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U.S. POSTAL
SERVICE

Improving Ratemaking
Data Quality through
Postal Service Actions
and Postal Reform
Legislation





Highlights of [GAO-05-820](#), a report to congressional requesters

U.S. POSTAL SERVICE

Improving Ratemaking Data Quality through Postal Service Actions and Postal Reform Legislation

Why GAO Did This Study

In 1999, the congressionally requested Data Quality Study (the Study) found opportunities to improve ratemaking data quality. The U.S. Postal Service (USPS) agreed to make improvements, but concerns remained that it is still unclear, from an overall perspective, what actions USPS has taken to improve data quality. Ratemaking data quality has also factored into congressional deliberations to reform postal laws. Thus, questions remain about USPS's actions to improve ratemaking data quality and how proposed legislation will address long-standing issues in this area. GAO was asked to (1) describe key USPS actions that were responsive to the Study to improve the quality of ratemaking data and (2) discuss possible implications of postal reform legislation for ratemaking data quality. GAO did not assess the extent to which USPS's actions affected data quality.

In its comments, USPS disagreed with GAO's finding on the need to reform the ratemaking structure. USPS also differed on GAO's finding that the legislation would likely lead to improving ratemaking data quality. It said "breakthrough improvements" would be unlikely without a significant increase in costs. GAO believes reform of the ratemaking structure is needed, but the outcome would depend on its implementation. Further, the legislative changes would likely lead to data quality improvements over time and at some cost.

www.gao.gov/cgi-bin/getrpt?GAO-05-820.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Katherine Siggerud at (202) 512-2834 or siggerudk@gao.gov.

What GAO Found

USPS took several key actions that it reported were responsive to the Study's findings. USPS reported that these actions increased the accuracy and precision of ratemaking data. First, USPS changed the In-Office Cost System to improve the quality of data on mail handled by postal employees and the activities they are performing. Personnel costs represent more than three-quarters of USPS costs; therefore, information on postal employees' handling of mail is necessary for ratemaking purposes. USPS made similar changes to the Revenue, Pieces, and Weight System, which produces data on the revenue, volume, and weight of each type of mail. Second, replacing ratemaking data that had been collected in the 1980s, USPS conducted the City Carrier Street Time Study to gather more complete and consistent data on letter carrier activities. Third, to increase the precision of ratemaking data, USPS collected a larger quantity of data. Fourth, USPS revised documentation of the Transportation Cost System, which the Study had criticized as inadequate.

Proposed postal reform legislation (H.R. 22 and S. 662) would create new oversight mechanisms and enhanced regulatory authority over the quality of ratemaking data. The legislation would transform the Postal Rate Commission into a new postal regulator that would prescribe what ratemaking data USPS must report annually, review these data, and determine whether USPS had complied with ratemaking requirements. The regulator could initiate proceedings to improve the quality of ratemaking data. To carry out its expanded duties, the regulator would have enhanced authority, including the authority to subpoena; the authority to order USPS to take actions to comply with laws and regulations; and the authority to impose sanctions for noncompliance.

The legislation would address persistent problems under the existing ratemaking structure, which has enabled long-standing deficiencies in ratemaking data quality and unresolved methodological issues to persist. The legislation would eliminate key disincentives for ratemaking data quality, including the litigious ratemaking process, the break-even requirement that creates incentives to shift costs from one type of mail to another, and the lack of adequate oversight mechanisms to address data quality issues. Under the current structure, regulatory oversight is generally conducted during rate cases that only USPS can initiate. The legislation would provide mechanisms for regular oversight of ratemaking data and enhance the regulator's authority so that the necessary transparency, oversight, and accountability could take place. Thus, the legislation would likely lead to improvements in the quality of ratemaking data over time and at some cost. However, if the legislation is enacted, the outcome would likely depend on how the regulator would use its discretion to define and implement the new ratemaking structure. Key implementation questions would remain, including what regulatory criteria and requirements would apply to ratemaking data.

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Abbreviations

CCSTS	City Carrier Street Time Study
IOCS	In-Office Cost System
MODS	Management Operating Data System
PRC	Postal Rate Commission
RPW	Revenue, Pieces, and Weight
TRACS	Transportation Cost System
USPS	United States Postal Service

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United States Government Accountability Office
Washington, DC 20548

July 28, 2005

The Honorable Tom Davis
Chairman, Committee on Government Reform
House of Representatives

The Honorable John M. McHugh
The Honorable Dan Burton
House of Representatives

The quality of data used to set postal rates has been a long-standing concern of Congress and postal stakeholders, including the U.S. Postal Service (USPS); the independent Postal Rate Commission (PRC), which reviews USPS proposals to change domestic postal rates; USPS competitors; and mailers, including businesses and the general public. Postal rates are critical to USPS's financial viability because USPS is intended to be self-supporting from postal operations and is mandated to break even over time. Ratemaking data are the variety of data that are used to establish postal rates. A key statutory ratemaking requirement is that each class of mail¹ or type of service² must bear the direct and indirect postal costs attributable to that class or type, plus that portion of all other USPS costs reasonably assignable to that class or type.³ USPS accounting systems collect detailed data, but do not collect sufficient data for ratemaking purposes. For example, USPS accounting systems collect data on the sales of postage stamps, but do not track how stamps are used to send different subclasses of mail (e.g., stamped First-Class Letters and Sealed Parcels, or Parcel Post items). Similarly, USPS accounting systems track employee time and payroll costs, but do not track employee time and payroll costs spent on handling each subclass of mail (e.g., time spent

¹The four major classes of mail are: First-Class Mail (mainly bills, bill payments, correspondence, advertising, and Priority Mail); Standard Mail (mainly bulk advertising and direct mail solicitations); Periodicals (mainly magazines and local newspapers); and Package Services Mail (e.g., parcels, merchandise, catalogs, media mail, library mail, and books). Another class of mail is Expedited Mail (i.e., Express Mail).

²Postal services include such services as post office boxes, money orders, and delivery confirmation.

³39 U.S.C. §3622(b)(3). PRC has long interpreted this requirement to apply to subdivisions of mail classes called subclasses. For example, Parcel Post and Library Mail are subclasses of the Package Services class.

manually sorting mail into the order it is to be delivered). Thus, USPS has established data collection systems that gather additional data needed to compile data specific to each subclass of mail. These data collection systems are highly complex, in part because USPS uses many different postal operations and work methods, and in part because original data collection is expensive and difficult. Further, these data collection systems are highly controversial, in part because there are multiple options to collect and analyze the data, and in part because the current ratemaking process gives various stakeholders an incentive to disagree over options that produce somewhat different results—thereby affecting postal rates. The statutory ratemaking process requires PRC proceedings called rate cases, which enable any stakeholder to review and comment on USPS proposals, including the supporting data and analysis. PRC then is required to issue a decision with recommended rates, which generally has included PRC’s assessment of the supporting ratemaking data.

In 1995, after the PRC Chairman and others raised concerns about the quality of ratemaking data in the 1994 rate case, the former House Subcommittee on the Postal Service, Committee on Government Reform and Oversight, requested a Data Quality Study (the Study). The Study’s report was issued in 1999 and found opportunities to improve the quality of ratemaking data.⁴ USPS agreed to implement improvements and has released information on its follow-up actions. However, concerns remained that it is still not clear, from an overall perspective, what specific actions USPS has taken to improve ratemaking data quality.

Further, the quality of ratemaking data has factored into ongoing congressional deliberations to reform the nation’s postal laws to enable USPS to better address its formidable financial, operational, and human capital challenges. Congress has considered comprehensive postal reform legislation over the past decade that, among other things, would provide USPS with more flexibility to establish postal rates. This flexibility would be balanced by enhanced regulatory authority and oversight to protect USPS customers and competitors, including new oversight mechanisms for the quality of ratemaking data. This legislation is being considered in the 109th Congress (H.R. 22 and S. 662, 109th Cong., 1st Sess., both of which are entitled the Postal Accountability and Enhancement Act), and was reported by USPS’s Senate oversight committee on July 14, 2005, and passed by the House on July 26, 2005, but has not yet been enacted.

⁴A.T. Kearney, Inc., *Data Quality Study* (Alexandria, VA: Apr. 16, 1999).

Thus, important questions remain about USPS's actions to improve the quality of ratemaking data and how proposed legislation will address long-standing issues in this area. Accordingly, as agreed with your staff, our objectives were to (1) describe key USPS actions that were responsive to the Study to improve the quality of ratemaking data and (2) discuss possible implications of postal reform legislation for ratemaking data quality.

To address these objectives, we identified key USPS actions taken that were responsive to the Study by reviewing the Study's report that prioritized its findings; reviewing USPS and PRC documents, including USPS progress reports that prioritized actions and PRC documents that summarized concerns about data quality; and interviewing USPS officials responsible for collecting ratemaking data. We focused our work primarily on USPS's key actions to enhance three of its five major data collection systems used for ratemaking because the Study's report noted that these systems had opportunities for improvement. These three systems include the In-Office Cost System (IOCS), which produces data on the time postal employees spend handling each subclass of mail in postal facilities; the Revenue, Pieces, and Weight (RPW) system, which produces data on the revenue, volume, and weight of each subclass of mail; and the Transportation Cost System (TRACS), which produces data on long-distance transportation of mail subclasses using trucks, airplanes, and freight trains.⁵ We also focused our work on another USPS key action to conduct a new special study to replace four USPS special studies because the Study's report identified that the four special studies had opportunities for improvement. USPS's new special study is called the City Carrier Street Time Study (CCSTS), which produced data on the activities of city carriers—that is, letter carriers who deliver mail in highly populated urban and suburban areas where most deliveries are made to the door, curbside mailboxes, centrally located mailboxes, or cluster boxes. To gain an understanding of how the ratemaking data are collected, we visited USPS facilities in the Capital Metro area to observe data collection operations and interviewed employees collecting the data, their supervisors, and management. We did not assess the extent to which USPS's actions affected the quality of these ratemaking data. To discuss the implications of proposed legislation, we reviewed proposed postal reform legislation,

⁵The Study identified only a few minor concerns regarding the other two major ratemaking data systems, which are the City Carrier Cost System and the Rural Carrier Cost System. These systems produce data on the volume of mail subclasses that are delivered and collected by carriers.

current postal laws and regulations, and other documents. See appendix I for more details on our objectives, scope, and methodology.

We requested comments on a draft of this report from PRC and USPS. PRC provided written comments that are also discussed later in this report and reproduced as appendix II. USPS provided comments via e-mail that are discussed later in this report. We conducted our review at USPS headquarters in Washington, D.C., and the Capital Metro area from June 2004 through July 2005 in accordance with generally accepted government auditing standards.

Results in Brief

USPS took several key actions that it reported were responsive to the Study's findings. USPS reported that these actions increased the accuracy and precision of ratemaking data. First, USPS changed IOCS to improve the quality of data on the mail subclasses that are handled by postal employees and the activities they are performing. Personnel costs represent more than three-quarters of USPS costs; therefore, information on postal employees' handling of mail is necessary to estimate the costs of handling each subclass of mail. Similarly, USPS made changes to RPW to improve the accuracy of data on the subclasses of mail in the postal system, including data on the revenue, volume, and weight of each subclass of mail. Second, USPS conducted CCSTS to replace ratemaking data that had previously been collected in the 1980s, using a different data collection approach to collect more complete and consistent data on carrier delivery activities. Data on city carrier delivery activities are needed for ratemaking because carriers typically deliver multiple subclasses of mail. Third, USPS substantially increased the quantity of data collected by RPW and TRACS to increase the precision of ratemaking data. Increasing data precision can be particularly beneficial to the quality of cost, revenue, and volume data for subclasses with smaller volumes. Fourth, USPS revised and expanded its documentation of TRACS, which the Study had criticized as inadequate. PRC commended the revised documentation, which USPS reported enhanced the transparency and administration of TRACS.

Proposed postal reform legislation being considered in the 109th Congress (H.R. 22 and S. 662, 109th Cong., 1st Sess.) would create new oversight mechanisms and enhanced regulatory authority over the quality of ratemaking data. The proposed legislation would transform PRC into a new postal regulator with enhanced authority compared with that of the current PRC. The postal regulator would be required to issue regulations prescribing what ratemaking data USPS must report on an annual basis.

The postal regulator would be required to annually review USPS ratemaking reports in order to determine whether USPS had complied with the requirements of the new ratemaking structure. In addition, USPS's Inspector General would be required to regularly audit the data collection systems and procedures used in collecting information and preparing the USPS annual reports. Further, the postal regulator would be provided with the authority to initiate proceedings to improve the quality of ratemaking data, including data on the attribution of costs and revenues to postal products. The postal regulator also would be provided with enhanced authority to carry out its expanded duties, including the authority to subpoena USPS documents and officials; the authority to order USPS to take appropriate actions to comply with laws and its regulations; and the authority to impose sanctions for noncompliance, including fines for deliberate noncompliance. The postal regulator could obtain court orders to enforce its subpoenas, orders, and sanctions. The proposed legislative changes would address persistent problems under the existing statutory ratemaking structure, which, as we have reported, has enabled long-standing deficiencies in ratemaking data quality and unresolved methodological issues to persist. The legislation would eliminate key disincentives for ratemaking data quality, including the litigious ratemaking process (which provides incentives for USPS and others to gain an advantage through the collection and analysis of ratemaking data), the break-even requirement that creates incentives to shift costs from one subclass of mail to another, and the lack of adequate oversight mechanisms to address data quality issues. Under the current structure, regulatory oversight is generally conducted during rate cases that only USPS can initiate, which has limited the frequency, scope, and depth of oversight of USPS ratemaking data and its data collection systems that generate these data. The legislation would provide mechanisms for regular oversight of ratemaking data and enhance the regulator's authority so that the necessary transparency, oversight, and accountability could take place. Thus, the proposed legislative changes would likely lead to improvements in the quality of ratemaking data over time and at some cost. However, if postal reform legislation is enacted, the outcome would likely depend on how the postal regulator would use its discretion to define and implement the new ratemaking structure. Key implementation questions would remain, including what regulatory criteria and requirements would apply to ratemaking data.

In commenting on the draft report, USPS disagreed with our findings on the ratemaking structure, stating the current process has worked "remarkably well" and that the proposed legislation is unlikely to lead to "breakthrough improvements" in the quality of its ratemaking data systems

without a significant increase in costs. In our view, for the reasons stated earlier, major changes are needed to the ratemaking structure. Further, the proposed legislative changes would likely lead to improvements in ratemaking data quality over time and at some cost. In our view, the extent of such improvements, and what the associated costs may be, would depend on how the legislation is implemented.

Background

USPS is an independent establishment of the executive branch mandated to provide postal services to bind the nation together through the personal, educational, literary, and business correspondence of the people. Established by the Postal Reorganization Act of 1970,⁶ USPS is one of the largest organizations in the nation; in fiscal year 2004, USPS reported revenues of \$69 billion and expenses of \$66 billion. USPS handles more than 200 billion pieces of mail annually.

The Postal Reorganization Act of 1970 shifted postal ratemaking authority from Congress to USPS and the independent PRC. When USPS wishes to change domestic postal rates and fees, it must submit its proposed changes and supporting material—including supporting ratemaking data on USPS costs, revenues, and mail volumes—to PRC. By law, PRC must hold a proceeding referred to as a “rate case.” Any interested party can participate in a rate case by filing a notice of intervention with PRC. The notice enables the party to submit material to PRC, as well as ask written questions of USPS. PRC also provides an opportunity for public hearings in which USPS witnesses appear and can be cross-examined by PRC and other interested parties. PRC generally must issue a recommended decision on postal rates and fees within 10 months of the inception of a rate case. USPS Governors may approve, allow under protest, reject, or modify PRC’s recommended decision.

Proposed postal rates must be sufficient for USPS to meet its mandate to break even, which requires that postal rates and fees shall provide sufficient revenues so that USPS’s total estimated income and appropriations will equal as nearly as practicable USPS’s total estimated costs.⁷ In addition, each class of mail or type of postal service is required

⁶The Postal Reorganization Act of 1970 (Pub. L. No. 91-375) reorganized the former U.S. Post Office Department into the U.S. Postal Service and created the Postal Rate Commission.

⁷39 U.S.C. §3621.

by law to cover its direct and indirect costs (attributable costs), as well as make a reasonable contribution to covering overhead costs (institutional costs).⁸ PRC has long interpreted this requirement to apply to subclasses of mail.

USPS maintains data collection systems to help attribute USPS costs to various subclasses of mail, in part because USPS employees typically handle multiple subclasses of mail every workday. Such cost attribution is critical because USPS personnel costs represent more than three-quarters of USPS costs. In fiscal year 2004, USPS personnel costs included about \$22 billion for clerks and mail handlers at mail processing and retail facilities, about \$18 billion for carriers on city routes (predominantly in highly populated urban areas and their suburbs), about \$5 billion for carriers on rural routes (predominantly in rural areas and suburbs not covered by city routes), and about \$2 billion for postmasters, among other things. USPS also collects ratemaking data on the revenue, cost, and volume of each subclass of mail.

About 900 USPS employees called data collectors gather ratemaking data on a full-time basis and about 2,000 USPS employees collect ratemaking data on a part-time basis in addition to their other duties. These personnel use laptop computers and digital scales to record ratemaking data at postal facilities located across the nation (see fig. 1). USPS has estimated that it budgeted about \$73 million for the administration and collection of ratemaking data in fiscal year 2005.⁹

⁸39 U.S.C. §3622(b)(3).

⁹This estimate does not include associated overhead costs, such as travel, office space and related costs, and computer operations and support, which USPS reported could not easily be determined; costs associated with accounting and operational data collection systems that are also used in ratemaking; and other costs associated with collecting data on international mail.

Figure 1: USPS Data Collector Using a Laptop Computer and Digital Scale to Record Ratemaking Data at a Postal Facility



Source: GAO.

Although the quality of ratemaking data has long been recognized as critical, as the Study's report noted, there are no definitive quality standards for postal ratemaking data. The Study concluded that the quality

of data accepted by any given regulatory or antitrust entity is negotiated between the regulator and the company or companies subject to that regulation.¹⁰ According to the Study, data quality is a subjective issue that regulators judge in every rate review process, with the quality of data accepted by regulators depending on the availability of data, the cost/benefit of collecting additional data, and the seriousness of the issue under review.

For the purpose of the Study, the criteria for the quality of ratemaking data were defined as having data that are “sufficiently complete” and “sufficiently accurate” for ratemaking, considering the costs involved in providing such data. Sufficiently complete data were defined as having enough of the necessary detail to enable the determination of each applicable rate. Sufficiently accurate data were defined as “free enough from error” to be used for this purpose. Error in this context referred to both “sampling error” (i.e., data precision associated with random error of data collected from randomly sampled employees or pieces of mail) and other sources of error (i.e., systematic error).

The contractor that conducted the Study, A.T. Kearney, primarily focused on the five major data collection systems used for ratemaking, as well as some special studies used for this purpose. The Study found opportunities for improvement in three of the five data collection systems. The Study also reviewed the economic and statistical concepts that USPS uses for ratemaking and estimated the precision of key cost data for certain subclasses of mail, among other things. The Study specifically focused on data used to establish rates for subclasses of mail. The Study did not perform extensive field testing and data gathering, attempt to quantify the extent to which systematic error is present in ratemaking data, or review the ratemaking process.

The Study’s report, issued in April 1999, concluded the following:

“In general, within the scope of the Study, the quality of the data provided by the Postal Service for rate making has been sufficiently complete and accurate to calculate subclass costs, and thus, enable subclass rates to be based on reasonably reliable data, considering the costs to collect the data. This conclusion is based on the Study team’s assessment that

¹⁰The Study reviewed postal ratemaking in the United States; 10 industrialized countries with postal administrations that have operating processes similar to USPS; and some U.S. industries subject to regulation, such as local telecommunications, natural gas, and railroads.

the Postal Service asks the appropriate economic questions, uses the best available data, and applies an economically sound approach grounded in activity based concepts to calculate its subclass costs with reasonable statistical accuracy. This assessment is based on extensive economic, statistical and simulation analyses contained in the Study's supporting Technical Reports."

At the same time, the Study's report concluded that "improvements and enhancements can—and must—be made to ensure future data provided for rate making will be sufficiently complete and accurate." The report stated that "The Study team has concerns regarding the quality of certain best available data used by the Postal Service to calculate its subclass costs. In some instances, these best available data were used regardless of their inherent level of error or their obsolescence." Specifically, the report noted opportunities for improvement in three major data collection systems used for ratemaking as well as the need to replace ratemaking data from special studies that had been collected in the 1980s.¹¹ USPS generally agreed with the Study's findings.

Over the past decade, Congress has debated comprehensive proposals to reform the nation's postal laws that would, among other things, transform the ratemaking structure and mechanisms for oversight of ratemaking data quality. In the last session of Congress, proposed postal reform legislation was reported by USPS's oversight committees (H.R. 4341 and S. 2468, 108th Cong., 2nd Sess., which were both entitled the Postal Accountability and Enhancement Act), but no further action was taken. The legislation has been reintroduced in the current session (H.R. 22 and S. 662, which are both entitled the Postal Accountability and Enhancement Act) but has not yet been enacted.

As we recently testified, comprehensive postal reform legislation continues to be needed in order to address the continuing financial, operational, governance, and human capital challenges that threaten USPS's long-term ability to provide high-quality, universal postal service at affordable rates.¹² USPS's core business of First-Class Mail is declining; compensation and benefits costs are rising; and USPS is burdened with roughly \$70 billion to \$80 billion in financial liabilities and obligations, most of which are for unfunded retiree health benefits. We and the

¹¹Kearney, *Data Quality Study: Summary Report*, pp. 5-7.

¹²GAO, *U.S. Postal Service: Despite Recent Progress, Postal Reform Legislation Is Still Needed*, [GAO-05-453T](#) (Washington, D.C.: Apr. 14, 2005).

President’s Commission on the United States Postal Service (Presidential Commission)—which was established by President George W. Bush in 2002 to examine the future of USPS and develop recommendations to ensure the viability of postal services in the United States—have reported that comprehensive postal reform legislation is needed to minimize the risk of a significant taxpayer bailout or dramatic rate increases.¹³ Because comprehensive postal reform legislation has not been enacted and USPS continues to face formidable competition, cost, and other challenges, its transformation efforts and long-term outlook remain on our High-Risk List. In this regard, we have reported that USPS progress is hindered by limited flexibility and incentives for success, including limited flexibility to establish postal rates and poor incentives for providing quality ratemaking data.¹⁴

USPS Took Action to Improve the Quality of Ratemaking Data

USPS took several key actions that it reported were responsive to the Study’s findings. USPS reported that these actions increased the accuracy and precision of ratemaking data. These USPS actions are summarized below:

- First, USPS made changes to IOCS and RPW to more accurately determine subclasses of mail in the postal system, including data on the revenue, volume, and weight of each subclass of mail, as well as to collect better information on the activities that postal employees are performing.
- Second, USPS conducted CCSTS to replace ratemaking data that had previously been collected in the 1980s, using a different data collection approach to collect more complete and consistent data on carrier delivery activities.
- Third, USPS substantially increased the quantity of data collected by RPW and TRACS to increase the precision of ratemaking data.

¹³GAO, *U.S. Postal Service: Key Elements of Comprehensive Postal Reform*, [GAO-04-397T](#) (Washington, D.C.: Jan. 28, 2004); *U.S. Postal Service: Bold Action Needed to Continue Progress on Postal Transformation*, [GAO-04-108T](#) (Washington, D.C.: Nov. 5, 2003); President’s Commission on the United States Postal Service, *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service* (Washington, D.C.: July 31, 2003).

¹⁴[GAO-04-397T](#) and [GAO-04-108T](#).

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- Fourth, USPS revised and expanded its documentation of TRACS, which the Study had criticized as inadequate.

USPS Made Changes to IOCS and RPW to More Accurately Determine Subclasses of Mail

USPS made changes to two major data collection systems used for ratemaking—IOCS and RPW—that USPS reported were responsive to the Study, in order to more accurately determine subclasses of mail in the postal system, including data on the revenue, volume, and weight of subclass of mail, as well as to collect better information on the activities that postal employees are performing. According to USPS, the changes to the data collection methods for IOCS and RPW were among the most significant since these data systems were established more than 30 years ago. To implement the changes, USPS undertook detailed pilot testing over a multiyear period, which required substantial efforts on the part of both USPS staff and contractors.

IOCS and RPW data are critical to postal ratemaking because these data are needed to estimate the costs for USPS to handle each subclass of mail. Although USPS timekeeping systems record the amount of employee time spent in each operation or work center, those systems do not track the subclasses of mail that employees handle, and also do not track the activities they are performing. USPS employees typically handle multiple subclasses of mail each workday, such as letter carriers preparing their mail for delivery by manually sorting piles of mail into pigeonholes corresponding to each address on their route. USPS has reported that letter carriers spend 2 to 3 hours each workday in the office, with much of that time spent manually sorting mail (see fig. 2). For example, USPS has estimated that carriers manually sort about 44 billion flat-sized pieces of mail each year, including such mail as catalogs, magazines, and large envelopes.¹⁵ This activity incurs substantial costs because letter carriers represent about 4 in 10 USPS career employees. To understand how much time is required for letter carriers to manually sort each subclass of mail and perform other duties in the office, at randomly selected times throughout the year, IOCS records the characteristics of mail that randomly sampled carriers are handling and the activities these carriers are performing. IOCS uses similar procedures to collect data from postal employees working to sort and route mail at mail processing and other facilities (see fig. 3), as well as postal employees working to provide

¹⁵Carriers also sort some letter mail into the order it is to be delivered, although USPS automated equipment sorts most letter mail into delivery order.

window service and perform other activities at post offices and other retail facilities (see fig. 4).¹⁶

Figure 2: USPS Letter Carrier Activities at Postal Facilities



Source: © 2005 USPS. Used with permission. All rights reserved.

Manually sorting mail.

Filling out paperwork.

Loading a delivery truck.

¹⁶IOCS also provides data on employee time spent on some special services, such as window service, time spent with customers purchasing postal money orders, and delivery confirmation, among other things.

Figure 3: USPS Employees Handling and Sorting Mail in Postal Facilities



Source: © 2005 USPS. Used with permission. All rights reserved.

Moving a pallet of mail (top left). Loading flat-sized mail and letter mail into sorting equipment (top middle and top right). Loading and unloading letter sorting equipment (bottom left and bottom middle). Moving a hamper containing mail (bottom right).

Figure 4: USPS Clerks Performing Retail Activities



Source: © 2005 USPS. Used with permission. All rights reserved.

Providing Express Mail service.

Completing a sale.

Providing stamp service.

Once IOCS produces data on the time employees spend handling each subclass of mail in various postal operations, these data are combined with other data, such as data on employee wages and benefits, to yield cost data (i.e., the in-office personnel costs attributable to each subclass of mail). USPS incurred \$28 billion in personnel costs in fiscal year 2004 for employees working in postal facilities (i.e., mail processing, retail, delivery unit, and other facilities), which represented more than one-third of USPS costs for the fiscal year. In addition, IOCS provides data for the calculation of some indirect costs that are related to mail handling activities, such as mail processing equipment costs.

USPS data collectors gather IOCS data in person at USPS facilities across the country. These data collectors gather information from sampled USPS employees about their activities and about the mail that they are handling (see figs. 5 and 6). Some IOCS data are gathered by data collectors via telephone interviews, generally from smaller facilities where it would not be cost-effective to collect data in person. IOCS data collection is a major effort, with more than 750,000 observations/interviews conducted annually. USPS has reported that it budgeted nearly \$15 million to collect IOCS data in fiscal year 2005.

Figure 5: USPS Data Collector Gathering Ratemaking Data from a Letter Carrier Manually Sorting Mail into Pigeonholes for Delivery



Source: GAO.

Figure 6: USPS Data Collector Gathering Ratemaking Data from a USPS Clerk Manually Sorting Mail at a Postal Facility



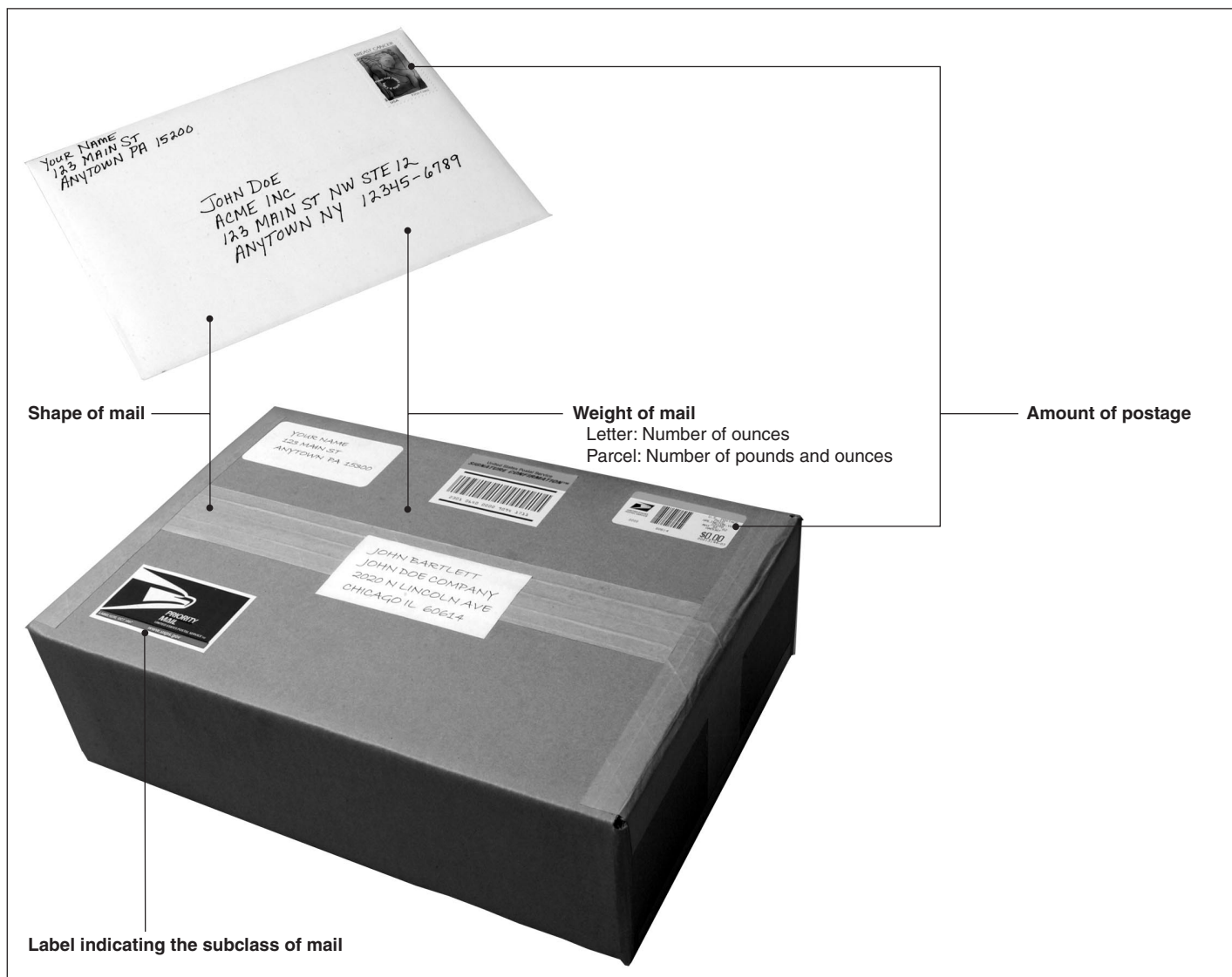
Source: GAO.

The Study had concluded that opportunities existed to improve the quality of ratemaking data collected by IOCS, stating that such action should be a “first priority.” USPS reported that it was responsive to this finding by modifying the IOCS data collection instrument to more accurately record the subclasses of mail and to collect better information on the activities that postal employees are performing. In addition, according to USPS, the redesigned IOCS instrument better aligns clerk and mail handler activities with current postal operations, and thus improves the division of certain postal costs into cost pools.¹⁷ Formerly, the data collector recorded the mail subclass on the basis of observations of certain characteristics of each sampled mail piece, such as its shape, weight, and markings (see fig. 7). This approach was revised so the data collector records detailed

¹⁷USPS costs are divided into cost pools that have common characteristics, so that, based on analysis of ratemaking data, each cost pool can be further divided into attributable and institutional costs.

characteristics of the mail piece, including its shape, weight, and markings. After IOCS data are collected, these data are uploaded to a mainframe computer. Then, USPS uses a computer program to analyze the combined IOCS data on mail piece characteristics and determine the subclass for each mail piece.

Figure 7: Some Mail Piece Characteristics Used to Determine the Subclass of Mail



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Because IOCS obtains information on postal employee activities using both in-person observation and interviewing and telephone interviewing, USPS redesigned the IOCS data collection instrument with a standard script to obtain information from postal employees in a more consistent manner. Previously, the IOCS data collection instrument listed the needed information but did not provide a script that asked questions in a standardized manner. Scripting questionnaires has long been considered a best practice and is the norm for surveys conducted by other organizations.

On the basis of pilot tests, USPS officials told us that the new IOCS approach categorized mail pieces more accurately because it relies less on the data collector's judgment and more on objective criteria built into the computer program that determines the mail subclass on the basis of the characteristics of each mail piece. USPS officials also said that pilot testing helped improve the script for IOCS data collection. These pilot tests¹⁸ are described below:

- *IOCS verification studies*: USPS pilot tested new versions of the IOCS data collection instrument, recording characteristics of actual mail pieces that were being handled by sampled USPS employees. These mail pieces were photocopied and sent to a USPS contractor who checked to see if the mail subclasses could be correctly categorized according to the information that was recorded. USPS staff double-checked this work. The results were used to test three versions of the instrument in an iterative manner, with each version being tested and the accuracy improving each time.
- *IOCS comparison studies*: USPS recorded mail piece characteristics from predeveloped examples (not actual mail) using different versions of the IOCS data collection instrument. USPS compared the results and reported that the final revised version of the instrument resulted in more accurate mail subclass determinations than the previous versions.

In addition to changing IOCS, USPS made some similar changes to the RPW data collection instrument to better estimate the revenue, volume,

¹⁸USPS did not use data collected for pilot tests for ratemaking.

and weight of each subclass. Although USPS separately tracks postage revenues, postage stamps and postage meters can be used to send any subclass of mail. Therefore, data collectors observe sampled mail pieces at USPS facilities, and, for each mail piece, gather data on its characteristics, including the revenue (i.e., the amount of postage) and weight.¹⁹ RPW data are used to calculate the revenue, volume, and weight of each subclass of mail.

As with IOCS, USPS modified RPW so that the subclass of mail could be determined more accurately through computerized analysis of detailed mail piece characteristics that are observed and recorded (see fig. 8). USPS pilot tested the new RPW approach, collecting RPW data in selected areas over a 1-year period using both the old and new data collection instruments. USPS compared the recorded data from these side-by-side tests and received feedback from field staff to refine the instrument, going through approximately 15 to 20 versions of the instrument. USPS has reported that this pilot testing method was the first of its kind for a major ratemaking data system.

¹⁹RPW data gathered by data collectors are merged with computerized data on business mailings, such as large mailings of bills, statements, catalogs, and magazines. These computerized data include information for each mailing on the subclass, revenue, volume, and weight. USPS refers to these combined data as RPW data.

Figure 8: Laptop Computer and Digital Scale Used to Record Ratemaking Data, Including Mail Piece Characteristics



Source: GAO.

USPS Conducted CCSTS to Replace Ratemaking Data That Had Been Collected in the 1980s

USPS conducted a new study called CCSTS to help attribute costs of city carriers—that is, letter carriers who deliver mail in highly populated urban and suburban areas where most deliveries are made to the door, curbside mailboxes, centrally located mailboxes, or cluster boxes. Data on city carrier delivery activities are needed for ratemaking because carriers typically deliver multiple subclasses of mail. USPS incurred about \$13 billion in employee costs for the street activities of city carriers in fiscal year 2004, which represented about one-fifth of USPS costs (see fig. 9). CCSTS replaced four special studies on city carrier street activities that had been conducted in the 1980s. The Study had criticized these special studies as outdated and imprecise. PRC and others had also criticized the age of the data collected by these special studies and the methodology of the studies. Recognizing the need for better data in this area, USPS conducted CCSTS in 2002. USPS has reported that CCSTS provided both more current and precise data, as well as a better methodological framework for analyzing city carrier costs than the four special studies that CCSTS replaced. USPS also has reported that CCSTS will be less costly to update than the four special studies that CCSTS replaced, thereby facilitating further updating of CCSTS in the future.

Figure 9: USPS City Carriers Performing Delivery Activities on the Street



Source: © 2005 USPS. Used with permission. All rights reserved.

Loading a mailbox (top left). Delivering a letter (top middle). Delivering packages (top right). Unloading a collection box (bottom left). Checking mail (bottom middle). Loading a cluster box (bottom right).

In developing CCSTS, USPS reported that it was mindful of several drawbacks of the four former special studies of city carrier street activities. First, USPS stated that the former special studies yielded inconsistent and incomplete data, explaining that they selectively reviewed different aspects of city carrier street activity, collected data at different times, and used different data collection methods. Therefore, USPS designed CCSTS as a single study to collect more complete and consistent data on all city carrier street activities. Second, the former special studies collected data that were not well suited for use with advanced data analysis techniques needed to produce ratemaking data. Therefore, USPS designed CCSTS to be compatible with advanced data analysis techniques. Third, the former special studies generated imprecise ratemaking data²⁰ for the costs of certain mail subclasses, largely because

²⁰Imprecise data are subject to a relatively high degree of random error, such as data that are imprecise because they are generated by data collected from a small random sample.

the expense of those studies had limited the quantity of data that was collected. Therefore, USPS designed CCSTS to collect a larger quantity of data so that its data would be more precise.

To develop CCSTS, USPS conducted a pilot study that tested CCSTS on a smaller scale. USPS used the pilot study results to refine CCSTS, which was conducted in May and June 2002. CCSTS randomly sampled over 160 ZIP Codes nationwide and recorded data during a 2-week period on the activities of more than 3,500 city carriers delivering mail to addresses in these ZIP Codes. USPS analyzed CCSTS data using advanced data analysis techniques involving econometric models and performing statistical tests to estimate how changes in mail volume affected city carrier street time and the associated costs. As a result of using CCSTS to replace the four former special studies, USPS reported that it attributed a somewhat higher percentage of city carrier street time costs to specific subclasses of mail (37 percent, up from 30 percent), thus diminishing the remaining institutional costs (63 percent, down from 70 percent). To understand why most carrier costs continue to be categorized as institutional, it is important to note that the universal service commitment to provide mail delivery requires carriers to traverse their routes each day, regardless of whether a particular subclass or volume of mail is being delivered.

USPS Took Actions to Improve the Precision of Ratemaking Data

The Study had raised concerns about the precision of ratemaking data, which are affected by the quantity of data collected from randomly sampled postal employees and pieces of mail, as well as by the precision of data on city carrier delivery activities. USPS reported that it took responsive actions by increasing the quantity of ratemaking data collected by RPW and TRACS, which are two of the five major data collection systems used for ratemaking. TRACS randomly samples long-distance mail transportation segments, such as airplane flights, truck trips, and trips of freight trains that carry mail. Data collectors observe a random sample of mail for each segment and record its characteristics, including the subclass of mail. TRACS data are used to help attribute about \$4 billion in USPS long-distance transportation costs (see fig. 10). According to USPS, the large increase in the quantity of RPW and TRACS data has improved the precision of ratemaking data. Increasing data precision can be particularly beneficial to the quality of cost, revenue, and volume data for subclasses of mail with smaller volumes.

Figure 10: Long-distance Transportation of Mail Using Trucks and Airplanes



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First, USPS increased the number of RPW tests from about 56,000 in fiscal year 2003 to about 136,000 in fiscal year 2004—an increase of 142 percent.²¹ USPS also revised the RPW sampling methodology, which according to USPS, resolved some technical issues identified by the Study and further contributed to data precision. According to USPS, these changes improved the precision of all RPW data as well as the precision of key ratemaking data for each subclass of mail. Second, USPS increased the number of transportation segments randomly sampled by TRACS each fiscal year from about 10,000 in fiscal year 2000 to about 17,000 in fiscal year 2004—an increase of 65 percent. USPS also reallocated the quantity of data collected for each mode of transportation (i.e., air, highway, and rail) to further increase the precision of subclass cost data. According to USPS, this change was responsive to the Study, which had found that the limited quantity of TRACS data collected for the highway transportation

²¹The increase in RPW sample size was enabled by USPS's concurrently merging RPW with an operations-oriented data system called the Origin-Destination Information System, which also collected data from sampled pieces of mail.

mode resulted in less precise ratemaking cost data, particularly for some subclasses of mail, such as Regular Rate Periodicals (e.g., news magazines) and Parcel Post.²²

In addition, as previously described, USPS designed CCSTS to yield more precise data by collecting a larger quantity of data than the data that CCSTS replaced. USPS noted that this change was responsive to the Study, which found that the four former special studies were highly imprecise.

USPS Took Actions to Enhance TRACS Documentation

USPS revised, updated, and expanded the documentation for TRACS, which USPS reported was responsive to the Study and was an area that USPS recognized needed improvement. According to USPS, the revised TRACS documentation improved the transparency and administration of this data collection system. The Study's report had found TRACS documentation to be deficient, particularly with respect to the documentation of TRACS sampling and estimation methodology. Consequently, the Study's team reported that, within the Study's time frame (June 1997 through April 1999), the team did not have the opportunity to understand some parts of the sampling design. The Study's report observed that the availability of improved documentation of TRACS estimation procedures is important and noted the need for clear and complete documentation on the TRACS sample design. The report further noted that once the TRACS sample design is completed, USPS should evaluate and adjust the sample to improve the precision of TRACS data.

USPS proceeded to expand TRACS sampling and estimation documentation and rewrote the handbook for TRACS data collection. The redone documentation was used in the 2000 rate proceedings, providing greater transparency of this data collection system, and was commended by PRC. USPS further revised TRACS documentation for the 2005 rate case. In addition, as previously described in this report, USPS also evaluated and adjusted the TRACS sample to improve the precision of TRACS data. Thus, USPS reported that the revised TRACS documentation enhanced the transparency and administration of this system.

²²The reallocation plan was developed with the aid of a statistical model to estimate data precision. This model had originally been developed for the Study.

Proposed Statutory Changes Could Lead to Better Ratemaking Data

The Presidential Commission and we have found that major changes are needed to the ratemaking process. In particular, the Presidential Commission found that the current ratemaking process is far too cumbersome and time consuming, with rate changes taking as long as 18 months.²³ The Presidential Commission concluded that the current ratemaking process creates “an impossible situation for an institution charged with the responsibility of acting in a businesslike manner.”²⁴ Our past work also reached a similar conclusion that “major changes are needed in this area,” and that improvements in the postal ratemaking structure will be a “fundamental component of a comprehensive transformation.”²⁵

Proposed postal reform legislation being considered in the 109th Congress (H.R. 22 and S. 662, 109th Cong., 1st Sess.) would create new oversight mechanisms and enhanced regulatory authority over the quality of ratemaking data. The postal regulator would be required to prescribe what ratemaking data USPS must annually report and review that data in order to determine whether USPS had complied with the requirements of the new ratemaking structure. The postal regulator would be provided with the authority to initiate proceedings to improve the quality of ratemaking data; the authority to subpoena USPS documents and officials; the authority to order USPS to take appropriate actions to comply with laws and its regulations; and the authority to impose sanctions for noncompliance, including fines for deliberate noncompliance. The postal regulator could obtain court orders to enforce its subpoenas, orders, and sanctions. The proposed legislative changes would address persistent problems under the existing statutory ratemaking structure, which, as we have reported, has enabled long-standing deficiencies in ratemaking data quality and unresolved methodological issues to persist. Thus, the proposed legislative changes would likely lead to improvements in the quality of ratemaking data. However, if postal reform legislation is enacted, the outcome would likely depend on how the postal regulator would use its discretion to define and implement the new ratemaking

²³The 18-month time frame for rate changes includes time for USPS to prepare its rate proposal, for PRC to review the proposal and issue its recommended decision (which the law generally limits to 10 months), and for USPS to consider PRC’s recommended decision and implement new postal rates.

²⁴President’s Commission on the United States Postal Service, *Embracing the Future*.

²⁵[GAO-04-108T](#).

structure. Key implementation questions would remain, including what regulatory criteria and requirements would apply to ratemaking data.

Major Changes Are Needed to the Ratemaking Process

The Presidential Commission concluded that for USPS to operate in a more businesslike fashion, its managers must have greater flexibility to manage and innovate, including in the ratemaking area. However, the Presidential Commission also stated that with this latitude comes the need for enhanced oversight from an independent postal regulator endowed with broad authority. Thus, the Presidential Commission concluded that the current ratemaking process should be abolished and replaced with a more streamlined structure that continues to impose rigorous ratemaking standards through independent regulatory oversight that would ensure that the outcome cannot be unduly influenced through the selective provision of information to the regulator. The Presidential Commission stated that the postal regulator must have access to the most reliable and current information possible to ensure financial transparency and enable the postal regulator to make fully informed determinations. To this end, the Presidential Commission recommended that the postal regulator have the authority to request accurate and complete financial information from USPS, including through the use of subpoena powers, if necessary.

We have also reported on how the statutory structure has led to persistent problems and issues regarding the quality of ratemaking data. Specifically, we found that the current ratemaking structure has poor incentives that impede progress in improving data quality, including the incentives described below:²⁶

- *Poor incentives to provide quality data:* Current law gives USPS opportunities to seek advantage in litigious rate cases by controlling what data are collected and how they are analyzed and reported. PRC cannot subpoena USPS or order USPS to collect or update data. For example, the Study found that key ratemaking data had not been updated for many years, but these data were used regardless of their obsolescence.
- *Poor incentives for resolving recurring issues:* Statutory due process rules have enabled parties to repeatedly litigate complex data quality and cost attribution issues that have previously been considered. In addition, as we have reported, the zero-sum nature of the break-even requirement

²⁶ [GAO-04-397T](#) and [GAO-04-108T](#).

provides powerful incentives for parties to repeatedly attempt to shift postal costs in ways that serve their self-interests.²⁷ Specifically, we have reported that when USPS proposes changes to domestic postal rates and fees, USPS (1) projects its “revenue requirement” for the “test year” (a fiscal year representative of the period of time when the new rates will go into effect), based on the total estimated costs plus a provision for contingencies, and a provision, if applicable, for the recovery of prior years’ losses²⁸ and (2) proposes rates and fees that are estimated to raise sufficient revenues to meet USPS’s revenue requirement. Thus, as the Institute of Public Administration reported more than a decade ago, “The current ratemaking structure is premised on the concept of a static pie, which represents the revenue requirement, and focuses on who is going to pay what share of the money (i.e., ratemaking is treated as a zero-sum game).”²⁹ The institute further reported that various interest groups have been organized that represent certain classes of mail in rate cases. These groups typically advocate cost attribution methods that are in their immediate self-interest, such as alternative methods that would result in fewer costs attributed to the class of mail they represent. USPS and private delivery firms have taken opposing positions on cost attribution methods for subclasses of mail, such as Priority Mail and Parcel Post. As a result, the same cost attribution issues have been debated for many years. Cost attribution issues are often a key reason why rate cases are so lengthy and litigious because these issues are complex and their disposition can directly affect postal rates. Although cost attribution issues are central to postal ratemaking, we have reported that the need to address such issues in every rate proceeding is inconsistent with providing USPS with greater flexibility to change rates under a streamlined ratemaking process.³⁰

Poor incentives to appropriate cost attribution: USPS has a disincentive to maximize the attribution of costs to specific subclasses of mail that must cover their costs because USPS loses pricing flexibility as more costs are attributed. Because ratemaking data and analyses of these data are

²⁷ [GAO-04-108T](#), p. 23.

²⁸ USPS did not include a provision for the recovery of prior years’ losses in the 2005 rate case because USPS had no such losses by the end of fiscal year 2004.

²⁹ Institute of Public Administration, *Report to the Board of Governors of the United States Postal Service: The Ratemaking Process for the United States Postal Service* (New York, NY: Oct. 8, 1991), p. 55.

³⁰ [GAO-04-108T](#), p. 25.

necessary to attribute costs, the quality of ratemaking data can affect the degree of cost attribution. In this regard, the PRC Chairman recently testified that the proposed postal regulator should have the means to examine all of the costs currently treated as institutional to assure Congress, USPS, and the public that all costs that can be attributed, are attributed. He concluded that “I believe there is room for improvement and would welcome the responsibility and authority to achieve it.”³¹

Proposed Requirements for Reporting Ratemaking Data

Proposed postal reform legislation would transform PRC into a new postal regulator mandated to issue regulations for USPS to annually report ratemaking data that would be audited by the USPS Inspector General and then reviewed by the regulator. Key provisions include the following:

USPS Reporting

The postal regulator would be required to issue regulations prescribing what ratemaking data USPS would be required to report (see table 1). Despite the quantity of material submitted in rate cases, PRC has reported that its ability to carry out its responsibilities has been hindered in some rate cases because of deficiencies in the completeness and accuracy of ratemaking data provided by USPS. For example, PRC reported that its ability to consider USPS proposed rates in the 1994 rate case was hindered because the supporting ratemaking data were deficient. PRC said USPS omitted data that had previously been provided in rate cases, such as new or updated studies of the sort that were necessary to develop rates for worksharing discounts that mailers receive in exchange for performing activities that are estimated to reduce USPS costs.³² As a result, PRC reported it was unable to develop worksharing discounts that tracked the associated USPS cost savings, which PRC reported should be based on current data to set appropriate discounts. PRC said that the absence of these studies was particularly significant because USPS operations had been in a state of major transition since the past rate case, but the former worksharing cost studies—and the worksharing discounts that had resulted—reflected former mail processing methods. In this regard, the proposed legislation would specifically require USPS to provide worksharing data on an annual basis—a requirement not included in

³¹Testimony of George Omas, Chairman, Postal Rate Commission, before the U.S. Senate Committee on Governmental Affairs (Washington, D.C.: Apr. 7, 2004), p. 10.

³²Mailer worksharing activities include barcoding mail, presorting mail by ZIP Code, and transporting mail so it is entered closer to the final destination. See GAO, *U.S. Postal Service: A Primer on Postal Worksharing*, [GAO-03-927](#) (Washington, D.C.: July 31, 2003).

current law. Further, the proposed legislation would provide the postal regulator with enhanced authority to obtain these data if USPS does not initially provide them. Specifically, the postal regulator would be provided with subpoena power and the power to obtain court orders to compel USPS compliance with the reporting requirements—powers not provided to PRC by current law. The proposals for enhanced regulatory authority are discussed further later in this report.

Table 1: Proposed Requirements for USPS to Report Ratemaking Data

Citation	Summary provision
H.R. 22, Sec. 204, §3652; and S. 662, Sec. 204, §3652 (similar provisions: differences noted in italics)	<p>USPS shall file annual reports with the Postal Regulatory Commission (the Commission) no later than 90 days after the end of each fiscal year that, for all permanent postal products:</p> <ul style="list-style-type: none"> • analyze costs, revenues, and rates for all products <i>using such methodologies as the Commission shall by regulation prescribe (House bill)</i> in sufficient detail to demonstrate that the rates in effect for all products during such year complied with all applicable requirements; • <i>provide product information (Senate bill) provide market information (House bill)</i> and mail volumes, for each market-dominant product; and • provide for each worksharing discount to market-dominant products: (1) the per-item cost avoided by USPS by virtue of such discount, (2) the percentage of such per-item cost avoided that the per-item discount represents, and (3) the per-item contribution made to institutional costs. <p>For experimental postal products in market tests (e.g., new products being tested), USPS's annual report may include summary data on the costs, revenues, and quality of service by market test <i>and service agreement (Senate bill)</i> and such data as the Commission requires.</p> <p>The Commission shall, by regulation, prescribe the content and form of the annual reports, including any nonpublic annex and supporting matter, giving due consideration to</p> <ul style="list-style-type: none"> • providing the public with <i>timely (Senate bill)</i> adequate information to assess the lawfulness of rates charged, • avoiding unnecessary or unwarranted administrative effort and expense by USPS, and • protecting the confidentiality of commercially sensitive information. <p>The Commission shall have access, in accordance with such regulations as it shall prescribe, to the working papers and any other supporting matter of USPS and its Inspector General in connection with any information submitted in the above reports.</p>

Sources: H.R. 22 and S. 662, 109th Cong., 1st Sess.

Another benefit of the proposed reporting requirements would likely be the end of a long-standing methodological dispute in which USPS prepares two sets of cost data for each regulatory proceeding—one according to its preferred methodology for analyzing mail processing costs, and one

according to PRC's preferred methodology for analyzing these costs.³³ The different methods produce different estimates for USPS savings resulting from worksharing discounts that currently apply to three-quarters of total mail volume, and thus the choice of analysis method could affect these discounts. The current statutory ratemaking structure allows this dispute to continue because it provides due process by enabling all interested parties to raise whatever issues they wish, regardless of how many times the same issues may have been considered in the past. USPS can repeatedly raise issues by building them into its initial proposals for changes to postal rates. For example, USPS has repeatedly submitted proposed rates based on its preferred analysis method for mail processing costs into its rate proposals, even though PRC has repeatedly rejected USPS's method. In each rate proceeding, USPS also submitted parallel data using the PRC analysis method, and both sets of data were considered by PRC and other stakeholders participating in the rate cases. The proposed requirements could resolve similar situations by mandating that the postal regulator issue regulations for how USPS cost, revenue, and rate data are to be analyzed in order to demonstrate compliance with ratemaking requirements, including newly proposed statutory requirements for worksharing discounts (see app. III for a listing of proposed ratemaking requirements). In this regard, the House bill is the most specific in that it requires the postal regulator to prescribe methodologies for analyzing ratemaking data. Further, both bills would eliminate current statutory rules for due process and stakeholder involvement in rate proceedings; the postal regulator would be given the flexibility to establish new rules in this area under its regulatory authority.

Auditing by the Inspector General

The proposed legislation would require the USPS Inspector General to audit the ratemaking data included in the USPS annual reports (see table 2). For example, under the House bill, the USPS Inspector General would be required to regularly audit USPS data collection systems and procedures used to prepare the annual reports. In contrast to the proposed requirements for regular Inspector General oversight of these USPS data collection systems, the current ratemaking structure relies on ad hoc regulatory oversight conducted during rate cases that only USPS can initiate. Specifically, since the Postal Reorganization Act of 1970 was

³³As we have reported, USPS and PRC differ over the level of mail processing costs that should be attributed, which can affect postal rates, particularly for types of mail priced at cost (e.g., the Periodicals class that includes mailed magazines and newspapers). See [GAO-04-108T](#), p. 32.

enacted, USPS has initiated 13 rate cases in the past 34 years, including the 2005 rate case. For example, the 2005 rate case was preceded by the 2001 rate case that resulted in a negotiated settlement, which resulted in limited regulatory review of USPS ratemaking data and its data collection systems. When USPS filed the 2005 rate case, it requested expedited review to consider a proposed settlement, which, if accepted, could again result in limited regulatory review of USPS ratemaking data and data collection systems.

Thus, the case-by-case approach to reviewing ratemaking data quality under the current ratemaking structure, combined with the infrequency of these reviews, has limited oversight of USPS ratemaking data and its data collection systems that generate these data. When oversight has occurred, the 10-month statutory deadline for rate cases, combined with the time and expense of litigating data quality issues, has limited the scope and depth of the data quality issues reviewed in rate cases. In our view, such limited external oversight is one reason why problems with the quality of ratemaking data have persisted. For example, in the 1994 rate case, PRC called for an examination of USPS costing systems used for ratemaking, especially IOCS, citing methodological concerns, reductions in the quantity of ratemaking data that USPS collected, and major changes in USPS operations, among other things. In spring 1995, then PRC Chairman Edward Gleiman testified before the former House Subcommittee on the Postal Service about his concerns regarding the quality of ratemaking data. This led to the Chairman of that Subcommittee, Representative John M. McHugh, requesting the Data Quality Study. The request for the Study, its progress, and USPS follow-up have been the subjects of continuing congressional oversight over the past decade. The Study validated the need for improving IOCS and other USPS data collection systems and special ratemaking studies. To USPS's credit, USPS reports making major efforts that were responsive to the Study. However, the congressional oversight provided by the Study was not envisioned by the Postal Reorganization Act of 1970, which separated Congress from the ratemaking process.³⁴ The Study was a unique event that required extraordinary involvement by Congress, USPS, PRC, and the contractor that conducted the Study.

³⁴Congress directly established postal rates prior to enactment of the Postal Reorganization Act of 1970 (Pub. L. No. 91-375).

Table 2: Proposed Statutory Requirements for the USPS Inspector General to Audit Ratemaking Data and Data Collection Systems

Citation	Summary provision
H.R. 22, Sec. 204, §3652(a)	The USPS Inspector General (USPS IG) must regularly audit the data collection systems and procedures used in collecting information and preparing the USPS annual reports (described in table 1), including any annex to these reports and the required information relating to worksharing discounts included in the reports. The results of any such USPS IG audit shall be submitted to USPS and the Postal Regulatory Commission.
S. 662, Sec. 204, §3652(a)	Before submitting an annual report (described in table 1), including any annex to the report and the required information relating to worksharing discounts, USPS shall have the information contained in such report and annex audited by the USPS IG. The results of any such audit shall be submitted along with the report to which it pertains.

Sources: H.R. 22 and S. 662, 109th Cong., 1st Sess.

Compliance review

Under the proposed legislation, the postal regulator would be required to annually review USPS ratemaking data reports and determine whether USPS had complied with the requirements of the new ratemaking structure (see table 3). In cases of noncompliance, the postal regulator would be required to order USPS to take appropriate action. Regulatory compliance reviews would be a critical element of the new ratemaking structure, which is intended to balance increased USPS ratemaking flexibility with enhanced transparency, oversight, and accountability.

Specifically, under the proposed legislation, the postal regulator would be charged with developing a new, streamlined ratemaking process that provides USPS with additional flexibility. The mandated compliance reviews would (1) verify that USPS rates are in compliance with applicable requirements on an annual basis and (2) require regulatory action to correct any instances of noncompliance. For example, the proposed legislation would require each USPS competitive product (e.g., Express Mail and Priority Mail) to cover its attributable costs. In order for the postal regulator to verify compliance with this cost-coverage requirement, data would be needed on the attributable costs and revenues of each USPS competitive product. The quality of this ratemaking data would be vital because the regulator would be required to address instances of noncompliance through certain actions, such as ordering USPS to adjust the rate of a competitive product that was not covering its costs or even to discontinue providing the loss-making product.

In contrast with current law, which depends on having USPS initiate rate cases for regulatory action to occur, the proposed compliance process triggers annual regulatory action based on actual results for each fiscal

year. For example, under current law, the requirement that each subclass of mail cover its costs is addressed in rate cases—which can be years apart from each other. Because postal revenues and costs change over time, a subclass of mail may not cover its costs in some years between rate cases. This situation may not be addressed until the next rate case. As previously described, the proposed legislation specifies that if a subclass of mail fails to cover its annual costs as required, the postal regulator would be required to order USPS to take appropriate action to come into compliance. The postal regulator would have the specific authority to order USPS to change the postal rates for that subclass of mail so that its revenues would begin to cover its costs.

Table 3: Proposed Compliance Review of USPS Annual Reports

Citation	Summary provision
H.R. 22, Sec. 204, §3653; and S. 662, Sec. 204, §3653 (Similar provisions: differences noted in italics)	After receiving the USPS annual reports with ratemaking data (see table 1), the Postal Regulatory Commission (the Commission) shall promptly provide an opportunity for comment on such reports by users of the mails, affected parties, and an officer of the Commission who must represent the interests of the general public. No later than 90 days after receiving these reports, the Commission shall make a written determination as to whether any rates or fees in effect during the year (for products individually or collectively) were not in compliance with applicable laws or regulations. <ul style="list-style-type: none"> • If no instance of noncompliance is found, the written determination shall be to that effect. • If a timely written determination of noncompliance is made, the Commission shall take appropriate <i>remedial (Senate version)</i> action as if a complaint averring such noncompliance had been duly filed and found to be justified. (See table 5 for actions that would be available to the Commission.)

Sources: H.R. 22 and S. 662, 109th Cong., 1st Sess.

Proposed Requirements for Data Quality Proceedings

Proposed postal reform legislation would authorize the postal regulator to initiate proceedings to improve the quality of ratemaking data, including data on the attribution of costs and revenues to postal products (see table 4). This mechanism would be needed because the legislation would abolish the current statutory ratemaking process, which has been the primary mechanism for oversight of data quality issues.³⁵ Authorizing the postal regulator to initiate data quality proceedings as needed would shift

³⁵Some data quality issues have also been considered during classification cases, which consider establishing or changing the groupings of mail that are subject to ratemaking requirements, as well as authorizing market tests of experimental products and negotiated service agreements (39 U.S.C. §3623 and 39 C.F.R. Part 3001, subpart C). Aside from rate and classification cases, USPS has opposed separate proceedings on issues of cost attribution methodology, and PRC has not conducted such proceedings.

from reactive oversight in USPS-initiated rate proceedings to proactive oversight by the postal regulator.

Table 4: Proposed Authorization for Regulatory Proceedings to Improve Data Quality

Citation	Summary provision
H.R. 22, Sec. 204, §3652(e)(2); and S. 662, Sec. 204, §3652(e)(2) (same provision in both bills)	<p>The Postal Regulatory Commission (the Commission) may, on its own motion or on request of an interested party, initiate proceedings—to be conducted in accordance with regulations that the Commission shall prescribe—to improve the quality, accuracy, or completeness of USPS data required by the Commission in USPS’s annual reports (see table 1) whenever it shall appear that</p> <ul style="list-style-type: none"> • the attribution of costs or revenues to products has become significantly inaccurate or can be significantly improved; • the quality of service data has become significantly inaccurate or can be significantly improved; or • such revisions are, in the judgment of the Commission, otherwise necessitated by the public interest.

Sources: H.R. 22 and S. 662, 109th Cong., 1st Sess.

The proposed statutory mechanism to consider data quality and related cost attribution issues has a number of potential benefits, including the following:

- *Providing a mechanism for considering data quality issues with adequate time and attention:* In rate cases, PRC reviews comprehensive proposals, voluminous documents, and complex issues, leaving limited time to consider data quality and related cost attribution issues. As USPS’s General Counsel has acknowledged, it is difficult for rate case participants to handle cost attribution issues involving ratemaking data and other issues within the statutory 10-month time frame for rate cases.
- *Revisiting data quality issues as needed:* Data quality is a moving target as postal operations, data needs, and data collection technologies evolve over time.³⁶ Thus, it is natural for data quality issues and opportunities for improvement to arise over time.

Proposed Enhancement of Regulatory Authority and Enforcement Powers

Providing the postal regulator with enhanced authority and enforcement powers is consistent with the overall intent of the proposed postal reform legislation to balance providing USPS with greater pricing flexibility with enhancing transparency, oversight, and accountability to protect USPS

³⁶Kearney, *Data Quality Study: Summary Report*, p. 5.

customers and competitors. Under the proposed postal legislation, the postal regulator would be provided with enhanced authority and enforcement powers compared with those of PRC. Specifically, the postal regulator would be provided with the authority to order USPS to take appropriate actions to comply with laws and its regulations and could impose sanctions for noncompliance, including fines for deliberate noncompliance (see table 5).

Table 5: Proposed Authority for the New Postal Regulator and Related Provisions

Citation	Summary provision
H.R. 22, Sec. 502; and S. 662, Sec. 602 (same provision in both bills)	<i>Subpoena power:</i> The Chairman of the Postal Regulatory Commission (the Commission), any of the Commissioners designated by the Chairman, and any administrative law judge appointed by the Commission could subpoena USPS officers, employees, contractors, and agents to require attendance, presentation of testimony and production of documents, and order depositions and responses to written interrogatories. Any subpoena would require the written concurrence of a majority of Commissioners then holding office in advance of its issuance.
H.R. 22, Sec. 205, §3663-3664, Sec. 502; and S. 662, Sec. 205, §3663-3664, Sec. 602 (same provision in both bills)	<i>Appellate review:</i> Within 30 days after the Commission issues a final order or decision, parties that are adversely affected or aggrieved may appeal to the U.S. Court of Appeals for the District of Columbia. <i>Enforcement of orders:</i> U.S. district courts have jurisdiction to enforce, enjoin, and restrain USPS from violating any order issued by the Commission. <i>Enforcement of subpoenas:</i> In case of contumacy or failure to obey a subpoena, upon application of the Commission, the district court of the United States for the district in which the person to whom the subpoena is addressed resides or is served may issue an order requiring such person to appear at any designated place or provide documentary or other evidence. Any failure to obey the court may be punished by the court as a contempt thereof.
H.R. 22, Sec. 205, §3662; and S. 662, Sec. 205, §3662 (same provision in both bills)	<i>Regulatory authority for rate and service complaints:</i> When the Commission finds that rate and service complaints (which also can be submitted by an officer of the Commission representing the interests of the general public) are justified, it shall order USPS to take such action as the Commission considers appropriate in order to achieve compliance with the applicable requirements and to remedy the effects of any noncompliance, such as ordering unlawful rates to be adjusted to lawful levels, ordering the cancellation of market tests, ordering USPS to discontinue providing loss-making products, or requiring USPS to make up for revenue shortfalls in competitive products. <i>Regulatory authority to impose fines:</i> In cases of deliberate USPS noncompliance with regulatory requirements, the Commission may order, based on the nature, circumstances, extent, and seriousness of the noncompliance, a fine (in the amount specified by the Commission) for each incidence of noncompliance. Fines resulting from the provision of competitive products shall be paid out of the USPS Competitive Products Fund. ^a All receipts from fines imposed shall be deposited in the general fund of the U.S. Treasury.

Sources: H.R. 22 and S. 662, 109th Cong., 1st Sess.

^aThe Competitive Products Fund would fund the costs related to USPS's competitive products (H.R. 22, Sec. 301; and S. 662, Sec. 401). For a list of these competitive products, see H.R. 22, Sec. 202, §3631; and S. 662, Sec. 202, §3631.

Regulatory orders could result from the required annual compliance reviews of ratemaking data conducted by the postal regulator, previously discussed, or from complaints that could be initiated by the regulator or any interested party. The federal courts would enforce the postal regulator's orders and sanctions. The postal regulator would be provided with subpoena power. The regulator's subpoenas would be enforced by federal courts, which could punish noncompliance as a contempt of court.

In contrast to the proposed legislation, PRC has limited authority and enforcement powers under the current statutory structure. PRC cannot unilaterally order USPS to take actions to comply with its regulations, cannot fine USPS, and does not have subpoena power to compel USPS to provide PRC with documents and data or to compel the testimony of USPS officials. Absent such explicit statutory authority, PRC has resorted to repeatedly requesting that USPS take action to improve the quality of ratemaking data, but its efforts have been met with mixed results. As PRC Chairman George Omas recently testified:

"Past Postal Rate Commission decisions have frequently contained requests for additional data and analysis in specific areas. Sometimes these requests were honored but all too often they have been ignored. Under the existing statute the Commission does not have the authority to compel USPS to collect specific data or perform needed studies."³⁷

Possible Implications of Proposed Postal Reform Legislation for the Quality of Ratemaking Data

The proposed legislative changes previously described would address persistent problems under the existing statutory structure, which, as we have reported, has enabled long-standing deficiencies in ratemaking data quality and unresolved methodological issues to persist.³⁸ Under the current structure, regulatory oversight is conducted during rate cases that only USPS can initiate, which has limited the frequency, scope, and depth of oversight of USPS ratemaking data and its data collection systems that generate these data. The legislation would eliminate key disincentives for ratemaking data quality, including the litigious ratemaking process (which provides incentives for USPS and others to gain an advantage through the collection and analysis of ratemaking data), the break-even requirement that creates incentives to shift costs from one subclass of mail to another, and the lack of adequate oversight mechanisms to address data quality

³⁷Testimony of George Omas, Chairman, Postal Rate Commission, before the U.S. Senate Committee on Governmental Affairs (Washington, D.C.: Apr. 7, 2004), p. 9.

³⁸[GAO-04-108T](#) and [GAO-04-397T](#).

issues. The legislation also would enhance regulatory authority so that the necessary transparency, oversight, and accountability can take place regarding ratemaking data quality. Thus, the proposed legislative changes would likely lead to improvements in the quality of ratemaking data over time and at some cost.

However, if postal reform legislation is enacted, the outcome would likely depend on how the postal regulator would use its discretion to define and implement the new ratemaking structure. Key implementation questions would remain, including what regulatory criteria and requirements would apply to ratemaking data. Should the legislation be enacted, implementation will be critical to achieving the intended results because the legislation would provide the postal regulator with great flexibility to establish the new ratemaking structure and implement provisions relating to data quality. This flexibility would enable the postal regulator to deal with changing circumstances, but it also creates substantial uncertainty and risks. Key implementation questions might include the following:

- What criteria would the new postal regulator use for evaluating the quality, completeness, and accuracy of ratemaking data?
- To what extent can USPS costs be rationally attributed to postal products and services, in accordance with sound economic principles?
- How would the postal regulator balance the need for high-quality ratemaking data with the time and expense involved in obtaining the data?
- How would any proceedings to improve the quality of ratemaking data be structured by the postal regulator? How could USPS and other stakeholders participate in such proceedings?
- Could the postal regulator use its enhanced authority over ratemaking data to require USPS to collect and/or update specific ratemaking data? If so, would that include regulatory authority over the quantity of data collected and the methods of data collection (e.g., in-person data collection v. telephone data collection)?

Agency Comments and Our Evaluation

We received written comments on a draft of this report from the Chairman of the Postal Rate Commission in a letter dated July 18, 2003, and the Controller and Vice President of the U.S. Postal Service via e-mail on the same date. Their comments are summarized below, and the PRC Chairman's comments are reproduced as appendix II. In addition, PRC and

USPS officials provided technical and clarifying comments, which were incorporated where appropriate.

USPS's Controller did not comment on the draft report's findings in the section on key USPS actions to improve the quality of ratemaking data, but she noted that USPS has a long history of working to improve data quality. She explained that USPS has worked to develop and improve its data systems in ways that have been beneficial to improving the overall quality and reliability of ratemaking data. However, she made some comments that disagree with the draft report's findings in the section on the possible implications of postal reform legislation for ratemaking data quality. First, she said that: "The Postal Service considers that its current ratemaking process has worked remarkably well for the past 30 years, since the Postal Service's first postal rate change" under the Postal Reorganization Act of 1970. Second, she said that USPS ratemaking data systems produce data of "world-class quality," explaining that "no other postal system's rates are better or more extensively supported by reliable and objective financial and operations data." Third, she concluded that:

"In light of the record of success under the current system, the proposed legislation relating to the requirements for reporting ratemaking data in practice is not likely to lead to the breakthrough improvements in the quality of the ratemaking data systems without a significant increase in costs to the stakeholders. [USPS is] concerned, furthermore, that the proposed legislative changes may sacrifice the checks and balances and the effective process of data review and refinement that have evolved under the current system."

We disagree with USPS's first comment that the current ratemaking process has worked "remarkably well" since postal reorganization. We continue to believe that major changes are needed to the ratemaking structure. As described in our report, the current ratemaking structure has enabled long-standing deficiencies in ratemaking data quality to persist. Further, we have reported that the ratemaking process is a litigious, costly, and lengthy process that can delay needed new revenues. In this regard, USPS's comments appear to be inconsistent with the April 14, 2005, testimony of the Postmaster General that "today's ratemaking process is both costly and time consuming" and needs major change, as well as the numerous criticisms that USPS has made of the ratemaking process over the years. We continue to believe that comprehensive postal reform legislation is urgently needed, including improvements to the regulation and oversight of postal rates. Second, we believe the need for reform is not diminished by comparisons of ratemaking data quality with that of foreign postal administrations, which have different regulatory environments. Indeed, some foreign countries that are implementing

postal reform are grappling with the need to improve ratemaking data quality. In our view, it is more appropriate to consider what level of ratemaking data quality is appropriate for the United States.

Third, regarding USPS's views about achieving "breakthrough improvements" in ratemaking data quality, in our view, the proposed legislative changes would likely lead to improvements in the quality of ratemaking data over time and at some cost. The extent of such improvements, and what the associated costs may be, would depend on how the legislation is implemented. In our view, enhanced regulatory authority over ratemaking data would enable the necessary transparency, oversight, and accountability in this area. Ratemaking data are fundamental to setting postal rates that touch the lives of all Americans and affect the financial viability of USPS and the mailing industry. These data are essential to establishing fair and equitable rates.

In comments on our draft report, the PRC Chairman said that the report had clearly presented USPS actions taken with respect to the Study recommendations. He commended USPS for taking steps to improve its ratemaking data systems and the data upon which postal rates are based. At the same time, he expressed concerns about ratemaking data quality and said that USPS can and should be taking more action to improve the quality of ratemaking data. He also said that the report aptly summarizes the potential of postal reform legislation to improve ratemaking data quality.

The PRC Chairman said USPS had not addressed many significant potential sources of systematic error in its ratemaking data systems, including IOCS. He explained that USPS had not addressed issues of systematic error in IOCS data that have been a major concern in prior rate cases. He also said that IOCS data had become less precise due to reductions in the quantity of IOCS data implemented prior to the Study. He also expressed concerns regarding the precision of TRACS data, while complimenting USPS for improving the precision of RPW data. On another matter, he expressed concerns regarding the quality of mail processing data produced by the Management Operating Data System (MODS) that the Study did not assess. Regarding postal reform, he said that the proposed legislation reflects a consensus within the postal community that new tools are needed to increase USPS's financial transparency. He concluded that PRC agreed that the proposed legislative changes would likely lead to improvement in the quality of ratemaking data.

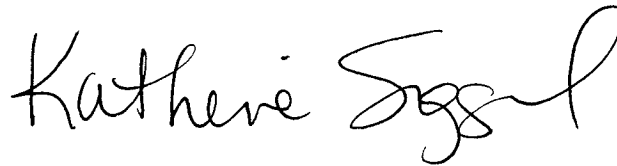
To put PRC comments about the IOCS data precision into context, the Study found that the reductions in IOCS sample size resulted in a minimally lower level of precision in overall subclass cost estimates and made no recommendations on the quantity of IOCS data that should be collected in the future. However, the Study did raise concerns about the precision of some ratemaking data, and USPS's responsive actions are described in our report. Looking ahead, we encourage USPS and PRC to work together—as they did during the Study—to better understand technical issues regarding data precision, using a statistical model that the Study developed to assess data precision that USPS is working to refine. More generally, we encourage USPS and PRC to use every opportunity to maximize progress on improving the quality of ratemaking data, such as working to improve data quality outside the ratemaking process. As the Study concluded: “Providing sufficiently complete and accurate data for ratemaking is an evolutionary process that requires the Postal Service to continually improve the quality of its ratemaking data and related data systems.”

Regarding PRC's comments on MODS data issues, they were outside the scope of our report, which focused on ratemaking data systems, city carrier cost data, documentation, and data precision that were assessed by the Study. These issues are part of a broader set of mail processing cost issues that PRC and USPS have long disagreed over. Current law allows this disagreement and others to continue by enabling all interested parties to raise whatever issues they wish in rate cases, regardless of how many times the same issues may have been considered in the past. However, as previously discussed, the legislation would likely lead to resolution of this long-standing methodological dispute.

We are sending copies of this report to the Ranking Minority Member of the House Committee on Government Reform, the Chairman and Ranking Minority Member of the Senate Committee on Homeland Security and Governmental Affairs, Senator Thomas R. Carper, the Postmaster General, the Chairman of the Postal Rate Commission, and other interested parties. We will make copies available to others on request. This report will also be available on our Web site at no charge at <http://www.gao.gov>.

If you have any questions about this report, please contact me at (202) 512-2834 or at siggerudk@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report included Gerald P. Barnes,

Assistant Director; Kenneth E. John; Anna Bonelli; Kevin Bailey; Jay Cherlow; Karen O'Connor; Richard Rockburn; and Walter Vance.

A handwritten signature in black ink that reads "Katherine Siggerud". The signature is written in a cursive, flowing style.

Katherine A. Siggerud
Director, Physical Infrastructure Issues

Appendix I: Objectives, Scope, and Methodology

Our objectives were to (1) describe key U.S. Postal Service (USPS) actions that were responsive to the 1999 Data Quality Study (the Study) to improve the quality of ratemaking data and (2) discuss possible implications of postal reform legislation for ratemaking data quality.

To address the first objective, we identified key USPS actions taken that USPS reported were responsive to the Study by reviewing the Study's report that prioritized its findings; reviewing USPS and Postal Rate Commission (PRC) documents, including USPS progress reports that prioritized actions and PRC documents that summarized concerns about data quality; and interviewing USPS officials responsible for collecting ratemaking data. We focused our work primarily on USPS's key actions to enhance three of its five major data collection systems used for ratemaking because the Study's report noted that these systems had opportunities for improvement. The three systems include the In-Office Cost System (IOCS), which produces data on the time that postal employees spend handling each subclass of mail in postal facilities; the Revenue, Pieces, and Weight (RPW) system, which produces data on the revenue, volume, and weight of each subclass of mail; and the Transportation Cost System (TRACS), which produces data on long-distance transportation of mail subclasses using trucks, airplanes, and freight trains.¹ To put IOCS into context, as previously noted, in fiscal year 2004, USPS incurred about \$28 billion in personnel costs for employees working in postal facilities (mail processing, retail, delivery unit, and other facilities), which comprised more than one-third of USPS costs of about \$66 billion for the fiscal year. To put TRACS into context, TRACS was used to help attribute about \$4 billion in fiscal year 2004 costs for long-distance transportation of mail using trucks, airplanes, and freight trains. We also focused our work on another USPS key action to conduct a new special study to replace four USPS special studies because the Study's report found that data collected by these studies needed improvement. USPS's new special study is called the City Carrier Street Time Study (CCSTS), which produced data on the activities of city carriers—that is, letter carriers who deliver mail in highly populated urban and suburban areas where most deliveries are made to the door, curbside mailboxes, centrally located mailboxes, or cluster boxes. We did not assess the extent to which USPS's actions affected the quality of these ratemaking data. Aside from

¹The Study identified relatively minor concerns regarding the other two major data collection systems used for ratemaking, which are the City Carrier Cost System and the Rural Carrier Cost System. These systems produce data on the volumes of mail subclasses that are delivered and collected by carriers.

these ratemaking data, we included some USPS data in this report for background purposes, such as audited USPS accounting data on total USPS costs and revenues for fiscal year 2004, data on USPS personnel costs, and USPS estimates of budgeted costs for collecting ratemaking data in fiscal year 2005.

We obtained information to describe the key actions taken by USPS by reviewing relevant documents, including USPS documents previously listed and additional USPS documents not submitted in rate cases, such as documentation of IOCS changes that were implemented in October 2004. We also requested and received USPS documentation of many of the reported improvements made to IOCS, RPW, and TRACS as well as interviewed USPS officials responsible for these systems. To gain an understanding of how the ratemaking data are collected, we visited some USPS mail processing facilities and post offices located in the Washington, D.C., area to observe the collection of ratemaking data, including IOCS, RPW, and TRACS data. These locations were judgmentally selected on the basis of the availability of USPS data collection personnel and their geographic proximity to our headquarters in Washington, D.C. Further, at post offices, we observed activities of letter carriers picking up their mail and organizing it for delivery, as well as delivering the mail on the street.

To address the second objective, we reviewed proposed postal reform legislation, current postal laws and regulations, and other documents. Specifically, we drew from our past work in this area, reviewed the proposed legislation (H.R. 22 and S. 662, 109th Cong., 1st Sess., both entitled the Postal Accountability and Enhancement Act) and documents pertinent to legislative intent, such as records of hearings and past versions of the legislation with accompanying committee reports. We reviewed current federal postal laws and regulations, including USPS and PRC regulations pertinent to ratemaking data quality, and other relevant documents, including documents submitted in past rate cases and other PRC proceedings on data quality issues. We also reviewed the report of the President's Commission on the United States Postal Service, past studies of the ratemaking process by other organizations, and books and articles on ratemaking data quality issues.

We conducted our review at USPS headquarters, in Washington, D.C., and the Capital Metro area from June 2004 through July 2005.

Appendix II: Comments from the Postal Rate Commission



POSTAL RATE COMMISSION

Washington, DC 20268-0001

George A. Omas
Chairman

July 18, 2005

Ms. Katherine A. Siggerud
Director, Physical Infrastructure Issues
United States Government Accountability Office
Washington, DC 20548

Dear Ms. Siggerud:

Thank you for the opportunity to review your proposed report *U.S. Postal Service: Improving Ratemaking Data Quality Through Postal Service Actions and Postal Reform Legislation (GAO Draft Report)*. The quality of rate setting and the speed with which it can be accomplished, depends to a large degree on the quality and availability of data. Your report clearly presents the actions taken by the United States Postal Service in response to some of the recommendations made in the April 1999 *Data Quality Study (Study)* prepared in response to a request of the House of Representatives Committee on Government Reform Subcommittee on Postal Service. It aptly summarizes, as well, the potential of postal reform legislation to improve ratemaking data quality.

Your report focuses on four specific data systems used in ratemaking: the In-Office Cost System (IOCS); the Revenue, Pieces, and Weight system (RPW); the new City Carrier Street Time Study (CCSTS); and the Transportation Cost System (TRACS). The Postal Service is to be commended for taking steps to improve these systems and the data upon which postal rates are based.

In Office Cost System. Regarding the IOCS, the *Study* focused on the problem of the large proportion of ambiguous tallies on which the system has come to rely. It concluded that

[t]he major difficulty with IOCS is the allocation of the time spent processing mixed-mail and non-handling tasks. This issue has grown rapidly in recent years to become very substantial because of the increase in automation.

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Data Quality Study Technical Report #2 – Statistical Analysis of Data Quality Issues, April 16, 1999, at 43. The *Study* recommended two alternative ways to deal with this problem: (1) replace the IOCS with a new sampling system designed to provide subclass distribution keys that are specific to each MODS cost pool, or, (2) retain IOCS with additional sub-sampling of mixed mail and non-handling tallies.

The Postal Service has rejected the first alternative, concluding that piece handlings is the appropriate cost driver/distribution key for each modeled MODS pool, and that the IOCS tallies are an adequate proxy for piece handlings. While it has not ruled out the second alternative, it apparently has not yet pursued sub-sampling of mixed mail and not-handling tallies. See Docket No. R2005-1, Institutional Response of United States Postal Service to Interrogatory of Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association Inc., Redirected from Witness Shaw (VP/USPS-T2-30). For now, the Postal Service has chosen to refine the traditional IOCS approach by implementing a standardized script for its survey instrument, and by utilizing computerized analysis to better identify the subclasses sampled. These changes focus on making direct tallies more accurate, but they do not address the system's reliance on mixed-mail and not handling tallies. Nor do they address significant issues of non-sampling errors in the administration of the IOCS that have been a major concern in prior rate cases.

The refinements to IOCS discussed in your report apparently did not take effect until fiscal year 2005 and therefore are not reflected in the historical data that supports the current rate filing (Docket No. R2005-1). Although it did provide two briefings to Commission staff as changes were being studied, the Postal Service has not informed the Commission or the public of the specific nature of the refinements to the IOCS that it ultimately put in place. As a result, the Commission does not have the information necessary to verify that improvements in accuracy and precision have actually been achieved.

If the Postal Service expects that its refinements to the IOCS will make mail processing cost estimates more precise, the results should be put in context. The *Study* used percentage coefficients of variation (CVs) as the preferred measure of precision in cost estimation. For claims of improvement to be properly assessed, it is important to identify the benchmark from which the improvements in precision are measured. In 1993, the Postal Service greatly reduced the number of IOCS tallies (by 35 to 40 percent, see Docket R94-1, Opinion and Recommended Decision, paragraph 3023). This action was one cause of the mailing community's concern about data quality that led to the commissioning of the *Study* itself.

The effect of reducing the size of the IOCS sample can be seen by comparing the CVs associated with IOCS tallies in FY 1989, before the sample

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was reduced, with CVs associated with FY 1993 tallies, after the sample was reduced.

**COMPARISON OF CLERK-MAILHANDLER IOCS
PERCENTAGE COEFFICIENTS OF VARIATION**

<u>Subclass/Mail Category</u>	<u>FY 1989</u> (1)	<u>FY 1993</u> (2)	<u>FY 2004</u> (3)
1 First- Class Letters & Sealed Parcels	0.22%	0.63%	0.73%
2 First-Class Presort Letters & Parcels	0.67%	1.41%	3.68%
3 Priority Mail	1.34%	2.19%	1.56%
4 Express Mail	1.51%	4.41%	3.06%
5 Periodicals -Within County	3.95%	6.09%	13.58%
6 Parcel Post	2.41%	3.57%	3.31%
7 Bound Printed Matter	3.40%	4.86%	5.43%

Source: Col. 1 from Docket No. R90-1, Direct Testimony of Ross Bailey, Table 5, Col. 2/Col.1 ; Col.2 from Docket No. R94-1, Direct Testimony of Ronald Steele, Table 9; Col.3 from Docket No. R2005-1, Direct Testimony of Robert Shaw, Table 1.

To facilitate comparison, the subclasses and mail categories listed in the above table existed in the same form in the years shown.

The deterioration of the CVs was general and substantial by FY 1993. As of FY 2004, they generally had not recovered. It is too soon to assess the degree of improvement that may result from the 2005 refinements that the Postal Service has made to the IOCS, since only the Postal Service has access to that data at this time. Since the refinements will be fully implemented for the first time in 2005, it may be appropriate for GAO to report in 2006 on the effect the changes have on the precision of IOCS-based cost estimates. When the degree of improvement is assessed, however, it should be with reference to the CVs that were obtained before 1992 as well as after.

Revenue, Pieces, and Weight. Your report states that the Postal Service made changes to the RPW that were similar to the changes made for IOCS, and that it also increased the size of the RPW sample by 142 percent. As you note this increase in the sample size reflects the merger of the RPW system with the Origin-Destination Information System, which had been a separate probability sampling system that estimated mail volume and transit time. In the current rate case the Postal Service's witness that presents information on the RPW asserts that the increased sample size and other improvements have led to reductions in CVs relative to the values presented in Docket No. R2001-1. A comparison of the CVs presented in each docket confirms this assertion. The Commission welcomes this improvement.

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City Carrier Street Time Study. You report that the new CCSTS was conducted in 2002. Despite being used in the development of the Postal Service's FY 2002 and FY 2003 Cost and Revenue Analysis (CRA) reports, the CCSTS is undergoing its first detailed public examination in the current omnibus rate case. This examination has raised issues regarding the conduct of the study and its results. It remains to be seen how the study will be viewed once the record is complete in the rate case. However, it should be noted that the current rate case might be proceeding more expeditiously if interested parties had been able to gain a better understanding of the details of the study procedures and the nature of the new data when the Postal Service first used it to produce its annual CRA.

Public knowledge of the details of the completed study well ahead of the current rate case might have generated useful input from interested parties and the Commission concerning the design of the special data collection effort that the Postal Service undertook in 2004 to update the 2002 study. It would have been much easier to properly evaluate the study in the current, accelerated rate case, and it would have improved the chances that parties could respond with alternatives, or at least offer useful proposed refinements to the 2002 study. While the Postal Service provided a broad overview of the study and some of the available data prior to the current rate case, it criticized the Commission for posting the data on the Commission's website, and refused requests for detailed information on the 2002 study. The restrictions placed on access to this major new study created a missed opportunity to have affected mailers contribute to the evolution of the analysis of city carrier costs. If the Postal Service were complying fully with the Commission's periodic reporting rules, it would improve transparency and promote cooperative improvements in data quality.

Transportation Cost System. Your report identifies actions taken to improve TRACS. These include better documentation, and a 65 percent increase in the number of transportation segments sampled by TRACS. A comparison of CVs from fiscal year 1998, before the improvements were implemented, to those from fiscal year 2004, after the improvements had been implemented, shows mixed results. While 75 percent of the CVs have improved, some CVs have deteriorated substantially, and the TRACS CVs continue to be rather high in general.

Other Data Quality Issues. Your report points out that the *Study* urged the Postal Service to identify the sources and the significance of systematic error in its sampling systems generally (what the *Study* called "non-sampling" error). Judging from your report, the Postal Service has introduced changes to deal with several of the potential sources of non-sampling error. Many significant potential sources of non-sampling error, however, remain unaddressed.

Your report does not mention some of the *Study's* most important recommendations since these are beyond the scope of your report. For

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example, the *Study* considered improving the attribution and distribution of mail processing costs to be the first priority for improving data quality. To that end, the *Study* recommended that the Postal Service evaluate the quality of data produced by the Management Operating Data System (MODS) on which mail processing costs depend, and identify the sources and evaluate the significance of potential measurement errors in that system.

The Postal Service's position is that no further action on this recommendation is needed. In previous status reports to Congressman McHugh it argues that the quality of MODS data is monitored on an ongoing basis and its volume variability analysis is "robust to potential errors in the MODS workhour data." USPS 7/16/04 detailed Status Report on follow-ups on Data Quality Study Recommendations. After reviewing the MODS data and the Postal Service's analysis in prior rate cases, however, the Commission concluded that errors in the data are of the kind that raises doubts about the process by which MODS data are collected and audited, and that the Postal Service's analysis raises the prospect that cost estimates based on the data will be flawed. For example, in rejecting the Postal Services proposed mail processing variability estimates in its Docket No. R2000-1 Opinion and Recommended Decision, at 90, the Commission stated that the supporting analyses

are based on MODS data in which obvious errors are common, but whose source cannot be identified. This strongly implies that errors that are not obvious, and therefore are not detected, are also common. This presents a substantial risk that data errors have biased [the] results.

Further, the Postal Service has begun using MODS data to evaluate and compare the performance of its mail processing plants. The Commission has long seen the need for special safeguards when self-reported data that are used to evaluate performance are also used to estimate costs.

Your report observes that postal reform legislation is likely to affect the quality of the data used in ratemaking. The legislation reflects a consensus within the postal community that new tools are needed to increase the financial transparency of the Postal Service. The report further observes that under the current system the Postal Service has an incentive to restrict the amount of data provided to the public. Rather than providing the mailing community with enough cost and volume information on a regular basis to allow it to help develop a rational set of rates, the Postal Service prefers to restrict access to the details of cost databases and new cost studies until the start of a rate case. A more useful approach would be to publicly document new studies and to share basic data with the mailing community through the Commission's periodic reporting mechanism. In this way, the mailing community could provide input into the design of special studies and the analysis of the costs of collecting, processing, transporting, and delivering mail.

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The GAO report comments that, on the one hand, it takes too long to litigate rate cases (GAO Draft Report at 20), and on the other, that it is difficult to analyze cost attribution issues within the limited time that a rate case allows (GAO Draft Report at 28). The Commission's periodic reporting rules were intended to mitigate these problems. By providing basic data to interested parties on an ongoing basis, the Postal Service would reduce the delay and burden associated with discovery in rate cases. So far, the Postal Service has decided that the pursuit of maximum litigation advantage is more important than its duty to comply with these rules. This illustrates the extent to which rate setting under the current law depends on the Postal Service's willingness to be cooperative, proactive and transparent in providing financial information. The Commission agrees with the conclusion in your report that "the proposed legislative changes would likely lead to improvement in the quality of ratemaking data." See GAO Draft Report at 30.

If I can be of further assistance, please contact me.

Sincerely,

A handwritten signature in cursive script that reads "George Omas". The signature is written in black ink and is positioned to the right of the typed name.

George Omas
Chairman

Appendix III: Selected Ratemaking Requirements in Proposed Postal Reform Legislation

Citation	Summary provision
<p>H.R. 22, Sec. 202, §3633; and S. 662, Sec. 202, §3633 (similar provisions)</p>	<p><i>Competitive products:</i> The Postal Regulatory Commission (the Commission) shall issue regulations for competitive products (such as Priority Mail and Express Mail) to prohibit the subsidization of competitive products by market-dominant products, ensure that each competitive product covers its attributable costs, and ensure that all competitive products collectively make a reasonable contribution to USPS institutional costs.</p>
<p>H.R. 22, Sec. 201, §3622; and S. 662, Sec. 201, §3622 (somewhat different provisions)</p>	<p><i>Market-dominant products:</i> The Commission shall by regulation establish a modern system for regulating rates and classes for market-dominant products (such as First-Class Mail, Standard Mail, Periodicals, and Special Services (such as post office boxes, money orders, and delivery confirmation).</p> <p><i>House version:</i> In establishing this system, the Commission must take various factors into account, including the attributable costs for each class of mail or type of mail service, plus that portion of institutional costs reasonably assignable to such class or type. The average rate of any subclass of mail cannot increase at an annual rate greater than the comparable increase in the Consumer Price Index for All Urban Consumers (CPI-U), unless the Commission has, after notice and opportunity for a public hearing and comment, determined that such increase is reasonable and equitable and necessary to enable USPS, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.</p> <p><i>Senate version:</i> In establishing this system, the Commission must take into various factors into account, including the requirement that each class of mail or type of mail service cover its attributable costs, plus that portion of institutional costs reasonably assignable to such class or type. The regulatory system for market-dominant products shall (1) require the Commission to set annual limitations on the percentage changes in rates based on the CPI-U unadjusted for seasonal variation over the 12-month period preceding the date USPS proposes to increase rates and (2) establish procedures whereby rates may be adjusted on an expedited basis due to unexpected and extraordinary circumstances.</p>
<p>H.R. 22, Sec. 203, §3641; and S. 662, Sec. 203, §3641 (same provision in both bills)</p>	<p><i>Market tests:</i> USPS may conduct market tests of experimental products provided that the product is, from the viewpoint of the mail users, significantly different from all products offered by USPS within the 2-year period preceding the start of the test; the introduction or continued offering of the product will not create an unfair or otherwise inappropriate competitive advantage for USPS or any mailer, particularly in regard to small business concerns; total revenues anticipated, or in fact received, by the tested product do not exceed \$10 million^a in any year, unless the Commission has increased the limit to \$50 million;^a and the market test does not exceed 24 months, unless the Commission has approved an extension of its total duration up to 36 months.</p>

**Appendix III: Selected Ratemaking
Requirements in Proposed Postal Reform
Legislation**

Citation	Summary provision
<p>H.R. 22, Sec. 206, §3687; and S. 662, Sec. 201, §3622(e) (same provision in both bills)</p>	<p><i>Worksharing discounts:</i> The Commission shall establish rules for worksharing discounts as part of its regulations for regulating market-dominant products that shall ensure that discounts do not exceed the cost that USPS avoids as a result of worksharing activity, unless</p> <ul style="list-style-type: none"> • the discount is (1) associated with a new postal service, a change to an existing postal service, or a new workshare initiative related to an existing postal service and (2) necessary to induce mailer behavior that furthers the economically efficient operation of the Postal Service and the portion of the discount in excess of the cost that the Postal Service avoids as a result of the workshare activity will be phased out over a limited period of time; • a reduction in the discount would (1) lead to a loss of volume in the affected category or subclass of mail and reduce the aggregate contribution to the institutional costs of the Postal Service from the category or subclass subject to the discount below what it otherwise would have been if the discount had not been reduced to costs avoided, (2) result in a further increase in the rates paid by mailers not able to take advantage of the discount, or (3) impede the efficient operation of the Postal Service; • the amount of the discount above costs avoided (1) is necessary to mitigate rate shock and (2) will be phased out over time; or • the discount is provided in connection with subclasses of mail consisting exclusively of mail matter of educational, cultural, scientific, or informational value.

Sources: H.R. 22 and S. 662, 109th Cong., 1st Sess.

^aLimits for market tests would be annually adjusted for inflation according to the change in the Consumer Price Index.

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