

GAO

Testimony

Before the Subcommittee on Federal
Workforce, Postal Service, and the District of
Columbia, Committee on Oversight and
Government Reform, House of Representatives

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U.S. POSTAL SERVICE

**Broad Restructuring
Needed to Address
Deteriorating Finances**

Statement of Phillip Herr, Director
Physical Infrastructure Issues



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Highlights

Highlights of GAO-09-790T, a testimony before the Subcommittee on Federal Workforce, Postal Service, and the District of Columbia, Committee on Oversight and Government Reform, House of Representatives

Why GAO Did This Study

The U.S. Postal Service's (USPS) financial condition has worsened this year, with the recession and changing mail use causing declines in mail volume and revenues despite postal rate increases. GAO testified in May to this subcommittee that USPS expects these declines to lead to a record net loss and an unprecedented cash shortfall even if ambitious cost cutting is achieved. GAO reported that maintaining USPS's financial viability as the provider of affordable, high-quality universal postal service will require actions in a number of areas, such as (1) rightsizing its retail and mail processing networks by consolidating operations and closing unnecessary facilities and (2) reducing the cost and size of its workforce, which generates about 80 percent of its costs. Today GAO is releasing its report on USPS efforts to improve the efficiency of delivery. Delivery accounts for nearly half of USPS salary and benefit costs.

This testimony (1) updates USPS's financial condition and outlook and explains GAO's decision to place USPS's financial condition on the High-Risk List and (2) discusses the need for USPS to restructure its mail processing, retail, and delivery networks and its efforts to improve their efficiency. It is based on GAO's past and ongoing work and updated USPS information.

View GAO-09-790T or key components. For more information, contact Phillip Herr at (202) 512-2834 or herrpagao.gov.

U.S. POSTAL SERVICE

Broad Restructuring Needed to Address Deteriorating Finances

What GAO Found

USPS's financial condition and outlook continue to deteriorate with a worsening outlook for mail volume and revenue. USPS now projects mail volume to decline by about 28 billion pieces to about 175 billion pieces in fiscal year 2009, a decline of 13.7 percent. As a result, USPS projects

- a net loss of about \$7 billion even with record savings of about \$6 billion;
- an increase in outstanding debt by the annual \$3 billion limit; and,
- despite this borrowing, an unprecedented \$1 billion cash shortfall.

Thus, USPS recently reported to Congress that, due to the need to maintain sufficient cash to cover costs, it will not fully make its mandated payment of \$5.4 billion for future retiree health benefits due by September 30, 2009, even if it receives \$2 billion in relief under pending House legislation.

GAO added USPS's financial condition to the High-Risk List this week. GAO reported USPS urgently needs to restructure to address its current and long-term financial viability. Accordingly, GAO calls for USPS to develop and implement a broad restructuring plan—with input from the Postal Regulatory Commission and other stakeholders, and approval by Congress and the administration—that includes key milestones and time frames for actions, addresses key issues, and identifies what steps Congress and other stakeholders may need to take.

USPS needs to optimize its retail, mail processing, and delivery networks to eliminate growing excess capacity and maintenance backlogs, reduce costs, and improve efficiency. USPS has a window of opportunity to reduce the cost and size of its workforce through attrition and the large number of upcoi-, retirements to minimize the need for layoffs. Although USPS has begun efforts to realign and consolidate some mail processing, retail, and delivery operations, much more is urgently needed. GAO recognizes that USPS would face formidable resistance to restructuring with many facility closures and consolidations because of concerns that these actions would affect service, employees, and communities. USPS management will need to provide leadership and work with stakeholders to overcome resistance for its actions to be successfully implemented. USPS must use an open, transparent, fair, and consistent process; engage with its unions, management associations, the mailing industry, and political leaders; and demonstrate results. In turn, these stakeholders and Congress need to recognize that major restructuring is urgently needed for USPS to be financially viable.

To its credit, USPS recently began a national initiative to consolidate some of its 3,200 postal retail stations and branches in urban and suburban areas. USPS has begun efforts to consolidate some mail processing operations but has closed only 1 of 400 major mail processing facilities. USPS is realigning city carrier routes to remove excess capacity and improve efficiency, which is expected to save nearly \$1 billion annually; has begun to install automated equipment to reduce costly manual sorting of flat-sized mail; and is studying how it could shift to 5-day delivery and the potential savings.

Chairman Lynch, Ranking Member Chaffetz, and Members of the Subcommittee:

I am pleased to participate in this hearing on U.S. Postal Service (USPS) operations. My statement will (1) update USPS's financial condition and outlook and explain our recent decision to place USPS's financial condition on our High-Risk List, and (2) discuss the need for USPS to restructure its mail processing, retail, and delivery networks and its efforts to improve their efficiency.

My statement is based upon our past and ongoing work, including the report being released today on USPS efforts to improve delivery efficiency,¹ and our report adding USPS to the High-Risk List,² as well as our continued monitoring of USPS's financial condition and outlook. We conducted our work from May 2009 to July 2009 in accordance with all sections of GAO's quality assurance framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions in this product.

USPS's Financial Condition Continues to Deteriorate, and Its Financial Condition Has Been Added to Our High-Risk List

USPS's financial condition and outlook continue to deteriorate with a worsening outlook for mail volume and revenue. USPS currently projects a mail volume decline of 13.7 percent for fiscal year 2009, triple the 4.5 percent decline in fiscal year 2008 and the largest percentage decline since the Great Depression. As a result, USPS is projecting the following for fiscal year 2009:

- a net loss of about \$7 billion,³ even if it achieves record cost savings of about \$6 billion;
- an increase in outstanding debt by the annual statutory limit of \$3 billion;⁴ and,

¹GAO, *U.S. Postal Service: Mail Delivery Efficiency Has Improved, but Additional Actions Needed to Achieve Further Gains*, GAO-09-696 (Washington, D.C.: July 15, 2009).

²GAO, *High-Risk Series Restructuring the U.S. Postal Service to Achieve Sustainable Financial Viability* GAO-09-937SP (Washington, D.C.: July 28, 2009).

³USPS lost \$2.8 billion in fiscal year 2008—its second-largest annual loss since 1971.

⁴39 U.S.C. §2005(a).

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- despite this borrowing, an unprecedented \$1 billion cash shortfall.

USPS has reported that it does not expect to generate sufficient cash from operations to fully make its mandated payment of \$5.4 billion for future retiree health benefits that is due by September 30, 2009. Further, USPS recently reported to Congress that—due to the need to maintain sufficient cash to cover costs—it will not fully make this payment, even if it receives \$2 billion *in relief* from fiscal year 2009 retiree health benefits payments that would be provided by H.R. 22, which has been reported out of the House Committee on Oversight and Government Reform.

USPS also expects continued financial problems in fiscal year 2010, with a similar deficit even if it achieves larger cost savings, and an even larger cash shortfall. Under this scenario, USPS would increase its outstanding debt by an additional \$3 billion, which would bring its total debt to \$13.2 billion at the end of fiscal year 2010—only \$1.8 billion less than its \$15 billion statutory limit.⁵

USPS's projected cost cutting of about \$6 billion for this fiscal year is much larger than its previous annual cost-cutting targets that have ranged from nearly \$900 million to \$2 billion since 2001. However, USPS projects *cash* shortfalls because cost cutting and rate increases will not fully offset the impact of mail volume declines and other factors that increase costs—notably semiannual cost-of-living allowances (COLA) for employees covered by union contracts. Compensation and benefits constitute close to 80 percent of its costs—a percentage that has remained similar over the years despite major advances in technology and automating postal operations. Also, USPS continues to pay a higher share of employee health benefit premiums than other federal agencies. Further, it has high overhead (institutional) costs that are hard to change in the short term, such as providing universal service that includes 6-day delivery and maintaining a network of 37,000 post offices and retail facilities, as well as a delivery network of more than 149 million addresses.

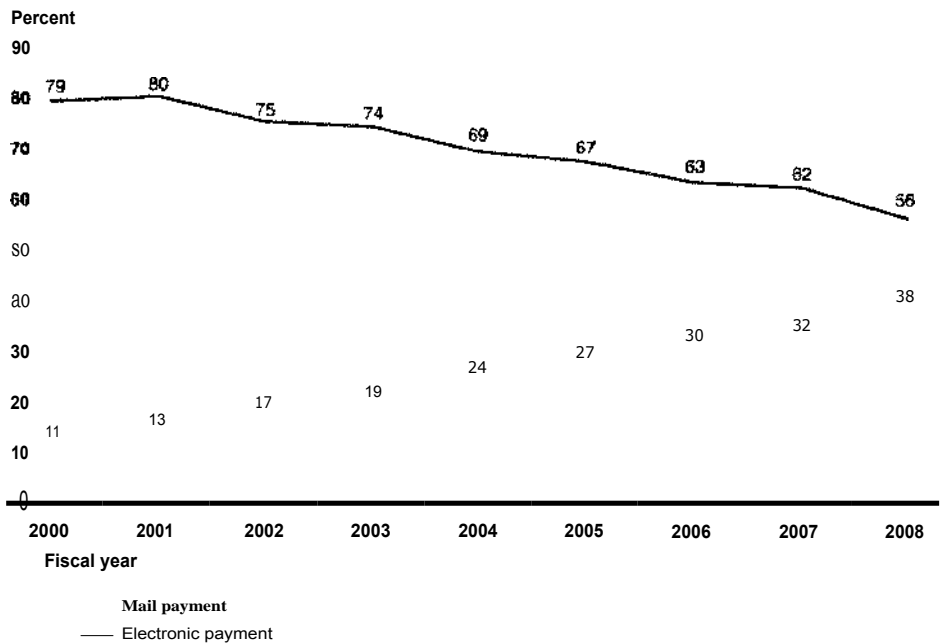
Two days ago, we added USPS's financial condition to the list of high-risk areas needing attention by Congress and the executive branch to achieve broad-based transformation. We reported that USPS urgently needs to restructure to address its current and long-term financial viability. USPS's cost structure has not been cut fast enough to offset accelerated decline in mail volume and revenue. In this regard, USPS has high personnel costs,

⁵39 U.S.C. §2005(a).

including those to provide 6-day delivery and retail services. To achieve financial viability, USPS must align its costs with revenues, generate sufficient earnings to finance capital investment, and manage its debt.

We noted that mail use has been changing over the past decade as businesses and consumers have moved to electronic communication and payment alternatives. Further innovations in, and use of, e-commerce and broadband are expected. The percentage of households paying bills by mail is declining while the percentage of electronic payments is increasing (see fig. 1). Mail volume peaked in 2006, and its decline has accelerated with the economic recession, particularly among major mail users in the advertising, financial, and housing sectors. Mail volume has typically returned after recessions, but USPS's 5-year forecast suggests that much of the lost volume will not return.

Figure 1: Percentage of Household Bill Payments Made by Mail and Electronically, Fiscal Years 2000 through 2008



Source: LISPS.

For these reasons, we concluded that action is needed in multiple areas, including possible action and support by Congress, as no single change will be sufficient to address USPS's challenges.

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- The short-term challenge for USPS is to cut costs quickly enough to offset the unprecedented volume and revenue declines, so that it can cover its operating expenses.
 - The long-term challenge is to restructure USPS operations, networks, and workforce to reflect changes in mail volume, use of the mail, and revenue.

Accordingly, we have called for USPS to develop and implement a broad restructuring plan—with input from the Postal Regulatory Commission (PRC) and other stakeholders, and approval by Congress and the administration—that includes key milestones and time frames for actions, addresses key issues, and identifies what steps Congress and other stakeholders may need to take. We stated that USPS's restructuring plan should address how it plans to

- realign postal services, such as delivery frequency, delivery standards, and access to retail services, with changes in the use of mail by consumers and businesses;
- better align costs and revenues, including compensation and benefit costs;
- optimize its operations, networks, and workforce;
- increase mail volumes and revenues; and
- retain earnings, so that it can finance needed capital investments and repay its growing debt.

Network Restructuring Needed to Help USPS Achieve Financial Viability

USPS needs to optimize its retail, mail processing, and delivery networks to eliminate growing excess capacity and maintenance backlogs, reduce costs, and improve efficiency. We recently reported that USPS needs to rightsize its retail and mail processing networks and reduce the size of its workforce.¹ USPS has a window of opportunity to further reduce the cost and size of its workforce through attrition and the large number of upcoming retirements to minimize the need for layoffs. As the Postmaster General testified this March, about 160,000 USPS employees are eligible for regular retirement this fiscal year, and this number will grow within the next 4 years to nearly 300,000. USPS has begun efforts to realign and consolidate some of its mail processing, retail, and delivery operations, but much more restructuring is urgently needed. We recognize that USPS would face formidable resistance to restructuring with many facility closures and consolidations because of concerns that these actions would

¹GAO. *U.S. Postal Service: Network Rightsizing Needed to Help Keep USPS Financially Viable*, GAO-09-674T (Washington, D.C.: May 20, 2009).

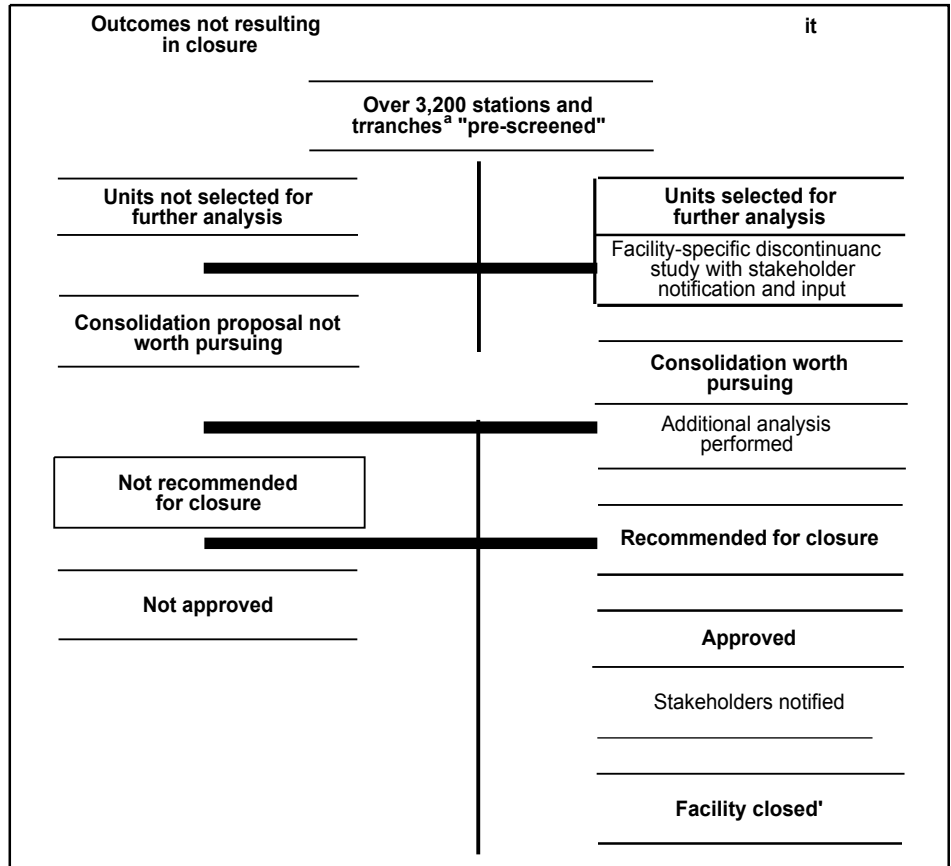
impact service, employees, and local communities. USPS senior management will need to provide leadership and work with stakeholders to overcome resistance for its actions to be successfully implemented. USPS must use an open and transparent process that is fairly and consistently applied; engage with its unions, management associations, the mailing industry, and political leaders; and demonstrate results of actions. In turn, these stakeholders and Congress need to recognize that major changes are urgently needed for USPS to be financially viable.

USPS Has Recently Begun Efforts to Consolidate Retail Facilities

To its credit, USPS recently began a national initiative to consolidate some of its 3,200 postal retail stations and branches *in* urban and suburban areas.⁷ It has nearly completed an initial review to identify which facilities will be studied for consolidation, and expects the studies to take about 4 months, with final decisions made starting this October. USPS has processes for notifying its unions and management associations, soliciting community input, and notifying affected employees *as* it winnows the list of stations and branches it is considering for consolidation (see fig. 2).

⁷Stations are subordinate units of a post office located within the same corporate limits (city or town limits) *as* the post office; branches are subordinate units outside these limits. Employees in these facilities report to the postmaster at the main post office, which generally is the community's primary retail facility.

Figure 2: Highlights of USPS's Process for Consolidating Retail Stations and Branches Under Its Ongoing Initiative



Source: USPS.

^aStations and branches report to the main post office of the community.

^cClosures are to be implemented at least 60 days after the final decision.

On July 2, 2009, USPS requested that PRC provide an advisory opinion on USPS's retail consolidation initiative, which has led to a public process that will provide stakeholders with opportunities for input.¹ In its request, USPS stated it would identify opportunities to consolidate retail operations and improve efficiency, but only after concluding that such changes will continue to provide ready access to essential postal services.

¹Documents in this PRC proceeding, N2009-1, are posted on the PRC Web site, www.prc.gov. 39 U.S.C. §3661(b) specifies requirements for this proceeding.

USPS noted that the branches and stations considered for consolidation are often in close proximity to each other. USPS stated that it could not estimate the savings because it had not made decisions on how many or which facilities would be closed. Going forward, issues may include whether stations and branches will be considered subject to statutory requirements for maintaining and closing post offices,¹ and the similar question of whether any branches and stations are covered by the long-standing appropriations provision that restricts post office closures.¹

USPS is required, among other things, to provide adequate, prompt, reliable, and efficient services to all communities, including a maximum degree of effective and regular services in rural areas, communities, and small towns where post offices are not self-sustaining." USPS is specifically prohibited from closing small post offices solely for operating at a deficit.¹ Consistent with reasonable economies, USPS is authorized to establish and maintain facilities *as* are necessary to provide ready access to essential services to customers throughout the nation. Before closing a post office, USPS must, among other things, provide customers with at least 60 days of notice before the proposed closure date, and any person served by the post office may appeal its closure to the PRC." However, USPS plans state that customers will have 20 days to comment on a proposed closure of a station or branch and that no appeals will be permitted. USPS explained that stations and branches are different from post offices. A recent Congressional Research Service report discussed this matter and other issues related to the closure of these retail facilities."

To put USPS's retail consolidation initiative into context, we recently testified before this subcommittee that USPS can streamline its network of 37,000 post offices, branches, and stations—a network that has remained largely static despite expanding use of retail alternatives and shifts in

²39 U.S.C. §§101, 403, and 404.

"For example, see Financial Services and General Government Appropriations Act, 2009, Pub. L. No. 11144, div. D, title V (Mar. 11, 2009), which provides: "That none of the funds provided in this Act shall be used to consolidate or close small rural and other small post offices in fiscal year 2009."

¹¹39 U.S.C. §101(a) and (b).

¹²39 U.S.C. §101(b).

¹³39 U.S.C. §404(d).

"Congressional Research Service, *Post Office and Retail Postal Facility Closures: Overview and Issues for Congress*, 840719 (Washington, D.C.: July 23, 2009).

population.' We have previously reported that the number of postal retail facilities has varied widely among comparable counties in urban areas, and a number of facilities we visited appeared to merit consideration for closure based on leading federal practices for rightsizing facility networks.' Our report also noted that USPS has a maintenance backlog for its retail facilities, and USPS officials stated that USPS has historically underfunded its maintenance needs. USPS has limited its capital expenditures to help conserve cash, which may affect its maintenance backlog. Fewer retail facilities would reduce maintenance needs.

USPS Has Made Limited Progress in Consolidating Its Mail Processing Network

USPS has begun efforts to consolidate some mail processing operations, but much more needs to be done to restructure this network, particularly since USPS has closed only 1 of its approximately 400 major mail processing facilities. In the Postal Accountability and Enhancement Act of 2006,¹⁷ Congress encouraged USPS to expeditiously move forward in its streamlining efforts, recognizing that the 400 processing facilities are more than USPS needs and streamlining this network can help eliminate excess costs. USPS has substantial excess capacity in its processing network that is growing with declining mail volume. According to USPS, it has 50 percent excess capacity for processing First-Class Mail.

USPS is using the Area Mail Processing process to propose consolidating some mail processing operations (see app. I and <http://www.usps.com/all/amp.htm>). USPS is also consolidating processing and transportation operations from Bulk Mail Centers and Surface Transfer Centers into what it refers to as Network Distribution Centers, which USPS officials expect to be completed this November (see <http://www.usps.com/allindc.htm>). In the past decade, USPS has closed some smaller facilities, such as 68 Airport Mail Centers and 50 Remote Encoding Centers.¹⁸ In 2005, we recommended that USPS enhance transparency and strengthen accountability of its realignment efforts to assure stakeholders that such efforts would be implemented fairly and

15GAO-09-6741.

¹⁸GAO, *U.S. Postal Service Facilities: Improvements in Data Would Strengthen Maintenance and Alignment of Access to Retail Service*, GAO-08-41 (Washington, D.C.: Dec. 10, 2007).

¹⁷Pub.L. No. 109-435 (Dec. 20, 2006).

¹⁶Remote Encoding Centers were established as a temporary solution to automate the processing of mail with handwritten addresses that could not be read by sorting equipment.

achieve the desired results. We since testified that USPS took steps to address these recommendations and should be positioned for action.

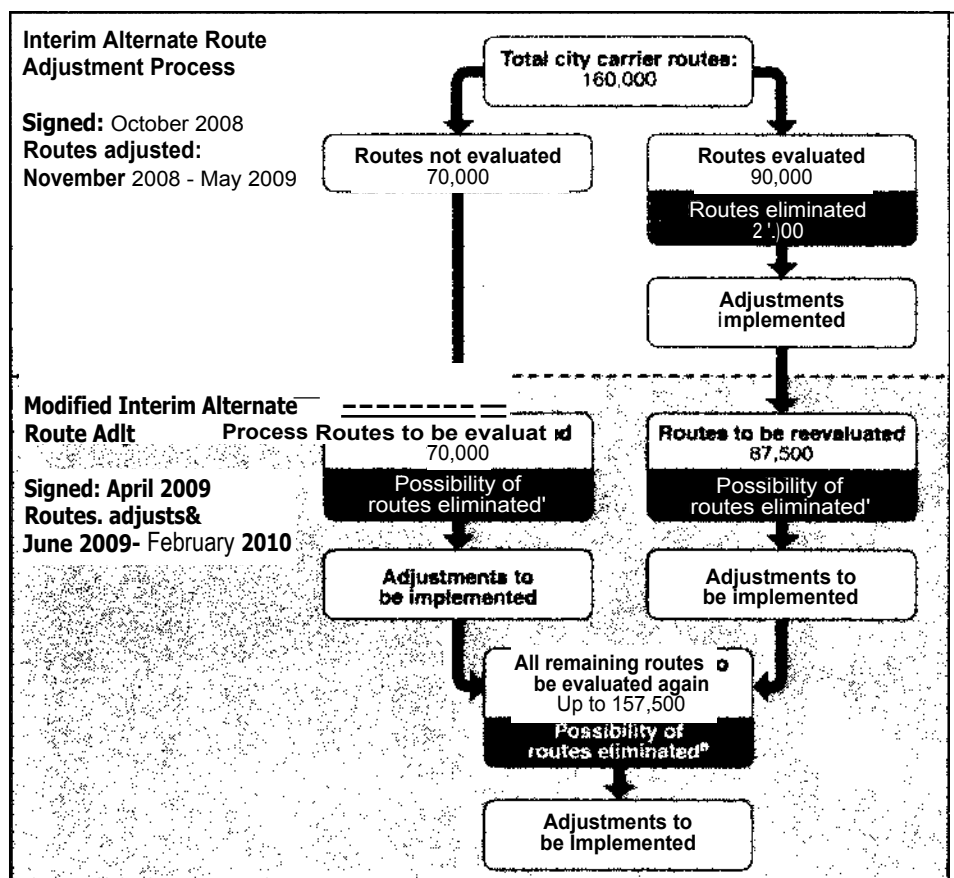
LISPS Has Ongoing Efforts to Improve Delivery Efficiency

USPS has ongoing efforts to increase the efficiency of mail delivery, which is USPS's largest cost segment and includes more than 350,000 carriers that account for approximately 45 percent of salary and benefit expenses. Two key efforts are (1) realignment of city delivery routes and (2) installing new Flats Sequencing Systems to automate the sorting of flat-sized mail—such as catalogs and magazines—into delivery order, so that time-consuming and costly manual sorting by carriers is no longer needed.

First, USPS is realigning city carrier routes to remove excess capacity and improve efficiency, which is expected to generate nearly \$1 billion in annual savings. USPS also expects this effort to result in reduced facility space needs, increased employee satisfaction, and more consistent delivery service. Route realignment has been made possible by collaboration between USPS and the National Association of Letter Carriers. The parties agreed on the original realignment process, which resulted in eliminating 2,500 routes. A modified process, which will cover all city delivery routes, has resulted in the elimination of an additional 1,800 routes through June 2009 (see fig. 3), and additional routes may be eliminated. Thus, route realignment should result in further savings next fiscal year.

"GAO, US 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, 2005).

Figure 3: Summary of the Process to Realign USPS City Delivery Routes



Source: GAO analysis of USPS operations.

'Depending on the results of the route evaluations, a segment of these routes could be eliminated.

Note: As a result of the modified process, an additional 1,800 routes were eliminated through June 2009.

USPS has established policies and procedures to notify customers if they will be affected by route realignment and taken actions to keep affected stakeholders informed. For example, USPS has made updated route information available on the Internet, which the mailing industry needs to prepare and organize the mail so USPS can efficiently handle it.

Second, USPS has begun to install 100 automated sorting machines for its \$1.5 billion Flats Sequencing System to sort flat-sized mail into delivery order, which is scheduled to be completed in October 2010. USPS expects this to improve delivery accuracy, consistency, and timeliness. USPS has

worked with the mailing industry to facilitate implementation, since the industry plays a major role in preparing, transporting, and addressing flat-sized mail for efficient USPS handling. Mailer representatives have praised USPS communications and coordination with them—a process that is continuing to address implementation issues. USPS and the two carrier unions (the National Association of Letter Carriers and the National Rural Letter Carriers' Association) reached agreement on revised work rules and procedures to realign routes and capture work hour savings. Because of mail volume declines, to maximize program savings, USPS is reconsidering where to deploy the machines and the number of delivery routes covered by the program. On routes covered by the machines, city carriers, on average, will be manually sorting nearly 500 fewer flat-sized mail pieces each day.

Finally, USPS has proposed moving to 5-day delivery to help address its financial problems. USPS is studying how 5-day delivery could be implemented, potential savings, and impacts on its employees. The study, which USPS expects to complete this fall, will incorporate input from postal unions and management associations, the mailing industry, and consumer and market research. Cutting delivery frequency would affect universal postal service and could further accelerate the decline in mail volume and revenues. Considering the potential impact on cost, volume, revenues, employees, and customers, it will be important for USPS to make its study publicly available so that Congress and stakeholders can better understand USPS's proposal and consider the trade-offs involved.

As USPS has recognized, implementing 5-day delivery would require congressional action because a long-standing appropriations provision mandates 6-day delivery.¹ PRC officials have stated that USPS would be required to seek an advisory opinion from PRC on such a change, which would lead to a public hearing with stakeholder input. According to USPS officials, USPS would need about 6 months to prepare for and implement 5-day delivery, including moving employees to other locations, reprogramming payroll systems, and realigning operations.

¹For example, see Financial Services and General Government Appropriations Act, 2009, Pub. L. No. 111-8, div. D, title V (Mar. 11, 2009). The provision states that, "6-day delivery and rural delivery of mail shall continue at not less than the 1983 level."

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

For further information regarding this statement, please contact Phillip Herr at (202) 512-2834 or herrp@gao.gov. Individuals who made key contributions to this statement include Shirley Abel, Teresa Anderson, Gerald P. Barnes, Josh Bartzen, Paul Hobart, Kenneth E. John, David Hooper, Hannah Laufe, Emily Larson, Josh Ormond, Susan Ragland, Amy Rosewarne, Travis Thomson, and Crystal Wesco.

Appendix I: Status of 2008-2009 Proposed Area Mail Processing Consolidations as of July 23, 2009

Area Mail Processing (AMP) study initiate	Study started	Public meeting notice	Public meeting held	AMP not approved	AMP approved
Total AMP proposals: 37	9	1	16	4	7
1. Aberdeen, SD, to Dakota Central, SD				X	
2. Athens, GA, to North Metro, GA			X		
3. Binghamton, NY, to Syracuse, NY					
4. Bloomington, IN, to Indianapolis, IN	X				
5. Bronx, NY, to Morgan, NY				X	
6. Canton, OH, to Akron, OH					X
7. Cape Cod, MA, to Brockton, MA			X		
8. Dallas, TX, to North Texas, TX			X		
9. Detroit, MI to Pontiac, MI			X		
10. Flint, MI to Pontiac, MI			X		
11. Hattiesburg, MS, to Gulfport, MS			X		
12. Industry, CA, to Santa Ana, CA, and/or Santa Clarita, CA	X ^a				
13. Kansas City, KS, to Kansas City, MO					X
14. Kilmer, NJ, to Dominick V. Daniels, NJ, and Trenton, NJ	X				
15. Lakeland, FL, to Tampa, FL					X
16. Long Beach, CA, to Santa Ana, CA, and/or Los Angeles, CA			X		
17. Manasota, FL, to Tampa, FL					X
18. Mansfield, OH, to Akron, OH				X	
19. Newark, NJ, to Dominick V. Daniels, NJ	X				
20. New Castle, PA, to Pittsburgh, PA			X		
21. Oxnard, CA, to Santa Clarita, CA		X			
22. Palatine, IL, to Carol Stream, IL	X				
23. Plattsburgh, NY, to Burlington, VT	x ^b				
24. Portsmouth, NH, to Manchester, NH					X
25. Queens, NY, to Brooklyn, NY			X		
26. Quincy, IL, to Springfield, IL	x				
27. Sioux City, IA, to Sioux Falls, SD				X	
28. South Florida, FL, to Ft. Lauderdale, FL, and Miami, FL					X
29. Springfield, MA, to Hartford, CT	X				
30. Staten Island, NY, to Brooklyn, NY					X
31. Utica, NY, to Syracuse, NY			X		
32. Watertown, NY, to Syracuse, NY			X		
33. West Jersey, NJ, to Northern NJ Metro and Kilmer, NJ	X				

Area Mail Processing (AMP) study initiated	Study started	Public meeting notice	Public meeting held	AMP not approved	AMP approved
34. Western Nassau, NY, to Mid-Island, NY			X		
35. Wilkes Barre, PA, to Scranton, PA, and Lehigh Valley, PA			X		
36. Winchester, VA, to Dulles, VA			X		
37 Zanesville, OH, to Columbus, OH			X		

Source: LISPS,

Note: For current information, see <http://vwww.usps.com/all/amp.htm>.

⁴USPS announced on June 6, 2009, that it had halted the Industry, California, study because it determined there were no significant opportunities to improve efficiency or service at that time.

^bUSPS announced on May 5, 2009, that it had halted the Plattsburgh, New York, study because of unresolved service issues.

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