Postal Regulatory Commission Costing Methodology

Margaret Cigno
Assistant Director of Auditing and Costing
Overview of Presentation

- Cost allocation
  - Accrued Costs
  - Attributable Costs
  - Institutional Costs
  - Worksharing

- Changes since Postal Enhancement and Accountability act
Overview of Cost Assignment

Accrued Costs
- Attributable Costs
- Institutional Costs
  - Volume Variable
    - Direct
    - Indirect
  - Product Specific
Accrued Costs

- Financial (Accounting) System Costs
  - National Chart of Accounts
  - Trial Balance
  - Revenue and Expense Summary

- Examples
  - Employee Expenses (Payroll System)
  - Building Expenses
  - Purchased Transportation
Accrued Costs

- Total Costs of Postal Service divided into two distinct categories
  - Attributable Costs: Costs causally related to a mail product
    - Mail Processing
    - In–Office Delivery Costs
  - Institutional Costs: Remaining costs
    - Postmaster General
    - Fixed Delivery Costs
      - Route Time
### Accrued Costs

**Fiscal Year 2008**

<table>
<thead>
<tr>
<th>Costs</th>
<th>Amount (000)</th>
<th>Percent of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Attributable Costs</td>
<td>$45,636,731</td>
<td>59%</td>
</tr>
<tr>
<td>Institutional Costs</td>
<td>$32,137,144</td>
<td>41%</td>
</tr>
<tr>
<td><strong>Total Costs</strong></td>
<td><strong>$77,773,875</strong></td>
<td></td>
</tr>
</tbody>
</table>
Overview of Cost Assignment

- **Attribution Costs**
  - Volume Variable
    - Direct
    - Indirect
  - Product Specific
  - Accrued Costs
  - Institutional Costs
What Are Attributable Costs?

- Costs exclusively incurred by a single product (product specific costs)
  - Causation evident directly from accounting system, if recorded; e.g. costs to advertise only Priority Mail

- Costs that vary with volume of a product
  - Requires analysis of the relationship between mail volumes, operations, and costs, typically with econometric techniques

- Reported in the Cost and Revenue Analysis report (CRA)
Why Attributable Costs Are Important

- Close to marginal costs
  - Allow rates that maximize revenue given certain policy goals
  - Critical for proper worksharing discounts

- Monopoly Products
  - Send efficient rate signals
    - Amount consumed reflects cost of production
  - Pricing reflects demand

- Competitive Products
  - Ensure fair competition
Costs are divided into Segments, or cost centers

- Allows for analysis of cost behavior
  - Identification of volume variable share
  - Distribution to mail products
- Generally identifiable with particular functions or with labor groups
  - An example is Cost Segment 1, which includes all the costs of Postmasters
## Cost Pools: 18 Segments subdivided into Components and Subcomponents

<table>
<thead>
<tr>
<th>Cost Segment</th>
<th>Accrued ($ Millions)</th>
<th>Attributable ($ Millions)</th>
<th>Percent Attributable</th>
</tr>
</thead>
<tbody>
<tr>
<td>POSTMASTERS</td>
<td>2,244</td>
<td>399</td>
<td>17.8%</td>
</tr>
<tr>
<td>SUPERVISORS &amp; TECHS</td>
<td>4,081</td>
<td>2,272</td>
<td>55.7%</td>
</tr>
<tr>
<td>CLERKS &amp; MAILHANDLER</td>
<td>18,010</td>
<td>15,188</td>
<td>84.3%</td>
</tr>
<tr>
<td>CLERKS CAG-K OFFICES</td>
<td>5</td>
<td>3</td>
<td>60.0%</td>
</tr>
<tr>
<td>CITY DEL - OFFICE</td>
<td>4,825</td>
<td>4,040</td>
<td>83.7%</td>
</tr>
<tr>
<td>CITY DEL - STREET TIME</td>
<td>11,125</td>
<td>4,124</td>
<td>37.1%</td>
</tr>
<tr>
<td>VEHICLE SERVICE DRIVERS</td>
<td>669</td>
<td>404</td>
<td>60.4%</td>
</tr>
<tr>
<td>RURAL CARRIERS</td>
<td>6,494</td>
<td>2,539</td>
<td>39.1%</td>
</tr>
<tr>
<td>CUSTODIAL &amp; MAINT SERV</td>
<td>3,400</td>
<td>2,469</td>
<td>72.6%</td>
</tr>
<tr>
<td>MOROR VEH SERVICE</td>
<td>1,330</td>
<td>383</td>
<td>27.6%</td>
</tr>
<tr>
<td>MISC OPER COSTS</td>
<td>506</td>
<td>71</td>
<td>14.0%</td>
</tr>
<tr>
<td>TRANSPORTATION</td>
<td>6,961</td>
<td>6,148</td>
<td>88.3%</td>
</tr>
<tr>
<td>BUILDING OCCUPANCY</td>
<td>2,001</td>
<td>1,407</td>
<td>70.3%</td>
</tr>
<tr>
<td>SUPPLIES &amp; SERVICES</td>
<td>2,781</td>
<td>1,379</td>
<td>49.6%</td>
</tr>
<tr>
<td>RESEARCH &amp; DEVELOPMENT</td>
<td>18</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td>ADMIN &amp; AREA OPERATIONS</td>
<td>10,610</td>
<td>3,622</td>
<td>34.1%</td>
</tr>
<tr>
<td>GEN MGMT SYSTEMS</td>
<td>57</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td>DEPRE. &amp; OTHER ACCRUED EXP</td>
<td>2,597</td>
<td>1,809</td>
<td>69.7%</td>
</tr>
</tbody>
</table>
Each Segment Subdivided into Components and Subcomponents

- **Examples**
  - **Clerks and Mailhandlers**
    - Mail processing
    - 54 operations (ex. Manual letter sorting)
    - Window service
    - Administration
    - Special Delivery Messengers
  - **City Carrier Delivery**
    - Delivery on route sections
    - Travel to and from route
    - Collections

- **Reported in the Cost Segment and Component Report (CSC)**
Overview of Cost Assignment

Volume Variable

- Direct
- Indirect

Attributable Costs

- Accrued Costs
- Institutional Costs

Product Specific
Analysis of Variability by Subcomponents

- Collect and analyze cost, volume and operational data
  - Time series (same activity different time period)
  - Cross sectional (similar activity same time period)
- Study characteristics of activity
  - Postmaster General (0% variability)
  - Carrier casing (100% variable)
  - Indirect costs that vary to same degree as direct
    - Ex. Supervisors to direct labor
- Management Operating Data System (MODS)
- Special studies
Statistical Systems Used in Distribution

- **In–Office Cost System (IOCS)**
  - Clerk and mailhandler activities

- **Carrier Cost Systems**
  - City – CCS
  - Rural – RCCS

- **Transportation Cost System (TRACS)**

- **Revenue, Pieces and Weight (RPW) system**
  - Volume
Overview of Cost Assignment

Accrued Costs

Attributable Costs

Volume
Variable

Product
Specific

Direct

Indirect

Institutional Costs
Distribution of Institutional Costs

Prior to Postal Accountability Enhancement Act (PAEA) of 2006
- Distributed to Classes of Mail based on Qualitative Factors
  - Value
  - Equity
  - Etc.

After PAEA
- Price cap limits rate increases at the class level to inflation
- Removes judgment in distributing institutional costs at the class level
  - Still implicitly available at product level
Worksharing
- Mailers perform some postal operations in exchange for discounted rates
- Sorting the mail
  - Receive “presort” discounts
- Barcoding the mail
  - Receive “prebarcording” discounts
- Handling the mail
- Transporting the mail
  - Receive “dropship” discounts
How are Discounts Calculated?

- Cost Avoidance determined by modeling costs
  - Unit cost calculated for processing operations
  - Flow of mail through operations determined for different types of mail
  - Cost of operations summed and adjusted to match the subclass unit mail processing cost
- First Tier – Unit cost difference between workshared and non-workshared piece (Benchmark)
- Subsequent Tiers – Unit cost difference between mailpiece and previous tier
### Example of Calculation of Cost Avoidance

<table>
<thead>
<tr>
<th>Presort Tier</th>
<th>Unit Cost</th>
<th>Cost Avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-workshared</td>
<td>10.0</td>
<td></td>
</tr>
<tr>
<td>1 Basic Sort</td>
<td>9.0</td>
<td>1.0</td>
</tr>
<tr>
<td>2 3-Digit Sort</td>
<td>7.6</td>
<td>1.4</td>
</tr>
<tr>
<td>3 5-Digit Sort</td>
<td>6.0</td>
<td>1.6</td>
</tr>
</tbody>
</table>
## How are Discounts Calculated?

- **Passthrough** – Percentage of cost avoidance that is reflected in discounts
  - Strive for 100%

### Example of Application of Passthrough

<table>
<thead>
<tr>
<th>Presort Tier</th>
<th>Unit Cost</th>
<th>100% Passthrough</th>
<th>Discount</th>
<th>75% Passthrough</th>
<th>Discount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Basic Sort</td>
<td>1.0</td>
<td>100%</td>
<td>1.0</td>
<td>75%</td>
<td>0.75</td>
</tr>
<tr>
<td>2 3-Digit Sort</td>
<td>1.4</td>
<td>100%</td>
<td>1.4</td>
<td>75%</td>
<td>1.05</td>
</tr>
<tr>
<td>3 5-Digit Sort</td>
<td>1.6</td>
<td>100%</td>
<td>1.6</td>
<td>75%</td>
<td>1.20</td>
</tr>
</tbody>
</table>
Changes Due to Postal Enhancement and Accountability Act

- New regulations for Competitive products (expedited packages)
  - No price cap
  - Products must cover attributable costs
    - New cost concept – Group Specific
  - On whole must make a “reasonable” contribution to institutional costs
  - Must transfer an imputed income tax amount to General Postal Fund
Changes Due to Postal Enhancement and Accountability Act

- Worksharing requirements codified
  - Passthroughs must not exceed 100% except under special circumstances
  - Benchmarking issue before the Commission now
Changes Due to Postal Enhancement and Accountability Act

- Financial reporting
  - Enhanced transparency of financial reporting
    - Security and Exchange Commission reporting
    - Sarbanes–Oxley Act compliance
Changes Due to Postal Enhancement and Accountability Act

- Integrity of data systems
  - Commission has enhanced role in data collection and cost methodology
  - Postal Inspector General monitors data quality
QUESTIONS?

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