OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

Challenges in Controlling Costs with Standard Mail Flats and Periodicals

White Paper

Report Number
SM-WP-15-001

February 26, 2015

OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

Executive Summary

The Postal Accountability and Enhancement Act of 2006 requires postal mail products to generate enough revenue to cover costs and contribute to U.S. Postal Service overhead. However, Standard Mail Flats and Periodicals have been unable to meet this requirement. Standard Mail Flats are mailpieces like newsletters or catalogs that exceed the maximum dimensions of a letter. Periodicals are newspapers, magazines, and other publications that provide information to an established list of subscribers or requesters.

To determine if postal products cover their costs (cost coverage), the Postal Service uses a complex system with two main components – costing and pricing – to attribute costs to specific postal products. Standard Mail Flats and Periodicals have consistently been unable to cover their costs despite increased investment in flats automation. In fiscal year (FY) 2008, Standard Mail Flats was initially reported below cost coverage, with revenues covering about 94 percent of costs. Periodicals cost coverage fell below 100 percent much earlier than Standard Mail Flats.[1] In FY 2008, Periodicals cost coverage was about 84 percent. Both remained below 100 percent through FY 2013.

During the same period, the Postal Service invested $1.4 billion in the Flats Sequencing System (FSS),[2] to further automate flat mail sorting and cut delivery costs. The Postal Service deployed 100 FSS machines nationwide from FY 2008 to FY 2011.

The U.S. Postal Service Office of Inspector General (OIG) conducted reviews from FY 2008 through FY 2013[3] of flat mail issues and FSS concerns. This white paper summarizes results from those reviews and identifies four overarching areas that have affected the cost component of cost coverage. We did not address the impact of these overarching issues to the pricing component of cost coverage. We also evaluated the decline of Standard Mail Flats and Periodicals cost coverage from FY 2008, the year Standard Mail Flats was initially reported below 100 percent cost coverage, through FY 2013, the year of the most recent Postal Regulatory Commission (PRC) Annual Compliance Determination Report.[4]

1 Cost coverage for Periodicals first fell below 100 percent in FY 1997 after a methodological change in how mail processing costs were attributed. This change increased the attributable costs for Periodicals by about 7 percent.

2 The FSS was designed to process a significant portion of flats that arrive at delivery units in bundles and sacks, generating savings by processing that mail to arrive at delivery units in walk sequence order, with no additional movement or sorting required.

3 See Appendix A for prior OIG reviews.

4 *FY 2013 Annual Compliance Determination Report*, dated March 27, 2014.

Standard Mail flats volume declined from about 10 billion pieces in FY 2008 to about 5.6 billion pieces in FY 2013.

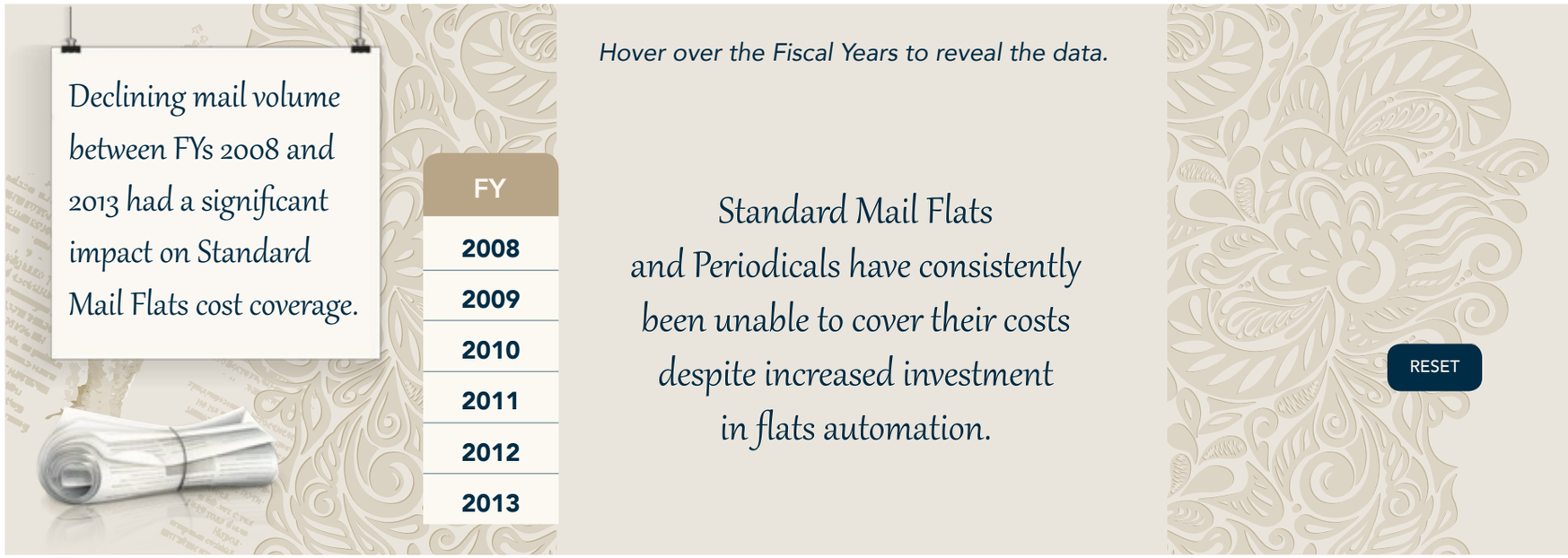
1. *Declining Standard Mail Flats volume*: The declining mail volume that occurred between FYs 2008 and 2013 had a significant impact on Standard Mail Flats cost coverage. Standard Mail Flats volume declined from about 10 billion pieces in FY 2008 to about 5.6 billion pieces in FY 2013. This 44 percent drop in volume has multiple causes, such as above-average rate increases, the economic recession, and a change in shape-based rates. The declining mail volume led to reduced revenue and increased costs to process each mailpiece.

   Although 99 percent of Periodicals pieces are processed as flat mail, the decrease in mail volume did not have the same significant impact as it did on Standard Mail Flats. As noted in Figure 1, Periodicals volume dropped from over 8 billion pieces to over 6 billion pieces during the period, and both products' cost coverage remained below 100 percent through FY 2013. The diverse mix of mail products and rates within the Periodicals class, as well as a change to how costs are allocated, are the reasons cost coverage first fell below 100 percent in FY 1997 and has fluctuated below that level for a much longer period compared to cost coverage for Standard Mail Flats.

2. *FSS challenges*: FSS deployment faced numerous challenges, such as failure to pass pre-production and production testing. Also, the limited number of machines deployed prevented the Postal Service from fully automating flats and Periodicals processing.

3. *Manually processed flat mail*: Despite investments in flats automation, the "total pieces handled" percentage of flat mail manually processed only decreased from 39 percent in FY 2008 to 29.1 percent in FY 2013. See Figure 2.

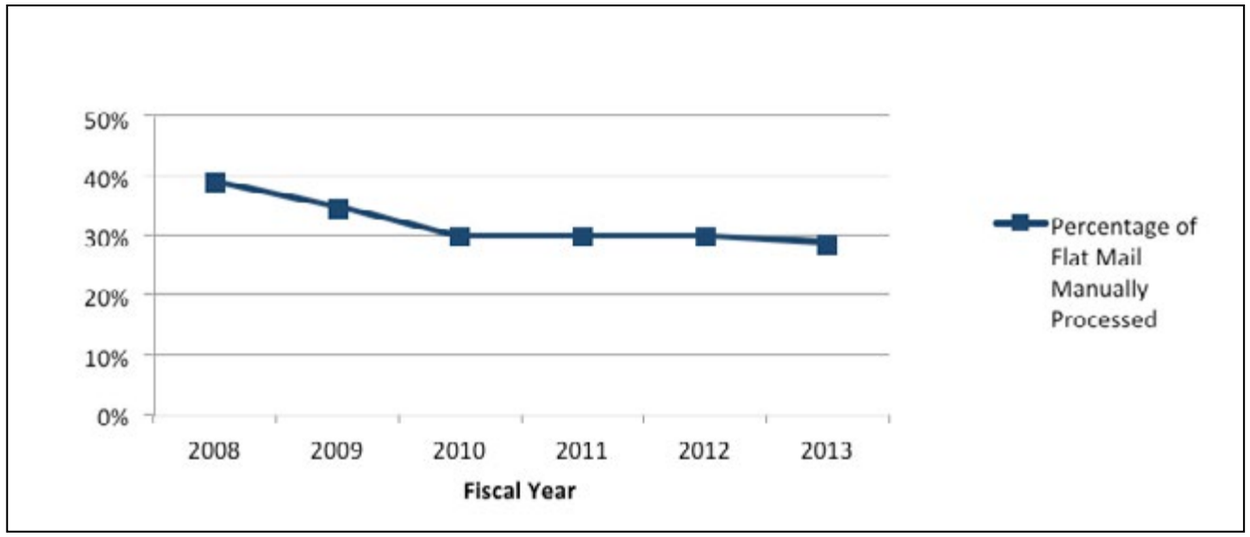
Figure 1. Standard Mail Flats and Periodicals Volume and Cost Coverage: FYs 2008 – 2013



Source: FY 2008 - 2013 *Annual Compliance Determination* reports.

Despite the Postal Service's collaboration with its stakeholders and efforts to develop solutions to improve cost coverage of Flats and Periodicals, it has not finalized a strategy document.

Figure 2. Percentage of Flat Mail Manually Processed: FYs 2008 – 2013



Source: *Flat-Shaped Mail Costs* (Report Number MS-AR-13-003, dated January 4, 2013).

4. *Excess network capacity:* Postal Service officials acknowledged challenges with excess capacity and are continuing to consolidate operations and facilities.

In its *FY 2009 Annual Compliance Determination,*[5] the PRC expressed concern over cost coverage for flat shaped products and directed the Postal Service to address the issue. The Postal Service responded to this directive with its first flats strategy in FY 2010. Since then, the Postal Service has collaborated with the mailing industry in further developing and improving on that strategy. In January 2014,[6] the Postal Service released a draft of the strategy, which summarizes flat mail distribution history and trends, introduces innovative products and pricing, and provides flat mail strategies intended to allow the mailing industry to make informed and strategic decisions.

As drafted, the strategy addresses the overarching areas affecting cost coverage noted above, and will present opportunities to reduce inefficiency in the postal network.

Despite the Postal Service's collaboration with its stakeholders and efforts to develop solutions to improve cost coverage of flats and Periodicals, it has not finalized a strategy document. As of November 2014, the document was still in draft and the Postal Service had not fully implemented the strategies. To continue recent improvements in cost coverage, the Postal Service will have to provide detailed actionable steps, and establish firm milestones to implement the strategy.

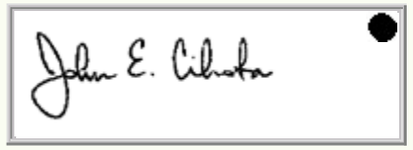
5 *FY 2009 Annual Compliance Determination,* dated March 29, 2010.
6 *2014 Strategic Guide for Flats Planning*, draft dated January 31, 2014.

Transmittal Letter

OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

February 26, 2015

MEMORANDUM FOR: LINDA M. MALONE
VICE PRESIDENT, NETWORK OPERATIONS



FROM: John E. Cihota
Deputy Assistant Inspector General
for Finance and Supply Management

SUBJECT: Challenges in Controlling Costs with Standard Mail Flats and Periodicals
(Report Number SM-WP-15-001)

Attached are the results of our review of Challenges in Controlling Costs with Standard Mail Flats and Periodicals (Project Number 14YG007SM000). The Postal Accountability and Enhancement Act of 2006 requires postal mail products to cover their costs. This white paper summarizes, from prior U.S. Postal Service Office of Inspector General reviews from fiscal year (FY) 2008 through FY 2013, popular theories why Standard Mail Flats and Periodicals have not met the cost coverage requirement, during a period of increased automation. It identifies four overarching areas that have affected the cost component of cost coverage. We did not specifically address the impact of these overarching issues to the pricing component of cost coverage. It also assesses the Postal Service's flats strategic plan.

If you have any questions or need additional information, please contact Keshia L. Trafton, director, Supply Management and Facilities, or me at 703-248-2100.

Attachment

cc: Corporate Audit and Response Management

Table of Contents

Observations

This white paper identifies four overarching areas that have affected the cost component of cost coverage. We did not address the impact of these overarching issues to the pricing component of cost coverage.

Introduction

This white paper presents the results of our review of Challenges in Controlling Costs with Standard Mail Flats and Periodicals (Project Number 14YG007SM000). We conducted this review to summarize flat mail issues and Flats Sequencing System (FSS)[7] concerns presented in multiple U.S. Postal Service Office of Inspector General (OIG) reports[8] and expressed by representatives in the mailing industry. We also evaluated the decline of Standard Mail Flats and Periodicals cost coverage from fiscal year (FY) 2008, the year Standard Mail Flats was initially reported below 100 percent cost coverage through FY 2013, the year of the most recent Postal Regulatory Commission (PRC) Annual Compliance Determination Report.[9] Lastly, we reviewed a draft of the U.S. Postal Service's flats strategy, developed to improve flats costs coverage, and address mailing industry concerns. This white paper identifies four overarching areas that have affected the cost component of cost coverage. We did not address the impact of these overarching issues to the pricing component of cost coverage.

The Postal Accountability and Enhancement Act of 2006[10] (Postal Act of 2006) requires that each postal mail product cover its attributable costs[11] and contribute toward non-attributable (institutional or overhead) costs. To determine if postal products cover their costs (cost coverage), the Postal Service uses a complex system with two main components – costing and pricing – to attribute costs to specific postal products. Standard Mail Flats and Periodicals have been unable to meet this requirement despite the Postal Service's significant investment to automate the processing of these products. Standard Mail Flats are mailpieces such as newsletters or catalogs that exceed the maximum dimensions of a letter, and Periodicals are newspapers, magazines, and other publications that provide information to an established list of subscribers or requesters. About 99 percent of Periodicals are processed as flat mail.

Challenges Impacting Cost Coverage

The trend of declining cost coverage occurred despite the Postal Service's $1.4 billion investment in the FSS. This equipment was designed to put flats in delivery point sequence,[12] lowering delivery unit costs by reducing manual distribution clerk workhours, eliminating manual carrier casing to delivery point sequence, and reducing the number of carrier routes. The Postal Service deployed 100 FSS machines at 47 postal facilities from FY 2008 to FY 2011. However, declines in mail volume led to reduced revenue as well as an increase in costs to process each mailpiece.

In addition to a decline in Standard Mail Flats and Periodicals volumes, challenges with the performance of FSS, manually processed flat mail, and excess capacity in the Postal Service network also contributed toward the decline in cost coverage for these products.

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7 The FSS was designed to process a significant portion of flats that arrive at delivery units in bundles and sacks, generating savings by processing that mail to arrive at delivery units in walk sequence order, with no additional movement or sorting required.
8 See Appendix A for prior OIG reports.
9 *FY 2013 Annual Compliance Determination Report*, dated March 27, 2014.
10 39 USC 3622(c)(2) requires that each class of mail or type of mail service bear the direct and indirect postal costs attributable to it through reliably identified causal relationships.
11 Attributable costs are those costs incurred directly or indirectly by a single product. Attributable costs also include product specific costs and volume variable costs, which are costs that fluctuate based on the volume of a specific product.
12 Delivery point sequence is a process to automatically sort mail into the order in which it is delivered by a letter carrier and eliminates the manual sorting by the carrier.

In addition, above average increases in postage rates and a change in shape-based rates that took effect in FY 2007, as well as the economic recession that followed shortly thereafter, negatively affected Standard Mail Flats volume.

Declining Standard Mail Flats Volume

The declining mail volume that occurred between FYs 2008 and 2013 had a significant impact on Standard Mail Flats cost coverage. Standard Mail Flats volume declined from about 10 billion pieces in FY 2008 to about 5.6 billion pieces in FY 2013. This 44 percent drop led to reduced revenue as well as an increase in the product specific costs allocated to each piece of mail. This occurred because the Postal Service uses a complex costing system that annually collects the total costs of a variety of cost pools, and allocates them to the products that caused them.[13] Lower volume means there are fewer pieces to absorb product specific costs. In FY 2008, Standard Mail Flats volume declined 22.2 percent from the previous year, and cost coverage fell below 100 percent for the first time.

Although 99 percent of Periodicals pieces are processed as flat mail, the FY 2008 through FY 2013 decrease in mail volume did not have the same significant impact as it did on Standard Mail Flats. Periodicals' cost coverage first dipped below 100 percent in 1997 and was about 84 percent in FY 2008. As noted in Figure 1, Periodicals volume dropped from over 8 billion pieces to over 6 billion pieces during the period, and both products' cost coverage remained below 100 percent through FY 2013.

The declining Periodicals cost coverage was due to some key differences in the character of the mail. The Periodicals class is composed of two products: outside county mail, mailed in one county and delivered in another, and within county mail, mailed and delivered in the same county. There are also specific standards for circulation, record keeping, and advertising limits, and there are special lower postage prices for Nonprofit, Science-of-Agriculture, and Classroom Periodicals. This diverse mix of mail products and rates within the Periodicals class, as well as a 1997 methodological change in how mail processing costs were attributed, impacted cost coverage.

In addition, above average increases in postage rates and a change in shape-based rates that took effect in FY 2007, as well as the economic recession that followed shortly thereafter, negatively affected Standard Mail Flats volume. In May 2006, the Postal Service Board of Governors approved filing a rate case with the PRC to adjust postage rates to cover increasing operational costs. One major change was the transition to shape-based pricing. In May 2007, the PRC approved the rate design changes and recommended a higher increase in rates. Changes to shaped-based rates led to a decrease in flats volume because some Standard Mail Flats were being converted to letter mail. The PRC acknowledged that, because of the change in these rates, some mailers faced "substantial rate increases" for flat mail, adding that mailers needed to know that "adjusting mailpiece shape could result in substantial postage reductions."[14] Because of the rate change, some mailers reported they invested in software and machines to design and fold flat-size mailpieces, including catalogs, to get the lower letter-size rates.

From FY 2008 through FY 2013, the economy also contributed to a drastic decline in flats volume. The Postal Service began to see the impact of the recession in December 2007, particularly in the finance, credit, and housing sectors, which are majority heavy mailers. Mailers acknowledged that during the recession, they drastically cut back on "prospecting" activity, mail sent to gain new customers. In testimony before the U.S. Senate in January 2009, former Postmaster General (PMG) John E. Potter stated Standard Mail is a medium that is extremely sensitive to the economy. He noted the entire nation was experiencing a significant recession and a reduction in economic activity. He added, "mail volume is a production of economic activity. When the economy is weak, mailers do not mail, which has led to percentage mail volume declines not seen by the Postal Service since the Great Depression."[15] This period of declining volume coincided with flats' inability to fully cover their costs.

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13 Postal Service product costing identifies costs by product. It measures the attributable cost for each product. Attributable cost is the cost of an additional unit and product specific costs, such as advertising. The remaining costs are called institutional costs, which do not vary with volume, and are not associated with a specific product.

14 Postal Regulatory Commission Docket Number R2006-1, Chapter V(5063).

15 *Hearing before the Federal Financial Management, Government Information, Federal Services, and International Security Subcommittee of the Committee on Homeland Security and Governmental Affairs, United States Senate, 111 Congress,* January 28, 2009.

Flats Sequencing System

In calendar year 2006, the Postal Service approved an investment of $1.4 billion to develop, purchase, and deploy FSS to increase the percentage of flat mail processed through automation. By March 31, 2009, the Postal Service spent at least $561 million for the development, production and initial deployment of FSS.[16] However, the production machine did not meet the original statement of work requirements and failed to achieve nearly all of the performance requirements during the initial first article testing (FAT).[17]

Typically, when there is a FAT failure, Postal Service acquisition guidelines call for retests before beginning deployment. However, in this case, the Postal Service deployed FSS machines despite major performance shortfalls to capture savings earlier. Delays in critical contract deliverables for hardware and software packages raised questions about the machine's maintainability and performance. Despite these performance issues, management concluded the system's progress from the first FAT warranted continuing with the next phase of installations and acceptance tests for production systems.[18] The Postal Service also conducted two evaluation tests in a controlled environment. These tests also confirmed FSS machines were performing below expectations. Performance results revealed the FSS system consistently failed to meet key performance requirements.[19] The Postal Service did not exercise options to purchase additional machines beyond the initial 100 FSS machines, eliminating the possibility of full network wide automation.[20]

FSS also faced numerous challenges during its production phases. The initial purchase of 100 FSS machines was originally planned for 33 locations. However, by FY 2009 Standard Mail Flats mail volume had declined about 22 percent for 2 consecutive years, and the declining catalog and Periodical mail volume necessitated a change in plans. As of January 2014, the Postal Service had deployed 100 machines in 47 locations.

Manually Processed Flat Mail

Before FSS was fully deployed in 2011, the Automated Flat Sorting Machines (AFSM) 100 and Upgraded Flat Sorter Machine (UFSM) 1000, sorted flat mail to carrier routes. The flats were distributed to carriers who manually sorted the mail in delivery sequence order. The FSS was designed to automate the sorting of flat mail into delivery sequence order, to reduce the number of workhours that carriers spend manually sequencing flats.[21] Although the percentage of mail processed by automation has increased since FY 2008, 70.9 percent of flat mail was still processed on the AFSM 100 equipment as of January 2013. 1.4 percent of flat mail was processed on the UFSM 1000, which is being phased out due to outdated technology. The total pieces handled percentage of flat mail manually processed only decreased from 39 percent in FY 2008 to 29.1 percent in FY 2013 (See Figure 3).

16 *Flats Sequencing System Contractual Remedies* (Report Number CA-AR-09-006, dated July 1, 2009).
17 FAT is a requirement that the supplier test the number of units specified in the contract, give notice to allow the Postal Service to witness the tests, and by the date specified, submit a report for approval. FAT ensures that the contractor can furnish a product that conforms to all contract requirements for acceptance.
18 *Flat Sequencing System: First Article Retest Results* (Report Number DA-AR-09-012, dated September 4, 2009).
19 *The Flats Sequencing System: Program Status and Related Cash Flow* (Report Number DA-AR-10-007, dated July 27, 2010).
20 The requirements assessment in the Decision Analysis Report for FSS determined that 450 machines would be needed to provide a "full-up" or nationwide FSS environment. The Postal Service expected that the Phase 1 FSS deployment of 100 machines would significantly reduce costs and generate operational savings of between $593 million and $677 million annually.
21 Customer Service (Function 2) workhours.

The OIG found that management's decision to manually process potentially machinable mail and limited flat mail processing equipment at certain processing facilities constrained the Postal Service's efforts to reduce costs associated with manually processing flat mail.

The OIG found that management's decision to manually process potentially machinable mail and limited flat mail processing equipment at certain processing facilities constrained the Postal Service's efforts to reduce costs associated with manually processing flat mail.[22] We reported that the Postal Service did not process flats on automated equipment when:

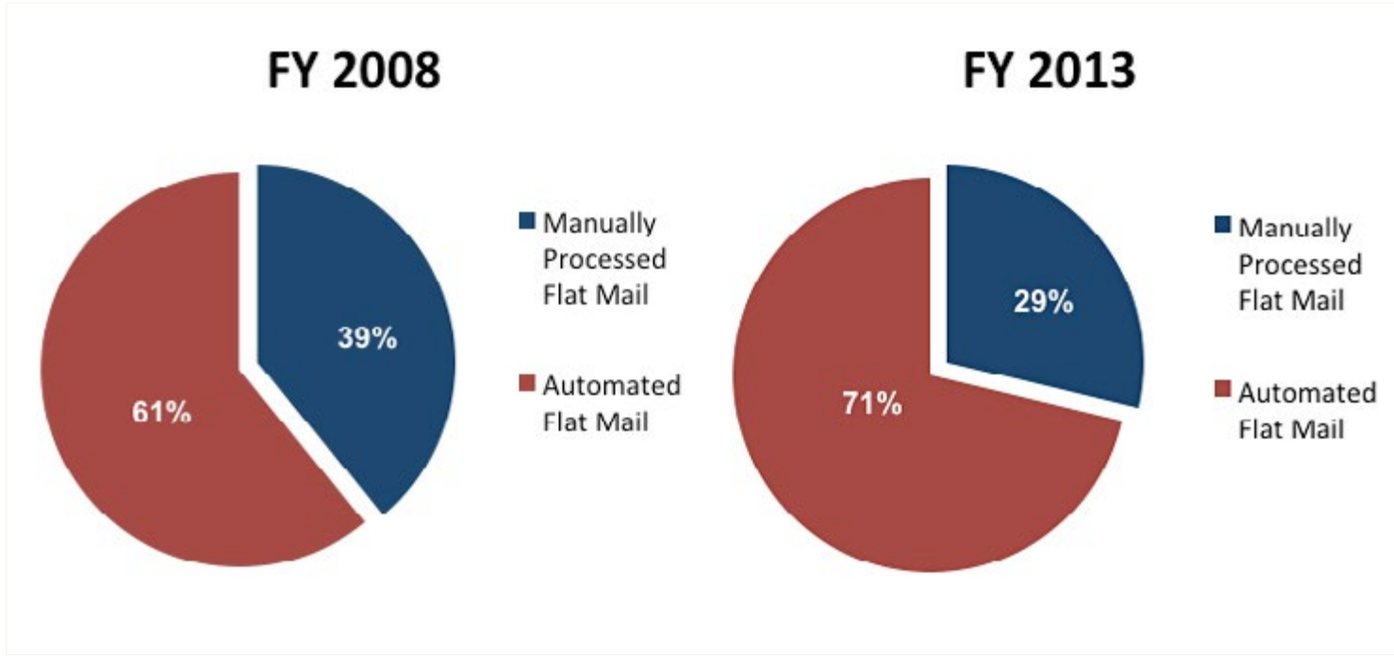
- Mailings sorted to 5-digit zone improvement codes (ZIP Codes) with fewer than 10 carrier routes were received. In these situations, the standard operating procedure in the field was to send 5-digit bundles directly to delivery units for manual processing.
- Thresholds for automated processing could not be met. For example, if the mail submission has too few mailpieces to process on automated equipment or the submission has insufficient mail processing densities[23] to meet automation processing thresholds, it will be manually processed.
- Other classes of mail had a higher processing priority to meet delivery schedule windows, and automation machinery assets were limited. For example, a manager may have directed First-Class Mail with overnight service requirements to receive a higher automated processing priority than machinable flats. Thus, automation equipment was not available to process certain types of flat mail, and the mail was processed manually to meet delivery standards.

Management has tried to reduce the flat mail they manually process and reduce overall mail processing costs. In FY 2011, total flat mail volume dropped about 876.9 million pieces while flat mail volume processed on automation equipment increased by more than 380 million pieces. Management stated the increase in automation processing was primarily due to deployment of the FSS, which began in FY 2008 and completed in FY 2011. However, despite declining flat mail volume and incremental increases in the percentage of flat mail manually processed, the percentage of flat mail manually processed has remained at about 30 percent and further reductions are achievable.

22 *Flat-Shaped Mail Costs* (Report Number MS-AR-13-003, dated January 14, 2013).
23 The number of mailpieces, as a percentage of total mailpieces, sorted to a destination.

Mailing industry stakeholders believe excess capacity reduces operational efficiencies, thereby increasing costs.

Figure 3. Percentage of Flat Mail Manually Processed Before and After Automation Investment



Source: *Flat-Shaped Mail Costs* (Report Number MS-AR-13-003, dated January 4, 2013); Management Operating Data System (MODS)[24] and eFlash.[25]

Also, management collaborated with business mailers to ensure flat mailpieces met automation requirements and reduced the amount of unworked flat mail sent to delivery units. In FYs 2010 and 2011, we observed that 18 delivery units in three districts[26] improved delivery operations during FSS full production. These units cut operating costs by reducing city carrier office hours, manual distribution clerk workhours, and city carrier routes. Although the FSS improved delivery operations, each of these delivery units received over 8.5 million flat mailpieces that could not be processed on FSS machines. Also, each district received about 2 million of these pieces that were not carrier-routed[27] and required manual sorting into walk sequence before leaving the mail facility. This occurred because these mailpieces did not meet flat mail automation requirements.

Excess Network Capacity

The Postal Service has acknowledged its network has excess capacity. In its *FY 2013 Annual Report,* the Postal Service stated that in the current business climate, it is even more important to eliminate excess capacity from the network. The focus is on reducing costs and matching capacity to mail volume because the Postal Service cannot afford to maintain excess equipment, operations, and facilities. Management is consolidating operations and facilities into more efficient locations to remain economically viable. Mailing industry stakeholders believe excess capacity reduces operational efficiencies, thereby increasing costs.

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24 MODS is a system that reports workhours and mail volume using operation numbers that identify activities in all functions including mail processing at large processing facilities.

25 The eFlash application is a weekly operating reporting management system. It combines data from delivery, mail processing, employee relations, labor relations, and finance. Data is accumulated for post offices and summarized at various organizational levels, including a national level report.

26 *The Effects of the Flats Sequencing System on Delivery Operations - Arizona District* (Report Number DR-MA-11-001, dated March 14, 2011); *The Effects of the Flats Sequencing System on Delivery Operations – Mid-America District* (Report Number DR-MA-10-001, dated September 23, 2010); and *The Effects of the Flats Sequencing System on Delivery Operations – Columbus District* (Report Number DR-MA-10-002, dated September 17, 2010).

27 Unworked pieces must be manually sorted by the clerks and cased by the carriers. Carrier-routed mailpieces are only handled by carriers.

To address this issue, the Postal Service has been reducing the number of career employees through attrition since mail volumes began to decline, and continues to make adjustments to match the workforce with the workload. It has also eliminated excess capacity and achieved costs savings by eliminating underutilized facilities and operations in mail processing plants using the Area Mail Processing (AMP)[28] plan. As a result:

- In 2012 and 2013, 141 facility consolidations were completed.
- On June 30, 2014, former PMG Patrick R. Donahoe announced an additional 82 consolidations were scheduled to begin in January 2015. The former PMG estimated this will save $750 million.

Postal Service Flats Strategy

In its *FY 2009 Annual Compliance Determination Report,*[29] the PRC expressed concern over cost coverage for flat shaped products and directed the Postal Service to address the issue. In response to that directive, the Postal Service issued its first comprehensive flats strategy document in June 2010. This plan devised operational and mail preparation changes, and a timeline, that the Postal Service deemed necessary to achieve a positive contribution for Standard Mail Flats. Since then, the Postal Service has continued to communicate with mailing industry stakeholders to further develop and improve its flats strategy and, in January 2014, issued a draft of a strategic, end-to-end guide for flats planning. This strategy summarizes the flat mail distribution history and trends, introduces innovative products and pricing, and provides flat mail strategies to allow the mailing industry to make informed and strategic decisions.

However, the mailing industry expressed concern the Postal Service is developing a “one size fits all” strategy for flat mail processing and delivery. In a March 2014 memorandum to the Postal Service, a mailers’ coalition[30] documented its concerns about the costs associated with flat mail and other topics. The mailers called for a strategy to handle non-FSS flat mail volume and the mandatory FSS preparation requirements. The coalition also suggested improvements and recommendations for the Postal Service to consider.

The strategy details three key goals for efficient Postal Service flat operations:

1. Automate piece and bundle distribution of flat mail;
2. Reduce non-value added work; and
3. Improve existing processes and standardization.

The Postal Service and the mailing industry are working towards these goals by:

- Reducing cycle time and waste, and improving overall efficiency through a Lean Mail Processing initiative. Cycle time is the total time from the beginning to the end of the process. The Postal Service intends to use this program to improve service performance and reduce costs.
- Reducing the number of entry points.

28 AMP is a process for determining if mail processing operations can be consolidated to increase efficiency and reduce cost.
29 *FY 2009 Annual Compliance Determination*.
30 PostCom, IDEAlliance, Association of Marketing Service Providers, and the National Association of Presort Mailers.

- Exploring modifications of FSS equipment to improve efficiency.
- Increasing automation in the mailing industry, which has given large-scale commercial mailers both the ability and, with workshare discounts, the incentive to enter bulk mailings closer to the delivery point within the Postal Service network, completely bypassing postal processing facilities.

In addition to reducing inefficiency in the network, the strategy addresses the overarching areas affecting cost coverage discussed in this whitepaper as follows:

Declining mail volume. The strategy aims to improve the value of flat mail by streamlining acceptance and promotions and incentives. Past strategies offered customers a variety of incentives and promotions, including the summer sales promotion. Although the success of these incentives and promotions is not easily quantified, they serve as a way for the Postal Service to invest, grow, and adapt to changing markets and technologies.

FSS challenges. The Postal Service has developed and expanded strategies to cut costs and improve efficiencies, such as reducing the number of entry points, inducting mail where first handling occurs, providing new Destination Flats Sequencing System (DFSS) workshare discounts,[31] and requiring FSS scheme bundles and pallets. By changing the optional FSS preparation to a requirement in January 2014, the strategy facilitates direct drop shipment at FSS processing sites for FSS scheme pallets. Direct drop shipment improves cycle time by bypassing handlings and transportation.

Manually processed mail. The plan identifies root causes of manual handlings and opportunities to convert them to automated processing. It also discusses opportunities to increase the percentage of FSS-processed mail in FSS zones and reduce leakage.[32]

Excess network capacity. While excess network capacity is not specific to Standard Mail Flats and Periodicals, it affects the costs of these products. The Postal Service continues to right-size its network and announced plans to consolidate up to 82 facilities beginning in January 2015 as part of its Network Rationalization plan.

See Table 2 for a summary of areas affecting Standard Mail Flats and Periodicals cost coverage, challenges associated with each area, and how the Postal Service's draft flats strategy addresses these challenges.

Despite the Postal Service's collaboration with its stakeholders and efforts to develop solutions to improve cost coverage of flats and Periodicals, it has not finalized a strategy document. As of November 2014, the document was still in draft and the Postal Service had not fully implemented the strategies. To continue recent improvements in cost coverage, the Postal Service will have to provide detailed actionable steps, and establish firm milestones to implement the strategy.

31 DFSS workshare discounts are reduced prices that apply to pieces deposited at a Postal Service-designated FSS processing facility and correctly placed on a pallet labeled to a FSS scheme processed by that facility.
32 Leakage is a Postal Service term that describes mail targeted for automated processing that ends up being manually processed.

Table 2. Summary of Areas of Concern

Area of Concern	Challenges	How the Postal Service Draft Plan Addresses the Issue
Declining Mail Volume	▪ Mail volumes declined due to the impact of the economic recession. ▪ 2006 Postal Service rate increases.	Improve the value of flats by: ▪ Streamlining acceptance. ▪ Promotions and incentives.
FSS	▪ FSS lacked the necessary volume to achieve the expected performance. ▪ Initially 100 FSS machines were purchased. No additional purchases are planned. ▪ 70.9 percent of flat mail is still processed on AFSM 100's.	Develop and expand strategies to cut costs and improve efficiencies, such as: ▪ Reduce number of entry points. ▪ Induct mail where first handling occurs. ▪ Provide more robust DFSS workshare discounts. ▪ Require FSS scheme bundle and pallet.
Manually Processed Flat Mail	▪ The total pieces handled percentage of flat mail manually processed only decreased from 39 percent in FY 2008 to 29.1 percent in FY 2013. ▪ Mailings sorted to 5-digit ZIP Codes with fewer than 10 carrier routes are not processed on automation. ▪ Mail is manually processed when thresholds for automated processing are not met. ▪ Higher priority classes of mail can receive precedence over flats for automated processing.	▪ Identify root causes of manual handlings and identify opportunities to convert to automated processing. ▪ Increase FSS-processed mail percentage in FSS zones and reduce leakage.
Excess Network Capacity	▪ The Postal Service is reducing career employees through attrition so it can match workforce to workload. ▪ Eliminating redundant facilities and operations in mail processing using the AMP plan. ▪ In 2013, 146 facility consolidations were planned, and 141 were completed as of fiscal year end.	▪ Excess capacity is not specific to Standard Mail Flats and Periodicals; additional facility consolidations to address excess capacity are being planned to address the overall excess capacity resulting from mail volume.

Source: OIG Analysis.

Appendix

Click on the appendix title to the right to navigate to the section content.

Appendix A: Prior Audit Coverage

Report Title	Report Number	Final Report Date	Monetary Impact
Flat-Shaped Mail Costs	MS-AR-13-003	1/4/2013	$259,154,687
Report Results: Management's decision to manually process potentially machinable mail and the limited flats mail processing equipment at certain processing facilities constrained the Postal Service's efforts to reduce costs associated with manually processing flat mail. In FY 2003, the Postal Service reported that it manually processed 33.3 percent of all flat mail. Eight years later, the percentage of manually processed flat mail has decreased by about 3.3 percent to about 30 percent. While declining flat mail volume and Postal Service initiatives to reduce manual flat mail processing have slightly reduced the percentage of flat mail manually processed and overall flat mail processing costs, further reductions are achievable. Management agreed with the findings and recommendations but stated that the monetary benefit is based on their stretch goal and not an addition of flat sorting machines, software enhancements, or operating practices.			
The Effects of the Flats Sequencing System on Delivery Operations - Arizona District	DR-MA-11-001	3/14/2011	$522,450
Report Results: About 14 million flat mailpieces could not be processed on FSS machines; 7 million of these pieces required manual sorting and casing. This occurred because these mailpieces did not meet flat mail automation requirements. Management agreed with the finding, recommendation, and monetary impact; however, management did not specifically address how they were going to reduce the amount of unworked flat mail to delivery units.			
The Effects of the Flats Sequencing System on Delivery Operations – Mid-America District	DR-MA-10-001	9/23/2010	$145,515
Report Results: The six Mid-America District delivery units reviewed had improved delivery operations during FSS full production. These units cut operating costs by $605,788 and reduced city carrier office hours, manual distribution clerk workhours, and city carrier routes. Although the FSS improved delivery operations, these delivery units received over 8.7 million flat mailpieces that were not processed on FSS. Approximately 2 million of these mailpieces were not carrier routed and required manual sorting and casing to put them in delivery walk sequence. This occurred because this mail did not meet flat mail automation requirements. As a result, the Postal Service missed the opportunity to further reduce workhour costs. Management agreed with our recommendation to continue to collaborate with business mailers to ensure flat mailpieces meet automation requirements and reduce the amount of unworked flat mail sent to delivery units.			
The Effects of the Flats Sequencing System on Delivery Operations – Columbus District	DR-MA-10-002	9/17/2010	$155,157
Report Results: While FSS improved delivery operations, the five delivery units reviewed received over 8 million flat mailpieces out of sequence. Over 2 million of these pieces were not carrier routed, which required manual sorting and casing, because they did not meet flat mail automation requirements. As a result, the Postal Service missed the opportunity to further reduce workhour costs. Management agreed with the findings and recommendations. They stated that they would continue notifying mailers of irregularities in the preparation of mail presented to the Columbus District utilizing the electronic mail improvement reporting system.			

Report Title	Report Number	Final Report Date	Monetary Impact
Flats Sequencing System: Program Status and Projected Cash Flow	DA-AR-10-007	7/27/2010	$831,532,000
Report Results: As of May 2010, management had spent $831,532,000 (59 percent) of the program's approved budget. In addition, 12 FSS systems were processing live mail but had yet to pass a FAT. The Postal Service also conducted two evaluation tests in a controlled environment, but FSS machines were performing below expectations. Performance results revealed that the FSS system consistently failed to meet key statement of work performance requirements. We recommended the vice president, Engineering, use actual machine performance and operational target data to more accurately report progress of the FSS programs financial outcomes and compliance reports such as the Investment Highlights reports. While management agreed with the recommendation to use actual machine performance data for compliance reports, they took exception to certain findings and our recommendation to use operational target data to report progress.			
Flats Sequencing System: Production First Article Testing Readiness and Quality	DA-AR-08-006	6/4/2008	None
Report Results: Without sufficient volume and mail zones, FSS could not be properly evaluated for FAT. In addition, delays in critical statement of work deliverables such as the Preliminary Production Baseline Technical Data Package, the Maintenance Diagnostic and Support System, and the Program Control System raised questions about the machine's maintainability and performance. The machine was deployed according to its FAT schedule anyway. We issued several recommendations to include that testing metrics should have been achieved before continuing with the deployment schedule. Management generally agreed with the findings and recommendations. They stated, in general, they had previously identified the findings and are actively addressing them. However, management did not agree to revise the FAT schedule. They acknowledged the finding was a good practice and one that their programs normally follow but, in this case, their current schedule maximizes the opportunity to capture the savings identified in the Decision Analysis Report.			

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