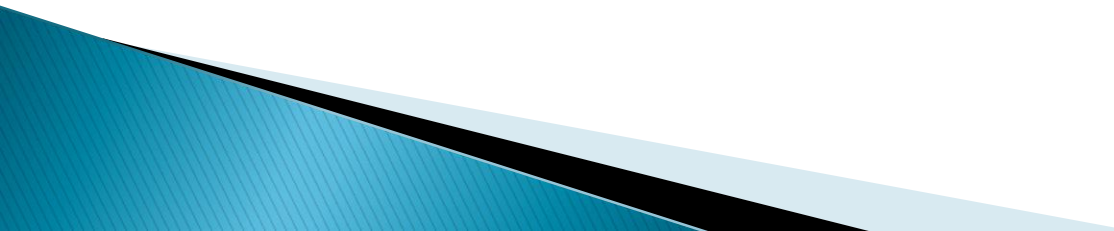




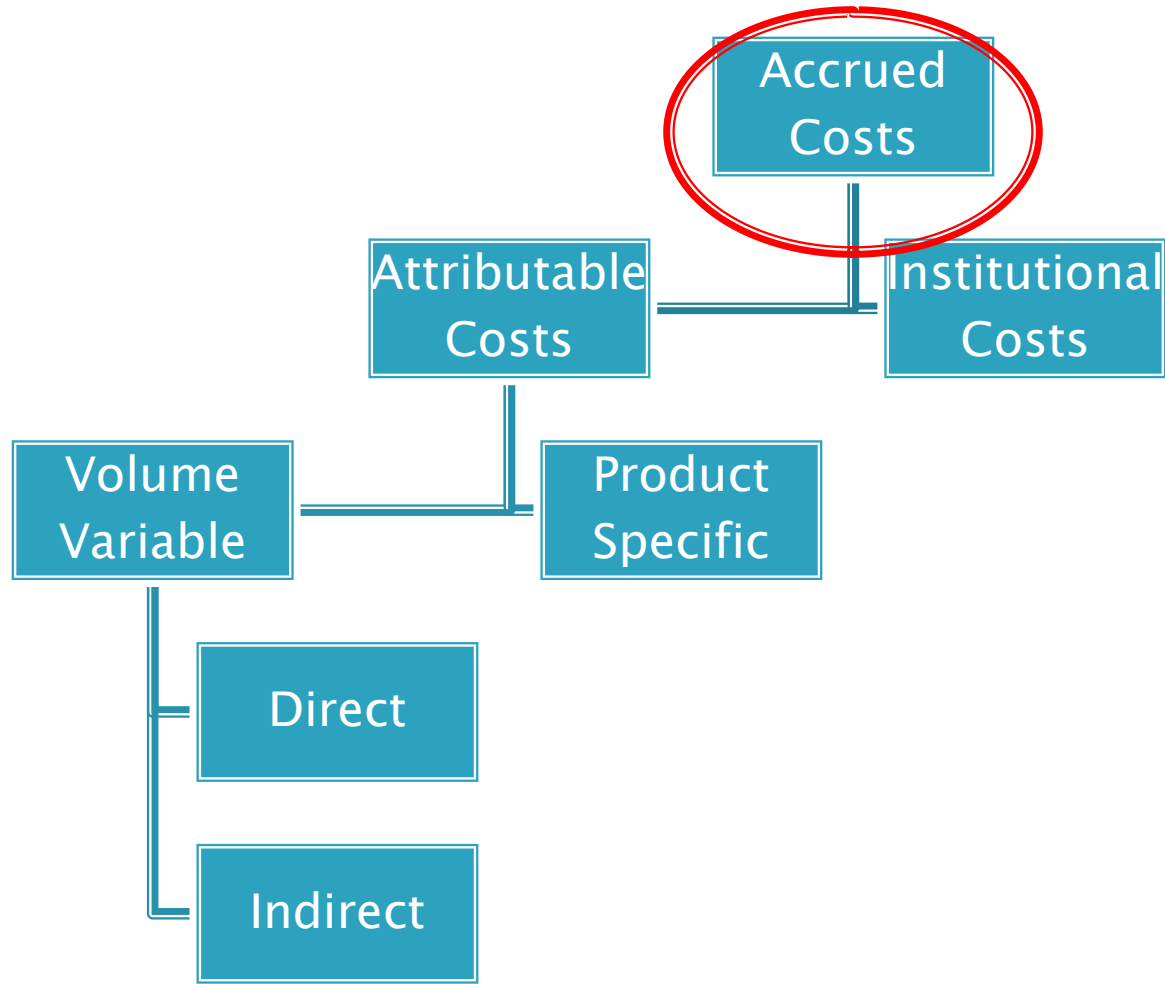
Postal Regulatory Commission Costing Methodology

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

- ▶ 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

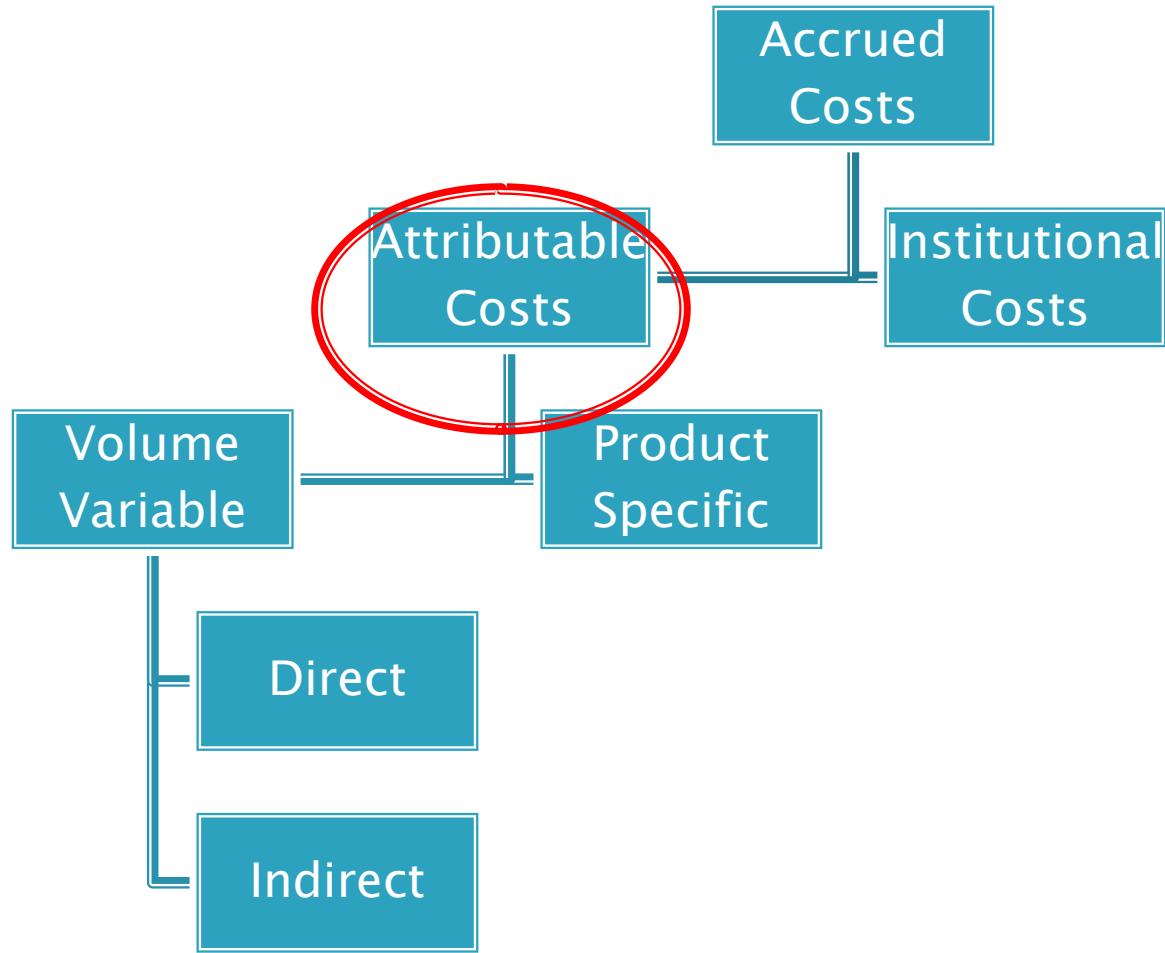
- ▶ Total Costs of Postal Service divided into two distinct categories
 - Attributable Costs: Costs causally related to a mail product
 - Mail Processing
 - In-Office Delivery Costs
 - Institutional Costs: Remaining costs
 - Postmaster General
 - Fixed Delivery Costs
 - Route Time

Accrued Costs

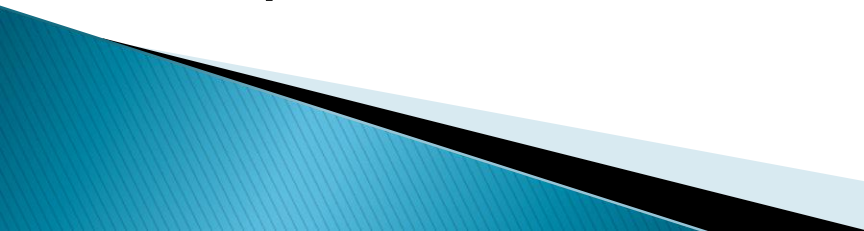
Fiscal Year 2008

	Amount (000)	Percent of Total
Attributable Costs	\$45,636,731	59%
Institutional Costs	\$32,137,144	41%
Total Costs	<u>\$77,773,875</u>	

Overview of Cost Assignment



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

Determining Attributable Costs

- ▶ 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

Cost Segment	FY 2008		
	Accrued (\$ Millions)	Attributable (\$ Millions)	Percent Attributable
POSTMASTERS	2,244	399	17.8%
SUPERVISORS & TECHS	4,081	2,272	55.7%
CLERKS & MAILHANDLER	18,010	15,188	84.3%
CLERKS CAG-K OFFICES	5	3	60.0%
CITY DEL - OFFICE	4,825	4,040	83.7%
CITY DEL - STREET TIME	11,125	4,124	37.1%
VEHICLE SERVICE DRIVERS	669	404	60.4%
RURAL CARRIERS	6,494	2,539	39.1%
CUSTODIAL & MAINT SERV	3,400	2,469	72.6%
MOROR VEH SERVICE	1,390	383	27.6%
MISC OPER COSTS	506	71	14.0%
TRANSPORTATION	6,961	6,148	88.3%
BUILDING OCCUPANCY	2,001	1,407	70.3%
SUPPLIES & SERVICES	2,781	1,379	49.6%
RESEARCH & DEVELOPMENT	18	0	0.0%
ADMIN & AREA OPERATIONS	10,610	3,622	34.1%
GEN MGMT SYSTEMS	57	0	0.0%
DEPREC. & OTHER ACCRUED EXP	2,597	1,809	69.7%

Each Segment Subdivided into Components and Subcomponents

▶ Examples

○ Clerks and Mailhandlers

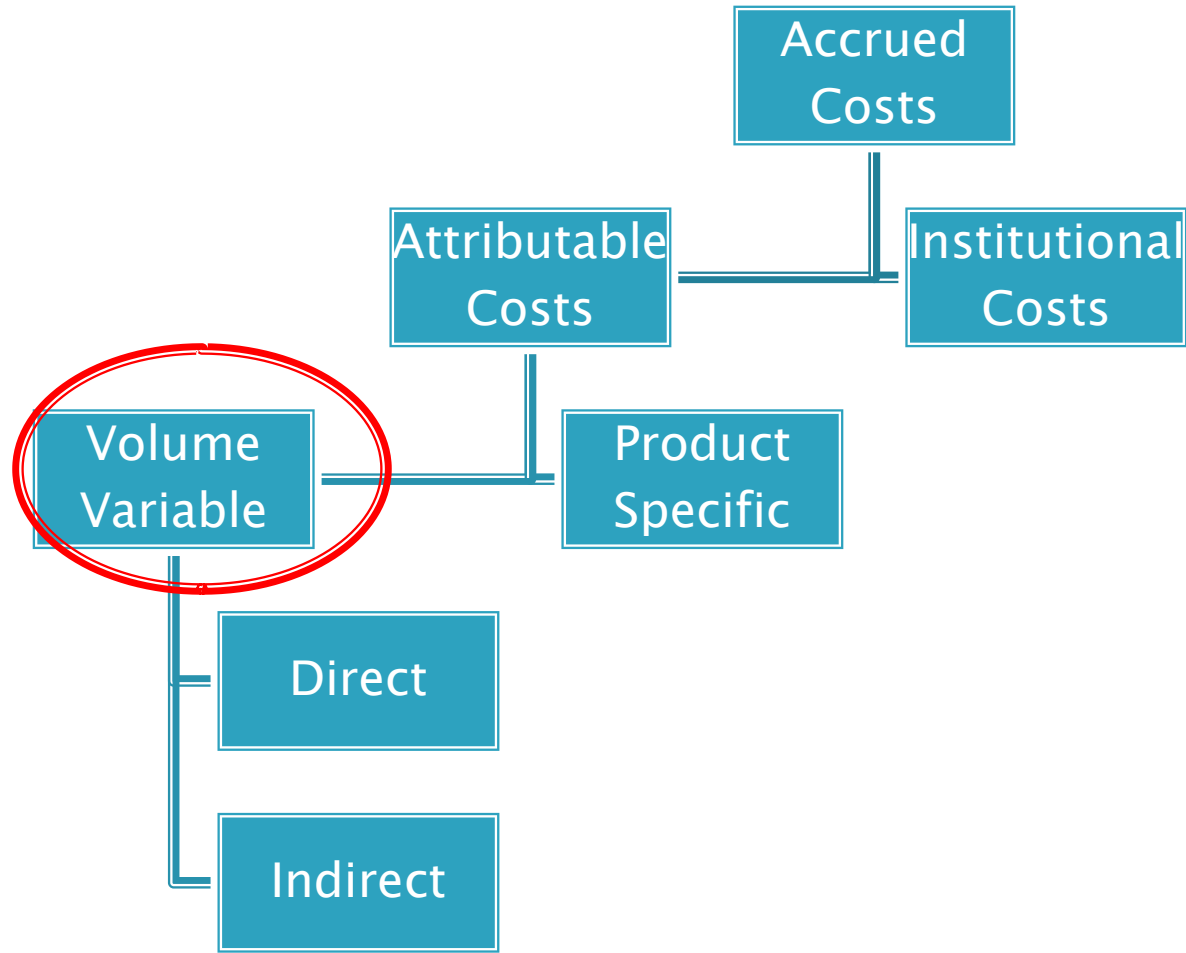
- Mail processing
 - 54 operations (ex. Manual letter sorting)
- Window service
- Administration
- Special Delivery Messengers

○ 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



Analysis of Variability by Subcomponents

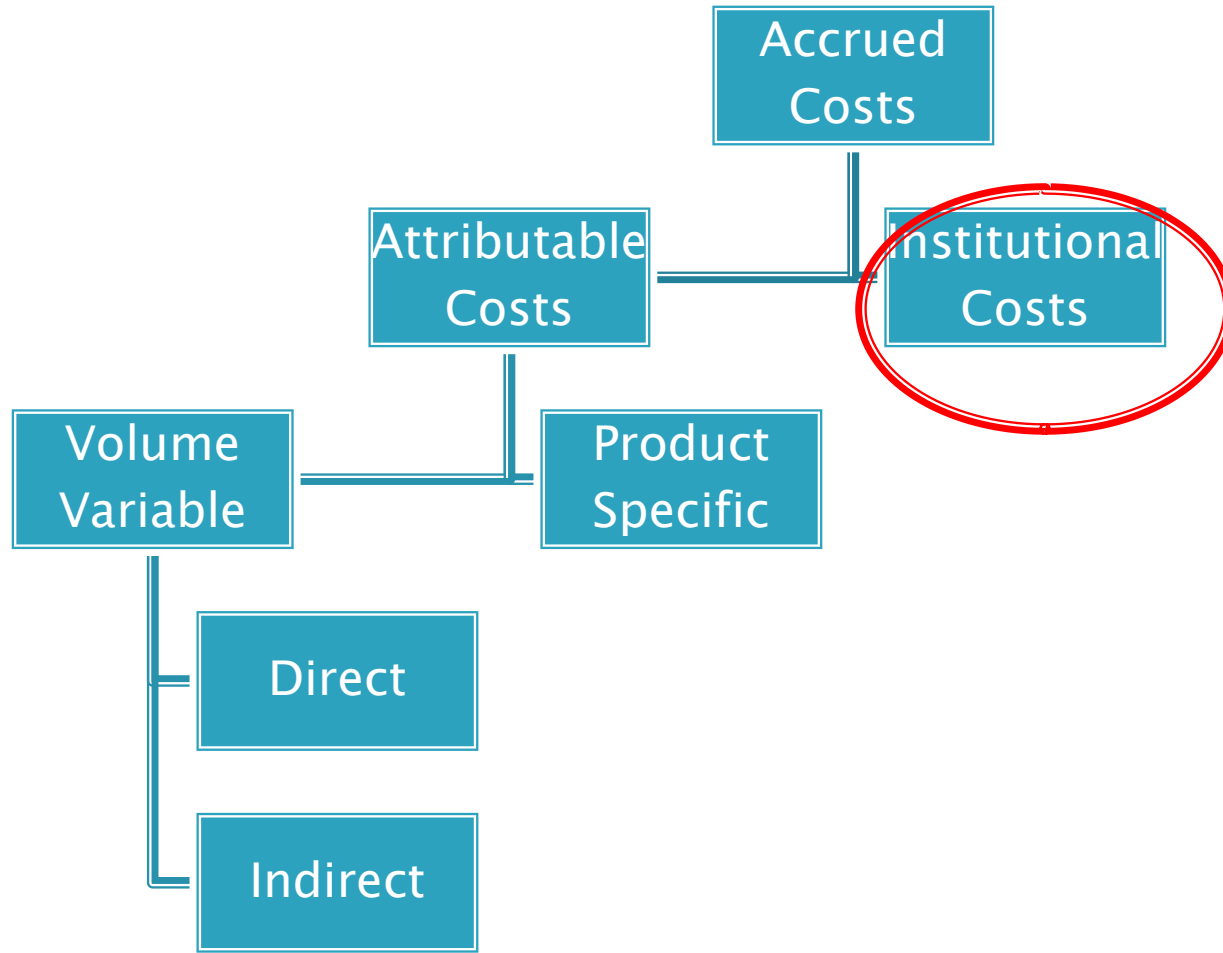
- ▶ Collect and analyze cost, volume and operational data
 - Time series (same activity different time period)
 - Cross sectional (similar activity same time period)
- ▶ Study characteristics of activity
 - Postmaster General (0% variability)
 - Carrier casing (100% variable)
 - Indirect costs that vary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

Distribution of Cost Pool Costs to Products

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



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

Cost Calculation Below the Class Level

- ▶ Worksharing
 - Mailers perform some postal operations in exchange for discounted rates
 - Sorting the mail
 - Receive “presort” discounts
 - Barcoding the mail
 - Receive “prebarcoding” 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

How are Discounts Calculated?

Example of Calculation of Cost Avoidance

Presort Tier		Unit Cost	Cost Avoided
	Non-workshared	10.0	
1	Basic Sort	9.0	1.0
2	3-Digit Sort	7.6	1.4
3	5-Digit Sort	6.0	1.6

How are Discounts Calculated?

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

Example of Application of Passthrough

Presort Tier	Unit Cost	100%		75%	
		Passthrough	Discount	Passthrough	Discount
1	Basic Sort	1.0	100%	1.0	0.75
2	3-Digit Sort	1.4	100%	1.4	1.05
3	5-Digit Sort	1.6	100%	1.6	1.20

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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