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U.S. POSTAL SERVICE

Postal Reform Law Provides
Opportunities to Address
Postal Challenges

Statement of Katherine Siggerud, Director
Physical Infrastructure Issues





Highlights of GAO-07-684T, a testimony before the Subcommittee on the Federal Workforce, Postal Service, and the District of Columbia, Committee on Oversight and Government Reform, U.S. House of Representatives

Why GAO Did This Study

When GAO originally placed the U.S. Postal Service's (the Service) transformation efforts and long-term outlook on its high-risk list in early 2001, it was to focus urgent attention on the Service's deteriorating financial situation. Aggressive action was needed, particularly in cutting costs, improving productivity, and enhancing financial transparency. GAO testified several times since 2001 that comprehensive postal reform legislation was needed to address the Service's unsustainable business model, which assumed that increasing mail volume would cover rising costs and mitigate rate increases. This outdated model limited its flexibility and incentives needed to realize sufficient cost savings to offset rising costs, declining First-Class Mail volumes, unfunded obligations, and an expanding delivery network. This limitation threatened the Service's ability to achieve its mission of providing affordable, high-quality universal postal services on a self-financing basis.

This testimony will focus on (1) why GAO recently removed the Service's transformation efforts and outlook from GAO's high-risk list, (2) the Service's financial condition in fiscal year 2007, (3) the opportunities and challenges facing the Service, and (4) major issues and areas for congressional oversight. This testimony is based on GAO's past work, review of the postal reform law, and updated information on the Service's financial condition.

www.gao.gov/cgi-bin/gettrpt?GAO-07-684T.

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

U.S. POSTAL SERVICE

Postal Reform Law Provides Opportunities to Address Postal Challenges

What GAO Found

Key actions by both the Service and Congress have led GAO to remove the Service's transformation efforts and long-term outlook from its high-risk list in January 2007. Specifically, the Service developed a Transformation Plan and achieved billions in cost-savings, improved productivity, downsized its workforce, and improved its financial reporting. Congress enacted a law in 2003 that reduced the Service's annual pension expenses, which enabled it to achieve record net incomes, repay debt, and delay rate increases until January 2006. Finally, as illustrated in the table, the postal reform law enacted in December 2006 provides tools and mechanisms that can be used to address key challenges facing the Service as it moves into a new regulatory and increasingly competitive environment.

The two key factors that will affect the Service's financial condition for this fiscal year are the new reform law and new postal rates that go into effect in May. The reform law increases the costs of funding retiree health benefits but provides opportunities to offset some of these cost pressures through efficiency gains and eliminating certain pension payments. For the rest of the year, Service officials do not expect significant changes from its projected expenses and revenues. Other factors, such as costs for fuel or labor resolutions varying from plan, could affect the Service's projected outcome for this fiscal year.

Postal Reform Law Provides Opportunities to Address Challenges

Challenges facing the Service	Opportunities to address challenges
Generating sufficient revenues to cover costs as the mail mix is changing.	Provides price-setting flexibility and allows the Service to retain earnings.
Controlling costs, particularly for compensation and long-term health benefits, and improving productivity.	Encourages the Service to reduce costs and operate more efficiently in areas such as realigning its network and workforce.
Maintaining affordable, reliable service and establishing reliable mechanisms to measure and report service performance.	Establishes service standards and monitoring by the new Postal Regulatory Commission (PRC).
Providing useful and reliable financial data to assess performance.	Establishes new reporting, accounting, and ratemaking data requirements.
Managing its workforce to respond to operational changes.	Requires a plan with the Service's vision for realigning its infrastructure and workforce, and the resulting impacts on its workforce.

Source: GAO.

Congress's continued oversight of the Service's transformation is critical at this time of significant changes for the Service, PRC, and mailing industry. Also, key to a successful transformation is innovative leadership by the Postmaster General and the PRC Chairman and their ability to work effectively with stakeholders to realize new opportunities provided under the postal reform law. GAO has identified key issues and areas for oversight related to implementing the reform law and new rate-setting structure, as well as other challenges to ensure the Service remains financially sound.

Chairman Davis, Representative Marchant, and Members of the Subcommittee:

I am pleased to be here today to participate in this oversight hearing for the U.S. Postal Service (the Service). To begin, I want to acknowledge Congress's efforts in passing comprehensive postal reform legislation.¹ The Postal Accountability and Enhancement Act (the act) provides tools and mechanisms that can be used to establish an efficient, flexible, fair, transparent, and financially sound Postal Service—a Service that can more effectively operate in an increasingly competitive environment not anticipated under the Postal Reorganization Act of 1970. Effective collaboration among the Service, the newly established Postal Regulatory Commission (PRC), mailers, and employee organizations can help to facilitate the successful implementation of the act by achieving a greater understanding of each other's changing needs and operations, and how they correspond to the American public's need for the continued provision of affordable, high-quality postal services.² My remarks today will focus on (1) why we recently removed the Service's transformation efforts and outlook from GAO's high-risk list, (2) the Service's financial condition in fiscal year 2007, (3) the opportunities and challenges facing the Service, and (4) major issues and areas for continued congressional oversight.

In summary:

When we originally placed the Service's transformation efforts and long-term outlook on our high-risk list in early 2001, we stated that a structural transformation would be needed to address the growing financial, operational, and human capital challenges that threatened its mission to provide affordable, high-quality universal postal services on a self-financing basis.³ This designation would help raise the urgency of taking actions to address these challenges before the situation escalated into a crisis where the options for action could be more limited. Since that time, key actions by both the Service and Congress have improved the Service's financial, operational, and human capital condition and outlook.

¹Pub. L. No. 109-435: The Postal Accountability and Enhancement Act, enacted Dec. 20, 2006.

²The act renames the Postal Rate Commission as the Postal Regulatory Commission. We will use the abbreviation PRC to represent both.

³GAO, *U.S. Postal Service: Transformation Challenges Present Significant Risks*, GAO-01-598T (Washington, D.C.: Apr. 4, 2001).

Specifically, the Service's management issued a Transformation Plan in 2002 that outlined steps to guide it in addressing its challenges and has demonstrated a commitment to implementing the Plan by cutting costs, improving productivity, downsizing its workforce, and improving its financial reporting. Further, a statute enacted in 2003 reduced the Service's annual pension expenses, which allowed the Service to achieve record net income, repay debt, and delay rate increases until January 2006.⁴ Comprehensive postal reform legislation was enacted in December 2006 that among other factors, provides:

- a framework for modernizing the Service's rate-setting process;
- an opportunity to preserve affordable universal service by reassessing the future needs of postal customers and taking actions to increase value and efficiencies throughout the postal network—fundamental principles of functioning in a competitive environment;
- recognition of the Service's long-term financial obligations by prefunding retiree health benefit obligations, which will result in short-term cost increases for the Service, but over the long-term this action improves the fairness and balance of cost burdens for current and future ratepayers;
- for a transfer of the obligation to fund civil service pension payments attributable to past military service from postal ratepayers to taxpayers;⁵ and
- enhanced transparency and accountability by requiring that the Service collect, track, and report financial and service performance information, including the creation and reporting of modern service standards.

Based on these actions, we determined that sufficient progress has been made to warrant the removal of the Service from our high-risk list in January 2007. We recognize, however, that the Service continues to face challenges to maintain its viability as it implements significant changes under the new law and will further discuss these challenges below.

⁴Pub. L. No. 108-18: Postal Civil Service Retirement System Funding Reform Act of 2003.

⁵Pub. L. No. 108-18 shifted the responsibility for funding benefits attributable to military service from taxpayers to postal ratepayers.

The Service's financial condition for the current fiscal year has been affected by the act, which, along with the ensuing rate increase, will continue to affect its near- and long-term financial outlook. Specifically, changes to either projected or actual Postal Service payments that result from this act include:

- accelerating funding of the Service's retiree health benefit obligations,
- expensing funds previously set aside in escrow (transferring them to the Treasury) and eliminating future escrow payments,
- transferring funding for selected military service benefits back to the Treasury, and
- eliminating certain annual Civil Service Retirement System (CSRS) pension funding requirements.

Since the law was enacted, the Service has updated its expense projections for fiscal year 2007. To date, those expenses not directly impacted by the 2006 Act and its total revenues have tracked closely to budgeted estimates. For the remainder of the fiscal year, Service officials do not expect significant changes from projected expenses, and still expect to meet revenue targets—even though the rate decision approved by the PRC was different than what the Service requested.⁶ These officials did acknowledge, however, that other factors could have a favorable or unfavorable impact on the Service's projected net loss for the year, such as the effect of rate increases on mail volumes, changes in fuel prices, and resolution of certain labor agreements. The Service is planning to borrow \$1.8 billion this year, which will push its total outstanding debt to almost \$4 billion to meet short-term cash flow needs that come at year end.

As the Service transitions to its new statutory framework in an increasingly competitive environment, it will continue to face financial, operational, and human capital challenges. Table 1 illustrates how the legislation provides opportunities to address some of these challenges.

⁶Higher postal rates for most mail classes will be implemented on May 14, 2007, including an increase in the price of a First-Class stamp from 39 to 41 cents. Rates for Periodicals (e.g., magazines, newspapers, etc.), however, will not increase until July 15, 2007, due to the need for more time to prepare for implementation by the Service and Periodical mailers. A detailed explanation of the recent rate developments are covered later in the testimony.

Table 1: Reform Legislation Provides Opportunities to Address Continuing Challenges

Challenges facing the Service	Opportunities to address challenges
Generating sufficient revenues to cover costs as the mail mix is changing.	Provides price-setting flexibility and allows the Service to retain earnings.
Controlling costs, particularly for compensation and long-term health benefits, and improving productivity.	Encourages the Service to reduce costs and operate more efficiently in areas such as realigning its network and workforce.
Maintaining affordable, reliable service and establishing reliable mechanisms to measure and report service performance.	Requires the Service to establish service standards in consultation with the new Postal Regulatory Commission, which will annually report on the Service's performance against these standards.
Providing useful and reliable financial data to assess performance to management, regulators, and oversight bodies.	Establishes new reporting, accounting, and ratemaking data requirements.
Managing its workforce to respond to operational needs.	Requires a plan to describe the Service's vision for realigning its infrastructure and workforce, including the impacts of facility changes on its workforce and whether the Service has sufficient flexibility to make needed workforce changes.

Source: GAO.

Continued oversight will be necessary to help ensure the Service's future financial condition remains sound and that the intent of the act is followed throughout implementation. In particular, we have identified major issues considered significant by various postal stakeholders, as well as areas for continued oversight including:

- the effect of the upcoming rate increases and statutory changes on the Postal Service's financial condition;
- the impact of the Service's decision on whether or not to submit a rate filing later this year under the old rate structure;
- actions by the PRC to establish a new price-setting and regulatory framework;
- the Service's ability to operate under an inflationary price cap while some of its cost segments are increasing above the rate of inflation;
- actions by the Service, in consultation with the PRC, to establish modern service standards, and the Postal Service's plan for meeting those standards;
- the Service's ability to provide high-quality delivery service as it takes actions to reduce costs and realign its infrastructure and workforce; and

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- the PRC's development of appropriate accounting and reporting requirements aimed at enhancing transparency and accountability of the Service's internal data and performance results.

The successful transformation of the Postal Service will require innovative leadership by the Postmaster General and the Chairman of the PRC, and their ability to work effectively with their employees, the mailing industry, and the general public. We are encouraged by the Service's ongoing efforts to facilitate workgroups with participants from the mailing industry that will make recommendations regarding new service standards and measures. It will be important for all postal stakeholders to take full advantage of the unique opportunities that are currently available by providing input and working together, particularly as challenges and uncertainties will continue to threaten the Service's financial condition and outlook.

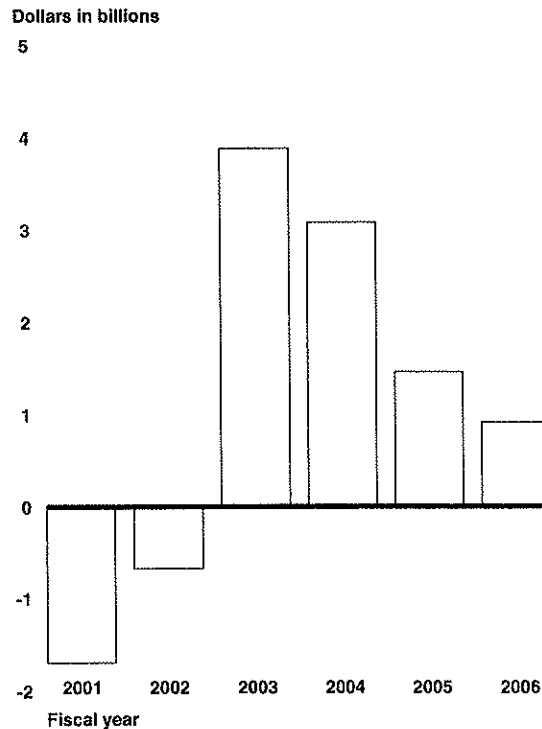
Recent Actions Warranted the Postal Service's Removal from Our High-Risk List

Several actions—both by the Service and the Congress—led us to remove the Service's transformation efforts and long-term outlook from our high-risk list. In 2001, we made this designation because the Service's financial outlook had deteriorated significantly. The Service had a projected deficit of \$2 billion to \$3 billion, severe cash flow pressures, debt approaching the statutory borrowing limit, cost growth outpacing revenue increases, and limited productivity gains. Other challenges the Service faced included liabilities that exceeded assets by \$3 billion at the end of fiscal year 2002, major liabilities and obligations estimated at close to \$100 billion, a restructuring of the workforce due to impending retirements and operational changes, and long-standing labor-management relations problems. We raised concerns that the Service had no comprehensive plan to address its financial, operational, or human capital challenges, including its plans for reducing debt, and it did not have adequate financial reporting and transparency that would allow the public to understand changes in its financial situation. Thus, we recommended that the Service develop a comprehensive plan, in conjunction with other stakeholders, which would identify the actions needed to address its challenges and provide publicly available quarterly financial reports with sufficient information to understand the Service's current and projected financial condition. As the Service's financial difficulties continued in 2002, we concluded that the need for a comprehensive transformation of the Service was more urgent than ever and called for Congress to act on comprehensive postal reform legislation. The Service's basic business model, which assumed that rising mail volume would cover rising costs and mitigate rate increases, was

outmoded as First-Class Mail volumes stagnated or deteriorated in an increasingly competitive environment.

Since 2001, the Service's financial condition has improved and it has reported positive net incomes for each of the last 4 years (see fig. 1).

Figure 1: Recent Postal Service Net Incomes



Source: Postal Service Annual Reports.

The Service has made significant progress in addressing some of the challenges that led to its high-risk designation. For example, the Service's management developed a Transformation Plan and has demonstrated a commitment to implementing this plan. Since our designation in 2001, the Service has:

- **Reduced workhours and improved productivity:** The Service has reported productivity gains in each year. According to the Service, its productivity increased by a cumulative 8.3 percent over that period, which generated \$5.4 billion in cost savings. The Service reported eliminating over 170

million workhours over this period, with a 4.5 million workhour reduction in fiscal year 2006.

- Downsized its workforce: The Service has made progress in addressing some of the human capital challenges associated with its vast workforce, by managing retirements, downsizing, and expanding the use of automation. At the end of fiscal year 2006, the Service reported that it had 696,138 career employees, the lowest count since fiscal year 1993. Attrition and automation have allowed the Service to downsize its workforce by more than 95,000, or about 10 percent, since fiscal year 2001.
- Enhanced the reporting of its financial condition and outlook: The Service responded to recommendations we made regarding the lack of sufficient and timely periodic information on its financial condition and outlook that is publicly available between publications of its audited year-end financial statements by enhancing its financial reporting and providing regular updates to the financial statements on its Web site.⁷ The Service instituted quarterly financial reports, expanded the discussion of financial matters in its annual report, and upgraded its Web site to include these and other reports in readily accessible file formats.

The 2003 pension act provided another key reason for why we removed the high-risk designation.⁸ Much of the Service's recent financial improvement was due to the change from this law that reduced the Service's annual pension expenses. Between fiscal years 2003 and 2005, the Service had a total of \$9 billion in decreased pension expenses when compared to the annual expenses that would have been paid without the statutory change. This change enabled the Service to significantly cut its costs, achieve record net incomes, repay over \$11 billion of outstanding debt, and delay rate increases until January 2006.

The Service's improved financial performance and condition during this time was also aided by increased revenue generated from growing

⁷GAO-01-598T; GAO, *U.S. Postal Service: Deteriorating Financial Outlook Increases Need for Transformation*, GAO-02-355 (Washington, D.C.: Feb. 28, 2002); *U.S. Postal Service: Accounting for Postretirement Benefits*, GAO-02-916R (Washington, D.C.: Sept. 12, 2002); *U.S. Postal Service Actions to Improve Its Financial Reporting*, GAO-03-26R (Washington, D.C.: Nov. 13, 2002).

⁸The Postal Service Civil Service Retirement System Funding Reform Act of 2003 (Pub. L. No. 108-18) was enacted in response to the Office of Personnel Management's analysis, performed at our request, which concluded that the Service was on course to overfund its pension payments.

volumes of Standard Mail (primarily advertising) and rate increases in June 2002 and January 2006. Standard Mail volumes grew by almost 14 percent from fiscal year 2001 to 2006, and Standard Mail revenues, when adjusted for inflation, increased by over 11 percent during the same time period. In June 2002, the Service implemented a rate increase (the price of a First-Class stamp increased from 34 cents to 37 cents) to offset rising costs. In January 2006, the Service implemented another rate increase (the price of a First-Class stamp increased from 37 cents to 39 cents) to generate the additional revenue needed to set aside \$3.0 billion in an escrow account in fiscal year 2006 as required by the 2003 pension law. Revenues in fiscal year 2006 increased by about 4 percent from the previous year due largely to the January 2006 rate increase.

The passage of the recent postal reform legislation was another reason why we removed this high-risk designation. Although noticeable improvements were being made to the Service's financial, operational, and human capital challenges, we had continued to advocate the need for comprehensive postal reform legislation.⁹ After years of thorough discussion, Congress passed a comprehensive postal reform law in late December 2006 that provides tools and mechanisms that can be used to establish an efficient, flexible, fair, transparent, and financially sound Postal Service. Later in this statement, I will discuss how some specific tools and mechanisms can be used to address the continuing challenges facing the Service.

The Postal Service's Current Financial Condition

The Service's financial condition for fiscal year 2007 has been affected by the reform act, which, along with the May change in postal rates, will continue to affect its near- and long-term financial outlook. The Service will benefit financially from an increase in postal rates in May averaging 7.6 percent. Key steps in the rate process are provided in appendix I. The Service is estimating that it will gain an additional \$2.2 billion in net income in fiscal year 2007 as a result of the new rates. The recent rate case, in addition to generating additional revenues, took significant strides

⁹GAO, *U.S. Postal Service: Bold Action Needed to Continue Progress on Postal Transformation*, GAO-04-108T (Washington, D.C.: Nov. 5, 2003); *Need for Comprehensive Postal Reform*, GAO-04-455R (Washington, D.C.: Feb. 6, 2004); *U.S. Postal Service: Key Elements of Comprehensive Postal Reform*, GAO-04-397T (Washington, D.C.: Jan. 28, 2004); *U.S. Postal Service: Key Reasons for Postal Reform*, GAO-04-565T (Washington, D.C.: Mar. 23, 2004); *U.S. Postal Service: Despite Recent Progress, Postal Reform Legislation Is Still Needed*, GAO-05-453T (Washington, D.C.: Apr. 14, 2005).

in aligning postal rates with the respective mail handling costs. Some rate increases are particularly large—i.e., some catalog rates may increase by 20 to 40 percent. The new rates structure is aimed at providing the necessary incentives to encourage efficient mailing practices (e.g., shape, weight, handling, preparation, and transportation) and thereby encourage smaller rate increases and steady mail volumes in the longer run.

At the beginning of fiscal year 2007 (before the enactment of the reform law), the Service expected to earn \$1.7 billion in net income, which reflected the additional revenue the Service estimated it would receive from the May increase in postal rates. The Service, however, planned to increase its outstanding debt of \$2.1 billion at the end of fiscal year 2006 by an additional \$1.2 billion in fiscal year 2007 in order to help fund the expected \$3.3 billion escrow requirement for 2007.

Since enactment of the reform law, the Service has updated its expense projections. While the Service's total expenses for fiscal year 2007 have been affected by passage of the act, those expenses not directly related to the act and total revenues have tracked closely to plan. The Service currently is estimating an overall fiscal year 2007 net loss of \$5.3 billion, largely due to changes in either projected or actual Postal Service payments as a result from the act including:

- Accelerating funding of the Service's retiree health benefit obligations: Beginning this fiscal year, the Postal Service must make the first of 10 annual payments into a newly created Postal Service Retiree Health Benefits Fund (PSRHBF) to help fund the Service's significant unfunded retiree health obligations. The 2007 payment of \$5.4 billion is due to be paid by September 30. The Service has accrued half of this expense—\$2.7 billion—during the first 6 months of the fiscal year and will accrue \$1.35 billion in each of the remaining 2 quarters.
- One-time expensing of funds previously set aside in escrow and eliminating future escrow payments: The act requires the Service to transfer the \$3.0 billion it escrowed in fiscal year 2006 to the PSRHBF, which the Service recognized as a one-time expense in the first quarter of fiscal year 2007.¹⁰ The reform act also eliminated future escrow payments required under the 2003 pension law, including the \$3.3 billion payment scheduled for fiscal year 2007.

¹⁰The Postal Civil Service Retirement System Funding Reform Act of 2003 required the Postal Service to escrow the reduction in its civil service pension expenses that resulted from changes to how the Service funded these pensions.

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- Transferring funding for selected military service benefits back to the Treasury: The act significantly reduced the Service's civil service pension obligations by transferring responsibility for funding civilian pension benefits attributable to the military service of the Service's retirees back to the Treasury Department, where it had been prior to enactment of the 2003 pension law. The reform act requires that any overfunding attributable to the military benefits as of September 30, 2006, be transferred to the PSRHBf by June 30, 2007.¹¹
 - Eliminating certain annual Civil Service Retirement System (CSRS) pension funding requirements: The act eliminated the requirement that the Service fund the annual normal cost of its civil service employees and the amortization of the unfunded pension obligation that existed prior to transferring the military service obligations to the Treasury Department.¹² The Service estimates that it will save \$1.5 billion in fiscal year 2007 from eliminating the annual pension funding requirements and amortization payments.

The result of these payments is a net increase in retirement-related expenses of \$3.9 billion,¹³ which is \$600 million higher than the expected \$3.3 billion escrow payment for 2007 that was eliminated. Thus, the Service is planning to borrow \$600 million more than initially budgeted to cover this shortfall. This increase is anticipated to result in the Service's borrowing \$1.8 billion in fiscal year 2007, which would bring its total outstanding debt to \$3.9 billion by the end of the fiscal year.

The Service has identified other factors and uncertainties that, depending on how results vary from budgeted estimates, could have a favorable or unfavorable impact on the Service's projected net loss for fiscal year 2007. For example, volumes and revenues may be affected by a continued slowdown in the U.S. economy or unanticipated consequences of the recent rate decision. The Service has anticipated economic growth to pick up in the third and fourth quarters of this year, but a slowdown may depress volume growth below projected levels for the rest of the year.

¹¹The Office of Personnel Management has preliminarily estimated the overfunding to be more than \$16 billion.

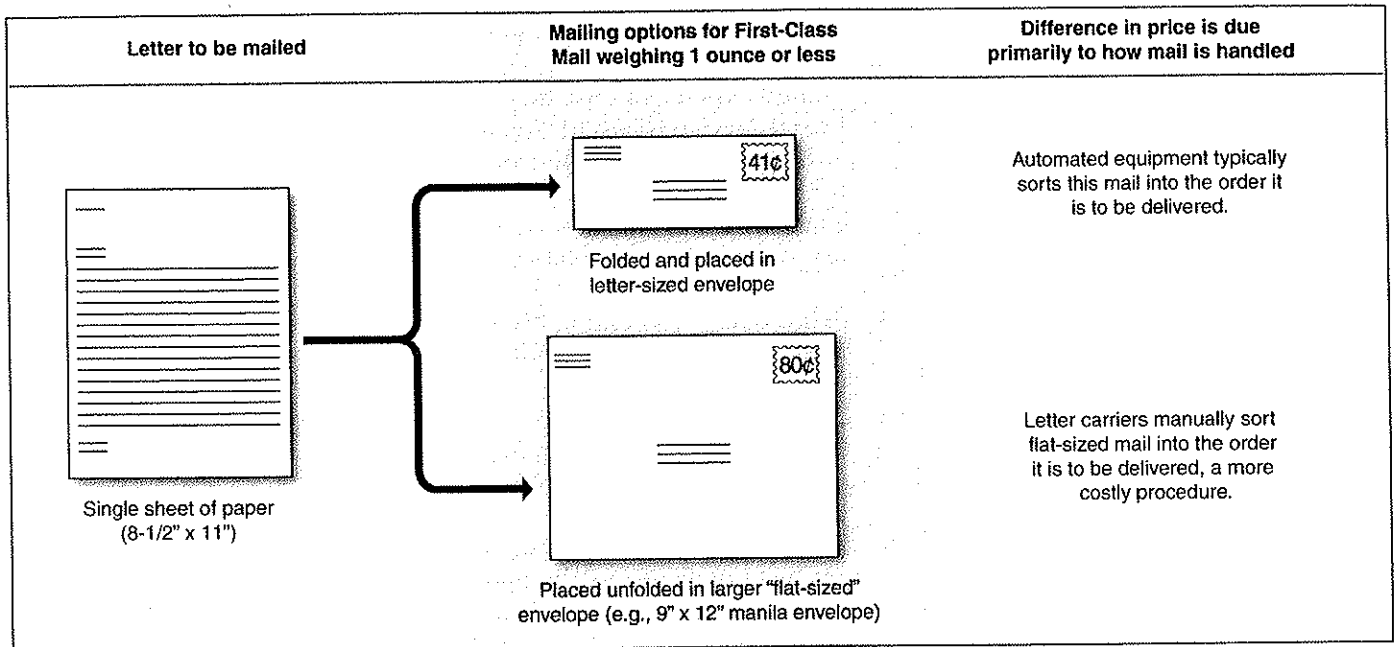
¹²The reform act delays resumption of payments from the Postal Service to liquidate any pension underfunding until September 30, 2018.

¹³The \$3.9 billion net increase in retirement-related expenses is comprised of the \$5.4 billion retiree health payment due to the PSRHBf by September 30, 2007, and the \$1.5 billion reduction in the Service's pension expenses through fiscal year end.

Furthermore, the unusual nature of the rate case creates uncertainties for the Service that may affect its financial results. These uncertainties include how the Service and its customers will respond to the:

- limited implementation times—the 2-month implementation period (the Postal Service Board of Governors decision on March 19, 2007, stated that most new rates would become effective on May 14, 2007) leaves little time for the Service to educate the public and business mailers on the new rate changes and to allow mailers sufficient time to adjust their mailing practices and operations accordingly;
- delayed implementation times—how mailers and the Service will be affected by the delay in implementing new Periodical rates until mid-July;
- magnitude of certain restructured rates, particularly for those specific types of mail that will experience rather significant increases, and the related impact on volumes and revenues; and
- unfamiliarity with restructured rates—the prices for many popular products, such as certain types of First-Class Mail, will experience significant shifts based on the shape of the mail. For example, figure 2 shows how the cost of First-Class Mail will differ based on its shape.

Figure 2: Cost of First-Class Mail Will Differ Based on Shape of Mail under New Rate System



Source: GAO.

Moreover, the Service's expense projections may be susceptible to rising fuel prices due to the Service's vulnerability in this area or that the outstanding contract negotiations for two of its major labor unions would vary from projected levels. Although the extent to which these factors and uncertainties will affect the Service's financial condition for fiscal year 2007 is not known, they may affect its subsequent financial outlook. For example, if the Service finds that its financial performance and condition is weakening—either through revenue shortfalls or expense increases—it may decide to file another rate increase later this year.

Postal Reform Law Provides Opportunities to Address Challenges

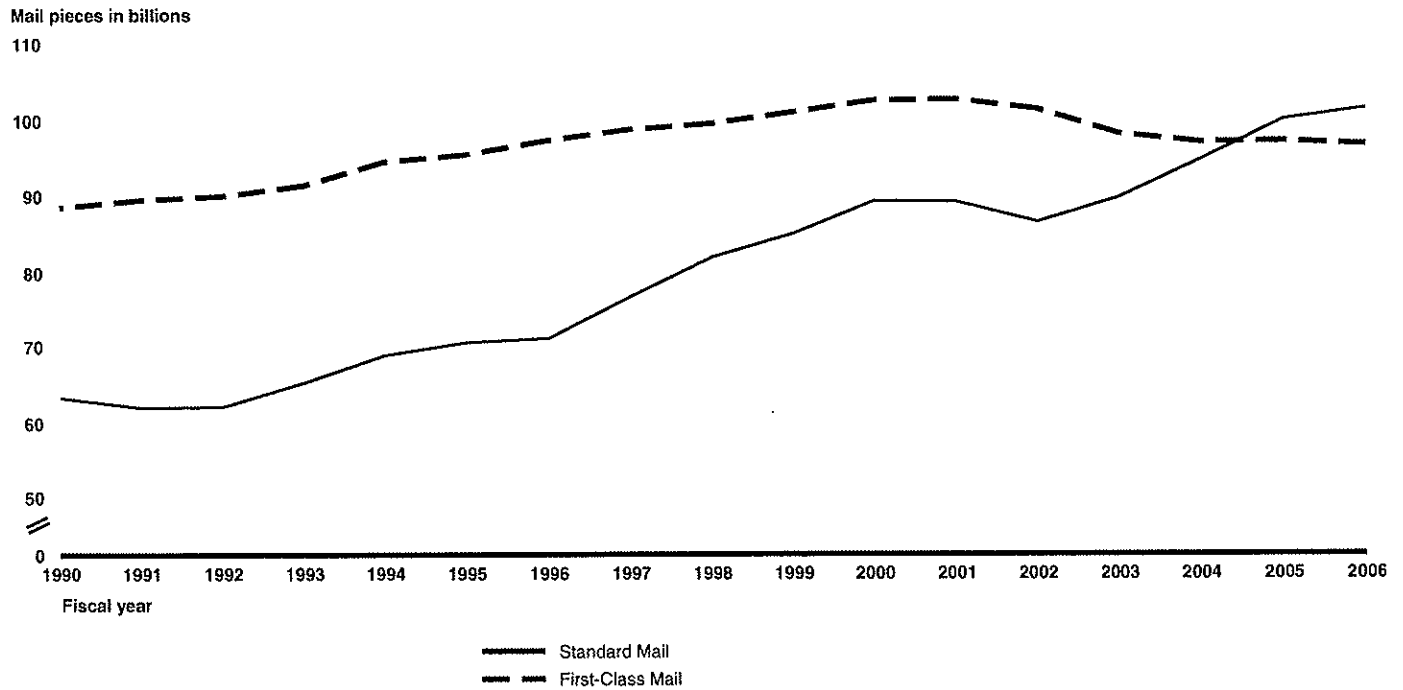
The new postal reform law provides new opportunities to address challenges facing the Service as it continues its transformation in a more competitive environment with a variety of electronic alternatives for communications and payments. Specifically, it provides tools and mechanisms to address the challenges of generating sufficient revenues, controlling costs, maintaining service, providing reliable performance information, and managing its workforce. Effectively using these tools will

be key to successfully implementing the act and addressing these challenges.

Generating sufficient revenue as First-Class Mail volume is declining and mail mix is changing

The Service continues to face challenges in generating sufficient revenues as First-Class Mail volume continues to decline and the mail mix changes. First-Class Mail, historically the class of mail with the largest volumes and revenues, saw volume shrink by almost 6 percent from fiscal year 2001 to 2006. The trends for First-Class Mail and Standard Mail, which currently combine for about 95 percent of mail volumes and 80 percent of revenues, experienced a historical shift in fiscal year 2005. For the first time, Standard Mail volumes exceeded those for First-Class Mail (see fig. 3).

Figure 3: Standard Mail Volumes Are Outpacing Those for First-Class Mail



Source: Postal Service Annual Reports.

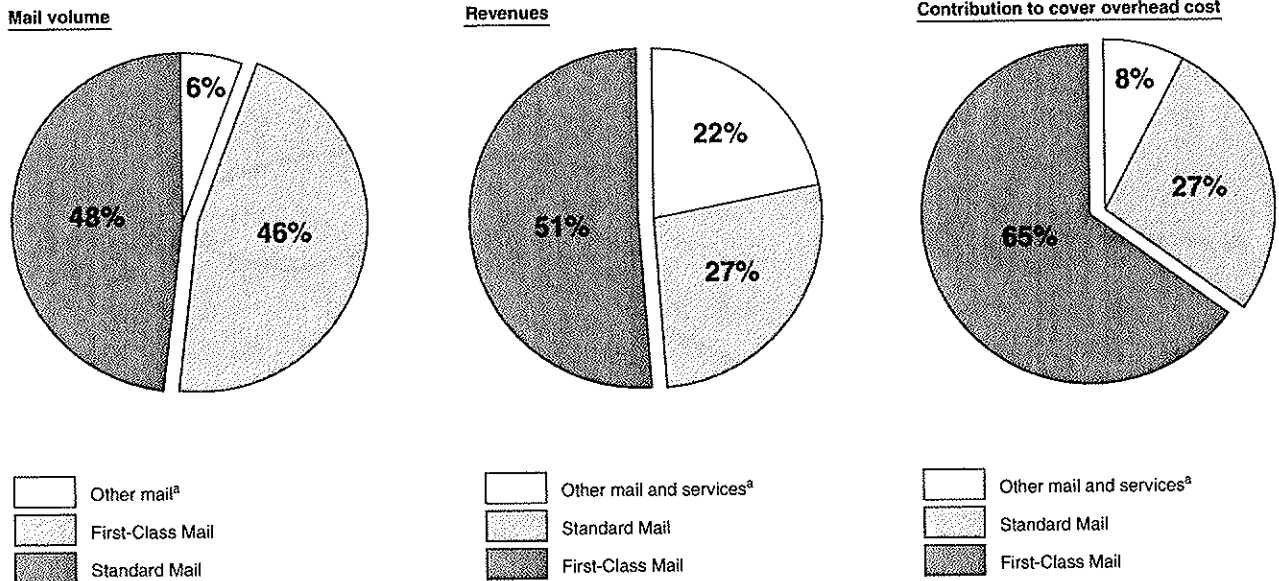
Note: First-Class Mail volume does not include Priority Mail.

This shift has major revenue implications because:

- First-Class Mail generates the most revenue and is used to finance most of the Service's institutional (overhead) costs (see fig. 4).

- Standard Mail generates less revenue per piece compared to First-Class Mail and it takes about two pieces of Standard Mail to make the same contribution to the Service's overhead costs as one piece of First-Class Mail.
- Standard Mail is a more price-sensitive product compared to First-Class Mail because it competes with other advertising media. Also, because advertising, including Standard Mail, tends to be affected by economic cycles to a greater extent than First-Class Mail, a larger portion of the Service's mail volumes is more susceptible to economic fluctuations.

Figure 4: Mail Volume, Revenues, and Contribution to Cover Overhead Costs, Fiscal Year 2006



Source: Postal Service.

^aOther mail includes mail such as magazines, newspapers, and parcels. Other services include postal services such as post office boxes, money orders, and delivery confirmation.

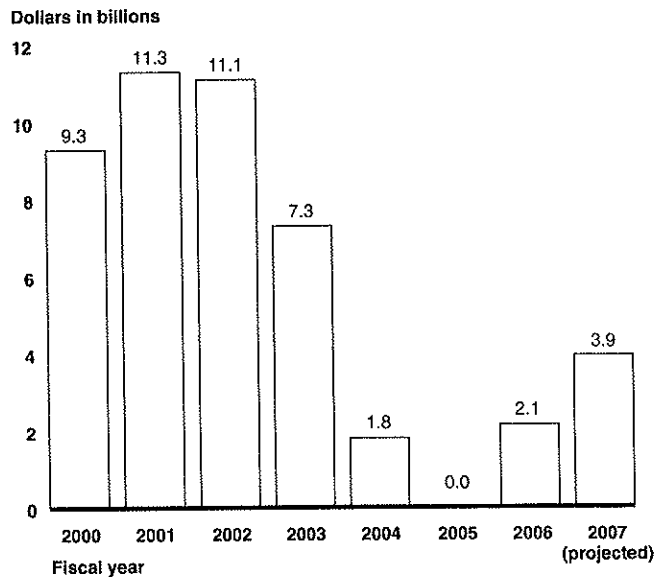
The act provides tools and mechanisms that can help address these revenue challenges by promoting revenue generation and retention of revenues. The act established flexible pricing mechanisms for the Service's competitive and market-dominant products.¹⁴ For example, it allows the Service to raise rates for its market-dominant products, such as First-Class

¹⁴Sections 201 and 202 lists which products are market-dominant and competitive.

Mail letters, Standard Mail, and Periodicals, up to a defined price cap; exceed the price cap should extraordinary or exceptional circumstances arise; and use any unused rate authority within 5 years. For its competitive products, such as Priority Mail or Expedited Mail, the Service may raise rates as it sees fit, as long as each competitive products covers its costs and competitive products as a whole cover their attributable costs and make a contribution to overhead.

The act also allows for the Service to retain any earnings, which may promote increased financial stability. First, to the extent the Service can generate net income to retain earnings, this could enhance its ability to weather economic downturns. For example, a slow economic cycle or sudden increase in fuel prices might not necessitate an immediate rate increase if sufficient retained earnings exist to cover related shortfalls. Furthermore, to the extent the Service can retain earnings as liquid assets, it may reduce the Service's reliance on borrowing to offset cash shortfalls. The Service has stated that it will take out debt to cover cash shortfalls in fiscal year 2007 and projects that this increase will result in \$3.9 billion of outstanding debt at the end of the year (see fig. 5). Controlling debt will be important because the Service needs to operate within its statutorily set borrowing limits (\$3 billion in new debt each year, and \$15 billion in total debt outstanding). Reducing debt was one of the key factors we cited in removing the Service's high-risk designation.

Figure 5: The Service Projects Nearly \$4 Billion in Outstanding Debt at the End of Fiscal Year 2007



Source: GAO analysis of Postal Service data.

Uncertainties related to the recent rate decision and reform law may impact the extent to which the Service is able to address its revenue related challenges. The uncertainties include:

- How will mailers and volume respond to the new rate decision's pricing signals?
- What types of innovative pricing methods will be allowed?
- How will the Service set rates under the new price cap system, and how will mailers respond to this additional flexibility? How will the Service and mailers be able to modify their information systems to accommodate more frequent rate increases?
- How will customer behavior change as prices change under the new system? To what extent will customers desire for mail be affected by privacy concerns, environmental concerns, preference for electronic

alternatives, or efforts to establish Do Not Mail lists?¹⁵

- How will the Service be able to enhance the value of its market-dominant and competitive products (e.g., predictable and consistent service, tracking and tracing capabilities, etc.)?
- What will the Service do with any retained earnings (e.g., improve its capital program, save to weather downturns in the economy)?

Controlling costs and improving productivity

The Service faces multiple cost pressures in the near- and long-term associated with the required multi-billion dollar payments into the PSRHBF, dealing with key cost categories experiencing above-inflation growth while operating under an inflationary-based price cap, and other costs associated with providing universal postal services to a growing network—one now expanding by about 2 million new addresses each year. While the reform act takes actions that increase current costs by improving the balance of retiree health benefit cost burdens between current and future ratepayers, it also eliminates other payments and provides opportunities to offset some of these costs pressures through efficiency gains that could restrain future rate increases. It will be crucial for the Service, however, to take advantage of this opportunity and achieve sustainable, realizable cost reductions and productivity improvements throughout its networks.

Personnel expenses (which include wages, employee and retiree benefits, and workers' compensation) have consistently accounted for nearly 80 percent of annual operating expenses, even though the Service has downsized its workforce by over 95,000 employees since fiscal year 2001. The Service's personnel expenses have grown at rates exceeding inflation since fiscal year 2003 and are expected to continue dominating the Service's financial condition. In particular, growth in retiree health benefit costs have, on average over the last 5 years, exceeded inflation by almost 13 percent each year. This growth is expected to continue due to (1) rising premiums, growth in the number of covered retirees and survivors, and increases in the Service's share of the premiums; and (2) the Service will continue paying the employer's share of the health insurance premiums of its retirees along with the required payments ranging from \$5.4 billion to

¹⁵As part of the reform act, GAO is required to issue a report on the activities of the Postal Service to promote recycling and other opportunities for improvement in this area.

\$5.8 billion into the PSRHBFB in each of the following 9 years. While we recognize the cost pressures that will be placed on the Service as it begins prefunding its retiree health benefits obligations, we continue to believe that such action is appropriate to improve the fairness and balance of cost burdens for current and future ratepayers. Furthermore, beginning in fiscal year 2017, the Service might enjoy a significant reduction in its retiree health costs if its obligations are fully funded.

In addition to these personnel expenses, the Service has also experienced growth in its transportation costs that exceeded the rate of inflation in fiscal years 2005 and 2006. Transportation costs represent the second largest cost category behind compensation and benefits. These costs grew by about 11 percent from fiscal year 2005 to 2006, largely due to rising fuel costs. In a February 2007 report, we stated that the Service is vulnerable to fuel price fluctuations and will be challenged to control fuel costs due to its expanding delivery network and inability to use surcharges.¹⁶

The Service has made some progress in containing cost growth, and pledged to cut another \$5 billion of costs out of its system between fiscal years 2006 and 2010 through productivity increases and operational improvements. The Service has reported productivity increases for the last 7 years, but the reported increase in fiscal year 2006 was its smallest during this period. The Service has recently had trouble absorbing gains in mail volumes while achieving targeted workhour reductions. Although the Service has reduced its workhours in 6 of the last 7 years, in fiscal year 2006, its goal was to reduce workhours by 42 million, but the Service reported a decrease of only 5 million workhours.

While both the recent rate decision and reform act seek to improve efficiencies in the postal networks, these developments will pose challenges to the Service. In terms of the rate case, the Service will be challenged to modify its mail processing and transportation networks to respond to changes in mailer behaviors (e.g., in the quantity and types of mail sent and how mail is prepared) to minimize their rates. Furthermore, the reform act provides an opportunity to address the Service's cost challenges because it requires the Service to develop a plan that, among other things, includes a strategy for how the Service intends to rationalize

¹⁶GAO, *U.S. Postal Service: Vulnerability to Fluctuating Fuel Prices Requires Improved Tracking and Monitoring of Consumption Information*, GAO-07-244 (Washington, D.C.: Feb. 16, 2007).

the postal facilities network and remove excess processing capacity and space from the network, as well as identifying the costs savings and other benefits associated with network rationalization alternatives discussed in the plan. This plan provides an opportunity to address some concerns we have raised in previous work, in which we stated that it was not clear how the Service intended to realign its processing and distribution network and workforce, and that its strategy lacked sufficient transparency and accountability, excluded stakeholder input, and lacked performance measures for results.¹⁷ We are currently conducting ongoing work on the Service's progress in this area over the past 2 years and will be issuing a report this summer with updated findings.

Taking advantage of the opportunities available will have a direct impact on the Service's ability to operate under an inflationary-based rate cap, achieve positive results, and limit the growth in its debt. If the Service is unable to achieve significant cost savings, it may have to take other actions such as borrow an increasing amount each year to make year-end property and equipment purchases and fund its retiree health obligations. The following uncertainties may have a significant impact on the Service's ability to achieve real cost savings and productivity in the future:

- How will operating under a rate cap provide an incentive to control costs?
- How will the Service operate under a rate cap, if certain key costs continue to increase at levels above inflation (e.g., health benefit costs)?
- How will the new rate designs/structure lead to efficiency improvements throughout the mail stream?
- Will the Service's implementation of its network realignment result in greater cost savings and improved efficiency?
- Will the Service achieve its expected return on investment and operational performance when it deploys the next phase of automated flat sorting equipment?

¹⁷GAO, *U.S. Postal Service: The Service's Strategy for Realigning Its Mail Processing Infrastructure Lacks Clarity, Criteria, and Accountability*, GAO-05-261 (Washington, D.C.: Apr. 8, 2004).

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- How will the Service's financial situation be impacted when the 10-year scheduled payments into the PSRHBF are completed?
 - Will the balance of the PSRHBF—which is a function of the PSRHBF's investment returns and the growth in the Service's retiree health obligations—be sufficient to cover the Service's retiree health obligation by the end of fiscal year 2016?

Maintaining, Measuring, and Reporting Service

The Service will be challenged to continue carrying out its mission of providing high-quality delivery and retail services to the American people. Maintaining these services while establishing reliable mechanisms for measuring and reporting performance will be critical to the Service's ability to effectively function in a competitive market and meet the needs of various postal stakeholders, including:

- The Service—so that it can effectively manage its nationwide service and respond to changes and/or problems in its network.
- The Service's customers (who may choose other alternatives to the mail)—so that they are aware of the Service's expected performance, can tailor their operations to those expectations, and understand the Service's actual performance against those targets.
- Oversight bodies—so that they are aware of the Service's ability to carry out its mission while effectively balancing costs, service needs, and the rate cap; can hold the Service accountable for its performance; and understand service performance (whether reported problems are widespread or service is getting better or worse).

The Service's delivery performance standards and results have been a long-standing concern for mailers and Congress.¹⁸ We found inadequate information is collected and available to both the Service and others to understand and address delivery service issues. Specifically, the Service does not measure and report its delivery performance for most types of mail (representative measures of delivery performance cover less than one-fifth of mail volume and do not include key types of mail such as Standard Mail, bulk First-Class Mail, Periodicals, and most Package Services), certain performance standards are outdated; and that progress

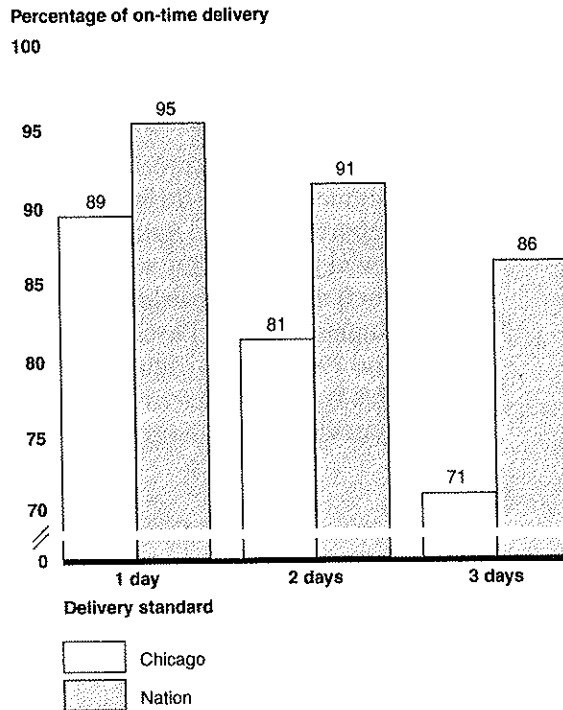
¹⁸GAO, *U.S. Postal Service: Delivery Performance Standards, Measurement, and Reporting Need Improvement*, GAO-06-733 (Washington, D.C.: July 27, 2006).

has been hindered by a lack of management commitment and collaboration by the Service and mailers. Based on these findings, we recommended the Service take actions to modernize its delivery service standards, develop a complete set of delivery service measures, more effectively collaborate with mailers, and improve transparency by publicly disclosing delivery performance information.

The Service has recently reported positive delivery results for the limited segment of mail for which the Service does track performance. It has reported on-time delivery performance improved in the first quarter of fiscal year 2007 for some single-piece First-Class Mail.¹⁹ However, issues such as late deliveries have been reported in places such as Chicago, Los Angeles, and El Paso; and for different types of mail such as Standard Mail and Periodicals. Figure 6 shows that delivery performance in Chicago for this type of mail was worse than the national average at the end of the first quarter for this fiscal year.

¹⁹The External First-Class Measurement System (EXFC) measures delivery performance for single-piece First-Class Mail deposited in collection boxes in selected areas of the country. EXFC is not a systemwide measurement of all First-Class Mail performance.

Figure 6: Delivery Performance in Chicago Was Below the National Average for Some Single-Piece First-Class Mail at the end of First Quarter, Fiscal Year 2007



Source: GAO analysis of Postal Service delivery information.

The reform act provides an opportunity for the Service to address this challenge by establishing requirements for maintaining, measuring, and reporting on service performance. Specifically, the act identified four key objectives for modern service standards:

- enhance the value of postal services to both senders and recipients;
- preserve regular and effective access to postal services in all communities, including those in rural areas or where post offices are not self-sustaining;
- reasonably assure Postal Service customers delivery reliability, speed, and frequency consistent with reasonable rates and best business practices; and
- provide a system of objective external performance measurements for each market-dominant product as a basis for measurement of Postal Service performance.

The act also required the Service to implement modern delivery performance standards, set goals for meeting these standards, and annually report on its delivery speed and reliability for each market-dominant product. Key steps specified in the act include that within 12 months of enactment (by December 2007) the Service must issue modern service standards, and within 6 months of issuing service standards the Service must, in consultation with the PRC, develop and submit to Congress a plan for meeting those standards. Furthermore, within 90 days after the end of each fiscal year the Service must report to PRC on the quality of service for each market-dominant product in terms of speed of delivery and reliability, as well as the degree of customer satisfaction with the service provided.²⁰

These requirements provide opportunities to resolve long-standing deficiencies in this area. As the Service transitions to the new law, the following uncertainties may impact its ability to address challenges in maintaining, measuring, and reporting service performance in the future:

- How will the Service implement representative measures of delivery speed and reliability within the timeframes of the reform act, while taking cost and technological limitations into account?
- How much transparency will be provided to the PRC, Congress, mailers, and the American people, including the frequency, detail, and methods of reporting?

Financial Performance Reporting

Another challenge facing the Service is to provide reliable data to management, regulators, and oversight entities to assess financial performance. Accurate and timely data on Service costs, revenues, and mail volumes helps provide appropriate transparency and accountability for all postal stakeholders to have a comprehensive understanding of the Service's financial condition and outlook and how postal rates are aligned with costs. Earlier I discussed the past issues we have raised related to the Service's financial reporting and the improvements that the Service has

²⁰The act further stipulates that the PRC must provide an opportunity for public comment on the report and must, within 90 days of receiving the annual service data from the Postal Service, make a written determination of compliance as to whether any service standards were not met. If PRC finds noncompliance, it is required to order the Service to take such action as PRC considers appropriate to achieve compliance. PRC also can fine the Service in cases of deliberate noncompliance.

recently made. We have also reported on the long-standing issues of ratemaking data quality that continue to persist.²¹

The act establishes new reporting and accounting requirements that should help to address this challenge. The major change is the establishment of, and authority provided, to the new PRC to help enhance the collection and reporting of information on postal rates and financial performance (see table 2).

Table 2: Selected PRC Responsibilities for Financial Transparency, Oversight, and Accountability

Subject	PRC Responsibilities
Oversight of market-dominant products	<ul style="list-style-type: none">• Prescribes by regulation the form and content of annual Service reports that analyze costs, revenues, and rates, using methods that PRC must prescribe, and in sufficient detail to demonstrate compliance with applicable requirements. Specify which reported information shall be made public. Initiate proceedings as necessary to improve the quality, completeness, or accuracy of this information.• Annually determine whether rates are in compliance, after providing an opportunity for public comments on the Service's annual reports.• If rates are not in compliance, order the Service to take appropriate action to come into compliance and remedy the effects of noncompliance, such as ordering rates to be adjusted to lawful levels.• Consider any complaints that rates are not in compliance, which stakeholders may file at any time during the year.
Oversight of competitive products	<ul style="list-style-type: none">• Establish regulations that ensure that each competitive product covers its attributable costs, prohibits the cross-subsidization of competitive products by market-dominant products, and ensures that competitive products collectively cover what PRC determines to be an appropriate share of the Service's institutional costs (overhead costs).• Consider any complaints that stakeholders may file at any time during the year. If noncompliance is found, PRC must order the Service to take appropriate action to come into compliance and remedy the effects of any noncompliance, such as requiring the Service to make up for revenue shortfalls in competitive products.

²¹GAO, *U.S. Postal Service: Improving Ratemaking Data Quality through Postal Service Actions and Postal Reform Legislation*, GAO-05-820 (Washington, D.C.: July 28, 2005).

Subject	PRC Responsibilities
Financial reporting	<ul style="list-style-type: none"> • Receive annual, quarterly, and other periodic reports from the Service that contain information required by the Securities and Exchange Commission (SEC) for registrants^a. The annual report must also include information on the Service's pension and post-retirement health obligations. Receive reports on the Service's compliance with rules prescribed by the SEC for registrants in implementing section 404 of the Sarbanes-Oxley Act of 2002. Initiate proceedings as necessary to improve the quality, completeness, or accuracy of this information. • Establish the accounting principles and practices that the Service must follow. • In establishing the Service's accounting principles and practices, consider recommendations of the Department of the Treasury, including how to value assets and liabilities associated with providing competitive products, among other factors.

Source: Pub.L. No. 109-435.

^aThe Postal Service is deemed the "registrant" by the reform act, however the Service is not a registrant for the purposes of submitting reports to the SEC.

Service officials have acknowledged the importance of financial reporting, but stated that there are cost implications associated with these improvements. The Service has recognized that it will incur costs in complying with the Securities and Exchange Commission's (SEC) internal control reporting rules and by changes needed to provide separate information for competitive and market-dominant products. We have reported that significant costs have been associated with complying with the SEC's implementing regulations for section 404 of the Sarbanes-Oxley Act, but have also reported that costs are expected to decline in subsequent years given the first-year investment in documenting internal controls.²²

As the Service transitions to these new reporting and accounting requirements, its ability to address future challenges in this area will be impacted by uncertainties including:

- How will the PRC use its discretion to define and implement the new statutory structure?
- What criteria will PRC use for evaluating the quality, completeness, and accuracy of ratemaking data, including the underlying accounting data and

²²GAO, *Internal Control: Analysis of Joint Study on Estimating the Costs and Benefits of Rendering Opinions on Internal Control over Financial Reporting in the Federal Environment*, GAO-06-255R (Washington, D.C.: Sept. 6, 2006); *Sarbanes-Oxley Act: Consideration of Key Principles Needed in Addressing Implementation for Smaller Public Companies*, GAO-06-361 (Washington, D.C.: Apr. 13, 2006).

additional data used to attribute costs and revenues to specific types of mail?

- How will PRC balance the need for high-quality ratemaking data with the time and expense involved in obtaining the data?
- How will PRC structure any proceedings to improve the quality of ratemaking data and enable the Service and others to participate in such proceedings? What proceedings might PRC initiate to address data quality deficiencies and issues that PRC has raised in its recent decision on the rate case?
- How will the Service be impacted by the costs associated with complying with the SEC rules for implementing section 404 of the Sarbanes-Oxley Act, as well as for the requirement of separate information for competitive and market-dominant products?

Managing Its Workforce

The Service will be challenged to manage its workforce as it transitions to operating in a new postal environment. The Service is one of the nation's largest employers, with almost 800,000 full and part-time workers. Personnel-related costs, which include compensation and benefits, are the Service's major cost category and are expected to increase due to the reform legislation requirements to begin prefunding retirement health benefit costs. We have reported on the human capital challenges facing the Service, but have found the Service has made progress in addressing some of these challenges by managing retirements, downsizing, and expanding the use of automation.²³

Provisions in the reform act related to workforce management can build on these successes. As part of the Postal Service Plan mandated by the act, the Service must describe its long-term vision for realigning its workforce and how it intends to implement that vision. This plan is to include a discussion of what impact any facility changes may have on the postal workforce and whether the Postal Service has sufficient flexibility to make needed workforce changes.

The Service, however, faces human capital challenges that will continue to impact its financial condition and outlook:

²³GAO-04-108T and GAO-05-453T.

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- *Outstanding labor agreements:* Labor agreements with the Service's four major unions expired late in calendar year 2006. In January 2007, the Service reached agreements with two of these unions, including semi-annual cost-of-living adjustments (COLA) and scheduled salary increases. Labor agreements, however, remain outstanding for the other two unions that cover over 42 percent of its career employees.
 - *Workforce realignment:* As the Service continues to make significant changes to its operations (i.e., rationalize its facilities, increase automation, improve retail access, and streamline its transportation network), it will be challenged to realign its workforce based on these changes. This challenge may become more significant as mailers alter their behavior in response to the new rate structure. These actions will require a different mix in the number, skills, and deployment of its employees, and may involve repositioning, retraining, outsourcing, and/or reducing the workforce.
 - *Retirements:* The Service expects a significant portion of its career workforce—over 113,000 employees—to retire within the next 5 years. In particular, it expects nearly half of its executives to retire during this time. The Service's decisions regarding these retirements (that is, whether or not to fill these positions, and if so, when, with whom, and where) may have significant financial and operational effects.

The following uncertainties will affect the Service's ability to address workforce-related challenges in the future:

- How will the Service be able to respond to operational changes? How will the Service balance the varying needs of diverse customers when realigning its delivery and processing networks?
- How will employees and employee organizations be affected and informed of network changes and how will the Service monitor the workplace environment?
- How will the resolutions to the outstanding labor agreements affect the Service's financial condition?
- How will the Service take advantage of flexibilities, including allowing more casual workers to deal with peak operating periods?

Key Issues and Areas for Continued Oversight

The Postal Service, the PRC, and mailers face a challenging environment with significant changes to make in the coming months related to implementing the recent rate decision and the new postal reform law. We have identified several major issues considered significant by various postal stakeholders, as well as areas related to implementation of the law that will warrant continued oversight. Specifically, focusing attention on these issues during this important transition period will help to ensure that the new statutory and regulatory requirements are carried out according to the intent of the reform act and that the Service's future financial condition is sound. These key issues and areas for continued oversight include:

- the effect of the upcoming rate increases and statutory changes on the Postal Service's financial condition;
- the decision by the Service whether or not to submit a rate filing under the old rate structure;
- actions by the PRC to establish a new price-setting and regulatory framework;
- the Service's ability to operate under an inflationary price cap while some of its cost segments are increasing above the rate of inflation;
- actions by the Service, in consultation with the PRC, to establish modern service standards and performance measures, and the Postal Service's plan for meeting those standards;
- the Service's ability to maintain high-quality delivery service as it takes actions to reduce costs and realign its infrastructure and workforce; and
- the PRC's development of appropriate accounting and reporting requirements aimed at enhancing transparency and accountability of the Service's internal data and performance results.

One of the most important decisions for monitoring in the short term is whether or not the Service decides to file another rate increase before the new rate structure takes effect. The trade-offs involved in the Service's decision on whether to file under the new or old systems include weighing the respective costs, benefits, and possible unintended consequences of the Service's need for new rates along with the time and resources required by the Service, the PRC, and the mailing industry to proceed under either the new or old systems. For example, the Service may benefit from filing under the old system because it would allow the Service to

further align costs with prices prior to moving into price-cap restrictions. Under the old rules, the Service would have to satisfy the “break-even” requirements that postal revenues will equal as nearly as practicable its total estimated costs. Under the new rules, the Service would have to ensure that rate increases for its market-dominant products do not exceed a cap based on the growth in the Consumer Price Index. Filing under the old system, however, could put additional strain on mailers and the PRC. In particular, the PRC would be reviewing the Service’s rate submission while transitioning to its new roles and responsibilities under the legislation—establishing a new organization structure, a new regulatory framework with new rules and reporting requirements, which must include time for public input, and a multitude of additional requirements.

Recognizing these challenges, the Chairman of the PRC has suggested (and asked for public comments on) that rather than expending resources on extending the application of the old system, the PRC would work with the Service and mailers to implement the new regulatory systems even sooner than the 18 months allotted by the new law. This action could allow the Service to implement new rates sooner under the new regulatory system depending upon when the PRC completes its work and the Service chooses to file new rates. The Service’s decision will not only impact its financial performance and condition, but also the mailing industry and the focus of the PRC.

Another key provision of the law that warrants close oversight is the requirement for the Service to develop modern service standards. We are encouraged by the Service’s actions to date to establish a workgroup that includes participants from the mailing industry to review and provide recommendations on service standards and measures. This workgroup is expected to complete their work in September of this year, and the Service is to make its decisions on the new service standards by December 20, 2007. The Service then has 6 months to provide Congress with a plan on how it intends to meet these standards, as well as its strategy for realigning and removing excess capacity from the postal network. We believe this plan is a particularly important opportunity to increase transparency in these areas, particularly given the changes to the Service’s plans for network realignment and the limited information available to the public. We will be reporting this summer on the status and results of the Service’s efforts to realign its mail processing network.

Finally, the PRC’s role in developing reporting requirements is critical to enhancing the Service’s transparency regarding its performance results. Congress was particularly mindful in crafting the reform act to ensure that

the provisions for additional pricing flexibility were balanced with increased transparency, oversight, and accountability. The new law provides the regulator with increased authority to establish reporting rules and monitor the Service's compliance with service standards on an annual basis.

The successful transformation of the Postal Service will depend heavily upon innovative leadership by the Postmaster General and the Chairman of the PRC, and their ability to work effectively with their employees, employee organizations, the mailing industry, Congress, and the general public. It will be important for all postal stakeholders to take full advantage of the unique opportunities that are currently available by providing input and working together, particularly as challenges and uncertainties will continue to threaten the Service's financial condition and outlook.

Chairman Davis, this concludes my prepared statement. I would be pleased to respond to any questions that you or the Members of the Subcommittee may have.

Contact and Acknowledgments

For further information regarding this statement, please contact Katherine Siggerud, Director, Physical Infrastructure Issues, at (202) 512-2834 or at siggerudk@gao.gov. Individuals making key contributions to this statement included Teresa Anderson, Joshua Bartzen, Kenneth John, John Stradling, Jeanette Franzel, Shirley Abel, Scott McNulty, and Kathy Gilhooly.

Appendix I: Summary of Recent Rate Developments

Date	Description	Rate increase, on-average	First-Class stamp rate ^a
5/3/06	<p>Postal Service submits proposal to Postal Rate Commission (PRC)^b</p> <ul style="list-style-type: none"> • Requests rate increases effective May 2007. • Proposes Forever Stamp^c • Establishes pricing structure based on mail weights and shapes: <ul style="list-style-type: none"> • Revises old structure which was primarily weight-based. • Recognizes that different mail shapes have different processing costs. • Gives mailers an opportunity to minimize their rates by altering shape of mail. 	8.1 percent	42 cents
2/26/07	<p>PRC issues recommended decision on Service's proposal</p> <ul style="list-style-type: none"> • Issued after detailed administrative proceeding involving mailers, employee organizations, consumer representatives and competitors. • Recommends revisions to many of the rates and rate designs submitted by the Service: <ul style="list-style-type: none"> • Increases rates substantially for some types of mail. • Revised rates are intended to more accurately reflect costs and send proper pricing signals. • Approves Forever Stamp. • Concurs with shape-based pricing structure and, according to the PRC, the change in rates will still meet the Service's revenue needs. • Anticipated that this would have been the last rate case initiated prior to implementation of the new rate structure established under the reform legislation and explained that its recommended rates are intended to provide a sound foundation for the future. 	7.6 percent	41 cents
3/19/07	<p>Postal Service's Board of Governors issues decision to implement PRC-recommended rates</p> <ul style="list-style-type: none"> • Implements most rates effective May 14, 2007. • Asks PRC to reconsider some rates, most notably those for flat-sized Standard Mail, which is generally advertising and direct mail solicitations (this could lead to further changes in these rates). • Delays rate implementation for Periodicals for over 2 months, citing reactions of magazine mailers and the publishing industry's need to update software. • Begins sale of Forever Stamp starting April 12; stamp will be valid for postage starting May 14. 	7.6 percent	41 cents

Source: U.S. Postal Service and Postal Regulatory Commission documents.

^aFirst-Class stamp prices cover letters weighing up to 1 ounce that are sent via First-Class Mail.

^bThe name of the Postal Rate Commission was changed to the Postal Regulatory Commission due to provisions of the Postal Reform and Enhancement Act.

^cThe Forever Stamp will sell at the First-Class one-ounce letter rate, and will continue to be worth the price of a First-Class one-ounce letter even if that price changes.

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