



Report to the Ranking Member,
Permanent Subcommittee on
Investigations, Committee on Homeland
Security and Governmental Affairs,
U.S. Senate

April 2015

U.S. POSTAL SERVICE

Improved Management Procedures Needed for Parcel Select Contracts

Accessible Version

Highlights of GAO-15-408, a report to the Ranking Member, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

USPS faces significant financial challenges. Parcel Select is a key USPS package shipping product to help address these challenges, with revenues growing from \$466 million to over \$2.5 billion from fiscal year 2009 through fiscal year 2014. As of April 3, 2015, USPS has executed 13 Parcel Select NSAs—customized contracts that lower mailers' shipping prices in exchange for meeting volume targets and other requirements. GAO was asked to review how USPS manages these contracts.

GAO examined (1) USPS's procedures to manage Parcel Select NSAs and (2) its method to determine attributable cost coverage for each contract. To perform this work, GAO reviewed relevant laws and regulations; analyzed documents for all 13 contracts; compared USPS's procedures against selected leading contract management practices most applicable to USPS's role; and interviewed USPS and PRC officials and representatives from 8 mailers that signed 12 of the 13 contracts.

What GAO Recommends

GAO recommends that USPS update its standard procedures to address gaps in documentation requirements and contract management responsibilities. Also, USPS should identify cost-effective methods to collect and study information on delivery costs for Parcel Select packages of varying characteristics to develop contract-specific attributable cost estimates. USPS agreed with these recommendations, but stated that the cost impact of package size and weight is likely small given where these packages enter the mail stream.

View GAO-15-408. For more information, contact Lori Rectanus at (202) 512-2834 or rectanusl@gao.gov.

April 2015

U.S. POSTAL SERVICE

Improved Management Procedures Needed for Parcel Select Contracts

What GAO Found

In June 2014, the U.S. Postal Service (USPS) established standard procedures that departments should follow to manage all negotiated service agreement (NSA) contracts, including Parcel Select NSAs. Although the procedures, in part, address some leading contract management practices, such as defining performance management activities, they lack documentation requirements and clearly defined management responsibilities for some activities. For example, the procedures do not require USPS to document some key management decisions, such as USPS's decision to forego additional revenue when a mailer did not ship a minimum volume of packages, as contractually required. Documenting such information could improve future decision making and enhance accountability for the effective and efficient use of USPS resources. USPS acknowledged that the procedures contained gaps when they were initially established. Reviewing and updating the standard procedures to include documentation requirements and clearly defined management responsibilities would provide additional assurance that USPS's Parcel Select NSAs are effectively managed.

USPS's costing method for Parcel Select NSAs does not account for package size or weight or use contract-specific cost estimates. Each Parcel Select NSA is required to earn sufficient revenues to cover USPS's costs—referred to as "attributable costs" in the postal context. The Postal Regulatory Commission (PRC), which annually reviews compliance, determined that each contract met this requirement. However, USPS's analysis of attributable costs for Parcel Select NSAs is limited, because USPS has not studied the impact of package size or weight on specific contracts or developed contract-specific cost estimates.

- *Package size and weight information:* USPS does not collect information on the size of NSA packages and has not studied the impact of package size and weight on USPS's delivery costs for specific contracts. However, larger and heavier packages can increase USPS's costs. For example, carriers must walk packages that are too large for a centralized mailbox to the customer's door, which increases costs. Moreover, mailers use size and weight to inform their own business decisions. For example, one mailer continually assesses package size and weight to make cost-effective decisions about the delivery method it chooses. If mailers route larger or heavier packages via Parcel Select, collecting and studying such information could improve USPS's analysis of attributable costs for Parcel Select NSAs.
- *Contract-specific cost estimates:* USPS's method to determine attributable costs uses average cost estimates for the Parcel Select product instead of contract-specific cost estimates. USPS's use of averages further limits its analysis of the extent to which each Parcel Select NSA covers its attributable costs, because USPS had not studied the extent to which the size and weight of packages shipped under individual contracts deviated from the characteristics of packages USPS used to estimate the average.

USPS officials questioned whether the benefits of developing contract-specific cost estimates would exceed the costs; however, USPS has used less intensive methods, such as sampling, to improve estimates for other products in the past.

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Abbreviations

DDU	Destination Delivery Unit
Finance	USPS Finance Department
Legal	USPS Legal Department
NSA	negotiated service agreement
PAEA	Postal Accountability and Enhancement Act
PRC	Postal Regulatory Commission
Sales	USPS Sales Department
USPS	U.S. Postal Service

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U.S. GOVERNMENT ACCOUNTABILITY OFFICE

441 G St. N.W.
Washington, DC 20548

April 23, 2015

The Honorable Claire McCaskill
Ranking Member
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate

Dear Senator McCaskill:

The U.S. Postal Service (USPS) faces significant financial challenges including insufficient revenues to cover its expenses and financial obligations.¹ Among the many factors that contribute to USPS's continuing financial challenges are precipitous declines in its most profitable product, First-Class Mail, with its volume falling over one-third from fiscal years 2006 to 2014—resulting in an \$8 billion decline in revenue during the same time period. Although USPS anticipates that First-Class Mail volume will continue to decline, it has identified package shipping as an increasingly important source of future revenue and volume growth.

Parcel Select is a key package shipping product for USPS because it provides USPS with a growing revenue source.² It also allows commercial mailers to lower delivery costs. Specifically, Parcel Select allows mailers to drop bulk shipments of packages at postal facilities, which are generally post offices where USPS carriers pick up their mail. Carriers then deliver the packages the “last mile” to consumers. Unlike end-to-end mail that USPS must process through its entire network, Parcel Select

¹In July 2009, we added USPS's financial condition to the list of high-risk areas needing attention by Congress and the executive branch. We subsequently retained USPS on the high-risk list in fiscal years 2011, 2013, and 2015. GAO, *High-Risk Series: Restructuring the U.S. Postal Service to Achieve Sustainable Financial Viability*, GAO-09-937SP (Washington, D.C.: July 2009); *High-Risk Series: An Update*, GAO-11-278 (Washington, D.C.: February 2011); *High-Risk Series: An Update*, GAO-13-283 (Washington, D.C.: February 2013); and *High-Risk Series: An Update*, GAO-15-290 (Washington, D.C.: February 2015).

²In its glossary of postal terms, USPS defines a “parcel” as a package or mail that does not meet the mail processing category of letter-size mail or flat-size mail. A parcel is usually enclosed in a mailing container such as a carton.

packages bypass most of USPS's processing and transportation network, because mailers drop package shipments closer to their final destination.

Parcel Select is attractive to high-volume mailers because it can lower ground shipping costs and allow them to take advantage of USPS's extensive delivery network. The product is important to USPS because it capitalizes on its last-mile delivery strengths to gain additional revenue. Revenues from Parcel Select have grown from \$466 million to over \$2.5 billion from fiscal year 2009 through fiscal year 2014.³ USPS has provided Parcel Select package delivery service for specific mailers under negotiated service agreements (NSA). NSAs are customized contracts between USPS and specific mailers that provide customer-specific rates—generally lower prices than those available to the general public—in exchange for the mailers meeting volume targets and other requirements. For example, each competitive product, such as Parcel Select contracts, must generate enough revenue to cover the costs caused by providing the service, referred to as “attributable costs” in the postal context.⁴ As of April 3, 2015, USPS has executed 13 Parcel Select NSAs.⁵ You requested that we review how USPS manages its Parcel Select NSAs. We examined (1) the procedures USPS has established to develop, monitor, and evaluate the performance of its Parcel Select NSAs, and (2) the method USPS uses to determine the extent to which each contract meets the requirement to cover its attributable costs.

To examine the procedures that USPS has established to develop, monitor, and evaluate the performance of its Parcel Select NSAs, including implementation, we reviewed relevant laws and regulations as well as USPS's and the Postal Regulatory Commission's (PRC) documents that describe these procedures. We also analyzed copies of all 13 Parcel Select NSAs implemented by USPS along with their supporting file documentation, such as contract performance reports. We compared USPS's procedures for managing the contracts against

³To determine revenue and volume trends for Parcel Select for fiscal year 2009 through fiscal year 2014, we reviewed USPS Revenue, Pieces, & Weight reports for fiscal year 2010 through fiscal year 2014, which present official USPS estimates.

⁴Pub. L. No. 109-435, § 201 (2006), codified at 39 U.S.C. § 3633(a)(2).

⁵This includes eight Parcel Select and five Parcel Select & Parcel Return Service contracts. For purposes of our report, we refer to both of these contract categories as Parcel Select NSAs, since each includes the Parcel Select product.

selected leading contract management practices. To select these practices, we analyzed our standards for internal control in the federal government⁶ and documents from organizations with expertise in contract management, such as the Office of Federal Procurement Policy and the National Contract Management Association. We then selected practices that, in our judgment, were most applicable to our review given USPS's unique role as an independent establishment of the executive branch of the federal government and as the service provider under Parcel Select NSAs. The selected practices are defining roles and responsibilities; establishing procedures for the contract management process; planning and negotiation; managing performance; communicating effectively; and documenting management activities and decisions. We conducted interviews with USPS officials responsible for developing, monitoring, and evaluating the performance of the Parcel Select NSAs; PRC officials responsible for reviewing the contracts; and representatives from 8 mailers that signed 12 of the 13 Parcel Select NSAs⁷ to determine how USPS implements its procedures. We did not report volume, revenue, or mailer-specific information for individual NSAs because USPS and mailers consider the information proprietary and, according to USPS officials, public disclosure would violate contractual confidentiality provisions.

To examine the method that USPS uses to determine whether each Parcel Select NSA covers its attributable costs, we reviewed relevant laws and regulations that establish requirements for the contracts. We reviewed USPS documents that describe or discuss the methodology that USPS uses, such as its fiscal year 2014 *Annual Compliance Report* and PRC's *Annual Compliance Determination Reports* for fiscal years 2008 through 2013, the most recent reports available during the time of this review. We also reviewed relevant federal agency, academic, and GAO reports that describe issues related to USPS's costing approach generally, such as the USPS Office of Inspector General's audit reports. In addition, we conducted interviews with USPS and PRC officials to

⁶GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

⁷Nine mailers have signed Parcel Select NSAs. The number of mailers is less than the number of implemented contracts, because some mailers signed more than one contract. We did not interview representatives from one mailer, because the company was sold and knowledgeable representatives were no longer available to meet with us. According to USPS, no packages were ever shipped under this contract.

obtain their views on USPS's cost coverage methodology. We did not review USPS's postal costing methodology generally, such as methods to divide costs into attributable and institutional costs and methods to distribute attributable costs to various USPS products and services. See appendix I for more information on our scope and methodology.

We conducted this performance audit from April 2014 through April 2015 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The Package Delivery Market Is Complex and Changing Rapidly

The package delivery market is growing and changing rapidly. In 2013, U.S. businesses and consumers reportedly spent more than \$68 billion to ship packages domestically using the three largest national package delivery providers in the U.S.—United Parcel Service (UPS), Federal Express Corporation (FedEx), and USPS.⁸ This spending is driven in large part by recent growth in electronic commerce, which is forecast to grow in the double digits year-over-year to bring electronic commerce's share of overall U.S. retail sales to almost 9 percent, or \$490 billion, by the end of 2018.⁹ According to USPS, revenues from its Shipping and Packages services—which includes Parcel Select—have grown from about \$11.6 billion in fiscal year 2012 to over \$13.7 billion in fiscal year 2014, and generate about 20 percent of USPS's total operating revenues.¹⁰ USPS is placing increased emphasis on growth in these services to partially offset a continued decline in First-Class Mail.

⁸USPS Office of Inspector General, *Package Services: Get Ready, Set, Grow!* Report number RARC-WP-14-012 (Arlington, VA: July 21, 2014).

⁹eMarketer, *Total US Retail Sales Top \$4.5 Trillion in 2013, Outpace GDP Growth* (Apr. 10, 2014).

¹⁰USPS, *United States Postal Service 2014 Annual Report to Congress*.

Mailers have developed new delivery options to grow their businesses as the package delivery market evolves. For example, Amazon and Google started offering same-day package delivery service in select metropolitan areas. Some mailers have also introduced services that allow consumers to avoid package deliveries when they are not at home by picking-up packages themselves at alternative delivery locations. This development could reduce the need to provide last-mile delivery to individual residences. For example, Amazon allows customers to retrieve packages at self-service lockers in shopping centers, retail stores, transit stations, and other access points in selected locations.¹¹ Similarly, in October 2014 UPS announced that consumers in two cities may retrieve packages from nearby locations—primarily neighborhood convenience and grocery stores—and it plans to expand the service to cover all major U.S. metropolitan markets in 2015.

In addition to large national mailers, smaller regional companies compete for business in the package delivery market. For example, LaserShip is a regional package delivery company that provides last-mile delivery to major East Coast markets. Similarly, OnTrac provides regional overnight package delivery service within several states on the West Coast.¹²

As the package delivery market has changed, USPS must manage complex business relationships with its competitors. For example, although UPS and FedEx both pay USPS to deliver packages the last mile under certain circumstances, they also compete with USPS for end-to-end package delivery business—a concept that USPS officials refer to as “coopetition”. Similarly, FedEx is USPS’s largest contractor providing air transportation for Priority Mail Express (formerly Express Mail), Priority

¹¹According to Amazon, as of January 2015, this service was available in Los Angeles, New York City, Philadelphia, Portland, San Diego, San Francisco, and Seattle. Locations were also available in Delaware, New Jersey and Virginia.

¹²According to OnTrac, it delivers to every address in California, and the major metropolitan areas of Arizona, Nevada, Oregon, Washington, Utah, Colorado, and Idaho.

Mail, and First-Class Mail. UPS also is one of USPS's largest contractors providing long-distance mail transportation.¹³

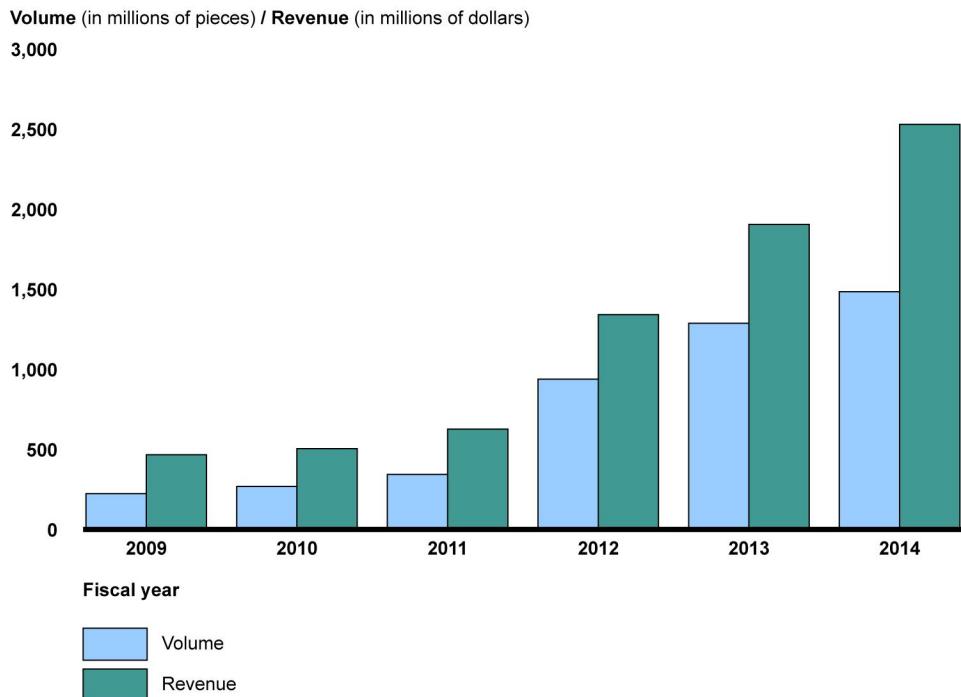
**Parcel Select NSAs
Provide Increased Volume
and Revenue to USPS
and Discounted Prices
to Mailers**

USPS uses Parcel Select NSAs to encourage additional mail volume and revenue by providing mailers with discounted prices in exchange for meeting the contract's terms and conditions. USPS data show that the Parcel Select product, including Parcel Select NSAs, is an increasingly important source of additional volume and revenue (see fig. 1).¹⁴

¹³In fiscal year 2013, FedEx revenues from its contract to transport mail were reportedly nearly \$1.8 billion, while UPS contract revenues for transportation services were \$129 million. See Husch Blackwell, *FedEx Again Tops List of U.S. Postal Service Contractors in Fiscal Year 2013* (Feb. 18, 2014), available at <http://www.huschblackwell.com/inthenews/fedex-again-tops-list-of-us-postal-service-contractors-in-fiscal-year-2013>.

¹⁴In January 2012, USPS transferred Standard Mail parcels to the Parcel Select product, under the name Lightweight Parcel Select.

Figure 1: U.S. Postal Service Data of Parcel Select Volume and Revenues, Fiscal Years 2009 through 2014



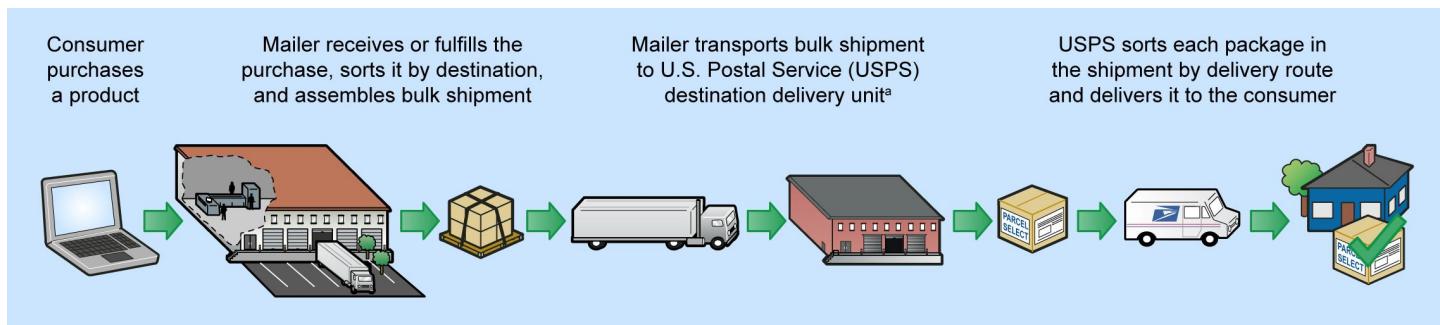
While USPS uses Parcel Select NSAs to generate additional revenue, among other benefits, mailers use them to lower delivery costs and to take advantage of USPS's extensive "last mile" network that serves more than 140 million residential delivery points 6 days a week.¹⁵ Contracts may require the mailer to ship a minimum volume of packages each

¹⁵USPS has a universal service obligation, part of which requires it to provide delivery service to all communities, 39 U.S.C. § 101(a) et. seq. A single residential delivery point can serve multiple addresses, such as centralized delivery at apartment buildings. USPS maintains data on the number of delivery points rather than addresses. According to USPS data, residential delivery points have increased from about 137 million in fiscal year 2009 to about 141 million in fiscal year 2014. USPS also delivers packages on Sunday under a Parcel Select NSA. According to the USPS's Office of Inspector General, at the end of April 2014, Sunday service was operating at 459 Postal Service Destination Delivery Units or hubs and USPS had delivered 2.7 million parcels to customers on Sunday from these locations. See USPS Office of Inspector General, *Sunday Parcel Delivery Service*, Report number DR-AR-15-002 (Arlington, VA: December 5, 2014).

contract year (minimum volume requirement) to qualify for discounted prices. Some contracts may require the mailer to pay USPS the difference between the discounted price and published price for Parcel Select if the mailer fails to meet this minimum volume requirement.¹⁶

Shipping packages under Parcel Select lowers mailers' delivery costs by allowing them to enter bulk shipments of packages into USPS's network—generally at Destination Delivery Units (DDU)¹⁷ that are located close to the final delivery point (see fig. 2). As a result, these packages generally bypass most of USPS's mail processing and transportation network. Prices vary, depending on package weight, entry point, and the total volume shipped.

Figure 2: Package Delivery Flow under Parcel Select Negotiated Service Agreements



Source: GAO. | GAO-15-408

^aThe mailer may also transport bulk shipments to USPS's destination entry network distribution centers or destination entry sectional center facilities, which are USPS facilities that process or distribute packages higher up in the delivery stream.

USPS must ensure that all Parcel Select NSAs comply with statutory requirements under the Postal Accountability and Enhancement Act (PAEA).¹⁸ Notably, each Parcel Select NSA is required to generate

¹⁶Published prices are the rates of general applicability that USPS charges the general public and are published in the Domestic Mail Manual. These rates are established by USPS and approved by the PRC.

¹⁷Carriers pick up mail to be delivered at DDUs, which are generally post offices.

¹⁸Pub. L. No. 109-435.

enough revenue to cover its attributable costs.¹⁹ For Parcel Select, these costs primarily include USPS labor involved in sorting packages at postal facilities and delivering them to the final delivery point. PRC reviews each Parcel Select NSA to ensure that it is projected to comply with this and other requirements before USPS can implement it. According to PRC, this pre-implementation review is justified to preserve fair competition.²⁰ PRC also reviews each contract after implementation to ensure compliance with statutory criteria—including the contract's attributable cost coverage—in its *Annual Compliance Determination Report*.

USPS's Recently Established Standard Procedures for Parcel Select NSAs Have Gaps

USPS Established Standard Procedures in June 2014

USPS's Sales Department (Sales) has lead responsibility for managing Parcel Select NSAs and recently established standard procedures for managing NSA contracts.²¹ Specifically, in June 2014, Sales created the Standard Procedure for Managing NSA Contracts (Standard Procedures), which is an internal document that provides guidance that USPS departments should follow to manage all NSAs. Sales officials told us that they created the guidance in an effort to incorporate best practices and to

¹⁹Each competitive product, which includes Parcel Select NSAs, is required to generate enough revenue to cover its attributable costs. 39 U.S.C. §3633(a)(2). Attributable costs are defined as the direct and indirect postal costs attributable to such product through reliably identified causal relationships. 39 U.S.C. § 3631(b). Each Parcel Select NSA is defined as a separate competitive product because Parcel Select is in the competitive products category and PRC has determined that each competitive NSA that is premised on distinct cost or market demand characteristics would be classified as a separate product. PRC, *Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products*, Order No. 43, Docket No. RM2007-1, October 29, 2007.

²⁰PRC, *Order Proposing Regulations to Establish a System of Ratemaking*, Order No. 26, Docket No. RM2007-1, August 15, 2007.

²¹The responsibility for managing Parcel Select NSAs has transitioned among three USPS entities since 2008. Sales took over management responsibility for Parcel Select NSAs in 2012.

improve USPS's NSA contract management procedures by balancing standardization with flexibility. The Standard Procedures address, in part, some leading contract management practices. For example, as we discuss below, the procedures define some contract management responsibilities, such as performance monitoring and evaluation activities. Previously, USPS officials told us that no document or policy outlined USPS's contract management procedures. Absent such guidance, USPS managers told us that they relied primarily upon their professional expertise and experience to manage the contracts.

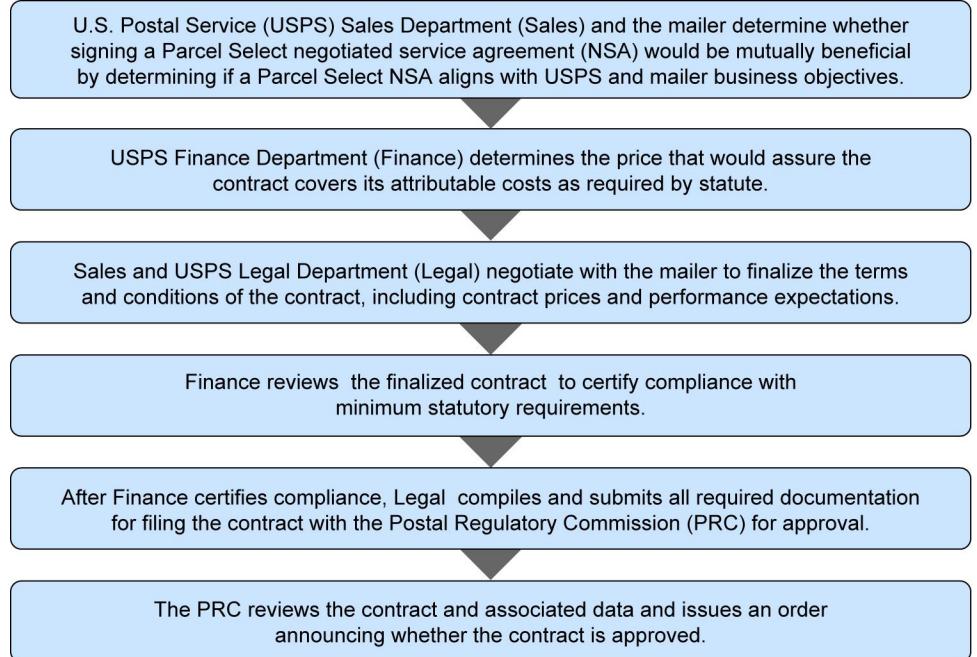
Standard Procedures Define Some Contract Management Responsibilities

The Standard Procedures define some responsibilities for USPS departments involved in developing, monitoring, and evaluating the performance of Parcel Select NSAs, as indicated below. USPS officials told us about other responsibilities that are not specifically included in the Standard Procedures.

Contract Development

The Standard Procedures delineate contract development responsibilities for various departments within USPS, including Sales, USPS's Finance Department (Finance), and USPS's Legal Department (Legal) (see fig. 3).

Figure 3: Parcel Select Negotiated Service Agreement Key Contract Development Responsibilities



Source: GAO. | GAO-15-408

Contract Monitoring and Evaluation

After PRC issues an order approving a Parcel Select NSA, USPS begins to monitor and evaluate the performance of the contract. These responsibilities include internal performance reporting by Sales and Finance, submission of an annual compliance review to the PRC by Finance, periodic business reviews between USPS and mailers, and following contract termination or renewal procedures, as described below.

Internal performance reporting: The Standard Procedures call for Sales and Finance to use internal reports to monitor and evaluate performance under each Parcel Select NSA. Thus, Sales or Finance creates monthly, quarterly, and annual reports that analyze data that include the volume of packages shipped and revenue generated under the contract. For example, Finance develops a quarterly performance report that is used internally by Sales. This report communicates the Parcel Select NSA's contractual requirements, actual and projected volume and revenue data, as well as descriptive information such as the contract's effective and expiration dates.

Submission of compliance review to the PRC: In addition to internal reporting, USPS reports each NSA's performance externally to the PRC. Specifically, Finance files USPS's *Annual Compliance Report* to the PRC; this report covers the extent to which USPS finds that each NSA has met statutory requirements including whether each contract has covered its attributable costs. According to PRC officials, all Parcel Select NSAs have complied with these statutory requirements each year. However, PRC officials noted that they do not review and are not statutorily required to review the extent to which mailers or USPS have complied with other contractual requirements, such as minimum volume requirements and any payments to USPS for failure to meet these requirements as part of its *Annual Compliance Determination Report*.

Business reviews: USPS officials said that they use performance reports to conduct business reviews with mailers. Business reviews are meetings where USPS and the mailer discuss business opportunities, contract terms—such as volume requirements and pricing—and contract performance.²² The Standard Procedures define additional responsibilities USPS should perform if a mailer is at risk of failing to meet contractual conditions. For example, if Parcel Select NSA performance is below contractual terms, Sales should establish a plan and timeline for improved performance. Furthermore, Sales should schedule additional monthly or bi-monthly business reviews to ensure performance improves in accordance with the established plan.

Contract termination or renewal: According to Sales officials, the final activity for managing a Parcel Select NSA is to terminate, renew, or allow the contract to expire. Each Parcel Select NSA describes how the contract can be terminated. Contract terms and conditions typically allow USPS and mailers to terminate a Parcel Select NSA by mutual agreement in writing for convenience. According to the PRC, USPS should promptly notify the PRC if a Parcel Select NSA is terminated prior to the scheduled expiration date. Sales officials said that they generally contact mailers 3 to 6 months before a Parcel Select NSA expires to explore whether renewing the contract would be mutually beneficial. If both parties agree, Sales officials told us that USPS and the mailer should follow the same procedures used to create the original contract to

²²Discussions during business reviews are open to any USPS contract or product and not limited to Parcel Select NSAs.

execute the renewal. If either party does not wish to renew the contract, the Parcel Select NSA expires on its contractually specified date.

Standard Procedures Have Gaps in Contract Monitoring and Evaluation

While the Standard Procedures address some responsibilities involved in managing Parcel Select NSAs, some gaps exist. Specifically, the procedures lack documentation requirements and clearly defined management responsibilities for some contract monitoring and evaluation activities. A senior USPS official acknowledged that the Standard Procedures contained gaps when the document was initially established and that Sales had not reviewed or updated the procedures, which could have provided USPS with an opportunity to identify and address such gaps.

- *Documenting contract monitoring and evaluation activities:* USPS's Standard Procedures lack documentation requirements for some contract monitoring and evaluation activities such as the occurrence and results of business reviews for active Parcel Select NSAs. Each of the seven contracts that were effective in October 2014 requires USPS to conduct business reviews to discuss contract performance semiannually. However, Sales officials told us they did not know the extent to which they conduct business reviews for each contract, because they do not always document that the meetings actually happen. Sales officials verified—through emails, meeting agendas, and other documents—that staff scheduled or conducted at least one business review for five of these seven contracts.

Similarly, the Standard Procedures lack requirements for documenting some key management decisions pertaining to contract monitoring and evaluation. For example, USPS did not document management decisions about an underperforming contract. Specifically, according to Sales officials, when one mailer did not reach its minimum volume requirement, Sales did not document any discussions with the mailer to address the issue. Moreover, USPS did not require the mailer to pay the difference between the discounted price and the published price, as called for under the contract. Sales officials told us that they decided not to require the payment for business reasons, including maintaining this mailer as a source of package volume and allowing the mailer time to adjust to changing market conditions that influenced its performance. Although we recognize that USPS should have flexibility to reach management decisions based upon the facts and circumstances of each contract, Sales officials did not document the reasons for their decision to leave the performance issue unresolved and forgo the additional revenue. Documenting such information

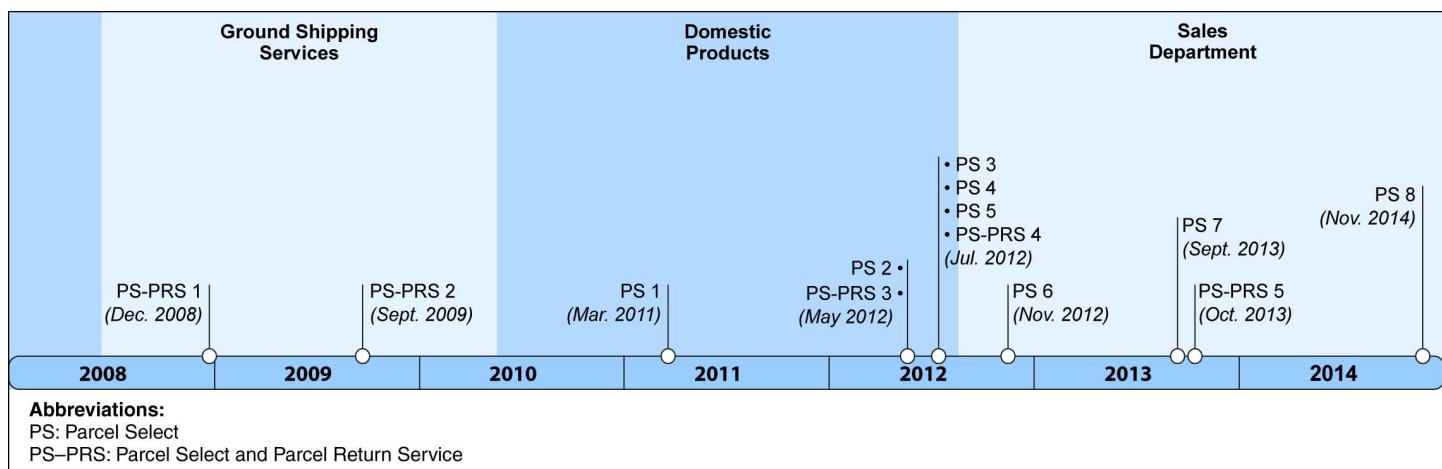
would help ensure that future decisions are based upon past results and enhance accountability for the effective and efficient use of USPS resources.

Internal control standards state that information should be documented in a form and within a time frame that enables individuals to carry out their internal control and other responsibilities and that the documentation should be properly managed and maintained.²³

Reviewing and updating the Standard Procedures to include documentation requirements would provide additional assurance that USPS's Parcel Select NSAs are effectively managed. Inconsistent management and maintenance of documentation also increases the risk that USPS may not retain important institutional knowledge. As previously mentioned, management responsibility for Parcel Select NSAs has transitioned among three different USPS entities since calendar year 2008 (see fig. 4). USPS officials told us that documentation of key management decisions was lost or discarded when lead responsibility for managing the contracts transitioned from Domestic Products to Sales in 2012. The projected importance of package shipping and Parcel Select NSAs to USPS's financial future highlights the importance for USPS to document contract management activities to retain institutional knowledge and inform future decision-making.

²³ GAO/AIMD-00-21.3.1.

Figure 4: Parcel Select Negotiated Service Agreement Timeline and U.S. Postal Service Entities with Lead Responsibility for Managing the Contracts



Sources: Postal Regulatory Commission (approval dates); U.S. Postal Service (management entities). | GAO-15-408

- *Defining management responsibilities for contract monitoring and evaluation activities:* USPS's Standard Procedures do not define who is responsible for addressing unresolved contract performance issues and how staff should resolve them. Internal control standards²⁴ state that organizations should clearly define key areas of responsibility and establish procedures to ensure that management promptly resolves performance issues. Without clearly defining who is responsible for promptly addressing performance issues and the procedures these individuals should follow, USPS is at risk of leaving performance issues unresolved—such as the example of a mailer's failure to reach minimum volumes discussed above—issues that could impact future contract performance.

In addition, the Standard Procedures do not clearly define who is responsible for reporting contract changes, such as rate adjustments and amendments, to PRC. Internal control standards²⁵ and leading

²⁴ GAO/AIMD-00-21.3.1.

²⁵ GAO/AIMD-00-21.3.1.

USPS Could Improve Its Method to Estimate Attributable Costs for Parcel Select NSAs

contract management practices we identified²⁶ state that organizations should establish appropriate lines of reporting. Without clearly defining who is responsible for reporting information to PRC in the Standard Procedures, USPS is at risk of not reporting contract changes to PRC as required. For example, although PRC requested that USPS file an amendment to a Parcel Select contract in November 2014, USPS did not file the requested amendment as ordered.²⁷ Similarly, according to PRC notices, on several occasions USPS did not report discretionary rate adjustments²⁸ for Parcel Select NSAs as required.

Each competitive product, including each Parcel Select NSA, must earn sufficient revenues to cover its attributable costs;²⁹ however, USPS's costing method to estimate attributable costs for individual Parcel Select contracts does not account for all key cost factors. USPS compiles attributable costs for the Parcel Select product by using data from various information systems—notably financial accounting systems—that collect data on employee compensation and benefit costs. USPS then estimates how much employee time is spent handling Parcel Select packages by

²⁶To identify these practices, we analyzed documents from organizations with expertise in contract management—such as the Office of Federal Procurement Policy and the National Contract Management Association—and selected practices that, in our judgment, were most applicable to our review given USPS's unique role as an independent establishment of the executive branch of the federal government and as the service provider under Parcel Select NSAs. See appendix I for more information on how we identified these practices.

²⁷PRC Order Adding Parcel Select Contract 8 to the Competitive Product List, Order No. 2242, Docket Nos. MC2015-1 and CP2015-3, November 5, 2014.

²⁸PRC requires USPS to report any discretionary rate adjustments at least 15 days before they go into effect. This allows PRC to review the adjusted rates to ensure that the contract remains in compliance with statutory requirements, including covering its attributable costs. PRC discussed the requirement to report rate adjustments in Order Nos. 216 and 1761, and distinguished the levels of review required for discretionary and non-discretionary adjustments. Non-discretionary rate adjustments are made according to a pre-determined schedule (e.g., at the beginning of a contract year or at the end of every quarter) and a pre-determined formula that is based on objective, external factors, (e.g., changed annually based on the average change in prices of general applicability for that product). Discretionary rate adjustments are not based on a pre-determined formula that is tied to objective, external events.

²⁹39 U.S.C. §3633(a)(2).

collecting additional data.³⁰ Combined with data on non-personnel costs, USPS then estimates the total attributable costs for the Parcel Select product. However, USPS officials told us that they do not collect or study some information that could improve these estimates for individual Parcel Select contracts. Specifically, while USPS does collect data on the weight of all Parcel Select packages, it does not collect information on the size of NSA packages and has not studied the impact of either of these factors on USPS's delivery costs for specific contracts. This limits USPS's analysis of attributable costs for Parcel Select NSAs.

Collecting and studying information on the size and weight of Parcel Select packages is important, because larger and heavier packages can increase USPS's delivery costs. For example, packages that are too large or heavy to carry on foot routes (where a carrier delivers mail without a vehicle) must be delivered by a separate carrier with a vehicle, while packages that are too large for curbline or centralized delivery require a carrier to walk to the door to attempt delivery, resulting in additional time.³¹ Such deliveries increase USPS carrier costs, which average about \$40 per hour in compensation and benefits. As another example of costs related to package size, USPS's Office of Inspector General reported in December 2014 that it observed USPS delivery vehicles with insufficient loading space to accommodate large Parcel Select NSA packages for Sunday delivery, which required carriers to make multiple street deliveries

³⁰For example, the In-Office Cost System sends data collectors to observe the type of mail handled by randomly selected employees when they are working in various postal facilities throughout the week. If 5 percent of those observations find an employee handing a piece of Parcel Select, then 5 percent of the employee's in-office time—and associated personnel costs—will be attributed to Parcel Select. USPS uses other data collection systems to attribute employee time and cost for delivering the mail and other activities outside of postal facilities, such as the City Carrier Cost System and the Rural Carrier Cost System.

³¹USPS uses three basic delivery modes: door, "curbline," and centralized delivery. Door delivery includes delivery to mail slots in the door as well as mailboxes attached to houses. Curbline delivery includes delivery to curbline mailboxes that are typically unlocked mail receptacles on a post and commonly used on routes serving residential customers. Centralized delivery is provided to centrally located mail receptacles, such as apartment house mailboxes and cluster box units. As we reported in May 2014, USPS estimated that its delivery costs in fiscal year 2012 ranged from about \$380 annually for the average door delivery point to about \$240 for curbline delivery and about \$170 for centralized delivery. See GAO, *U.S. Postal Service: Delivery Mode Conversions Could Yield Large Savings, but More Current Data Are Needed*, GAO-14-444 (Washington, D.C.: May 12, 2014).

or split routes, resulting in decreased operational efficiency and additional operating costs (see fig. 5).³²

Figure 5: U.S. Postal Service Delivery Vehicles with Insufficient Loading Space to Accommodate Large Packages



Source: U.S. Postal Service, Office of Inspector General. | GAO-15-408

Moreover, private sector mailers use package weight and size information to inform their own business decisions. For example, UPS and FedEx—both of which pay USPS to deliver packages the last mile under certain circumstances and compete with USPS for end-to-end package delivery business—recently began basing the ground delivery rates they charge on both the size and weight of packages, a concept called “dimensional weighting.”³³ Representatives from another mailer told us that in serving their own customers, they continually assess the characteristics of each package—including weight and size—to determine the costs of handling each package and to make cost-effective decisions regarding the delivery

³²USPS Office of Inspector General, *Sunday Parcel Delivery Service*, Report Number DR-AR-15-002 (Arlington, VA: Dec. 5, 2014).

³³“Dimensional weight” reflects package density, which is the amount of the space a package occupies in relation to its actual weight.

method they choose. If mailers choose to route larger or heavier packages via Parcel Select, collecting and studying information on the weight and size of packages could position USPS to better understand how this affects its delivery costs and the extent to which revenues for individual Parcel Select NSAs cover their attributable costs.

In addition to not collecting detailed cost information that accounts for key package characteristics, USPS's method to estimate attributable costs uses national averages for Parcel Select packages³⁴ instead of contract-specific cost estimates for each NSA. This estimating further limits USPS's analysis of the extent to which each contract covers its attributable costs. Specifically, because USPS does not have contract-specific cost estimates, USPS compares (a) the average cost per piece for Parcel Select packages with (b) the average revenue per piece for each Parcel Select NSA.³⁵

PRC officials told us that based on currently available information, they had not observed significant variations in the characteristics of packages shipped under individual Parcel Select NSAs that would suggest that using average costs is not reasonable. However, as we describe above, USPS does not collect or study information that could help inform the reasonableness of its method to estimate attributable costs. Finance officials stated that because the weight of packages shipped under the Parcel Select NSAs did not vary significantly from the average weight, they had no reason to believe that heavier Parcel Select packages delivered under the NSAs would be more costly to process and deliver than the average cost to deliver packages that are not under the NSAs. However, these officials noted that they had not studied the extent to which package characteristics—including package weight and dimension—varied under individual Parcel Select NSAs or whether they deviated from the characteristics of packages that USPS used to estimate the national average.

³⁴USPS's method excludes Lightweight Parcel Select parcels, which weigh less than one pound. For purposes of our discussion about USPS's use of average costs, we refer to "Parcel Select packages" to exclude these lightweight parcels.

³⁵For each Parcel Select NSA, USPS's method assumes that the cost to deliver each Parcel Select NSA package at the DDU is the same as the national average for Parcel Select packages. USPS also assumes that the per-piece processing and transportation costs of pieces entered at sectional center facilities and network distribution centers are the average for Parcel Select packages entered at each of these facilities.

USPS officials questioned whether the time and expense required to develop contract-specific attributable cost estimates that account for package weight and dimension would significantly improve decision-making. Specifically, USPS officials said that for packages that mailers enter at DDUs, developing such estimates would require USPS to determine the costs that each DDU in its network would accrue—including costs associated with package size, package weight, delivery mode, and exact handling and delivery personnel—for each contract. For packages entered higher in USPS's delivery stream (at sectional center facilities and network distribution centers), USPS officials noted that obtaining contract-specific information would require USPS to fully integrate the entire USPS mail data system and entirely replace its existing cost system, which would cost many hundreds of millions of dollars.

We recognize that USPS must carefully balance the costs and benefits associated with developing contract-specific attributable cost estimates for Parcel Select NSAs. However, without taking steps to collect and study key cost information to develop these estimates, limitations on USPS's analysis of attributable costs will persist. In the past, USPS has used other less intensive methods to improve its cost estimates for other products. For example, USPS has used "special studies"³⁶ to improve cost information by examining operations at a sample of USPS facilities over a limited period of time. According to USPS officials, such special studies have generally cost hundreds of thousands of dollars to conduct in the past, with costs varying depending on the study's scope. For example, in 2008 PRC noted that disaggregated Parcel Select and Parcel Return Service costs were needed.³⁷ To disaggregate these costs, USPS conducted a field study at sampled DDUs in the summer of 2008 and used the data it collected to isolate transportation and mail processing costs specifically for Parcel Select and Parcel Return Service products.

³⁶PRC requires USPS to annually provide or update a list of special studies whose results are used to produce the estimates in its annual periodic reports to PRC. In its fiscal year 2013 report, USPS noted that although no established definition for "special studies" existed, USPS characterized "special studies" as those analyses that cannot be updated routinely by reference to information contained in ongoing data systems. PRC Notice of Final Rule Prescribing Form and Content of Periodic Reports, Order No. 203, Docket No. RM2008-4, April 16, 2009.

³⁷PRC Order Concerning Costing Methods Used in Periodic Reporting (Proposal Thirteen), Order No. 156, Docket No. RM2009-2, December 23, 2008.

As another example, USPS recently conducted a comprehensive study of city carrier street time activities and costs, which involved collecting data on sampled city routes to help attribute city carrier costs to various types of mail, including parcels.

Conclusions

USPS continues to face significant financial challenges. Parcel Select helps to address these challenges by providing USPS with a revenue source that has increased from \$466 million in fiscal year 2009 to over \$2.5 billion in fiscal year 2014. Over time, USPS has taken important steps to standardize the procedures it uses to develop, monitor, and evaluate the performance of its Parcel Select NSAs, including developing its Standard Procedures in June 2014. However, the Standard Procedures lack documentation requirements and clearly defined management responsibilities for some contract monitoring and evaluation activities. Reviewing and updating the standard procedures to address these gaps would provide additional assurance that USPS's Parcel Select NSAs are effectively managed. In addition, collecting and studying information on the size and weight of Parcel Select NSA packages could improve USPS's analysis of attributable cost coverage for each contract and position USPS to better understand how mailers' business decisions affect these costs. This may prove to be important, as mailers have developed more discrete costing methods based on both the size and weight of packages, which may influence the characteristics of packages that they provide to USPS for last-mile delivery.

Recommendations for Executive Action

To provide additional assurance that the procedures USPS uses to develop, monitor, and evaluate the performance of its Parcel Select NSAs are effective, the Postmaster General should direct executive leaders in Sales to:

- review the Standard Procedures to identify gaps in contract management responsibilities, including documentation requirements and assigning clearly defined management responsibilities for contract monitoring and evaluation activities, and update the procedures to address the identified gaps.

To better understand attributable costs for individual Parcel Select NSAs, the Postmaster General should direct the appropriate staff to:

- identify and implement cost-effective methods, such as using a sample, to collect and study information on the costs of delivering

Parcel Select packages of varying characteristics in order to develop contract-specific attributable cost estimates.

Agency Comments and Our Evaluation

We provided a draft of this report to USPS and PRC for review and comment. USPS and PRC provided written comments, which are summarized below and reproduced in appendix II and appendix III, respectively. USPS and PRC also provided technical comments, which we incorporated, as appropriate.

In its comments, USPS agreed to update its Standard Procedures and concurred in principle to develop contract-specific attributable cost estimates for Parcel Select NSAs. USPS noted that it did not believe that package size and weight significantly affect the costs of Parcel Select NSAs, because most packages are entered at the DDU and thus bypass much of USPS's processing and transportation network. However, as the report notes, while USPS does collect data on the weight of all Parcel Select packages, it does not collect information on the size of NSA packages and has not studied the impact of either of these factors on USPS's delivery costs for specific contracts. This limits USPS's analysis of attributable costs for Parcel Select NSAs. USPS stated it would explore obtaining additional mailer characteristics and ascertaining their relationships to costs for specific Parcel Select NSAs. USPS noted in its comments that it has already taken steps to obtain contract-specific characteristics for Sunday delivery of NSA packages. Sunday delivery, however, currently constitutes a relatively small percentage of Parcel Select volume.

As the report notes, collecting and studying information on the size and weight of Parcel Select packages is important, because larger and heavier packages can increase USPS's delivery costs. The report also points out that private sector mailers use package weight and size information to inform their own business decisions, such as making cost-effective decisions regarding the delivery method they choose. As the report concludes, collecting and studying information on the size and weight of Parcel Select NSA packages could improve USPS's analysis of attributable cost coverage for each contract and position USPS to better understand how mailers' business decisions affect these costs. This understanding will be important given the rapidly changing package delivery market.

In its comments, PRC said that it found our draft report well-researched and balanced and agreed with both of our recommendations. PRC

supported the cost-effective development of more accurate attributable cost estimates for Parcel Select NSAs. PRC also clarified that USPS's method to estimate average costs for Parcel Select packages excludes Parcel Select mail weighing less than one pound. We modified the relevant text to note this clarification.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the appropriate congressional committees, Postmaster General, Acting Chairman of PRC, USPS Office of Inspector General, and other interested parties. In addition, the report will be available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at 202-512-2834 or rectanusl@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff making key contributions to this report are listed in appendix IV.

Sincerely yours,

A handwritten signature in black ink that reads "Lori Rectanus". The signature is fluid and cursive, with "Lori" on the left and "Rectanus" on the right, connected by a flourish.

Lori Rectanus
Director
Physical Infrastructure Issues

Appendix I: Scope and Methodology

To examine the procedures that the U.S. Postal Service (USPS) has established to develop, monitor, and evaluate the performance of its Parcel Select negotiated service agreements (NSA), including implementation, we reviewed relevant laws and regulations such as the Postal Accountability and Enhancement Act (PAEA).¹ We also examined USPS documents such as the Standard Procedure for Managing NSA Contracts that describe the procedures. We also reviewed copies of all 13 Parcel Select NSAs executed by USPS along with their supporting file documentation, such as contract performance and business review reports. This includes eight Parcel Select and five Parcel Select & Parcel Return Service contracts. For purposes of our report, we refer to both of these contract categories as Parcel Select NSAs, since each includes the Parcel Select product. We also examined Postal Regulatory Commission (PRC) documents, such as orders and notices. We did not review the extent to which USPS complied with all of its management procedures because this did not fall within the scope of this review. We also did not report volume, revenue, or mailer-specific information for individual NSAs because USPS and mailers consider the information proprietary, and according to USPS officials, public disclosure would violate contractual confidentiality provisions.

In addition, we conducted interviews with USPS officials from the Sales, Finance, and Legal departments, who are responsible for developing, monitoring, and evaluating the performance of Parcel Select NSAs; PRC officials responsible for reviewing the contracts; and representatives from eight mailers that signed 12 of the 13 Parcel Select NSAs to determine how USPS implements its procedures. The number of mailers is less than the number of implemented contracts because some mailers signed more than one contract. We did not interview representatives from one of the mailers that signed a Parcel Select NSA, because the company was sold and knowledgeable representatives were no longer available to meet with us. According to USPS, no packages were ever shipped under that contract. We compared USPS's procedures for managing the contracts against selected leading contract management practices. To select these practices, we:

- Identified criteria sources that included leading contract management practices and then confirmed that these sources were appropriate

¹Pub. L. No. 109-435, 120 Stat. 3198 (Dec. 20, 2006).

through consultation with internal stakeholders. These sources included: (a) our standards for internal control in the federal government;² (b) guidance documents and regulations for federal agencies, such as best practices issued by the Office of Federal Procurement Policy; and (c) documents from contract management and administration organizations including the National Contract Management Association and the Institute for Supply Management, which were recognized for their expertise in this area.

- Reviewed information included in each criteria source to identify practices that are relevant to either (a) buyers and sellers or (b) just sellers. Because the Postal Service is the service provider (or seller) under Parcel Select NSAs, we excluded leading practices that are only pertinent to buyers. In addition, we identified practices that were applicable to USPS and its unique statutory and regulatory requirements as an independent establishment of the executive branch of the federal government.
- Exercised professional judgment to select practices that we identified as particularly relevant to the managing Parcel Select NSAs.

Based upon these steps, we selected the following leading contract management practices: defining roles and responsibilities; establishing procedures for the contract management process; planning and negotiation; managing performance; communicating effectively; and documenting management activities and decisions. USPS agreed that these practices were relevant and reasonable.

To determine revenue and volume trends for Parcel Select, which we describe in the background of our report, we reviewed USPS Revenue, Pieces, & Weight reports, which present official USPS estimates. We assessed the reliability of these data by reviewing related documentation, such as a December 2007 USPS Office of Inspector General report on USPS's data system,³ and by collecting information from knowledgeable USPS officials, and determined that the data were sufficiently reliable for our reporting purpose.

²[GAO/AIMD-00-21.3.1](#).

³USPS Office of Inspector General, *Management Advisory – Internal Controls over the Revenue, Pieces, and Weight Adjustment System*, Report Number CRR-MA-08-001 (Dec. 14, 2007).

To examine the method that USPS uses to determine whether each Parcel Select NSA covers its attributable costs, we reviewed relevant laws and regulations that establish requirements for product categories and contracts such as PAEA. We also analyzed agency documents that describe or discuss the methodology that USPS uses, such as USPS's fiscal year 2014 *Annual Compliance Report* and PRC's *Annual Compliance Determination Reports* for fiscal years 2008 through 2013, the most recent reports available. We also reviewed relevant federal agency, academic, and GAO reports that describe USPS's costing approach and related issues, such as the USPS Office of Inspector General's audit reports. In addition, we conducted interviews with USPS and PRC officials to obtain their views on USPS's cost coverage methodology. Finally, we made written requests for information regarding the methodology used to calculate attributable cost to USPS and PRC officials, who provided written responses on the subject. We did not review USPS's postal costing methodology generally, such as methods to divide costs into attributable and institutional costs and methods to distribute attributable costs to various USPS products and services.

We conducted this performance audit from April 2014 through April 2015 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from the United States Postal Service



April 3, 2015

Ms. Lori Rectanus
Director, Physical Infrastructure Team
United States Government Accountability Office
441 G Street, NW
Washington, DC 20548-0001

Dear Ms. Rectanus:

The United States Postal Service (USPS) appreciates the recommendations of the United States Government Accountability Office (GAO) contained in the GAO report titled, "U.S. Postal Service: Improved Management Procedures Needed for Parcel Select Contracts" (GAO-15-408) regarding the procedures the USPS uses to develop, monitor, and evaluate the performance of its Parcel Select Negotiated Service Agreements (NSAs). Thank you for the opportunity to provide comments in response to GAO-15-408. Our responses to the GAO's Recommendations for Executive Action are as follows.

Recommendation 1:

Review the Standard Procedures to identify gaps in contract-management responsibilities, including documentation requirements and assigning clearly defined management responsibilities for contract monitoring and evaluation activities, and update the procedures to address the identified gaps.

USPS Response:

Based in part on discussions with the GAO during the study period, the USPS is reviewing, revising, and will update standard procedures for managing NSAs effective as of May 1, 2015.

Recommendation 2:

Identify and implement cost-effective methods, such as using a sample, to collect and study information on the costs of delivering Parcel Select packages of varying characteristics to develop contract-specific attributable cost estimates.

USPS Response:

In principle, the USPS concurs with the GAO's recommendation regarding development of contract-specific cost estimates for Parcel Select NSAs. The prices for NSAs for competitive products are largely determined by negotiations (and competitive market prices) rather than purely as a relationship with costs. Although the USPS cost estimates include the impacts of several significant mailer characteristics, we will explore whether we can efficiently obtain additional mailer characteristics and ascertain their relationships to costs for even greater costing accuracy.

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**Appendix II: Comments from the
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Contrary to the impression given by the GAO report, the USPS incorporates certain contract-specific characteristics that significantly impact costs. Specifically, the USPS:

- obtains customer-specific data for Sunday Delivery package delivery separately from the regular weekday delivery packages. The costs associated with the potential inefficiencies posited in the GAO report (e.g., insufficient loading space resulting in multiple street deliveries or split routes) are fully reflected in the contract-specific costs for Sunday Delivery activity.
- considers the proportions of the mail and the costs associated with each of the levels of presort and drop shipment corresponding to each contract.

While the GAO report emphasizes the impact on cost of the size and weight characteristics for each contract, these factors would have relatively little impact on the costs for Parcel Select NSAs for the following reasons:

Virtually all of the Parcel Select NSA pieces are entered at destination delivery units (DDUs), whereby they bypass virtually all upstream mail processing and postal transportation. Package size and weight are not significant cost drivers for DDU-entered mail.

- The only mail processing activity that takes place for DDU mail is sorting the parcels to the appropriate carrier. This mail processing (i.e., sorting) of parcels is not very sensitive to size for the typical size range for these packages.
- While it is true that cubic dimensions of the piece (cube) would be a determinant of transportation cost, there is almost no transportation or corresponding transportation cost for the pieces entered at DDUs. As DDUs account for almost all of the Parcel Select NSA volume, cube is largely irrelevant as a determinant of cost.
- Delivery cost is the same for parcels delivered by rural carriers regardless of the parcel size because it is driven by a contractual agreement for rural carriers which does not establish different levels of compensation for parcels of different sizes.
- Currently, the majority of all Parcel Select (excluding Parcel Select Lightweight) packages delivered by city carriers are "deviation" parcels that already require the carrier to deviate from the regular delivery routine, for example to carry to the door rather than deposit in a mailbox. The evaluations for Parcel Select NSAs fully incorporate the costs associated with this national average characteristic. For mailers that have the same characteristic of packages requiring deviation delivery as the national average, the delivery cost would be the same. Costs for mailers sending packages less likely to be a deviation than the national average would be somewhat overstated. However, the potential understatement of the cost for mailers with a deviation share that exceeds the Parcel Select national average is small. Even if a mailer had 100 percent deviation parcels, the attributable cost will not increase substantially and the NSA will still cover the cost.

In summary, the cost impact due to size and weight is likely to be very small for Parcel Select NSAs. As the USPS discussed with the GAO during its review, the additional studies to obtain size data may be costly. Furthermore, costs are only important insofar as each NSA is required to have at least a 100 percent cost coverage overall. We do not believe that the additional expense and required complexity in the analysis of each contract would have a meaningful impact on the prices negotiated. Nevertheless, the

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United States Postal Service**

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USPS will drill down a layer to explore whether incorporating more contract-specific information in Parcel Select NSAs could be done in a cost-effective manner for potentially greater costing accuracy.

Sincerely,



Joseph Corbett
Chief Financial Officer &
Executive Vice President



Nagisa Manabe
Chief Marketing/Sales Officer &
Executive Vice President

cc: Ms. Haring

Appendix III: Comments from the Postal Regulatory Commission



POSTAL REGULATORY COMMISSION
Washington, DC 20268-0001

Robert G. Taub
Acting Chairman

April 7, 2015

Ms. Lori Rectanus
Director, Physical Infrastructure Issues
Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Rectanus:

Thank you for the opportunity to offer comments on the Government Accountability Office's (GAO) draft report titled *U.S. Postal Service Improved Management Procedures Needed for Parcel Select Contracts* (GAO-15-408).

The GAO made two recommendations in this draft report:

- (1) The U.S. Postal Service should review and update its standard procedures to identify and address gaps in documentation requirements and contract-management responsibilities.
- (2) The U.S. Postal Service should identify and implement cost-effective methods, such as using a sample, to collect and study information on the cost of delivering Parcel Select packages of varying characteristics to develop contract-specific attributable cost estimates.

The Commission found the draft report well-researched and balanced and agrees with both recommendations. The second recommendation touches on an area of the Commission's jurisdiction. The Commission supports the cost-effective development of a more accurate estimate of attributable costs for Parcel Select negotiated service agreements (NSAs). If the Postal Service improves its estimate as a result of GAO's recommendation, the Commission would welcome a petition for a rulemaking to change an accepted analytical principle "to improve the quality, accuracy, or completeness of the data or analysis of the data contained in the Postal Service's annual periodic reports to the Commission." 39 C.F.R. § 3050.11(a).

The Commission would like to clarify a statement in the draft report concerning the current methodology used to estimate attributable costs for Parcel Select NSAs. The draft report states that the methodology "uses average cost estimates for the Parcel Select product as a whole...." This statement is partially correct. The methodology uses average cost estimates for most

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Parcel Select mail, including the Parcel Select product (for rates of general applicability) and the Parcel Select NSAs (for rates not of general applicability). The methodology, however, excludes Parcel Select mail weighing less than one pound, *i.e.*, lightweight parcels that were formerly Standard Mail parcels. Thus, it is the average cost estimates of the Parcel Select product (excluding lightweight parcels) and the Parcel Select NSA products that are used to approximate contract-specific cost estimates for Parcel Select NSAs.

The Commission notes that it released its FY 2014 Annual Compliance Determination Report (FY 2014 ACD) on March 27, 2015. In the FY 2014 ACD, the Commission found that the Parcel Select product, the Parcel Return Service product, and all competitive domestic NSAs complied with the requirements of 39 U.S.C. § 3633 in FY 2014, including the requirement that each product cover its attributable costs. The Commission also notes that the Postal Service requested approval of an additional Parcel Select NSA on March 27, 2015. This request is currently pending before the Commission.

The Commission appreciates GAO's collaboration and careful efforts on this draft report.

Sincerely,



Robert G. Taub
Acting Chairman
Postal Regulatory Commission

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact

Lori Rectanus, (202) 512-2834 or rectanusl@gao.gov

Staff Acknowledgments

In addition to the individual named above, key contributors to this report were Lorelei St. James (Director); Derrick Collins (Assistant Director); Amy Abramowitz; Teresa Anderson; William Colwell; Aaron Colsher; Caitlin Dardenne; Colin Fallon; Kenneth John; DuEwa Kamara; Kimberly McGatlin; SaraAnn Moessbauer; Josh Ormond; Amelia Shachoy; Crystal Wesco; and Bill Woods.

Appendix V: Accessible Data

Data Table for Figure 1: U.S. Postal Service Data of Parcel Select Volume and Revenues, Fiscal Years 2009 through 2014

Year	Volume (in millions of pieces)	Revenue (in millions of dollars)
2009	222.932	466.112
2010	268.357	503.795
2011	342.97	626.102
2012	937.631	1,341.44
2013	1,287.05	1,904.28
2014	1,484	2,529

Source: U.S. Postal Service, Revenue, Pieces & Weight reports. GAO-15-408.

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