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U.S. POSTAL SERVICE

Modernization and Restructuring Needed to Address Financial Challenges

Statement of Phillip Herr, Director
Physical Infrastructure Issues

GAO-11-428T

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Highlights

Highlights of GAO-11-428T, a testimony before the Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy, Committee on Oversight and Government Reform, House of Representatives

U.S. POSTAL SERVICE

Modernization and Restructuring Needed to Address Financial Challenges

Why GAO Did This Study

The U.S. Postal Service's (USPS) financial condition and outlook are deteriorating because revenues are not sufficient to cover its expenses and financial obligations. These challenges continue to threaten USPS's financial viability and GAO has therefore retained USPS on its high risk list issued in February 2011. USPS also faces cost pressures from maintaining a national network of processing, retail, and delivery operations.

This testimony discusses (1) updated information on USPS's financial condition and outlook and (2) actions needed to modernize and restructure USPS. It is based primarily on GAO's past and ongoing work, as well as GAO's review of USPS's recent financial results and the President's proposed budget for fiscal year 2012.

What GAO Recommends

While this testimony contains no new recommendations, GAO has reported that Congress, the administration, and USPS urgently need to reach agreement on a package of actions to restore USPS's financial viability by modernizing its operations, networks, and workforce. GAO has also recommended that Congress consider providing USPS with financial relief, and in doing so, consider all options available to reduce costs. In commenting on this statement, USPS generally agreed with its accuracy and provided technical comments that were incorporated as appropriate.

View GAO-11-428T or key components.
For more information, contact Phillip Herr at (202) 512-2834 or herrp@gao.gov.

What GAO Found

USPS experienced a net loss of $329 million in the first quarter of fiscal year 2011 and is projecting a $6.4 billion total net loss for fiscal year 2011. Mail volumes, USPS's main revenue source, have generally been decreasing as customers have shifted to electronic alternatives. This trend exposes weaknesses in USPS's business model, which has relied on mail volume growth to help cover costs. While USPS continues to reduce employees' work hours, its cost reduction efforts have not been sufficient to offset lost revenue. Since fiscal year 2006, USPS has relied on debt to help cover its obligations. If it borrows $3 billion in fiscal year 2011 as its plans indicate, USPS will reach its $15 billion statutory debt limit. The President's Fiscal Year 2012 Budget Request proposes providing USPS with over $4.5 billion in short-term financial relief in fiscal year 2011 by reducing its retiree health benefit payment by $4 billion and reimbursing it for approximately $550 million in Federal Employee Retirement System payments. While useful, these actions would not sufficiently address USPS's structural problems.

Postal Service Financial Results and Projections, Fiscal Years 2006 through 2011
Dollars in billions

Fiscal year	Net income (loss)	Total revenues	Total expenses	Outstanding debt
2006	$0.9	$72.8	$71.9	$2.1
2007	(5.1)	75.0	80.1	4.2
2008	(2.8)	75.0	77.8	7.2
2009	(3.8)	68.1	71.9	10.2
2010	(8.5)	67.1	75.6	12.0
2011 (projected)	(6.4)	67.7	74.1	15.0

Source: USPS.

As seen in the table, USPS's financial condition has reached a tipping point. Given USPS's role in facilitating key aspects of the U.S. economy, Congress, the administration, USPS, and stakeholders need to reach agreement on a package of actions to restore USPS's financial viability, facilitate progress toward modernizing its services to meet changing customer needs, and remove barriers restricting USPS actions. This would allow USPS to optimize its networks and workforce so that it can become more efficient and reduce costs. GAO recently reported on lessons learned from foreign posts' modernization efforts, including using outreach and communication strategies to inform public officials and customers of increased access to products and services to help gain acceptance for retail network changes. Some posts also developed labor transition strategies that included training, relocation, job search services, and financial incentives to support employees who were negatively affected. While USPS has taken steps to generate ideas for modernizing its retail and delivery networks, the experiences of foreign posts suggest that it will be critically important for USPS to fully develop and implement similar outreach, communication, and labor transition strategies.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to participate in this hearing on the U.S. Postal Service's (USPS) financial condition, a topic we have addressed in recent reports and testimonies. My statement will discuss (1) updated information on USPS's financial condition and outlook and (2) actions needed to modernize and restructure USPS.

This statement is based primarily on our past and ongoing work, and updated financial information, including our reviews of USPS's business model, financial condition, networks, service, and postal reform issues.[1] To perform our work, we reviewed USPS's financial statements for the fiscal year that ended September 30, 2010, and for the first quarter of fiscal year 2011 that ended December 31, 2010; USPS's Fiscal Year 2011 Integrated Financial Plan; the President's Fiscal Year 2012 Budget Request; and other reports, testimonies, and documentation on USPS's financial condition, operations, and outlook. In addition, we interviewed senior USPS officials. We conducted this performance audit in February 2011 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our objectives.

[1] A list of GAO's recent work on USPS-related issues is provided at the end of this testimony. We conducted our work for these reports in accordance with generally accepted government auditing standards or in accordance with our quality assurance framework. A more detailed discussion of our scope and methodology is available in each of the reports cited in the GAO Related Products list.

USPS's Financial Condition Continues to Deteriorate, and USPS May Face a Cash Shortfall This Fiscal Year

USPS's financial condition has deteriorated significantly since fiscal year 2006, and its financial outlook is grim in both the short- and long-term. In July 2009, we added USPS's financial condition and outlook to our high-risk list because USPS was incurring billion-dollar deficits and its debt was increasing as mail volumes and revenues declined and costs rose. USPS experienced a net loss of $329 million in the first quarter of fiscal year 2011 and is projecting a $6.4 billion total net loss for fiscal year 2011. In February 2011, we retained USPS on our updated high-risk list and reported that USPS finds itself without sufficient revenues to cover its expenses and financial obligations (see table 1).[2]

Table 1: Postal Service Financial Results and Projections, Fiscal Years 2006 through 2011

Dollars in billions

Fiscal year	Net income (loss)	Total revenues	Total expenses	Outstanding debt
2006	$0.9	$72.8	$71.9	$2.1
2007	(5.1)	75.0	80.1	4.2
2008	(2.8)	75.0	77.8	7.2
2009	(3.8)	68.1	71.9	10.2
2010	(8.5)	67.1	75.6	12.0
2011 (projected)	(6.4)	67.7	74.1	15.0

Source: USPS.

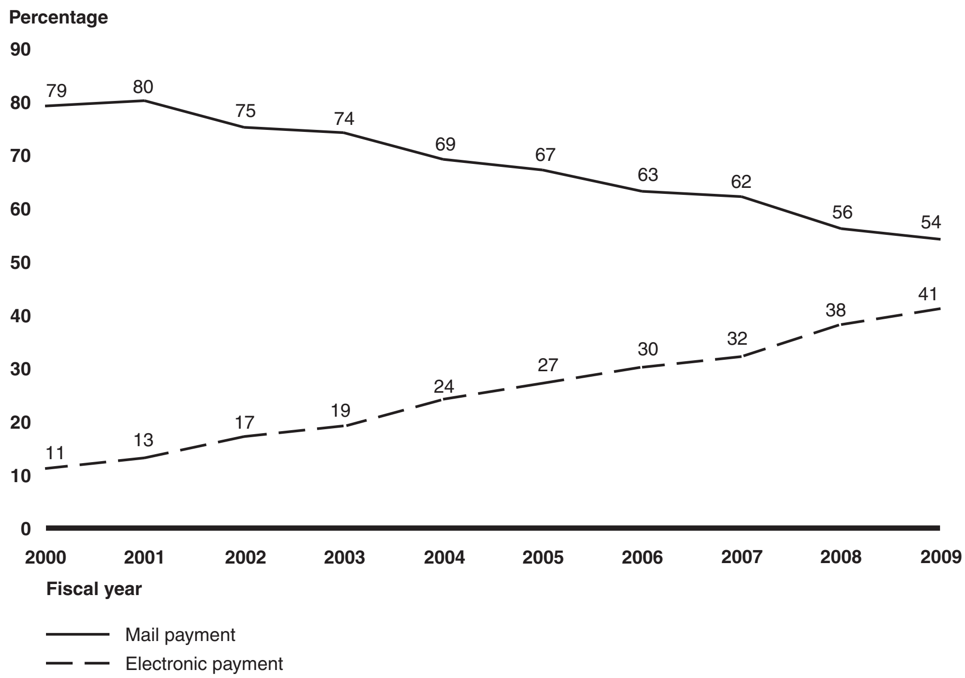
Mail volumes have generally been decreasing as customers have increasingly shifted to electronic communications and payment alternatives (see fig. 1), a trend that is expected to continue. USPS's two major products are First-Class Mail and Standard Mail.[3] These accounted for nearly 94 percent of all mail volume and 77 percent of USPS revenues in fiscal year 2010. One piece of First-Class Mail generated about three times the profitability of the average piece of Standard Mail. USPS expects First-Class Mail volumes to continue declining in both the short- and long-term, as customers increasingly rely on electronic alternatives. In the first quarter of fiscal year 2011, First-Class Mail decreased by about 6 percent

[2]GAO, *High-Risk Series: An Update*, GAO-11-278 (Washington, D.C.: February 2011).

[3]First-Class Mail consists of single-piece mail (e.g., bill payments and letters) and bulk mail (e.g., bills, statements, and advertising). Standard Mail is mainly bulk advertising and direct mail solicitations.

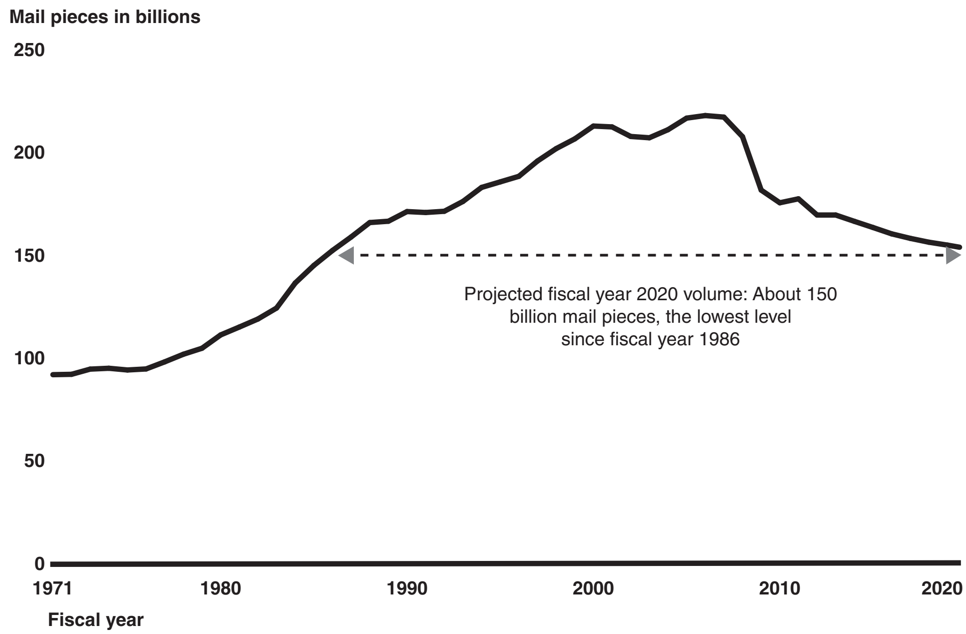
compared to the same period last year, while Standard Mail volumes grew by about 9 percent. Figure 2 depicts actual and projected mail volume trends—which show that by fiscal year 2020 mail volume is projected to decline to a level not seen since fiscal year 1986. Additionally, USPS expects the gap between First-Class and Standard Mail to expand—Standard Mail volumes first exceeded those in First-Class Mail in fiscal year 2005.

Figure 1: Percentage of Household Bill Payments Made by Mail and Electronically, Fiscal Years 2000 through 2009



Source: USPS.

Figure 2: Actual and Projected Total Mail Volume, Fiscal Years 1971 through 2020



Source: USPS.

In 2010, USPS delivered mail to over 150 million addresses nationwide. USPS has about 670,000 full-and part-time employees, and reports that, when benchmarked against other large posts, it has the highest percentage of full-time employees—about 79 percent. USPS has reported achieving cost savings close to $13 billion in the last 5 years. For example, USPS eliminated 125,000 full- and part-time positions (about 16 percent). Despite these achievements, USPS has had difficulty significantly reducing its compensation and benefits costs and has struggled to optimize its workforce and retail, mail processing, and delivery networks. For example, during the first quarter of fiscal year 2011 despite a reduction of 6.4 million work hours when compared with the same period last year, savings from this reduction were partially offset by wage increases and increase in total retirement and health benefits expenses. Further, some USPS savings during these years came as a result of congressional action—Congress deferred $4 billion of USPS's $5.4 billion scheduled payment to its retiree health benefit fund that was due at the end of fiscal year 2009.[4] Table 2 provides an overview of key components of USPS's operational network.

Table 2: Key Aspects of USPS's Operational Network, Fiscal Year 2010

• Delivered to over 150 million business and residential addresses	• Processed about 563 million pieces, on average, of mail each day
• Nearly 740,000 new additional delivery points	• Over 670,000 full- and part-time employees
• 6-day mail delivery to most addresses	• $60 billion in compensation and benefits expense (80 percent of total expenses)
• Over 32,500 post offices and other retail and delivery facilities	• 528 mail processing facilities
• Over 215,000 vehicles, 193,000 of which are delivery vehicles	• Nearly 1.2 billion staff work hours
• 4.1 million miles driven in an average day by letter carriers and truck drivers	• $5.9 billion in transportation expense, primarily for highway and air transportation

Source: USPS.

USPS has relied increasingly on debt to fund its operations and has increased its net borrowing by nearly $12 billion over the last 5 years. USPS also ended fiscal year 2010 with about $1.2 billion in cash and unfunded obligations and liabilities of roughly $105 billion (see table 3). For fiscal year 2011, USPS has not updated its financial projections based on its first quarter results and it still plans to borrow an additional $3 billion—an increase that would place USPS at its $15 billion statutory limit and prevent it from further borrowing in fiscal year 2012 absent congressional action. USPS also projects a $2.7 billion cash shortfall at the end of fiscal year 2011.

[4] USPS made its scheduled $5.5 billion payment into the Postal Service Retiree Health Benefit Fund that was due at the end of fiscal year 2010.

Table 3: USPS Financial Liabilities and Unfunded Obligations, Fiscal Years 2007 through 2010

Dollars in billions

	Liabilities				Obligations			
Fiscal year	Outstanding debt	Workers' compensation liabilities	Other liabilities[a]	Total liabilities	Unfunded obligations for retiree health benefits	Unfunded obligations (surplus) for pension benefits	Total unfunded obligations	Total liabilities and obligations
2007	$4.2	$7.8	$12.7	$24.7	$55.0	$(5.3)	$49.7	$74.4
2008	7.2	8.0	12.5	27.7	53.5	2.5	56.0	83.7
2009	10.2	10.1	13.2	33.5	52.0	16.7[b]	68.7	102.2
2010	12.0	12.6	13.6	38.2	48.6	17.9[b]	66.5	104.7

Source: USPS.

Note: Data may not add exactly to totals due to rounding; workers' compensation liabilities include the current and non current portion of this liability.

[a]Other liabilities include many items, such as operating expenses that USPS committed to in fiscal year 2009 but has not yet paid, the value of postage purchased by customers but has not yet been used, and the value of employees' accumulated leave.

[b]Pension obligations for 2009 and 2010 reflect the adoption of new accounting principles by the plan administrator in the Office of Personnel Management (OPM). In fiscal year 2010, OPM adopted the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standard No. 33: Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Date.

The President's Fiscal Year 2012 Budget Request also proposes changes that, if enacted, would provide USPS with over $4.5 billion in short-term financial relief for fiscal year 2011. The majority of this relief—$4 billion—would come as a result of USPS paying $1.5 billion into the Postal Service Retiree Health Benefit Fund instead of the $5.5 billion required under current law. The remaining relief would come from reducing USPS's obligation for future funding of retirement payments to the Federal Employees Retirement System (FERS).[5] This relief, however, would be somewhat offset by terminating $29 million in annual appropriations in

[5]The proposal would reduce USPS's obligation for future funding of retirement payments to FERS—a change that would result in a reduction of this obligation totaling approximately $6.9 billion, payable over 30 years with an estimated impact of $550 million in fiscal year 2011.

fiscal year 2012, that reimburses USPS for revenue foregone from reduced rate mail.[6]

USPS's financial problems will not be fixed easily or quickly. USPS projects future mail volume declines, stagnant revenues, large financial losses and continued significant financial obligations.

Actions Are Urgently Needed to Modernize and Restructure USPS to Achieve Financial Viability

Considering USPS's important role, action is urgently needed to facilitate its financial viability as USPS cannot support its current level of service and operations. Congress, USPS, the administration, and stakeholders need to reach agreement on a package of actions to restore USPS's financial viability and take steps to modernize and restructure it. USPS needs to become a leaner, more flexible organization so that it can operate more efficiently, control costs, keep rates affordable, and meet customers' changing needs. In considering proposed legislation, incentives and oversight mechanisms would help to ensure an appropriate balance between providing USPS with more flexibility and assuring sufficient transparency, oversight, and accountability.

We have previously identified five key areas where action is needed to facilitate progress toward meeting USPS's growing fiscal challenges:

- *Realign postal service with customers' changing use of mail*: As mail use by businesses and consumers continues to change, USPS has stated that it cannot afford to sustain its current level of delivery and retail services. For example, it has estimated that it could reduce its costs by about $3 billion annually if it reduced delivery frequency from 6 days to 5 days per week, but congressional action would be needed for this change. USPS filed its proposal to eliminate Saturday delivery with the Postal Regulatory Commission (PRC) on March 30, 2010, and the PRC's advisory opinion is expected to be released in 2011.[7] Key questions to consider when evaluating this proposal include:

[6]Under this appropriation, USPS receives reimbursement for previously provided services—free mail service for the blind and overseas voting. See e.g., Pub. L. No. 111-117, div. C, tit. V, 123 Stat. 3200 (Dec. 16, 2009).

[7]We also expect to issue a report on 5-Day delivery this spring.

- What aspects of universal postal service, including 6-day delivery, are appropriate in light of fundamental changes in customers' use of the mail?

- What, if any, changes are needed to other elements of universal service (e.g., delivery standards)? How can USPS improve customers' access to postal services while modernizing its retail network to maximize costs savings?

- Should USPS implement its proposal to reduce delivery frequency to 5 days a week? How would such a change affect its operations, costs, workforce mix, employees, service, competition, value of mail, mail volume, and revenue? How would shifting to 5-day delivery affect business mailers and the public?

- *Realign operations, networks, and workforce*: USPS's operations, networks, and workforce need to be realigned with the changes in mail usage and customer behavior, as USPS now has costly excess capacity. Key questions to consider when evaluating proposed actions in this area include:

  - How should USPS optimize its operations, networks, and workforce to support changes in services? How quickly can this happen? How can it work with its employees and customers to minimize potential disruptions?

  - Should USPS have greater flexibility to realign its retail networks and workforce, which may involve closing post offices and moving retail services to alternative commercial locations that are often open 7 days a week and keep longer hours than postal facilities?

  - What process is appropriate to assure sufficient transparency, oversight, and accountability?

- *Reduce compensation and benefit costs:* Wages and benefits represent 80 percent of USPS's costs (about $60 billion in fiscal year 2010). One of the most difficult yet critical challenges is making changes to USPS's compensation systems. These systems have been set in law and also negotiated during collective bargaining with its four largest employee unions. USPS also consulted with its three management associations. We suggested that Congress should consider revisiting the statutory framework for USPS's collective bargaining to ensure that binding arbitration takes USPS's financial condition into account.[8] We also reported other possible options for reducing compensation and benefit costs, including implementing a two-tier pay system, outsourcing if it results in cost savings, or revising employees' share of health and life insurance premiums. Key questions to consider when evaluating proposals in this area include:

- What changes, if any, should be made to USPS's compensation and benefits?
- Is it appropriate that USPS pays a larger share of its employees' health and life insurance premiums than do most other federal agencies? What impact would changes to these premiums have on USPS and its employees?

- *Generating revenue through new or enhanced products and services*: A key issue is whether USPS can generate sufficient new revenues using the pricing and product flexibility provided in the Postal Accountability and Enhancement Act of 2006[9] or if changes are needed. In 2009, USPS asked Congress to change the law to permit it to diversify into nonpostal areas to find new opportunities for revenue growth. USPS also asked for additional pricing flexibility in a 2010 action plan.[10] However, it is unclear what the potential impact of such changes would be and what statutory or regulatory changes would be needed. Key questions to consider when evaluating proposals in this area include:

  - New products and services: What opportunities are there to introduce profitable new postal products and enhancements to existing ones?
  - Should USPS engage in nonpostal areas where there are private sector providers? If so, under what terms?

[8]About 77 percent of USPS employees are covered by collective bargaining agreements, and if the current collective bargaining process reaches binding arbitration, there is no statutory requirement to consider USPS's financial condition when determining pay or other compensation.

[9]Pub. L. No. 109-435 (Dec. 20, 2006).

[10]United States Postal Service, *Ensuring a Viable Postal Service for America: An Action Plan for the Future* (Washington, D.C. March 2010).

- *Funding postal retiree health ben*efits: USPS has said that it cannot afford its required annual prefunding payments ($5.5 billion in fiscal year 2011 and gradually increasing to $5.8 billion by 2016), and it has requested that Congress reduce these payments.[11] Several proposals have been put forth to revise the current statutory requirements and reduce or defer some of these costs, thereby providing USPS with financial relief.[12] Changes to this structure, however, could affect the federal budget, and the Congressional Budget Office has raised concerns about how aggressive USPS's cost-cutting measures would be if these payments were reduced.[13] As we reported in 2010, Congress should consider modifying USPS's retiree health benefit payments in a fiscally responsible manner. However, we also believe that it is important that USPS fund its retiree health benefit financial obligations—including prefunding these obligations—to the maximum extent that its finances permit. Key questions to consider when evaluating proposals in this area include:

  - What changes, if any, should be made to USPS pension and retiree health benefit obligations and payment schedules?

  - What would be the impact on the federal budget?

The President's Fiscal Year 2012 Budget Request proposed specific short-term financial relief measures, that it stated are grounded in principles of fiscal responsibility and sound financial management. The budget request states that these steps are to provide USPS with the "breathing room" necessary to continue restructuring its operations without severe disruptions and notes that they must be coupled with meaningful business model reforms to make USPS viable for the medium- and long-term. To that end, the budget request outlines three principles to guide these reforms: (1) realigning postal infrastructure, including processing and delivery facilities; (2) adapting the postal workforce to the 21st century; and (3) enhancing service and accelerating the value of USPS services

[11]The Postal Accountability and Enhancement Act of 2006 required USPS to prefund its retiree health benefit obligations with annual payments through 2016 to the Postal Service Retiree Health Benefits Fund.

[12]See GAO, *U.S. Postal Service: Strategies and Options to Facilitate Progress toward Financial Viability*, GAO-10-455 (Washington, D.C.: Apr. 12, 2010) for a discussion of different approaches for funding USPS's retiree health benefit obligations.

[13]Congressional Budget Office, *H.R. 22: United States Postal Service Financial Relief Act of 2009* (Washington, D.C. July 20, 2009); *S. 1507: Postal Service Retiree Health Benefits Funding Reform Act of 2009* (Washington, D.C., Sept. 14, 2009).

while respecting fair competition in the marketplace. However, while promoting realignment and modernization, the budget request would also continue to restrict USPS from reducing delivery from 6 days a week and closing small rural and other small post offices.

Much attention has been focused on ways postal services may be reduced—such as USPS's proposals to move to 5-day-a week delivery or to close post offices. Less attention has been given to more positive aspects of USPS's plans to modernize its retail services, which it believes will improve customer access and convenience while reducing costs and improving efficiency. In a recently issued report on strategies and initiatives foreign posts have used to modernize their delivery and retail networks, we discussed some lessons learned that could inform USPS's modernization efforts.[14]

Although the foreign posts we reviewed reported that changing how postal services were provided was challenging, they also found that outreach and communication strategies helped to inform public officials and customers of increased access to products and services and to gain acceptance for retail network changes. For example, when realigning their respective retail networks, Australia Post developed a labor outreach strategy, and the Swedish postal operator, Posten AB, created a communications strategy to inform customers of its retail network transformation. Additionally, foreign posts modernized their retail networks by forming partnerships with private sector businesses such as grocery stores to sell postal services. According to the foreign posts we reviewed, retail modernization improved customer service, in some cases because the private sector partners stayed open longer, reduced operating and labor costs through closures of post-owned and -operated facilities, or both.

When modernizing, foreign posts also transitioned their workforce to have a greater percentage of part-time employees, which they reported afforded flexibility to adjust work to decreased mail volumes. A few foreign posts developed labor transition plans or strategies under which they provided training, relocation and job search services, and financial incentives to support employees who were negatively affected by the modernizations.

[14]GAO, *U.S. Postal Service: Foreign Posts' Strategies Could Inform U.S. Postal Service's Efforts to Modernize*, GAO-11-282 (Washington, D.C.: Feb. 16, 2011).

The foreign posts we reviewed did not plan or implement changes or realize improvements to their networks overnight. Modernization took several posts 10 to 20 years to implement and was often met with stakeholder resistance. Among the key principles that foreign posts used to help modernize and restructure their organizations are the following:

- Strategic outreach and coordination with governments, the public, mailers, small businesses, and retail customers can address political resistance. For example, foreign posts communicated with and reached out to customers to increase acceptance of changes and to better meet customers' needs, including providing alternatives before implementing major retail network changes.
- A labor relations strategy can assist employees in making the necessary transition to modernization changes. For example, a few foreign posts provided training, relocation and job search services, and financial incentives to support employees who were negatively affected by the modernizations.

The lesson from these experiences is that USPS needs to clarify what its modernization plans are, how and over what period it will implement them, and what improvements in customer service and cost savings it expects to achieve. In its efforts to modernize its retail network, USPS needs to assure customers that they will have alternative access to postal services, such as through self-service retail kiosks or retail partners. While USPS has taken steps in the past year to generate ideas for modernizing its retail and delivery networks, the experiences of foreign posts suggest that it will be critically important for USPS to fully develop and implement similar outreach, communication, and labor transition strategies.

In summary, modernizing and restructuring USPS so that it can be viable in the future is imperative given its financial condition. While we recognize that this will not be easy, changes—some difficult—are needed to ensure that postal services remain available to all U.S. residents and businesses. Mr. Chairman, this concludes my prepared statement. I would be pleased to answer any questions that you or other Members of the Subcommittee may have.

Contacts and Staff Acknowledgments

For further information about this statement, please contact Phillip Herr at (202) 512-2834 or herrp@gao.gov. Individuals who made key contributions to this statement include Susan Ragland, Director, Financial Management and Assurance; Teresa Anderson, Joshua Bartzen, Heather Frevert, Margaret McDavid, Robert Owens, and Crystal Wesco.

Related GAO Products

U.S. Postal Service: Foreign Posts' Strategies Could Inform U.S. Postal Service's Efforts to Modernize. GAO-11-282. Washington, D.C.: February 16, 2011.

High-Risk Series: An Update. GAO-11-278. Washington, D.C.: February 2011.

U.S. Postal Service: Legislation Needed to Address Key Challenges. GAO-11-244T. Washington, D.C.: December 2, 2010.

U.S. Postal Service: Mail Processing Network Initiatives Progressing, and Guidance for Consolidating Area Mail Processing Operations Being Followed. GAO-10-731. Washington, D.C.: June 16, 2010.

U.S. Postal Service: Action Needed to Facilitate Financial Viability. GAO-10-601T. Washington, D.C.: April 22, 2010.

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U.S. Postal Service: Strategies and Options to Facilitate Progress toward Financial Viability. GAO-10-455. Washington, D.C.: April 12, 2010.

U.S. Postal Service: Financial Crisis Demands Aggressive Action. GAO-10-538T. Washington, D.C.: March 18, 2010.

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