIG recommendations and has begun the process of establishing a documented process to guide in the preparation of the price adjustment proposal and internal review process. This documented process will include procedures for filing complex mail classification changes. Management provided a target implementation date of December 31, 2016 for both recommendations.

All recommendations require OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective action is completed. All recommendations should not be closed in the Postal Service's follow-up tracking system until the OIG provides written confirmation that the recommendations can be closed.

Appendices

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Appendix A: Additional Information

Background

The Postal Service Pricing department is responsible for preparing price adjustment proposals for market dominant products to be filed with the PRC. The proposals need to include supporting information and justifications for the PRC to determine whether the proposed prices comply with applicable laws and PRC regulations.

The PAEA ties price increases for market dominant mail classes to the CPI, a commonly used measure of inflation. The Postal Service has the flexibility to vary the percentage changes for mail products within each mail class, as long as the average of those product increases does not exceed the rate of the CPI.

The price adjustment computation should be based on the most recently available economic and financial data. The primary data inputs for the calculation are CPI, billing determinants, and products costing data.

- CPI data is released every month, which means the Pricing department has about 30 days to finalize a price adjustment proposal prior to submitting it to the PRC.
- The Pricing department should use the most recent 4 consecutive quarters of billing determinants data, which is generally available by the final month of the following quarter. For example, Quarter 4 (July–September) data are available in December.
- Products costing data comes from the Postal Service's most recent *Annual Compliance Report*.

The PAEA streamlined the PRC's price adjustment review and approval process from 10 months to 45 days. The implication of this shortened timeframe is that the PRC would have fewer compliance issues to resolve and need less time than it previously did to adequately review proposed price adjustments.

Moreover, the PAEA included a directive for the PRC to establish a system that would provide predictability and stability in price changes. The PRC developed rules requiring the Postal Services to provide the mailing community with estimated implementation dates for future price adjustments. The price adjustments should be scheduled at specified regular intervals.

Objective, Scope, and Methodology

Our objective was to evaluate the Postal Service's process for compiling market dominant price adjustment proposals filed with the PRC. To accomplish our objective we:

- Reviewed and analyzed the Postal Service's January 2011 through January 2015 market dominant price adjustment proposals filed with the PRC and related inquiries and remands from the PRC and the Postal Service's responses to those remands.
- Reviewed PAEA, Title 39 U.S. Code §3622, and PRC regulations to determine the requirements for price adjustments and mail classification changes.
- Interviewed Postal Service Pricing department staff members to determine whether there is a documented and repeatable process that guides the compilation of price adjustment proposals; the internal process for reviewing price adjustment proposals prior to filing them with the PRC; the reasons for the remands of the January 2015 price adjustment filing; and the impact of delaying implementation of price adjustments from April 26 to May 31, 2015.

- Interviewed PRC staff members to determine the impact on their review process when the Postal Service includes complex mail classification changes with a price adjustment filing.

We conducted this performance audit from August 2015 through January 2016, in accordance with generally accepted government auditing standards and included such tests of internal controls as we considered necessary under the circumstances. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. We discussed our observations and conclusions with management on November 24, 2015, and included their comments where appropriate.

We did not assess the reliability of any computer-generated data for the purposes of this report.

Prior Audit Coverage

Report Title	Report Number	Final Report Date	Monetary Impact
<i>Market Dominant Billing Determinants: Periodicals</i>	CP-AR-15-004	9/14/2015	N/A
Report Results: This report identified data inaccuracies the Postal Service could prevent by improving procedures used to prepare Periodicals billing determinants. Specifically, errors identified resulted from the use of outdated and mislabeled source data and other incorrect calculations. Further, the Postal Service did not establish adequate controls over the Periodicals billing determinant process. The OIG made four recommendations and management agreed with two and disagreed with two.			
<i>Market Dominant Billing Determinants: First-Class Mail</i>	CP-AR-15-003	6/11/2015	N/A
Report Results: This report determined that opportunities exist to improve the accuracy of the Postal Service's billing determinant calculations for First-Class Mail. Specifically, errors identified were resulting from an inconsistent accounting of mail volume and calculations that could not be verified. The errors occurred because the Postal Service did not have documented repeatable processes to guide in the preparation of billing determinant spreadsheets and did not conduct quality reviews of billing determinants prior to publication. The OIG made two recommendations and management agreed with both.			

Appendix B: Management's Comments



December 31, 2015

Lori Lau Dillard
Director, Audit Operations

SUBJECT: Market Dominant Price Adjustment Filings
(Report Number CP-AR-16-DRAFT)

Management agrees that there are opportunities to strengthen the price adjustment process and appreciates the thorough review by the USPS Office of Inspector General (OIG). The timing and complexity of the most recent Market Dominant price adjustment created issues in the filing that could have been helped by a more comprehensive review of the supporting documentation. While a stronger review process would have improved this filing, certain PRC remand issues were the result of methodology differences which would not have been resolved by internal reviews.

Management understands the revenue forgone number of \$108 million, however we want to re-emphasize that the value of the remanded classes was \$27 million. The Postal Service could have implemented the First-Class Mail, Special Services, and Competitive prices on April 26, 2015 but chose to delay all classes until May to minimize the impact to our customers.

Management would also like to point out that we had already started down the path of documenting our processes prior to this audit. This includes the establishment of structured quality reviews. As noted in the report, we have completed a training guide for new employees and are completing the documentation of the billing determinants portion of the process. Our plan is to complete these activities by the end of 2016.

Recommendation 1:

Establish a documented and repeatable process to guide the preparation of price adjustment proposals and to ensure comprehensive internal reviews of price adjustment proposals were performed prior to filing with the Postal Regulatory Commission.

Management Response:

The Postal Service agrees to establish a documented process to guide in the preparation of price adjustments proposals. This will include a structured review process.

Target Implementation Date:

December 31, 2016

Responsible Management Official:

Manager Pricing

Recommendation 2:

Establish and document internal procedures for filing complex mail classification changes separately from price adjustment filings.

Management Response:

Management does not believe that in this last price change we could have separated the structural change from a price change as it involved creating a blended rate to support the new structure. Management believes that the process for filing a complex classification change separately would be similar to the process for filing price adjustment proposals. The only difference would be that we would file those changes without a concurrent change in prices. Therefore the documented process to be established in Recommendation 1 will cover this possibility as well. Management agrees to include a process for this possibility within the overall price change process documentation.

Target Implementation Date:

December 31, 2016

Responsible Management Official:

Manager Pricing


for James P Cochrane
(A) Executive Vice President, Chief Marketing and Sales Officer

cc: Manager, Corporate Audit Response Management



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