



Office of Inspector General | United States Postal Service

Audit Report

Contract Delivery Service Cost Attribution

Report Number 20-313-R21 | June 21, 2021



Table of Contents

- Cover
- Highlights..... 1
 - Objective 1
 - Findings..... 1
 - Recommendations..... 2
- Transmittal Letter 3
- Results..... 4
 - Introduction/Objective 4
 - Background..... 4
 - Finding #1: Accrued Contract Delivery Service Costs..... 5
 - Recommendation #1..... 9
 - Finding #2: Contract Delivery Service Cost Distribution 9
 - Recommendation #2 13
- Management’s Comments..... 13
- Evaluation of Management’s Comments 14
- Appendices 15
 - Appendix A: Additional Information..... 16
 - Objective, Scope, and Methodology 16
 - Prior Audit Coverage 16
 - Appendix B: Management’s Comments..... 17
- Contact Information 19

Highlights

Objective

Contract Delivery Service (CDS) is a contractual agreement between the U.S. Postal Service and an individual or firm for the delivery and collection of mail to and from homes and businesses. The Postal Service considers CDS to be one of its three primary delivery types, in addition to city carriers and rural carriers. CDS suppliers are not Postal Service employees, but independent contractors who provide delivery on specific routes not serviced by Postal Service mail carriers. The Postal Service manages CDS contracts within the transportation functional area, which consists of a wide variety of different contracts related to transportation. In fiscal year (FY) 2020, the Postal Service had more than 7,900 active CDS contracts, which cost a total of about \$447 million.

The Postal Accountability and Enhancement Act of 2006 (PAEA) requires the Postal Service to ensure that revenue for mail products and services cover their costs. To meet this requirement, the Postal Service has developed methods to allocate incurred costs to the appropriate mail products and services. The PAEA stipulates that the Postal Service use methodologies that have been authorized by the Postal Regulatory Commission (PRC). It also mandates that we regularly audit the systems and procedures used to collect information and prepare reports that analyze costs.

Our objective was to assess whether all CDS costs are accurately captured and reliably attributed to mail products and services.

Findings

Opportunities exist for the Postal Service to more accurately and reliably capture and attribute CDS costs to mail products and services. Using management's current methodology, we found that the Postal Service overestimated its accrued CDS costs by an average of about 7 percent from FY 2016 to FY 2020. Postal Service personnel used calculations approved by the PRC in September 2014 to estimate its accrued CDS costs. Using these calculations, the Postal Service estimated that it had accrued about \$2.1 billion in CDS costs from FY 2016 to FY 2020. However, our review of CDS payment data from the

accounts payable system determined that the Postal Service incurred about \$2 billion in CDS costs during that time period.

The Postal Service overestimated or underestimated its total accrued CDS costs for product costing purposes, in any given year, over the past five fiscal years because it did not isolate these costs in its general ledger (GL). Instead, it captured CDS costs with transportation-related expenses across 27 different GL expense accounts during FYs 2016 through 2020. The Postal Service used estimated cost proportion percentages to project total accrued CDS costs within two of the transportation GL accounts instead of using CDS payment data from its accounts payable system. Management explained that they focus their accrued cost estimation on the two GL accounts because they contain the majority of CDS costs.

When comparing all CDS payments from across the 27 GL accounts against the Postal Service's estimated accrued CDS costs, the use of the cost proportions resulted in the Postal Service overestimating or underestimating total accrued CDS costs by an absolute value of about \$84 million from FY 2016 to FY 2020. This resulted in a subsequent overestimation or underestimation of CDS product and/or institutional costs. We determined that, from FY 2016 to FY 2020, the Postal Service overestimated CDS product and institutional costs by at least \$35 million and \$107 million, respectively.

Using costing methodologies that achieve the most precise cost estimates possible would more reliably ensure that the revenue for each product and service covers its costs and that regulatory reports capture the correct allocation of product-specific and institutional costs. Using cost proportions that result in estimates that do not closely align to actual costs may lead to cost misallocations, the reporting of inaccurate product costs, and reliance on incorrect information when determining cost coverage and negotiating prices with mailers.

Opportunities also exist to enhance the precision of CDS cost attribution through updates to the percentages used to attribute CDS costs to mail products and services. The Postal Service uses percentages specific to transportation to attribute CDS costs. The Postal Service uses transportation (instead of rural

delivery) percentage rates to attribute CDS costs to mail products and services because this has been the PRC-approved cost attribution methodology since January 1991. However, our review of CDS operational activities and mail mix data indicates that the use of rural delivery distribution keys may result in more reliable attribution of CDS costs than the current methodology.

Management could not confirm whether the percentage rates used for CDS costs should be the same as those for rural delivery costs because it was unknown whether CDS suppliers and rural carriers deliver similar mail volumes. To gauge whether there was a possibility that CDS suppliers' mail mix was like that of rural carriers, we analyzed available volume data for a random, judgmental sample of CDS and rural routes. Our analysis indicated that the mail mixes for CDS and rural routes were very similar at the delivery facilities we reviewed. The similarities in mail mix between CDS routes and rural routes, in conjunction with the similar operational functions, suggest that rural delivery may be a better proxy for CDS than transportation.

We believe this warrants further study by the Postal Service to determine if it would be appropriate to update percentage rates used to attribute CDS costs because the current transportation percentage rates may not distribute the appropriate amount of CDS costs to mail products and services. A reevaluation of the current methodology would help the Postal Service to determine if there is an opportunity to improve the reliability and precision of cost estimates.

Recommendations

We recommended management:

1. Reevaluate the cost proportion percentages used to estimate accrued CDS costs; assess the possibility of using actual CDS payment data to calculate product costs; and, if deemed appropriate, submit a proposal to the PRC to update the costing methodology.
2. Conduct a study to determine whether similar mail volumes are delivered on CDS and rural routes; and, based on the results of that study, submit a proposal to the PRC to update distribution keys used to attribute CDS costs, if deemed appropriate.

Transmittal Letter



OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

June 21, 2021

MEMORANDUM FOR: SHARON D. OWENS
VICE PRESIDENT, PRICING AND COSTING

A handwritten signature in black ink, reading "M S Schoenberg", is positioned below the recipient information.

FROM: Mitchell S. Schoenberg
Deputy Assistant Inspector General for Finance
and Pricing

SUBJECT: Audit Report – Contract Delivery Service Cost
Attribution (Report Number 20-313-R21)

This report presents the results of our audit of Contract Delivery Service Cost Attribution.

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

Attachment

cc: Postmaster General
Corporate Audit Response Management

Results

Introduction/Objective

This report presents the results of our self-initiated audit of Contract Delivery Service (CDS) Cost Attribution (Project Number 20-313). We performed this audit as part of our mandate under the Postal Accountability and Enhancement Act of 2006 (PAEA)¹ to regularly audit U.S. Postal Service data collection systems and procedures used to collect information and prepare reports.² Our objective was to assess whether all CDS costs are accurately captured and reliably attributed to mail products and services. See [Appendix A](#) for additional information about this audit.

Background

CDS is a contractual agreement between the Postal Service and an individual or firm for the delivery and collection of mail to and from homes and businesses. The Postal Service considers CDS to be one of its three primary delivery types, in addition to city carriers and rural carriers. CDS suppliers are not Postal Service employees, but independent contractors who provide delivery on specific routes not serviced by city or rural carriers. A CDS route may be operated personally by the supplier (owner-operator) or supported by employees hired by the supplier. The Postal Service uses CDS suppliers because they are comparatively less expensive than career employees.³

CDS suppliers provide services similar to those provided by Postal Service mail carriers. Generally, a supplier's responsibilities include:

- Casing⁴ mail
- Delivering mail
- Selling stamps, Certified Mail, Collect on Delivery, Priority Mail Express, Registered Mail, Standard Post, merchandise returns, or money orders
- Picking up mail from collection boxes
- Forwarding and markup of mail

The Postal Service manages CDS contracts in the transportation and related services functional area, which consists of a wide variety of different contracts related to transportation. CDS contract costs are made up of two portions: a fixed contract cost and a variable cost for additional services.⁵

In fiscal year (FY) 2020, the Postal Service had more than 7,900 active CDS contracts, which cost a total of about \$447 million. CDS costs for FY 2016 through FY 2020 increased by about 4 percent year-over-year, as shown in [Figure 1](#). This represented a total cost increase of about 20 percent during the five-year period.

“In FY 2020, the Postal Service had more than 7,900 active CDS contracts, which cost a total of about \$447 million.”

1 39 U.S.C. §§101 et seq.

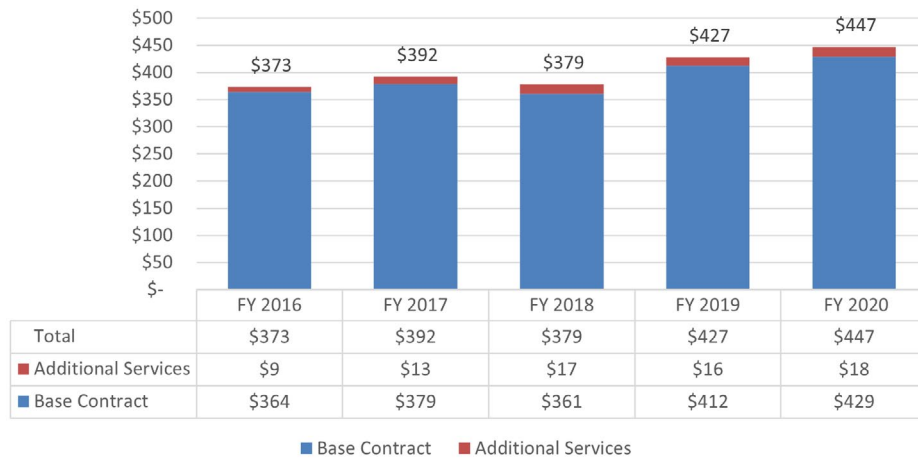
2 39 U.S.C. §3652(a).

3 An employee under a career appointment. A personnel action for a position without time limit requiring the completion of a probationary period that confers full employee benefits and privileges. The term can apply to (a) new employees, (b) former employees who are reinstated, (c) employees transferring from federal agencies, and (d) current employees who choose to transfer to or from the rural carrier craft.

4 The amount of time that a carrier spends in the delivery unit casing mail and performing other administrative duties before leaving to deliver mail.

5 Additional services (such as extra trips, operational peak period for the Christmas holiday, natural disaster, late slips, and emergency trips) may be required only when an unanticipated increase in mail volume or other condition arises necessitating the performance of additional services or use of additional equipment.

Figure 1. FYs 2016-2020 Total CDS Contract Costs (in millions)



Source: FYs 2016-2020 Accounts Payable Excellence System (APEX)⁶ pay data.

The PAEA⁷ requires the Postal Service to ensure mail products and services cover their attributable costs.⁸ To meet this requirement, the Postal Service has developed methods to allocate incurred costs to each mail class,⁹ product, and type of service. The PAEA stipulates that the Postal Service use methodologies that have been authorized by the Postal Regulatory Commission (PRC¹⁰).¹¹ When the Postal Service wants to change a cost system, method, or data source, it must obtain prior approval from the PRC.¹² The PAEA also mandates that the U.S. Postal Service Office of Inspector General (OIG) regularly audit the systems and procedures the Postal Service uses to collect information and prepare reports

that analyze costs.¹³ As part of this mandate, the OIG evaluates the accuracy and quality of cost data that the Postal Service uses to develop its regulatory reports.

Finding #1: Accrued Contract Delivery Service Costs

Opportunities exist for the Postal Service to more accurately and reliably capture and attribute CDS costs to mail products and services. Using management’s current methodology, we found that the Postal Service overestimated accrued CDS costs by an average of about 7 percent from FY 2016 to FY 2020, as noted in Table 3. Postal Service personnel used calculations approved

“Opportunities exist for the Postal Service to more accurately and reliably capture and attribute CDS costs to mail products and services.”

by the PRC in September 2014¹⁴ to estimate accrued¹⁵ CDS costs. Using these calculations, personnel estimated that the Postal Service had accrued about \$2.1 billion in CDS costs from FY 2016 to FY 2020. However, our review of CDS payment data from APEX determined that the Postal Service incurred about \$2 billion in CDS costs during that time period.

The Postal Service overestimated accrued CDS costs for product costing purposes over the past five fiscal years because it did not isolate these costs in its general ledger (GL).¹⁶ Instead, it captured CDS costs with transportation-related expenses across 27 different GL expense accounts during FYs 2016 through 2020. The current approved methodology requires the Postal Service

6 A commercial off-the-shelf product the Postal Service purchased to modernize its financial systems. According to Postal Service personnel, APEX is the most inclusive data source for capturing CDS payments.
 7 The PAEA requires the Postal Service to report annual costs, revenues, volumes, and quality of service to the PRC. The PAEA also requires that market dominant products do not subsidize competitive products and that each competitive product covers its attributable costs.
 8 Direct and indirect costs that can be clearly associated with a particular mail product. It is the sum of volume-variable costs plus product-specific costs.
 9 The mail class is the classification of domestic mail according to content (for example, personal correspondence versus printed advertising) and other factors. It is codified in the Mail Classification Schedule. The term product, rather than mail class, is used for divisions within competitive products.
 10 The PRC is an independent establishment of the executive branch of the U.S. government that has regulatory oversight over many aspects of the Postal Service, including the development and maintenance of regulations for pricing and performance measures.
 11 See 39 U.S.C. §3652(a)(1).
 12 See 39 C.F.R. §3050.11(a).
 13 39 U.S.C. §3652(a)(2).
 14 Docket Number RM2014-6 (Proposal Six), Order Number 2180, dated September 10, 2014.
 15 Accrued costs are the costs of goods or services received or incurred during a period.
 16 A record of each financial transaction that holds account information needed to prepare an organization’s financial statements.

to use approximated cost proportion percentages (or weights¹⁷) developed in FY 2013 to estimate total accrued CDS costs within the GL accounts instead of using CDS payment data from its accounts payable¹⁸ system. Specifically, to calculate estimated accrued CDS costs, management multiplied the total costs within two of the 27 GL accounts by the designated cost proportions for different transportation types represented within the accounts, as shown in Table 1. Management explained that they focused their accrued cost estimation on the two GL accounts because they contain the majority of CDS costs.

Table 1. Cost Proportions Used to Estimate Specific Accrued Costs by Transportation Type within GL Accounts 53601 and 53605

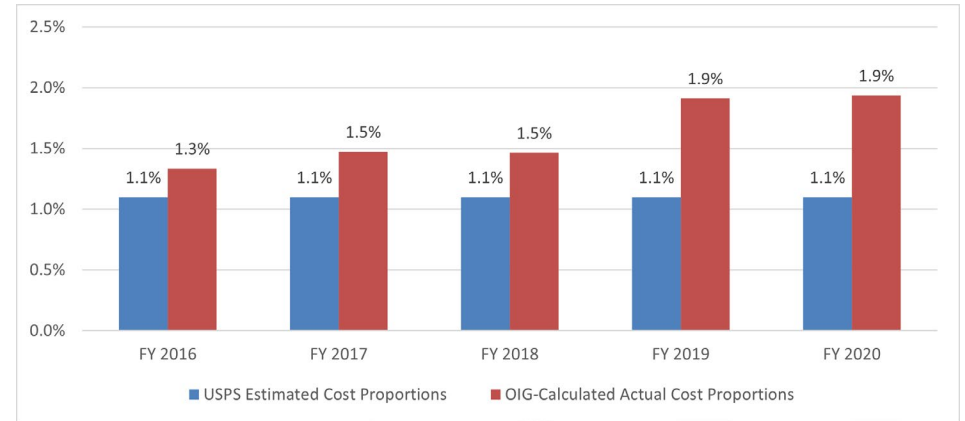
GL Account	Type	Cost Proportions
53601 Intra-Processing and Distribution Center (P&DC)	CDS	1.1%
	City	8.6%
	Van	58.9%
	Tractor Trailer	31.5%
53605 Intra-District	CDS	80.5%
	City	3.3%
	Van	14.4%
	Tractor Trailer	1.9%

Source: PRC Docket Number RM2014-6, Proposal Six, Order Number 2180, dated September 10, 2014.

As indicated in the table above, the approved cost proportions estimated that accrued CDS costs comprise 1.1 percent of the year-end Intra-P&DC account balance and 80.5 percent of the year-end Intra-District account balance. However, our analysis of CDS payment data for FYs 2016 through 2020 found that those costs only made up an average of 1.6 percent and 74 percent of the Intra-P&DC and Intra-District account balances, respectively. Figure 2 and Figure 3 show the

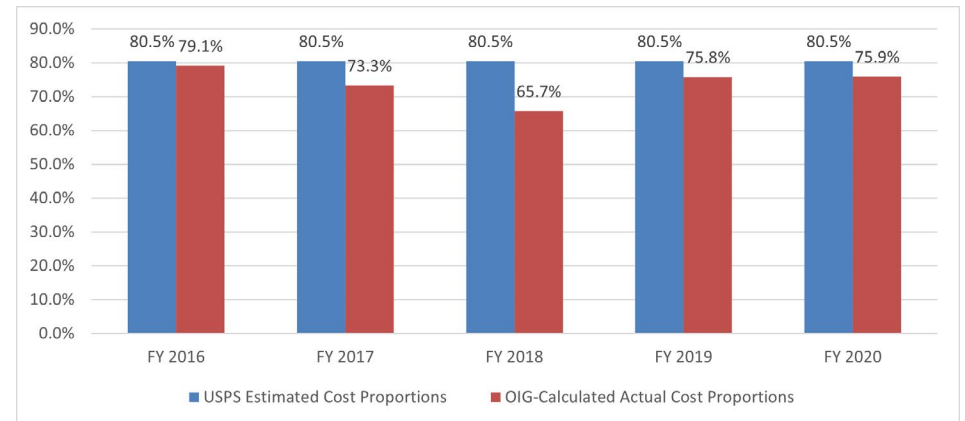
annual variance between the Postal Service’s estimated cost proportions and the cost proportions we calculated from FY 2016 to FY 2020.

Figure 2. FYs 2016-2020 Cost Proportion Variances for GL Account 53601



Source: OIG analysis.

Figure 3. FYs 2016-2020 Cost Proportion Variances for GL Account 53605



Source: OIG analysis.

¹⁷ A weight function is a mathematical device used when performing a sum, integral, or average to give some elements more “weight” or influence on the result than other elements in the same set.
¹⁸ A software system that provides for processing and reporting of payments.

Management explained that, at the time the PRC approved the current methodology for estimating accrued CDS costs, the Postal Service had determined that the proportion of CDS costs to the costs of other route types (city, van, and tractor trailer) within the GL accounts were sufficiently stable from year-to-year. In addition, they believe that CDS costs have not changed significantly since they developed the cost proportions in FY 2013. For these reasons, they did not feel it was necessary to perform annual recalculations with current year data.

When comparing all CDS payments from across the 27 GL accounts against the Postal Service's estimated accrued CDS costs, the use of cost proportions to estimate CDS costs resulted in the Postal Service overestimating or underestimating total accrued CDS costs in any given year. Specifically, the Postal Service overestimated or underestimated total accrued CDS costs by an absolute value¹⁹ of about \$84 million²⁰ from FY 2016 to FY 2020, as shown in Table 2.

Table 2. Estimated CDS Costs vs. CDS Payments

Fiscal Year	Estimated CDS Costs ²¹	CDS Payments ²²	Overestimation/Underestimation
2016	\$364,123,359	\$372,945,325	\$8,821,966
2017	\$407,631,985	\$391,809,037	15,822,949
2018	\$436,049,000	\$378,742,826	57,306,174
2019	\$428,036,604	\$427,476,510	560,093
2020	\$446,122,881	\$447,304,333	1,181,453
Total			\$83,692,635

Source: OIG analysis of FYs 2016-2020 Annual Compliance Report (ACR)²³ library reference non-public (NP) 29, *Cost Segments and Components Reconciliation of Financial Statements and Account Reallocation*; PRC Docket Number RM2014-6, Proposal Six, Order Number 2180, dated September 10, 2014; and FYs 2016-2020 APEX pay data.

This resulted in a subsequent overestimation or underestimation of CDS product and/or institutional costs.²⁴ However, we could only partially calculate the impact of the overestimation or underestimation on CDS product and institutional costs because the existing costing methodology only establishes volume variabilities²⁵ for the two primary accounts that contain CDS costs. We applied those volume

variabilities to CDS payments (incurred within the two primary GL accounts) from FY 2016 to FY 2020 and determined that the Postal Service overestimated CDS product and institutional costs for those years by at least \$35 million and \$107 million,²⁶ respectively, as shown in Table 3. These overestimated costs should have been allocated to other route types (city, van, or tractor trailer), which

19 Absolute value means to remove any negative sign in front of a number and to think of all numbers as positive (or zero).

20 Of the \$84 million, the OIG will claim about \$1.7 million for misallocated costs for FYs 2019 and 2020.

21 The Postal Service estimated these costs by only applying cost proportions (or weights) to two GL accounts that contain CDS costs: the Intra-P&DC account (53601) and the Intra-District account (53605).

22 Our calculation of incurred CDS payments accounts for applicable costs in all 27 GL accounts that contained CDS costs in a given year during FYs 2016-2020.

23 The ACR analyzes cost, revenue, rates, and quality of service for all products and determines whether revenue for each mail class and service type covers its attributable costs.

24 Institutional costs are those that are not volume variable or attributed to specific products or services. They make up the difference between total accrued costs and total attributable costs.

25 Volume variable costs are those that change with mail volume and operational activities. The volume variabilities that the Postal Service uses to derive volume variable costs from accrued CDS costs can be found in Docket Number RM2014-6 (Proposal Six), Order Number 2180, dated September 10, 2014; and Docket Number RM2016-12 (Proposal Four), Order Number 3973, dated June 22, 2017.

26 These estimates for the impact on volume variable and institutional CDS costs would be higher if the Postal Service had established volume variability percentages for all GL accounts that contain CDS costs instead of just two.

have volume variabilities that are different from the volume variabilities for CDS. This suggests that the total product costs that the Postal Service estimated for city, van, and/or tractor trailer routes may have been different if personnel had used payment data. We were not able to confirm the net impact on product costs

across all four route types because the accounts payable system does not clearly distinguish whether transportation payments were associated with city, van, or tractor trailer transportation routes.

Table 3. FYs 2016-2020 USPS Cost Estimates, OIG-Calculated Costs,²⁷ and Variances of Accrued, Product, and Institutional CDS Costs²⁸ (in millions)

Costs	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	Totals
<u>USPS Cost Estimates</u>						
Accrued Costs	\$364.1	\$407.6	\$436.0	\$428.0	\$446.1	\$2,082.0
Product Costs	\$86.4	\$96.8	\$103.6	\$101.8	\$106.1	\$494.6
Institutional Costs	\$277.7	\$310.9	\$332.5	\$326.3	\$340.0	\$1,587.4
<u>OIG Cost Calculations</u>						
Accrued Costs	\$360.7	\$376.4	\$362.2	\$411.4	\$429.0	\$1,939.6
Product Costs	\$85.4	\$89.1	\$85.7	\$97.4	\$101.6	\$459.2
Institutional Costs	\$275.3	\$287.3	\$276.4	\$314.0	\$327.4	\$1,480.4
<u>Variance (Overestimations)</u>						
Accrued Costs	\$3.4	\$31.3	\$73.9	\$16.6	\$17.1	\$142.3
Product Costs	\$1.0	\$7.7	\$17.9	\$4.4	\$4.5	\$35.4
Institutional Costs	\$2.5	\$23.6	\$56.0	\$12.3	\$12.6	\$106.9

Source: OIG analysis of FYs 2016-2020 ACR library reference non-public (NP) 29, *Cost Segments and Components Reconciliation of Financial Statements and Account Reallocation*; PRC Docket Number RM2014-6, Proposal Six, dated September 10, 2014; and FYs 2016-2020 APEX pay data.

²⁷ OIG-calculated accrued cost totals in this table do not match the totals in Table 2 because, while the CDS payments in Table 2 reflect a total of all GL accounts that contain CDS costs, the OIG-calculated CDS payments in this table only reflect the total of two GL accounts with CDS costs for which the Postal Service has established volume variabilities. Without volume variabilities for the remaining 25 GL accounts with CDS costs (for FYs 2016-2020), we were only able to calculate the impact on volume variable and institutional costs for \$1.9 billion CDS costs instead of the full \$2 billion.

²⁸ Totals may be off slightly due to rounding errors.

To demonstrate how overestimated accrued CDS costs could impact a specific product's costs, consider the following example that uses a hypothetical volume variability and distribution key:

- If accrued costs are overestimated by \$84 million²⁹ and the volume variability was 20 percent,³⁰ then total CDS product costs would be overstated by about \$16.8 million.
- If total CDS product costs are overstated by \$16.8 million and the distribution key³¹ for Product A was 10 percent of the total CDS product costs, then total costs attributed to Product A would be overstated by \$1.68 million.
- Likewise, if Product B had a distribution key of 5 percent, then total CDS product costs attributed Product B would be overstated by \$840,000.

Using costing methodologies that achieve the most precise cost estimates possible would more reliably ensure that each product's and service's revenue covers its costs and that regulatory reports capture the correct allocation of attributable and institutional costs. Using cost proportions (instead of actual payment data) that result in estimates that do not closely align to actual costs poses a data integrity risk.³² This may lead to cost misallocations, the reporting of inaccurate product costs, and reliance on incorrect information when determining cost coverage and negotiating prices.

Further, a prior OIG audit³³ found that the use of actual census data³⁴ would strengthen costing data accuracy and reliability. Specifically, it found that enhancing the current cost system to include more real-time, granular census data would:

- Increase the accuracy of the Postal Service's cost attribution calculations.
- Better support complex product and pricing decisions.

²⁹ \$84 million is derived from the absolute value of all overestimated and underestimated costs in Table 2.

³⁰ We use this hypothetical percentage based on the overall volume variability percentages for GL accounts 53601 (18.7 percent) and 53605 (23.9 percent).

³¹ Distribution keys are percentages used to assign volume variable costs to products.

³² Validation of the consistency, accuracy, and completeness of data used by the Postal Service. Data used to support management decisions that are not fully supported or completely accurate. This can be the result of flawed methodology; procedural errors; or missing or unsupported facts, assumptions, or conclusions.

³³ *Costing Best Practices* (Report Number CP-AR-19-004, dated September 17, 2019).

³⁴ Census data capture information about everything in the population.

³⁵ Intra-SCF contractors transport mail between SCFs and post offices. They usually receive and dispatch all mail classes and products to and from the SCF.

- Allow management to apply cost analysis to specific customers and/or specific geographic areas.
- Help identify cost reduction opportunities in the operational network.

Recommendation #1

We recommend the **Vice President, Pricing and Costing**, reevaluate the cost proportion percentages used to estimate accrued contract delivery service (CDS) costs; assess the feasibility of using actual CDS payment data to calculate volume variable costs; and, if deemed appropriate, submit a proposal to the Postal Regulatory Commission to update the costing methodology.

Finding #2: Contract Delivery Service Cost Distribution

Opportunities also exist to enhance the precision of CDS cost attribution through updates to the distribution keys used to attribute CDS costs to mail products and services. The Postal Service uses intra-sectional center facility (SCF)³⁵ transportation distribution keys to attribute CDS costs to products.

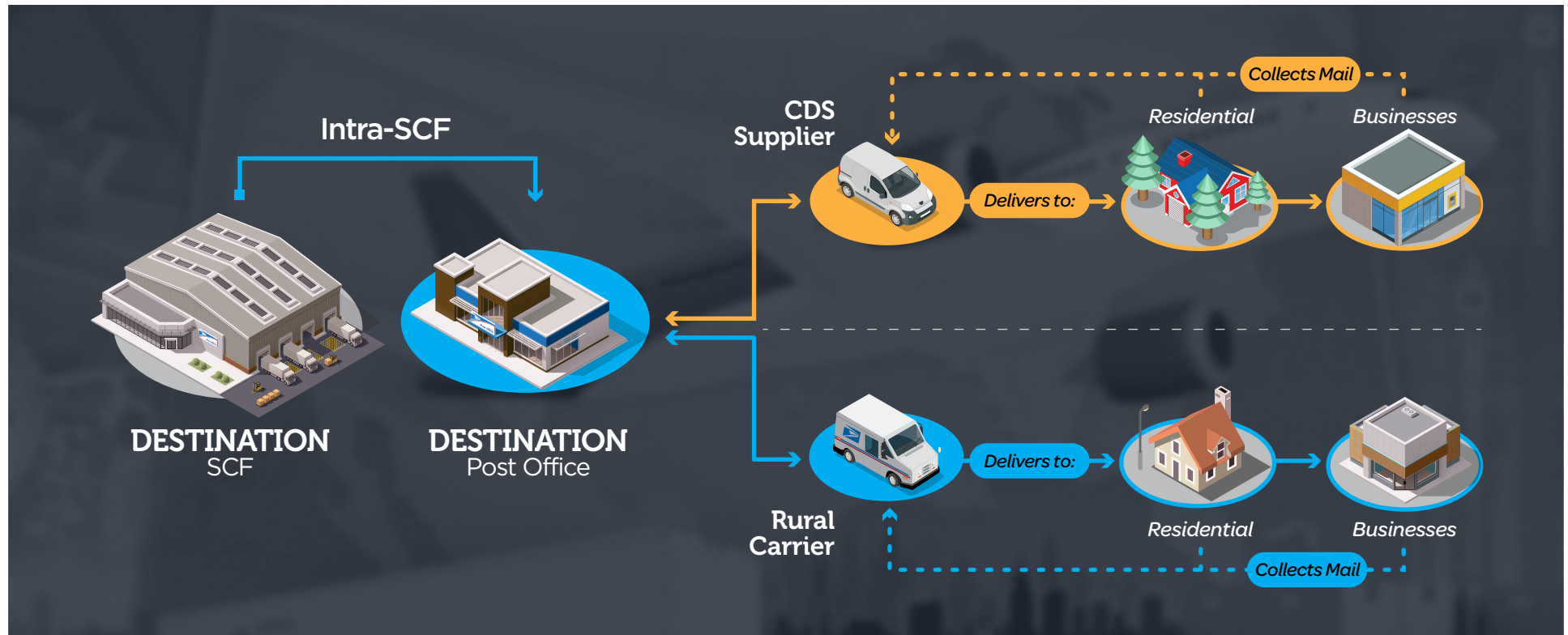
However, our review of CDS operational activities and mail mix data indicates that the use of rural delivery distribution keys may result in more reliable attribution of CDS costs than the current methodology.

“Our review of CDS operational activities and mail mix data indicates that the use of rural delivery distribution keys may result in more reliable attribution of CDS costs than the current methodology.”

The Postal Service groups costs into 17 active cost segments. Each cost segment is further divided into cost components,³⁶ which are comprised of individual cost pools.³⁷ These cost groupings are used to determine product cost attribution. The Postal Service allocates the majority of CDS costs to Cost

Component 143 – Highway within Cost Segment 14 – Transportation.³⁸ Although CDS is a delivery function that differs from intra-SCF transportation functions, as shown in Figure 4, the Postal Service uses intra-SCF distribution keys within that cost component to attribute CDS costs to mail products and services.³⁹

Figure 4. Illustration of the Intra-SCF, CDS Supplier, and Rural Carrier Functions



Source: OIG analysis based on Handbook SP-1, *Highway Contract Routes – Contract Delivery Service*, dated July 2013; Handbook PO-603, *Rural Carrier Duties and Responsibilities*, dated September 2013; and Publication 32, *Glossary Terms*, dated July 2013.

³⁶ Cost components consist of cost elements that represent the finest level of cost analysis (with respect to estimating volume variability of costs) within a cost segment.

³⁷ A cost pool represents the cumulative costs incurred from related activities performed within an organization.

³⁸ While the Postal Service also allocates some CDS costs to Cost Component 145 – Domestic Water, those costs are treated in the same manner as the non-CDS costs within that cost component because, according to management, the amount of CDS costs is immaterial. For this reason, the Postal Service does not factor the costs within cost component 145 into its estimation of accrued CDS costs. Therefore, our finding focuses on cost component 143.

³⁹ The PRC approved this methodology in Docket Number R87-1 (date unknown) and Docket Number R90-1 on January 4, 1991. The methodology was updated in Docket Number RM2016-12 (Proposal Four), Order 3973, dated June 22, 2017; and Docket Number RM2014-6 (Proposal Six), Order 2180, dated September 10, 2014.

The Postal Service uses intra-SCF (instead of rural delivery) distribution keys to attribute CDS costs because this has been the PRC-approved cost attribution methodology since January 4, 1991. In addition, management explained that the Postal Service incurs CDS costs based on negotiated contracts, like purchased transportation contracts, while it incurs rural delivery labor costs based on a set of collective bargaining⁴⁰ evaluation factors. Management further stated they could not confirm whether the distribution keys used for CDS costs should be the same as those for rural delivery costs because it is unknown whether CDS suppliers and rural carriers deliver similar mail volumes. However, they explained that different methodologies and distribution keys could be used to attribute CDS costs, if deemed appropriate. They said further study would be needed to determine if applying current rural delivery distribution keys to CDS costs would result in more reliable cost estimates.

Our review of the specific activities performed by CDS suppliers, rural carriers, and intra-SCF contractors found that those related to CDS are more closely aligned to those of rural delivery than transportation, as shown in Table 4.

Table 4. Activities of CDS Suppliers, Rural Carriers, and Intra-SCF Contractors

Activities	CDS Suppliers	Rural Carriers	Intra-SCF Contractors
Case mail	✓	✓	✗
Deliver mail	✓	✓	✗
Collect mail	✓	✓	✗
Sell stamps	✓	✓	✗
Collect postage dues	✓	✓	✗
Perform mail markups	✓	✓	✗
Collect on Delivery	✓	✓	✗
Making merchandise returns	✓	✓	✗
Perform mail forwarding	✓	✓	✗
Selling money orders	✓	✓	✗
Transport mail between SCFs and post offices	✗	✗	✓

Source: Handbook SP-1, *Highway Contract Routes – Contract Delivery Service*, dated July 2013; Handbook PO-603, *Rural Carrier Duties and Responsibilities*, dated September 2013; and Publication 32, *Glossary Terms*, dated July 2013.

⁴⁰ An organized group of employees found appropriate for representation by Federal Labor Relations Authority and voted on by employees who are represented by a labor union in their dealings and negotiations with management for wages, hours, and other terms and conditions of employment.

While it is clear that CDS suppliers perform similar activities as rural carriers, management cannot easily compare the mail mix between the two carrier types because the Postal Service does not track aggregated CDS mail volumes on a national level. In addition, while the Postal Service uses Transportation Cost System (TRACS)⁴¹ sample data to measure the mail mix on purchased transportation modes and develop the intra-SCF distribution keys currently used to attribute CDS costs to products, it does not sample or collect mail mix data on CDS routes to incorporate in those distribution keys. Management stated that the Postal Service does not sample CDS mail volumes for TRACS or any of its other cost systems because:

- They do not believe they can develop a reliable and accurate sampling frame from which a statistically defensible sampling design could be established.
- There is limited resource availability of data collection technicians (DCT)⁴² to reliably access the many remote areas where CDS routes are located.

- There would be challenges with the amount of time DCTs would need to sample the mail and the CDS suppliers' scheduled departure time needed to ensure they can complete their routes, which tend to entail more miles, on time.

Since the Postal Service does not collect CDS sample data to develop CDS-specific distribution keys, it is important that it uses the most appropriate proxy to reliably attribute CDS costs to products. To gauge whether there was a possibility that CDS suppliers' mail mix was like that of rural carriers, we analyzed available volume data for a select number of CDS and rural routes. Specifically, we randomly selected a judgmental sample of forty facilities that have CDS suppliers and rural carriers from across the four postal areas. We then pulled and aggregated mail volume data⁴³ by mail type and route type to determine the mail mix for CDS and rural routes at those facilities. Though limited in scope,⁴⁴ our analysis indicated that the mail mixes for CDS and rural routes were very similar at the delivery facilities we reviewed, as shown in Table 5.

Table 5. Mail Mix Comparison for CDS Routes and Rural Routes at Select Delivery Facilities in Each Postal Area

Types of Mail	Atlantic		Central		Southern		Western Pacific	
	CDS Suppliers	Rural Carriers	CDS Suppliers	Rural Carriers	CDS Suppliers	Rural Carriers	CDS Suppliers	Rural Carriers
Letters	88.35%	88.50%	81.34%	88.90%	87.96%	88.58%	86.20%	84.14%
Flats	2.92%	2.79%	5.17%	3.09%	5.42%	3.50%	5.47%	7.93%
Competitive Packages ⁴⁵	4.57%	4.35%	3.15%	3.72%	3.80%	3.79%	4.57%	5.18%
Other	4.16%	4.35%	10.34%	4.29%	2.82%	4.14%	3.76%	2.75%
Total	100%	100%	100%	100%	100%	100%	100%	100%

Source: OIG analysis of WebEOR and PTR mail volume data for forty delivery facilities across all postal areas from February 22, 2021 to March 6, 2021 (excluding Sunday).

⁴¹ TRACS is a statistical sampling and data collection system that provides information to assign attributable contract transportation costs to products.

⁴² DCTs are employees dedicated to statistical work that entails gathering and recording data from mail samples and other valid sources.

⁴³ We pulled mail volume data from the Web End-of-Run (WebEOR) and Product Tracking and Reporting (PTR) systems. WebEOR is a server-based software application that stores data from mail processing equipment. PTR is the database that stores tracking scan data for all barcoded packages and extra services products.

⁴⁴ These systems only allowed us to pull one day's worth (PTR) or one month's worth (WebEOR) of volume data at a time for the forty facilities that we sampled.

⁴⁵ This line item is comprised of four different competitive package products.

The similarities in mail mix between CDS routes and rural routes, in conjunction with the similar operational activities, suggest that rural delivery may be a better proxy for CDS than intra-SCF transportation. We were unable to include any mail mix data associated with the intra-SCF routes that service the facilities represented in the table above, for comparison purposes, because the Postal Service does not track volumes for mail traveling along intra-SCF routes. However, we can infer that the mail mix for those transportation routes is more likely to be different from the mail mix for CDS and rural routes. This is because some mailers dropship⁴⁶ their mail directly at destinating post offices (for example, Every Door Direct Mail⁴⁷ and Carrier Route mail⁴⁸). While this mail bypasses transportation on intra-SCF routes, it would be delivered on both CDS and rural routes at the destinating post office.

We believe that the similarities between CDS and rural delivery functions and mail mix warrant further study by the Postal Service to determine if it would be appropriate to update distribution keys used to attribute CDS costs. This is important because, due to the more apparent differences between CDS delivery and intra-SCF transportation functions, the current intra-SCF distribution keys may not distribute the appropriate amount of CDS costs to mail products and services.

We acknowledge that the PRC approved the current costing methodology using the intra-SCF distribution keys to attribute CDS costs to mail products and services in January 1991. In addition, according to management, they would have to assess the rural delivery and intra-SCF cost drivers to determine if using the rural delivery distribution keys in place of the intra-SCF distribution keys would result in improved CDS product cost estimates. While we understand these factors, we believe that CDS cost increases, volume changes, and information made available since 1991 necessitate a reevaluation of the current methodology

to help the Postal Service determine if there is an opportunity to improve the reliability and precision of cost estimates.

Recommendation #2

We recommend the **Vice President, Pricing and Costing**, conduct a study to determine whether similar mail volumes are delivered on contract delivery service (CDS) and rural routes; and, based on the results of that study, submit a proposal to the Postal Regulatory Commission to update distribution keys used to attribute CDS costs, if deemed appropriate.

Management's Comments

Management agreed with all recommendations presented in the report.

Regarding recommendation 1, management plans to investigate the possibility of using APEX payment data to estimate CDS accrued costs. As part of this effort, they may assess the impact of using alternative data sources on product cost estimates to determine whether there is a material change. If the results suggest that the CDS payment data source improves the quality and accuracy of cost reporting, management plans to submit a proposal to the PRC to change the current methodology. The target implementation date is May 31, 2022.

Regarding recommendation 2, management plans to investigate CDS cost drivers and the mail mix delivered on CDS routes to determine an appropriate distribution key to distribute CDS costs to products. If the investigation results in a more accurate and reliable distribution key than the current one used, then management plans to submit a proposal to the PRC to change the current methodology. The target implementation date is May 31, 2022.

See [Appendix B](#) for management's comments in their entirety.

⁴⁶ The movement of a mailer's product on private (non-postal) transportation from the point of production to a postal facility located closer to the destination of that product. The pieces in a mailer's drop shipment mailings frequently receive a reduced price or discount based on mail class or product.

⁴⁷ An easy-to-use service designed mainly for local businesses to send geographically targeted advertising mail to every household or business on a postal delivery route.

⁴⁸ A presort level in which all pieces in the bundle or container are addressed for delivery to the same route.

Evaluation of Management's Comments

The OIG considers management's comments responsive to the recommendations in the report and corrective actions should resolve the issues identified in the report.

All recommendations require OIG concurrence before closure. The OIG requests written confirmation when corrective actions are 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

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

Appendix A: Additional Information.....	16
Objective, Scope, and Methodology.....	16
Prior Audit Coverage	16
Appendix B: Management’s Comments.....	17

Appendix A: Additional Information

Objective, Scope, and Methodology

The scope of the project included a review of the Postal Service's CDS cost attribution methodology between FYs 2016 and 2020. Specifically, we assessed how the Postal Service calculated accrued CDS costs and distributed those costs to the appropriate mail products and services.

To accomplish our objective, we:

- Reviewed and analyzed documents and data pertaining to the CDS cost attribution process.
- Interviewed Postal Service personnel in the Cost Attribution and Cost Systems & Analysis groups to determine the methodology and procedures used to collect data on CDS activities and attribute CDS costs to mail products and services.
- Interviewed Postal Service personnel in the CDS group to determine how to retrieve data on actual payments made to CDS suppliers and discuss the types of payments made to CDS suppliers and other transportation contractors.
- Interviewed PRC representatives to discuss CDS functions and the currently approved CDS cost attribution methodology.
- Trended volume and costs associated with CDS from FY 2016 to FY 2020.
- Conducted site visits to the following Capitol District facilities to observe CDS delivery operations:
 - Chesapeake Beach Post Office, MD

- Owings Post Office, MD

- Evaluated whether CDS related cost calculations reflect current operational and contractual activities.
- Assessed whether current costing procedures reliably capture and distribute all relevant CDS costs to mail products and services.

We conducted this performance audit from October 2020 through June 2021 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 May 26, 2021 and included their comments where appropriate.

We assessed the reliability of APEX payment data and WebEOR and PTR mail volume data by performing logical tests of completeness, accuracy, and validity on key fields. We also interviewed knowledgeable officials from the Transportation Contracts group about how the APEX payment data was retrieved and used. We determined that the data were sufficiently reliable for the purposes of this report.

Prior Audit Coverage

The OIG did not identify any prior audits or reviews related to the objective of this audit within the last five years.

Appendix B: Management's Comments

SHARON OWENS
VICE PRESIDENT, PRICING AND COSTING



June 16, 2021

JOSEPH WOLSKI
DIRECTOR, AUDIT OPERATIONS

SUBJECT: Contract Delivery Service Cost Attribution
(Project Number 20-313)

Thank you for the opportunity to review and comment on the findings and recommendations in the subject audit report. Management generally agrees with the findings in the report and will address each recommendation separately below.

Recommendation 1:

We recommend the Vice President, Pricing and Costing, Reevaluate the cost proportion percentages used to estimate accrued CDS costs; assess the possibility of using actual CDS payment data to calculate product costs; and, if deemed appropriate, submit a proposal to the PRC to update the costing methodology.

Management Response/Action Plan:

Management agrees with this recommendation. Management will investigate the possibility of using APEX payment data to estimate CDS accrued costs. If the results of this investigation suggest that the CDS payment data source improves the quality and accuracy of cost reporting, Management will initiate a rulemaking docket before the Commission to propose a change to the established methodology. As a part of this effort, Management may estimate the product cost impacts of using alternative data sources to estimate CDS accrued costs to assess the materiality of the change in data inputs.

Target Implementation Date:

May 2022

Responsible Official:

Director, Cost Attribution

Recommendation 2:

We recommend the Vice President, Pricing and Costing, conduct a study to determine whether similar mail volumes are delivered on CDS and rural routes; and, based on the results of that study, submit a proposal to the PRC to update distribution keys used to attribute CDS costs, if deemed appropriate.

Management Response/Action Plan:

Management agrees with this recommendation. Cost Attribution and Cost Systems and Analysis will investigate both the cost drivers for CDS expenses, and the mail product mix delivered on CDS routes

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- 2 -

to determine an appropriate distribution key to distribute the variable CDS costs to products. If the investigation results in a reliable and more accurate distribution key compared to the current one used (Intra-SCF) under the established methodology, then Management will initiate a rulemaking docket with the Commission to request a change in the established distribution key used to distribute volume variable CDS costs to products.

Target Implementation Date:

May 2022

Responsible Officials:

Director, Cost Systems and Analysis and Director, Cost Attribution

E-SIGNED by Sharon D Owens
on 2021-06-16 11:08:10 CDT

Sharon Owens,
Vice President Pricing and Costing

cc: VP, Delivery Operations
VP Supply Management
VP Transportation Strategy
Manager, Corporate Audit Response Management

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UNITED STATES POSTAL SERVICE

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