United States General Accounting Office 140552

GAO

Testimony

140552

For Release
on Delivery
Expected at
10:00 a.m. EST
Wednesday
February 7, 1990

Financial Performance of the United States Postal Service

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Before the Committee on
Post Office & Civil Service
U.S. House of Representatives

047663/140552

GAO/T-GGD-90-16

FINANCIAL PERFORMANCE OF THE UNITED STATES POSTAL SERVICE

Summary of Statement by L. Nye Stevens
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U.S. General Accounting Office

During fiscal year 1989, postal revenues reached the level anticipated when the present rates were set in April 1988. Costs, however, exceeded the anticipated level by about $1.6 billion. The major cause of the overrun was the Service's failure to accomplish workforce reductions as anticipated. Overall, workyears used during 1989 exceeded the prediction by about 38,000 at a cost of about $1.34 billion.

The Service's cost savings estimates and assumptions were not examined during the rate making process. Postal Rate Commission officials said they could not legally question such estimates unless they were contradicted by other data or challenged by other parties to the rate case. Postal customers, however, have little incentive to challenge predicted cost reductions because they produce a lower revenue requirement and lower postage rates. Under such circumstances, the Postal Service must ensure that predicted cost reductions are realistic and accomplished.

In its estimate of 1989 costs, the Service expected that it would save about $748 million in reduced clerk and mailhandler workhours by installing labor saving equipment such as automated sorting machinery. Although the equipment was put in place, clerk and mailhandler costs exceeded the planned level by $761 million. The Service's savings estimates were not backed up with actions to achieve them. Workhours that might have been replaced by automation were not put to effective use elsewhere.

The productivity potential of automated equipment is critical to the Service's ability to control future costs. GAO's analysis of 1989 processing costs indicates that productivity gains were insufficient to offset the cost of increased mail volume, and were dwarfed by the increase in per hour labor costs. Unless productivity improves substantially or the growth in labor costs is restrained, the cost of mail service in the future is likely to become increasingly less competitive with other forms of communication and delivering information.

The Postal Service's financial performance during 1989--a profit of $61 million--was well below the level anticipated at the beginning of the year--a profit of about $600 million. The disappointing financial performance of 1989 will continue into 1990, during which the Postal Service expects to have a deficit of $1.6 billion, the largest in history.

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the Postal Service financial results in 1989 compared to the forecast that was the basis for the April 1988 postal rate increase.

As you know, general rate increases are requested by the Postal Service and reviewed by the Postal Rate Commission, which makes a recommendation to the Board of Governors of the Postal Service. The Postal Service filed the request for the 1988 increase in May of 1987. The Commission reviewed the request and issued its recommended decision the following March. The estimate of Postal Service revenues and costs in support of the rate increase was for fiscal year 1989. The estimates were projections based on actual 1986 amounts. Some adjustments were made during the review process based on experience in fiscal year 1987. The total revenue requirement of about $38.78 billion was comprised of $37.21 billion in estimated costs and $1.57 billion for contingencies (a 3.5 percent allowance for unforeseen cost increases and revenue shortfalls) and recovery of prior year losses (0.7 percent).

Attachment I to my statement is a schedule of estimated and actual revenue and costs in each of the segments into which data is aggregated for rate case purposes. The first column is the Postal Service's estimate, followed by the Commission's recommendation, 1989 actual costs, and the difference between the recommendation and actual. As you can see, the estimates of the Postal Service and the Rate Commission were not significantly different.

REVENUES WERE ACCURATELY PREDICTED, BUT COSTS WERE NOT

Revenues actually collected in 1989 slightly exceeded the Service and Commission projections. Operating receipts of about $38 billion nearly coincided with the estimates, indicating that mail volume had been accurately predicted. Appropriations to compensate for subsidies in certain mail categories, and investment income were about $200 million more than the Commission projection. Overall revenues and receipts were within half of one percent of the amount projected.

On the cost side, however, there was an overrun of 4.4 percent or about $1.65 billion above the projected amounts. This essentially consumed the contingency amount and the provision for recovery of prior year losses.

To identify the major factors contributing to the cost overrun we focused on the cost segments with the largest overruns. We looked at the supporting estimates and records and interviewed Postal Service and Commission officials to determine the causes of the differences.

The major cause of the overrun was the Service's failure to accomplish the workforce reductions anticipated in the rate case. Overall, the Postal Service used about 38,000 more workyears in 1989 than were predicted. Most of this occurred in cost segments covering clerks and mailhandlers and rural carriers. Other large dollar overruns occurred in segments covering administration and regional operations, and depreciation and servicewide costs. I would like to elaborate on what we found in these areas.

NOT MANAGING THE WORKFORCE AS PREDICTED

The predicted workforce level for 1989 was 797,000 workyears. Utilization during the year, however, totaled 835,000 workyears, about 5 percent more than predicted. At an average pay and benefit cost of $35,348 per workyear in 1989, the overrun of 38,000 workyears cost the Postal Service, and ultimately will cost postal customers, about $1.34 billion. Since mail volume in the test year was very close to the projected level, it appears that a major cause of the deficit was the Service's failure to realize various workyear reduction goals that were built into the estimates. The cost segment with the largest anticipated reduction was clerks and mailhandlers.

CLERK AND MAILHANDLER

COSTS - $761 MILLION OVERRUN

This segment covers the salaries and benefits of clerks and mailhandlers who process mail, tend windows, and work in administrative and support positions. This is the largest of all the cost segments, amounting to about a third of the Service's total costs.

Actual costs for clerks and mailhandlers ($12.61 billion) exceeded the projected amounts ($11.85 billion) by 6.4 percent. The totals can be broken down into components representing cost per workyear (employee pay and benefits) and workyears. Actual pay and benefits per work year in 1989 were slightly less than was projected; thus the overrun in this cost segment was due to using more clerk and mailhandler workyears than anticipated. Specifically, about 24,400 more were used than projected.

In projecting 1989 costs, the Postal Service anticipated that cost reduction programs would have the cumulative effect of reducing the clerk and mailhandler cost segment by about 36,000 workyears or $1.19 billion. Most of the savings (22,000 workyears, $748 million) were expected to come from the deployment of labor saving equipment such as optical character readers, sorting machinery, and electronic terminals at retail windows.

We reviewed the documentation that was still available in support of various cost reductions anticipated from the utilization of equipment. Generally the estimates were based on engineering and financial analyses of the performance capabilities of the equipment rather than proven reductions in operating costs. For example, savings of 412 clerk workyears or $13.9 million were attributed to the introduction of electronic terminals at retail windows. The terminals do not actually replace clerks, but allow them to do their work more quickly. It was assumed that each terminal would save 15 minutes a day of clerks' time and that operating costs would decrease correspondingly. In a working environment where most employees are guaranteed 8 hours of work per day, it can be extremely difficult to capture actual savings of 15 minutes a day.

Over $400 million in projected cost savings was attributed to the introduction of optical character readers which automatically read and barcode letter mail. This is a key component in the Service's long-range automation program to handle growing mail volume and control labor costs. Since the early 1980's the Service has spent about $1.2 billion on automated equipment. Last March, in response to a request from the Chairman of the Senate Governmental Affairs Committee, the Postal Rate Commission reported that, based on 1987 data, it could not detect any improvement in postal cost containment since the inception of the automated equipment. The Commission concluded that it was possible that the savings goals from this equipment were being met, but if so they were being more than offset by cost growth in other areas.

In December of 1989, the Postal Inspection Service reported the results of a national audit of the optical character reader and bar code sorter automation program. The review covered one month's experience early in 1989 at 23 post offices. The Inspection Service concluded that while the equipment was functioning well and producing some savings, it was not capturing nearly the savings that were possible.

At 22 sites reviewed, only about a third of the workhour savings forecast from the equipment was being attained. This shortfall in savings was attributed to poor management and utilization of automated equipment. For example, at 20 sites, mail which should have been processed by automated equipment was diverted to less efficient mechanized and manual processing to keep employees busy. The inspectors said that managers did not or were unable, because of work rules, to reduce staffing levels in mechanized or manual operations. The Inspection Service made several recommendations to improve the utilization of the workforce, but noted that the Postal Service needed to obtain, through negotiations with labor, more flexibility in its use of employees.

MORE MANAGEMENT ATTENTION GIVEN TO CAPTURING SAVINGS

The Service seems to be giving more attention to gaining savings from automation. The Service recently implemented a uniform system-wide tracking system to identify savings from the automation program. Past performance measurement by local and regional management stressed the number of pieces of mail processed rather than costs, and was not comprehensive or uniform. Site review teams were established to identify successes and opportunities for improving automated processing. Equipment utilization is, according to the Service, being guided by a systematic planning process. A new Department of Automation Implementation Management, headed by an Assistant Postmaster General, was also created last month to coordinate the overall automation effort.

We believe the Postal Service needs to devote the highest priority to the issue of what to do with the workhours and employees that are made surplus by an automated mail processing and distribution system. If managers are not able to put these resources to effective use, the financial performance of the Postal Service will continue to be disappointing.

RATEMAKING PROCESS DID NOT QUESTION SAVINGS

Rate proposals necessarily are based on data developed before the case is considered. When the rate case was being considered various information was available or trends were occurring that would put the Service's cost reduction estimates into question. For example, the Service's May 1987 rate proposal anticipated the use of 798,000 workyears during fiscal year 1988 (October 1987 to September 1988). By October 1987, halfway through the ratemaking process, the Service had a 1988 internal operating plan, and it anticipated 822,000 workyears, or 24,000 more than being used for ratemaking purposes.

The Service's cost reduction estimates, which impacted heavily on clerk and mailhandler costs and the revenue requirement, was not examined during the rate making process. Postal Rate Commission officials pointed out that a 1981 court decision interpreted postal legislation as giving prime responsibility for deciding the Service's revenue requirement to the Board of Governors, not the Commission. Further, while postal customers involved in the rate setting process may challenge predicted cost reductions, they have little incentive to do so because such a challenge would produce a higher revenue requirement, and therefore higher postal rates. Rate Commission officials also told us that the Commission cannot legally make determinations of fact without record evidence to support its findings, and no evidence challenging the Service's figures was offered in this case. Under such circumstances, to have postal rates based on authentic information the Postal Service must ensure that predicted cost reductions are realistic and subsequently accomplished by having specific operating objectives.

RURAL CARRIERS - $181.9 MILLION OVER

This segment covers the salaries, benefits, and related costs of rural carriers who serve about 46,000 rural routes nationwide. It also includes reimbursement for the use of private vehicles.

As with the clerks and mailhandlers, the difference is due to more work hours being used than were anticipated. Postal Service officials said that part of the difference was due to an unanticipated growth in routes and boxes served in 1989. The growth, about 3.5 percent actual versus 2.6 percent estimated, would not appear to fully account for the 9.6 percent overrun in costs. Officials also speculated that a change in the mix of classes of mail carried may also have had an impact, and has undertaken an analysis to identify the cause of the variance.

OTHER MAJOR VARIANCES

Large overruns also occurred in cost segments called administration and regional operations ($447 million over) and depreciation and servicewide expenses ($105 million over). These segments include a variety of significant expenses which accrue at the national level, such as workers compensation, unfunded retirement liabilities, and depreciation. As shown in attachment II, we can tie overruns to specific cost accounts, but we did not corroborate the reasons offered for the variance since that would require significant analysis to verify. In some cases the workpapers supporting the estimates are no longer available.

IMPLICATIONS FOR 1990 AND BEYOND

The Postal Service's financial performance during 1989--a profit of $61 million--was well below the level anticipated as late as the beginning of the year--a profit of about $600 million. The disappointing financial performance of 1989 will continue into 1990, during which the Postal Service expects to have a deficit of $1.6 billion, the largest in history. Controls on the size of the workforce were instituted in 1989, and financial performance started to improve late in the year. This trend seems to be continuing so far in 1990. However, the Postmaster General informed the Board of Governors last month that cost reductions could be hurting service, and that the Service is monitoring the situation closely.

As you are aware, rates are expected to increase early in 1991, and the Postmaster General has acknowledged that the increase will exceed inflation. To offset this increase, he has set for the Service an objective of holding average yearly cost increases to two percent below inflation through 1995.

The Postmaster General believes that this will require higher productivity gains than have been achieved in recent times and restraint of growth in workhour costs. We certainly agree. To gain insight into the factors that influence postal costs, we are analyzing the change in operating costs from 1988 and 1989. Specifically, using increases in mail processing and distribution costs, we have developed a method for apportioning the change among three factors: (1) increased mail volume, (2) increased per hour labor costs, and (3) productivity, whether improving or declining. While not complete, the analysis so far indicates that savings from improved productivity are not nearly enough to offset cost increases due to volume growth and labor cost increases, especially the latter.

We analyzed selected mail processing and distribution costs at 114 of the largest mail processing facilities. Mail processing and distribution costs at these facilities increased a net $444.9

million from 1988 to 1989. We estimate that $138.2 million was saved due to improvements in mail processing and distribution; however this savings was dwarfed by higher costs associated with increased mail volume and labor. Specifically, costs increased $148.6 million because of higher volume and $434.5 million due to the increase in per hour labor cost. In terms of 1988 levels, productivity improvement resulted in a savings of 2.1 percent, higher volume increased costs 2.2 percent, and the per hour increase in labor raised costs by 6.5 percent. This analysis is admittedly a simplification of many cost interactions in a complex operating environment. Nevertheless, it indicates that the Postmaster General has selected the right targets for financial improvement -- productivity gains and restrained growth in labor costs.

That concludes my prepared statement, Mr. Chairman. I would be happy to answer any questions you may have.

Comparison of Rate Case Amounts With Actual Cost
1989 - in $000s

Segment Description	Rate Case: Postal Service	Rate Case: Rate Commission	Actual	Difference-Actual Less Rate Commission
Mail	38,027,976	38,037,657	37,978,674	(58,983)
Appropriations	461,966	348,042	436,417	88,375
Investment Income	336,600	388,577	504,513	115,936
Total Revenue & Receipts	38,826,542	38,774,276	38,919,605	145,329
Postmasters	1,298,664	1,264,557	1,240,409	(24,148)
Supervisors	2,858,229	2,795,713	2,787,466	(8,247)
Clerks & Mailhandlers	11,899,712	11,854,005	12,614,722	760,717
Clerks, small offices	30,394	29,825	19,635	(10,190)
City Delivery,	8,463,611	8,414,548	8,505,103	90,555
Vehicle Service Drivers	283,836	279,203	273,202	(6,001)
Special Del. Messengers	107,657	103,084	103,989	905
Rural Carriers	1,938,508	1,901,620	2,083,523	181,903
Custodial Maint. Service	1,528,872	1,497,739	1,393,688	(104,051)
Motor Vehicle Service	484,677	490,904	455,868	(35,036)
Misc. Operating Costs	145,130	145,427	205,603	60,176
Transportation	2,403,408	2,451,458	2,471,348	19,890
Building Occupancy	847,106	865,621	893,382	27,761
Supplies & Services	808,236	838,049	931,637	93,588
Research & Development	19,209	19,209	63,631	44,422
Admin. & Regional Operations	3,531,134	3,566,513	4,014,247	447,734
General Management Systems	16,775	16,712	17,860	1,148
Depreciation & Servicewide	681,338	678,318	783,572	105,254
Total Costs	37,346,496	37,212,505	38,858,886	1,646,381
Contingency	1,307,127	1,302,438		(1,302,438)
Recovery of Prior Losses	191,300	265,410		(265,410)
Total Costs/Cont/Recovery	38,844,923	38,780,353	38,858,886	78,533
Net Surplus (Deficiency)	(18,381)	(6,077)	60,719	66,796

Accounts With Large Overruns in Segments for Administrative and Regional Operations and Depreciation and Servicewide Costs

Segment and Account

Administration and Regional Operations

Health Benefits for Retired Annuitants $270 million

A $270 million payment was made to the Federal Employees Health Benefits fund in 1989, as required by the Omnibus Reconciliation Act of 1987. The requirement to make the payment occurred after the rate case was prepared, thus the payment was not provided for in the Service's estimate. Although operating costs were also required to be reduced by an equal amount thus offsetting this expense, most of these reductions occurred in other cost segments while the payment was drawn on this account.

Workers' Compensation $133 million

According to Postal Service officials, it is extremely difficult to estimate the annual adjustment to the Postal Service's workers' compensation liability. Many uncontrollable and unpredictable factors impact the actual cost each year, such as the number of paid cases, the cost of each case, and the length of time an employee receives medical attention/compensation. The 1989 workers' compensation expense was projected to increase by $37 million (7.1 percent), and actually increased by $171.4 million (33 percent). Correspondingly, total paid cases increased by 13.6 percent in 1989, compared to a historical increase of 1.3 percent from 1984 to 1988.

Capitalized interest $59 million

This account represents the interest cost on the cost of capital projects during the period they are under construction. It reduces current year interest expense and is added to the cost of each project. The account is affected by a variety of factors such as interest rates, the level of construction activity, and the time taken to put projects into service. Capitalized interest for 1989 was $59 million less than planned. Service officials attribute the difference to completing and transferring construction projects to in-service status sooner than expected, more favorable interest rates than forecasted, and/or fewer expenditures for facilities than planned. They also acknowledge that, like workers' compensation, capitalized interest is difficult to estimate beyond a year or so into the future.

Depreciation and Servicewide

Depreciation $76 million

Depreciation for buildings, equipment, and vehicles was $76 million higher in 1989 than estimated in the rate case. The difference appears to be due to several factors. Beginning in 1988, the scheduled service life for some equipment was reduced, which in turn increased the annual depreciation charges. During the same year, construction projects began being classified to an in-service status according to an automated process. In addition, there has been an effort to shorten the time frame of projects from construction to occupancy. Both of these actions tended to accelerate the acquisition of assets for financial reporting purposes and thereby increase actual depreciation expenses above the amount estimated.