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POSTAL REGULATORY COMMISSION

Financial Analysis of United States Postal Service Financial Results and 10-K Statement

Fiscal Year 2016

March 31, 2017

Contents

Chapter 1

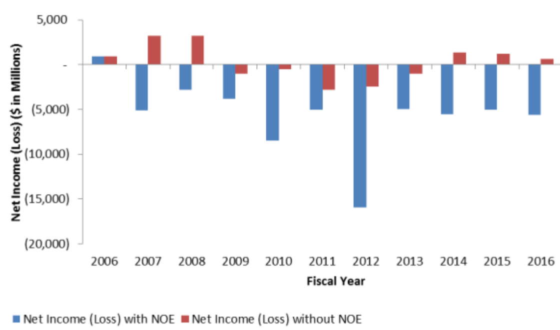
Report Overview

Financial Changes

In FY 2016, the Postal Service generated its third consecutive year of Operating Income despite an increase in operating expenses and the expiration of the exigent surcharge in April 2016. Revenue from the Market Dominant and the Competitive products rate increases, the exigent price surcharge during the earlier half of the fiscal year, and the continuing growth in Competitive products volume contributed to a net operating income of $0.6 billion.[1] This is $0.6 billion less than the net operating income of $1.2 billion recorded in FY 2015. When all adjustments are included, the net operating income of $0.6 billion becomes a total net loss of $5.6 billion, a deterioration of $0.5 billion compared to FY 2015. The increase in the total net loss is largely driven by a $1.5 billion increase in overall compensation and benefits costs and an increase in non-cash workers' compensation expense of $0.9 billion caused by a decrease in the discount rate.

Figure I-1 shows the net income and loss results for the last 10 years, both with and without Non-operating Expenses (NOEs). The Postal Service considers non-cash workers' compensation costs, statutory accruals into the Retiree Health Benefit Fund (RHBF), Federal Employees Retirement System (FERS) supplemental payments, and one-time adjustments to be NOE's.

Figure I-1
Postal Service Income/(Loss) ($ in Millions)

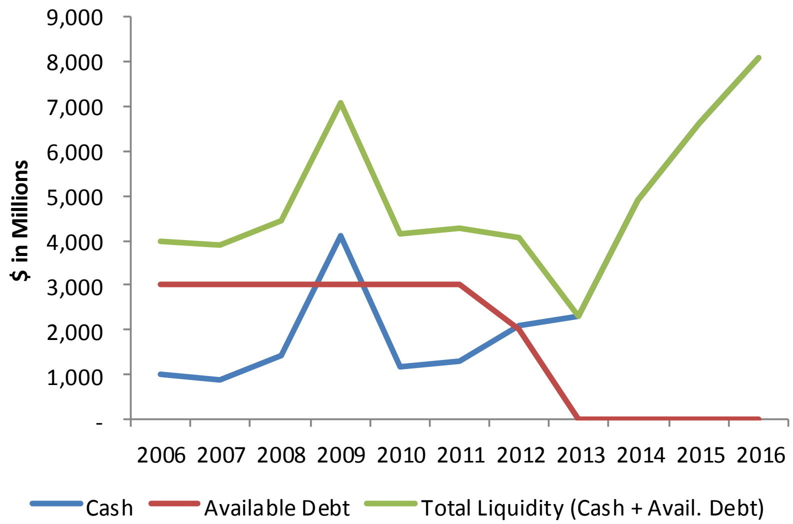


Source: Postal Service FY 2006 to 2016 Forms 10-K and USPS Annual Reports
Note: NOEs include all non-cash worker's compensation costs, statutory accruals into the Postal Service's RHBF, the FERS supplemental payment, and any one-time expense or revenue adjustments.

[1] United States Postal Service, 2016 Report on Form 10-K, November 15, 2016, at 15 (Postal Service FY 2016 Form 10-K).

The Postal Service's liquidity continued to improve in FY 2016. Figure I-2 illustrates the overall liquidity, along with cash and debt trends, since FY 2006. The Postal Service reached its statutory debt limit of $15 billion at the end of FY 2012.[2]

Figure I-2
Postal Service Liquidity ($ in Millions)



Source: Postal Service Form 10-K and USPS Annual Report, FY 2006-2016.

The recent improvements in its cash balance have allowed the Postal Service to increase its capital investment plans. The FY 2016 Integrated Financial Plan (IFP) included a capital investment budget of $1.8 billion for facilities, mail processing equipment, vehicles, and information technology.[3]

Significant highlights of FY 2016 include:

- Consumer price index (CPI) based price increases were not enough to offset revenue lost from declining volumes and the expiration of the exigent surcharge.
- Total Market Dominant revenue decreased 1.5 percent after two consecutive years of revenue growth.
- Market Dominant products unit revenue decreased by 0.4 cents while unit attributable cost remained nearly unchanged.
- Competitive products attributable cost grew 4.9 percent and institutional cost contribution grew 32.8 percent.
- Competitive products share of total Postal Service revenue, attributable cost, and contribution to institutional cost have more than doubled since FY 2007.

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[2] *Id*. at 10.
[3] United States Postal Service, 2016 Integrated Financial Plan, at 5.

- Growth in Competitive products volume increased its share of total attributable cost in every cost segment, more than doubling since FY 2008.
- Total Factor Productivity (TFP) declined slightly for the first time since FY 2009.
- Net deficiency is $55.9 billion resulting from several years of net losses starting in FY 2007.
- Financial sustainability continues to erode due to large personnel related liabilities and the slow replacement of fully depreciated capital assets. Overall financial condition is adversely impacted by insufficient current assets (38 percent of total assets) to cover current liabilities (67 percent of total liabilities).
- Working capital is negative $45.1 billion, largely due to the growth in employee-related liabilities, including the statutory accruals for payments into the RHBF.
- Cash position is at the highest level since FY 2007 but significant balance sheet liabilities and off-balance sheet unfunded liabilities for pension and annuitant health benefits are affecting improvements in financial condition.

Chapter 2. Postal Service Financial Status

Introduction

This chapter analyzes the Postal Service's overall financial status. The Commission evaluates relationships between the essential components of the Postal Service's financial statements in order to better understand the Postal Service's viability, stability, and profitability. The Commission also discusses the Postal Service's operational status and allocation of resources.

The Commission's analysis is primarily based upon the Postal Service's Form 10-K financial statements for FY 2016 and FY 2015. To provide a basis for comparison, the Commission also incorporates select key financial data from the past 10 years.

The Postal Service's Form 10-K report consists of the Income Statements, Balance Sheets, Statements of Changes in Net Deficiency, and Statements of Cash Flows. The Income Statements measure the Postal Service's financial performance (profit and loss) over the fiscal year. The Balance Sheets summarize the Postal Service's assets and liabilities held at the end of the fiscal year. The Statements of Changes in Net Deficiency combines the accumulated net deficit from operations and initial capital contributions. The Statements of Cash Flows measure the Postal Service's inflows and outflows of cash during the fiscal year.

The remainder of this chapter is divided into the following sections:

Analysis of Income Statements. This section reviews overall income and loss, and compares current revenue and expenses with those forecasted for the current year and reported during the prior fiscal year. It also compares changes in Postal Service productivity between FY 2015 and FY 2016.

Analysis of Balance Sheets. This section begins with a discussion of changes in the net deficiency, which occurs because Postal Service liabilities exceed assets. It then summarizes the Postal Service's assets and liabilities at the end of the fiscal year.

Analysis of Off-Balance Sheet Items. This section examines items that are effectively liabilities of the Postal Service, but that do not appear on its Balance Sheets. More specifically, these items are future net liabilities that will need to be funded by future revenue.[4]

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[4] The off-balance sheet items are found in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operation in the Postal Service Form 10-K. Postal Service FY 2016 Form 10-K Statements, November 15, 2016, at 24–27 (Postal Service FY 2016 Form 10-K).

Analysis of Statements of Cash Flows. This section analyzes the Postal Service's inflows and outflows of cash and debt during the year.

Analysis of Income Statements

To facilitate a detailed financial analysis of the Postal Service's Income Statements, the Commission separately identifies elements of the reported operating revenue and operating expenses.

In FY 2016, the Postal Service made a $1.0 billion adjustment to total Market Dominant products revenue.[5] For purposes of this analysis, the adjustment is shown separately.

Net operating expense is operating expenses adjusted to exclude the payment to the Postal Service Retiree Health Benefits Fund (RHBF), the supplemental contribution to the Federal Employees Retirement System (FERS) annuity, and the non-cash adjustments to the workers' compensation liability. Those adjustments and expenses are properly recognized as accrual entries and disaggregated by the Commission to provide an in-depth analysis of the financial results for FY 2016.

Table II-1 illustrates the Commission's disaggregated version of the Income Statements.

[5] Estimated revenue recognized for postage sold but not used (deferred revenue) was increased to record omitted revenue from a recalculation of Forever Stamps usage included in Postage in the Hands of the Public (PIHOP) during the past years.

Table II-1
Postal Service Income Statements Restated to Facilitate Analysis, FY 2016 and FY 2015
($ in Millions)

	FY 2016	FY 2015	Variance		FY 2016 Plan	Variance from Plan
Operating Revenue as Reported by the Postal Service	$ 71,498	$ 68,928	$ 2,570		$ 69,321	$ 2,177
Less: Adjustment for Postage Related to Forever Stamps	(1,061)	-	(1,061)		-	(1,061)
Net Operating Revenue	$ 70,437	$ 68,928	$ 1,509		$ 69,321	$ 1,116
Operating Expense as Reported by the Postal Service	76,899	73,827	3,072		75,004	1,895
Less: Statutory Accrual into Retiree Health Benefit Fund	(5,800)	(5,700)	(100)		(5,800)	-
Supplemental Contribution to FERS Annuity	(248)	(241)	(7)		(241)	(7)
Non-Cash Change to Workers' Compensation Liability	(1,214)	(307)	(907)		-	(1,214)
Net Operating Expense	**$ 69,637**	**$ 67,579**	**$ 2,059**		**$ 68,963**	**$ 674**
Interest Income	32	23	9		23	9
Interest Expense	222	184	38		235	(13)
Net Income (Loss) from Operations	**$ 610**	**$ 1,188**	**$ (578)**		**$ 146**	**$ 464**
Adjustment for Postage Related to Forever Stamps	1,061	-	1,061		-	1,061
Statutory Accrual into Retiree Health Benefit Fund	5,800	5,700	100		5,800	-
Supplemental Contribution to FERS Annuity	248	241	7		241	7
Non-Cash Change to Workers' Compensation Liability	1,214	307	907		-	1,214
Net Loss	**$ (5,591)**	**$ (5,060)**	**$ (531)**		**$ (5,895)**	**$ 304**

Decrease in revenue and expense is denoted by (). Increase in net loss is denoted by ().

Numbers may not add across due to rounding.

Source: Docket No. ACR2016, Library Reference USPS-FY16-5, December 29, 2016; Docket No. ACR2015, Library Reference USPS-FY15-5, December 29, 2015 ; FY 2016 Plan data from USPS Preliminary Financial Information (Unaudited), September 2016, November 15, 2016 (November 15, 2016, Preliminary Financial Information); file "2016.11.15 September FY 2016 Report to the PRC--Report.pdf."

The Postal Service recorded a net operating income of $0.6 billion in FY 2016. This is $0.6 billion less than the net operating income of $1.2 billion recorded in FY 2015. Most of this operational net income can be attributed to an increase in revenue from the Market Dominant and the Competitive products rate increases, the exigent price surcharge on Market Dominant products, and the continuing growth in Competitive products parcels. Net operating expense[6] was $2 billion higher than in FY 2015, primarily driven by increases in compensation and benefits costs.

When all adjustments are included, the net operating income of $0.6 billion becomes a total net loss of $5.6 billion. This is a deterioration of $0.5 billion compared to FY 2015. The increase in the total net loss is largely driven by higher overall compensation and benefits costs of $1.5 billion and an increase in workers' compensation expense of $0.9 billion caused by a decrease in the discount rate.

[6] Net operating expense is operating expense adjusted to exclude the payment to the Postal Service RHBF, the supplemental contribution to the FERS annuity, and the non-cash adjustments to the workers' compensation liability.

MARKET DOMINANT REVENUE COMPARED TO PRIOR YEAR

This section summarizes the overall revenue by class for Market Dominant products. Chapter 3 provides a more detailed discussion of revenue by class and product.

Table II-2 reflects FY 2016 and FY 2015 revenue by class.

Table II-2
Revenue by Market Dominant Mail Class, FY 2016 and FY 2015
($ in Millions)

	FY 2016	FY 2015	$ Variance	% Variance
First-Class Mail	$ 29,059	$ 29,597	$ (538)	(1.8%)
Standard Mail	17,675	17,711	(36)	(0.2%)
Periodicals	1,507	1,589	(82)	(5.2%)
Package Services	799	806	(7)	(0.9%)
Ancillary and Special Services	1,828	1,925	(97)	(5.0%)
Sub-total Market Dominant Mail and Services Revenue	$ 50,868	$ 51,628	$ (760)	-1.5%
Other	994	798	196	24.5%
Change in estimate of prepaid postage	1,061	-	1,061	100.0%
Total Adjusted Market Dominant Mail and Services Revenue	$ 52,923	$ 52,426	$ (564)	0.9%

Decrease in revenue is denoted by ().

Numbers may not add across due to rounding.

Source: Library Reference PRC-LR-ACR2016/1, March 28, 2017; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1, March 28, 2016 ; Library Reference USPS-FY16-42, December 28, 2016.

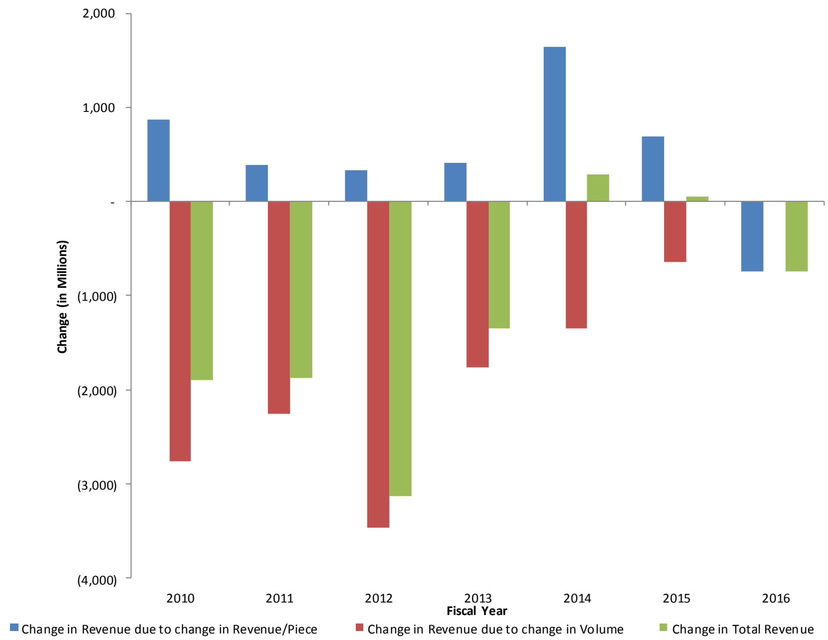
Total Market Dominant revenue, excluding the adjustment for the prior usage of Forever Stamps, declined 1.5 percent from the prior year. Consumer price index (CPI) based price increases were not enough to offset revenue lost from declining volumes and the expiration of the exigent surcharge.[7] First-Class revenue declined by 1.8 percent, while Standard Mail revenue declined by 0.2 percent despite a slight increase in volume. Total Market Dominant revenue increased 0.9 percent from the prior year with the inclusion of the adjustment for the prior usage of Forever Stamps.

In FY 2016, the average revenue per piece declined significantly for Market Dominant products primarily due to the expiration of the exigent surcharge. As shown in Figure II-1, the change in revenue due to the change in average revenue per piece was negative for the first time since FY 2010 and accounts for practically all of the change in revenue.[8] The loss in revenue due to the decline in mail volume is effectively zero as Market Dominant mail volume decreased just 0.3 percent in FY 2016.

[7] Docket No. R2013-11, Order No. 3186, Order on Removal of the Exigent Surcharge and Related Changes to the Mail Classification Schedule, March 29, 2016.

[8] The change in revenue per piece can be affected by more than just rate changes. Changes in mail mix, average weight per piece, and in the case of Periodicals, changes in the editorial/advertising content, can influence the overall average revenue per piece. However, the predominant factor affecting changes in revenue per piece is generally changes in rates.

Figure II-1
Change in Market Dominant Revenue Due to Changes In Average Revenue per Piece and Total Mail Volumes, FY 2010 – FY 2016



Source: Postal Regulatory Commission (PRC) derived from Postal Service Revenue, Pieces and Weight Report, FY 2010 - 2016.

Table II-3 shows that for Market Dominant products, the $1.0 billion in revenue generated from the exigent surcharge in the first 6 months and the change in revenue from changes in volume were not enough to offset the change in revenue from rates and extrinsic factors. Extrinsic factors include changes in mail mix, average weight per piece, and, in the case of Periodicals, changes in the editorial/advertising content.

Table II-3
Disaggregation of Change in Market Dominant Revenue, FY 2016
($ in Millions)

	Change in Revenue from Average Change in Revenue Per Piece	Revenue from Exigent Surcharge	Change in Revenue from Extrinsic Changes in Revenue Per Piece	Change in Revenue from Changes in Volume	Net Change in Revenue
	1	2	3=1-2	4	5=1+4
First-Class Mail	$ (79)	$ 602	$ (681)	$ (447)	$ (527)
Standard Mail	(248)	362	(610)	213	(34)
Periodicals	(2)	30	(32)	(80)	(83)
Package Services	(35)	19	(54)	29	(6)
Special Services	(382)	42	(424)	286	(96)
Total Market Dominant	**$ (747)**	**$ 1,054**	**$ (1,801)**	**$ 1**	**$ (746)**

Decrease in revenue is denoted by ().

Numbers may not add across due to rounding.

Source: Docket No. ACR2016, Library Reference USPS-FY16/42, December 29,2016; Docket No. R2013-11, Notice of the United States Postal Service of Filing Biweekly Surcharge Revenue Report,March 28, 2016.

COMPETITIVE PRODUCT REVENUE COMPARED TO PRIOR YEAR

Table II-4 compares revenue for Competitive products between FY 2016 and FY 2015. Competitive products' overall revenue increased $2.1 billion or 12.6 percent. The Competitive product price increase (effective January 17, 2016) and higher volume primarily contributed to the additional revenue.[9] This positive variance is comprised of $1.2 billion from price increases and $0.9 billion from volume increases.

[9] Docket No. CP2016-9, Order No. 2814, Order Approving Changes in Rates of General Applicability for Competitive Products, November 13, 2015..

Table II-4

Competitive Product Revenue, FY 2016 and FY 2015 ($ in Millions)

	FY 2016	FY 2015	$ Variance	% Variance
Priority Mail	$ 7,785	$ 7,276	$ 509	7.0%
Total Ground	5,192	3,925	1,267	32.3%
First-Class Packages	2,076	1,689	387	22.9%
Priority Mail Express	809	779	30	3.8%
International	1,792	1,970	(178)	(9.1%)
Ancillary and Special Services	842	786	56	7.2%
Sub-total Competitive Products Mail and Services Revenue	$ 18,496	$ 16,426	$ 2,070	12.6%
Other Revenue	111	99	12	12.1%
Total Adjusted Competitive Products Mail and Services Revenue	$ 18,607	$ 16,525	$ 2,082	12.6%

Decrease in revenue is denoted by ().

Numbers may not add across due to rounding.

Source: Library Reference PRC-LR-ACR2016/1; Library Reference PRC-LR-ACR2015/1; Library Reference USPS-FY16-42.

EXPENSE ANALYSIS AS COMPARED TO PRIOR YEAR

As shown in Table II-5, total expenses increased 4.2 percent or $3.1 billion in FY 2016 resulting from higher operating expenses and the impact of lower discount rates on the workers' compensation liability.

Table II-5

Total Expenses, FY 2016 and FY 2015 ($ in Millions)

	FY 2016	FY 2015	$ Variance	% Variance
Compensation & Benefits Expenses:				
Salaries and Benefits	$ 48,115	$ 46,944	$ 1,171	2.5%
Workers' Compensation	1,468	1,452	16	1.1%
Annuitant Health Benefits-Current Payment	3,305	3,111	194	6.2%
Other Personnel Related	326	334	(8)	(2.4%)
Subtotal Personnel Expenses	$ 53,214	$ 51,841	$ 1,373	3.0%
Transportation	6,992	6,579	413	6.3%
Other Expenses	9,431	9,158	273	3.0%
Total Operating Expenses	**$ 69,637**	**$ 67,579**	**$ 2,058**	**3.0%**
Systemwide Personnel Expenses:				
Workers' Compensation Non-Cash Adjustments	1,214	308	906	294.5%
Statutory Accrual into RHBF	5,800	5,700	100	1.8%
Supplemental Contrib. to FERS	248	241	7	2.9%
Total Expenses	**$ 76,899**	**$ 73,827**	**$ 3,072**	**4.2%**

Decrease in expenses is denoted by ().

Numbers may not add across due to rounding.

Source: PRC derived from Postal Service National Trial Balance September 2016, November 15, 2016; Postal Service National Trial Balance September 2015, November 13, 2015.

Personnel expense included in operating expenses are compensation, retirement, health benefit costs, and certain system-wide benefits, such as the cash payment for workers' compensation and the current year's premiums for annuitant health benefits. Personnel costs included in operational expenses account for 69.2 percent of total expenses, 1.0 percent lower than in FY 2015.

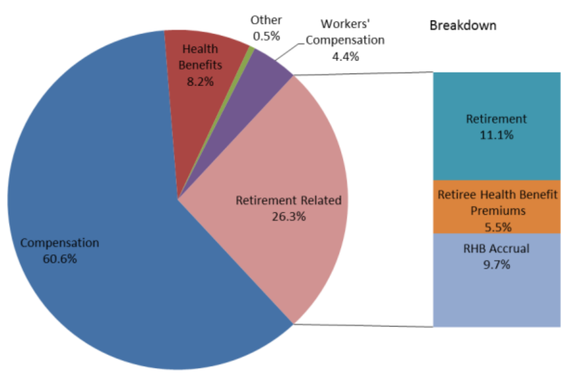
Operating and non-operating personnel costs as a percent of total expenses remained the same as in the prior year at 78.6 percent. Purchased transportation costs are 9.1 percent of total expenses, 0.2 percent higher than in FY 2015. Other expenses make up the remaining 12.3 percent of total expenses.[10]

PERSONNEL EXPENSES

Figure II-2 illustrates the composition of FY 2016 personnel expenses. Compensation accounts for the largest portion of personnel expenses, representing 60.6 percent of total personnel costs. Retirement benefits are the next largest component of total personnel expenses, at over 26.3 percent.

Retirement benefits comprise of statutory RHBF payments, annuitant health premiums, and employer contributions to the FERS, the Civil Service Retirement System (CSRS) pensions, and Social Security. The current premiums for annuitant health benefits along with the statutory prefunding RHBF payments account for 15.2 percent of total retirement related expenses.

Figure II-2
Total Personnel Expenses, FY 2016



Source: Postal Service FY 2016 Form 10-K at 21, 27, and 30.

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[10] Other expenses comprise of supplies and services, depreciation and amortization, rent and utilities, vehicle maintenance service, delivery vehicle fuel, information technology and communications, rural carrier equipment maintenance, and miscellaneous costs. Postal Service FY 2016 Form 10-K at 30.

Table II-6 shows that the total personnel expenses for FY 2016 were $2.4 billion higher than in FY 2015. Higher operating personnel expenses and the non-cash adjustment to the workers' compensation liability of $1.4 billion and $0.9 billion, respectively, increased total personnel expenses compared to FY 2015.

Table II-6
Breakdown of Total Personnel Expenses
($ in Millions)

	FY 2016	FY 2015	$ Variance	% Variance
Total Compensation	$ 36,634	$ 35,931	$ 703	2.0%
Retirement	6,509	6,239	270	4.3%
Health Benefits-Current Employees	4,972	4,774	198	4.1%
Workers' Compensation	1,468	1,452	16	1.1%
Retiree Health Benefits-Current Year Premiums	3,305	3,111	194	6.2%
Other Compensation	326	334	(8)	(2.4%)
Total Operating Personnel Expenses	**$ 53,214**	**$ 51,841**	**$ 1,373**	**2.6%**
Statutory Accrual into Retiree Health Benefit Fund	5,800	5,700	100	1.8%
Non-Cash Change to Workers' Compensation Liability	1,214	308	906	294.2%
Supplemental Contribution to FERS	248	241	7	2.9%
Total Personnel Expenses	**$ 60,476**	**$ 58,090**	**$ 2,386**	**4.1%**

Decrease in expenses is denoted by ().

Numbers may not add across due to rounding.

Source: PRC derived from Postal Service National Trial Balance September 2016; Postal Service National Trial Balance September 2015.

Total compensation comprises salaries for employees (full-time career, part-time career, and non-career), overtime and leave pay, and performance or arbitration awards. There are several cost drivers for compensation, including contractual pay increases, inflation used to calculate semi-annual Cost of Living Allowances (COLAs), work hours used, and the composition of the work force. Total compensation increased by $0.7 billion compared to FY 2015. According to the Postal Service, this increase was primarily caused by contractual salary increases and additional work hours necessitated by the growing demand for shipping services.[11] Shipping services are more labor intensive consuming additional work hours.

The Postal Service's work force is composed of career (full-time and part-time) and non-career employees, which include postal support, city carrier assistants, mailhandler assistants, and other non-career employees. Table II-7 shows the number of employees by type for FY 2014, FY 2015, and FY 2016.

[11] Postal Service FY 2016 Form 10-K at 20.

Table II-7

Postal Service Employee Complement, FY 2016 - FY 2014

	FY 2016	FY 2015	Change FY 2016 over FY 2015	FY 2014	Change FY 2015 over FY 2014
Career Employees	508,908	491,863	17,045	488,299	3,564
Postal Support Employees (PSE)	26,368	29,312	(2,944)	24,781	4,531
City Carrier Assistants (CCA)	40,436	37,767	2,669	36,081	1,686
Mailhandler Assistants (MHA)	5,280	5,322	(42)	5,475	(153)
Other Non-Career	58,797	57,573	1,224	63,240	(5,667)
Total On-Roll Employees	**639,789**	**621,837**	**17,952**	**617,876**	**3,961**

Decrease in amounts is denoted by ().
Numbers may not add across due to rounding.

Source: On-Roll and Paid Employee Statistics (OPRES) , September 2016, October 6, 2016; On-Roll and Paid Employee Statistics (OPRES), September 2015, September 24, 2015; On-Roll and Paid Employee Statistics (OPRES) , September 2014, September 26, 2014.

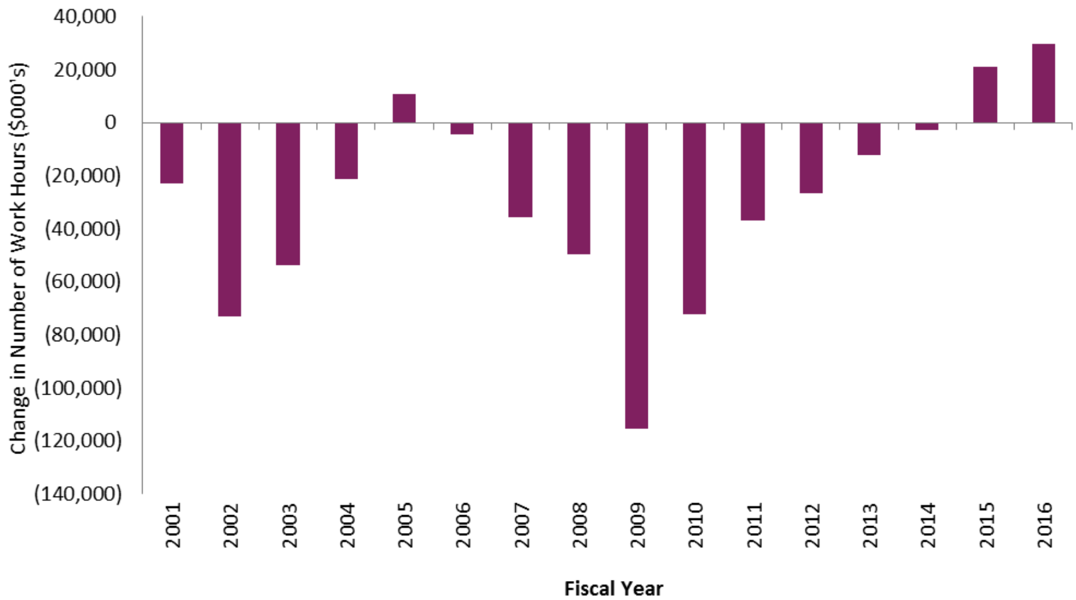
From FY 1999 through FY 2014, the Postal Service reduced the number of career employees every year, resulting in a total reduction of almost 309,000 career employees. However, for the past 2 years, the number of career employees increased by almost 20,600. According to the Postal Service, this is the result of the continuing need for additional employees to help facilitate the growth in shipping and packaging business and the delivery network.[12]

In 2016, collective bargaining agreements between the Postal Service and the National Rural Letter Carriers' Association (NRLCA)[13] and the American Postal Workers Union, AFL-CIO (APWU)[14] were ratified.[15] Both contracts include general wage increases of 3.8 percent, and a reduction in the Postal Service's share of health insurance premiums. The NRLCA agreement also resulted in the creation of a new non-career employee category to provide weekend and parcel deliveries. The APWU agreement converted approximately 5,000 non-career positions to career positions.

Figure II-3 shows the change in work hours since FY 2001. The Postal Service experienced a significant increase in work hours during FY 2016.

[12] Postal Service FY 2016 Form 10-K at 20.
[13] Agreement between the United States Postal Service and the National Rural Letter Carriers' Association, 2015-2018.
[14] Collective Bargaining Agreement between American Postakl Workers Union, AFL-CIO and U.S. Postal Service, May 21, 2015 to September 20, 2018.
[15] Postal Service FY 2016 Form 10-K at 21-22.

Figure II-3
Change in Work Hours, FY 2001 - FY 2016



Source: Postal Service Form 10-K and Annual Reports, FY 2004 - 2016.

Following the trend for career employees, the Postal Service reduced total work hours each year from FY 1999 through FY 2014. However, for FY 2016 and FY 2015, the number of work hours has increased by 29.7 million (2.6 percent) and 20.9 million (1.9 percent). According to the Postal Service, this is the result of the continuing need for additional employees to help facilitate the growth in shipping and packaging business and the delivery network.[16]

[16] Postal Service FY 2016 Form 10-K at 21.

Table II-8

Work Hours by Function (Thousands of Work Hours)

	FY 2016	FY 2015	% Variance FY 2016 over FY 2015	FY 2014	% Variance FY 2015 over FY 2014
Mail Processing	204,403	200,661	1.9%	198,076	1.3%
Customer Service	170,377	159,249	7.0%	146,370	8.8%
Delivery Service:					
City Delivery	416,646	403,983	3.1%	394,123	2.5%
Rural Delivery	191,806	184,726	3.8%	179,466	2.9%
Maintenance:					
Plant & Equipment	65,946	66,741	(1.2%)	65,227	2.3%
Vehicle	28,637	28,153	1.7%	27,646	1.8%
Other	80,281	84,886	(5.4%)	95,996	(11.6%)
Total Work Hours	**1,158,096**	**1,128,399**	**2.6%**	**1,106,903**	**1.9%**

Decrease in amounts is denoted by ().

Numbers may not add across due to rounding.

Source: Docket No. ACR2016, Docket No. ACR2016, Responses of the United States Postal Service to Questions 1-2, 4-9, 11-13, 15-19, 23, 28, and 31-33 of Chairman's Information Request No. 3, January 13, 2017, question 1, Excel file "ChIR.3.Q.1.LDC.Workhours.xlsx."; Docket No. ACR2015, Responses of the United States Postal Service to Questions 1-5 of Chairman's Information Request No. 1, January 13, 2016, question 3, Excel file "ChIR.1.Q3.Ntnl.LDC.Workhours.xlsx."

Overall delivery work hours increased 3.4 percent from FY 2015. City delivery work hours were higher by 12.7 million or 3.1 percent and rural delivery work hours were higher by 7.1 million or 3.8 percent from the prior year. Customer Service work hours also increased significantly by 11.1 million or 7.0 percent compared to last year.

The increase in career employees and work hours impacted the growth in the productive hourly wage rates for certain crafts. Table II-9 shows that the rate for clerks, mailhandlers and city delivery carriers declined by 2.8, 1.2, and 1.0 percent, respectively, compared to last year. For the 2 year period from FY 2014 through FY 2016, the rate has increased in every category except for clerks, city delivery carriers, and Building Services which declined by 2.6, 0.9, and 1.3 percent, respectively.

Table II-9

Productive Hourly Wage Rates ($ per Work Hour), FY 2014 - FY 2016

Segment/Subsegment	FY 2016	FY 2015	% Change FY 2015 to FY 2016	FY 2014	% Change FY 2014 to FY 2015
Supervisors & Technicians	$ 50.65	$ 50.12	1.0%	$ 49.39	1.5%
Clerks	39.29	40.44	(2.8%)	40.34	0.2%
Mailhandlers	40.44	40.91	(1.2%)	39.92	2.5%
City Delivery Carriers	40.90	41.32	(1.0%)	41.26	0.1%
Vehicle Drivers	43.44	43.34	0.2%	42.51	1.9%
Rural Carriers	36.42	36.21	0.6%	35.85	1.0%
Building Services	39.60	40.06	(1.1%)	40.12	(0.2%)
Operating Equipment	53.55	53.21	0.6%	51.28	3.8%
Building Equipment	49.43	49.07	0.7%	47.59	3.1%
Motor Vehicle Service	47.34	46.70	1.4%	45.39	2.9%
Headquarters	64.24	63.71	0.8%	62.31	2.2%

Decrease in amounts is denoted by ().

Numbers may not add across due to rounding.

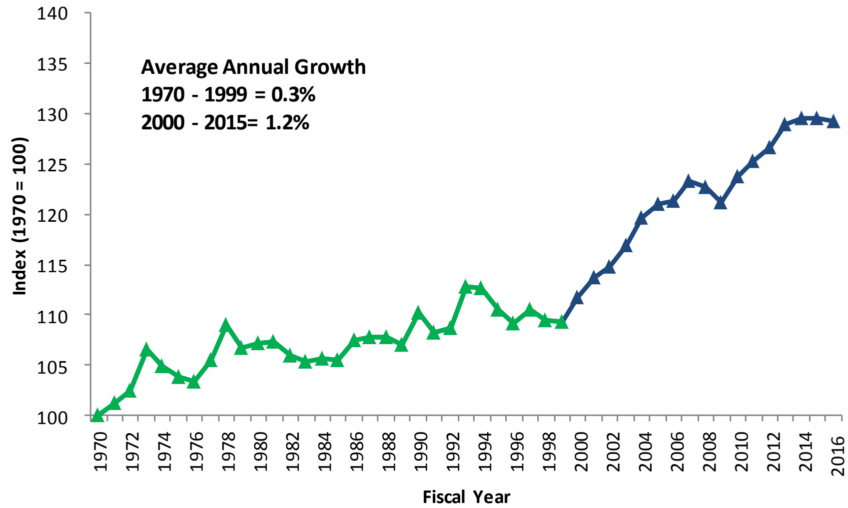
Source: Library Reference USPS-FY16-7, December 28, 2016; Library Reference PRC-ACR2015/1; Docket No. ACR2014, Library Reference PRC-ACR2014/1, March 27, 2015.

TOTAL FACTOR PRODUCTIVITY

Total Factor Productivity (TFP) measures the change in the relationship between outputs (weighted workload) and inputs (resources used) over a period of time. Total workload is calculated using weighted mail volumes, miscellaneous output, and the change in delivery points. Resources consist of labor, materials (including purchased transportation), and deployed capital assets. Workload growth, less growth in resources used, equals TFP growth.

TFP declined slightly for the first time since FY 2009. Total workload grew by 1.3 percent in FY 2016. Increases in delivery points and weighted mail volume were the primary contributors. The growth in weighted mail volume was due to the increase in parcel volume, which requires more resources to process than letter and flat-shaped mail. Capital inputs continued to decrease while labor and material inputs increased. The growth in work hours, employment levels, and the price of labor also contributed to the slight TFP decline in FY 2016.

Figure II-4
Postal Service Total Factor Productivity, FY 1970 - FY 2016



Source: Postal Service Annual Tables, FY 2016 TFP (Total Factor Productivity).

Health benefits for current employees increased by 4.1 percent in FY 2016. Contractual reductions in the Postal Service's share of health benefits premiums were offset by an increase in the career employee headcount and average increases in health plan premiums.

The cost of health benefits for Postal Service annuitants increased by $0.2 billion compared to FY 2015 resulting from higher average health premium costs and an increasing number of annuitants and survivors.

Workers' compensation expense increased $0.9 billion in FY 2016. Workers' compensation expense consists of a cash payment and a non-cash accrual expense. The cash payment is made to the United States Department of Labor for the current year cost of medical and compensation benefits payment and an administrative fee. This payment increased by $0.2 billion. Non-cash adjustments include actuarial revaluations of existing cases and new cases, initial costs of new cases for the year, and any changes in the discount rate used to estimate the amount of current funds needed to settle all claims in the current year. In FY 2016, the non-cash adjustment resulted in a $1.2 billion increase in liability. Table II-10 shows the non-cash changes to workers' compensation liability for the past 2 years, as well as the other components factoring into the workers' compensation expense.

Table II-10

Components of Workers' Compensation Expense, FY 2016 - FY 2015

($ in Millions)

	FY 2016	FY 2015	$ Variance	% Variance
Noncash changes in the discount rate	$ 1,026	$ 809	$ 217	26.8%
Cost of new cases	1,697	1,767	(70)	(4.0%)
Actuarial valuation of new cases and revaluation of existing cases	(113)	(886)	773	(87.2%)
Subtotal	$ 2,610	$ 1,690	$ 920	54.4%
Administrative fee	72	70	2	2.9%
Total workers' compensation expense	$ 2,682	$ 1,760	$ 922	52.4%
Less medical claims payments	(1,468)	(1,452)	(16)	1.1%
Total non-cash workers' compensation expense	**$ 1,214**	**$ 308**	**$ 906**	**294.2%**

Decrease in expenses is denoted by ().
Numbers may not add across due to rounding.

Source: Postal Service FY 2016 Form 10-K at 60.

NON-PERSONNEL EXPENSES

Table II-11 shows a major component of non-personnel related expenses is transportation which accounted for 9.1 percent of total costs.

Table II-11

Transportation Costs by Category, FY 2016 and FY 2015

($ in Millions)

	FY 2016	FY 2015	$ Variance	% Variance
Highway Transportation	$ 3,827	$ 3,638	$ 189	5.2%
Air Transportation	2,469	2,151	318	14.8%
International Transportation	642	773	(131)	(16.9%)
Other Transportation	54	17	37	217.6%
Total Transportation	$ 6,992	$ 6,579	$ 413	6.3%

Decrease in expenses is denoted by ().
Numbers may not add across due to rounding.

Source: Postal Service FY 2016 Form 10-K at 29.

Total transportation expenses increased by 6.3 percent from FY 2015 to FY 2016. Highway transportation costs increased by 5.2 percent while air transportation costs increased by 14.8 percent from the prior year. According to the Postal Service, these increases were primarily due to increased volume in shipping services and strategic efforts to improve delivery service results.[17] These increases were offset slightly by a decline in international transportation costs by $0.1 billion.

Table II-12 shows all other non-personnel related expenses which increased by $0.3 billion in FY 2016. The largest increase was in miscellaneous expenses by $0.3 billion in FY 2016. Miscellaneous Other expenses consist mainly of travel, training, repairs, and contingencies. In FY 2015 the same category declined by $0.2 billion from lower labor and employment contingencies.[18] Offsetting this increase were declines in depreciation, vehicle maintenance, and rural carrier equipment maintenance.

Table II-12
Other Non-Personnel Expenses, FY 2016 and FY 2015
($ in Millions)

	FY 2016	FY 2015	$ Variance	% Variance
Supplies and Services	$ 2,755	$ 2,705	$ 50	1.8%
Depreciation and Amortization	1,740	1,769	(29)	(1.6%)
Rent and Utilities	1,560	1,613	(53)	(3.3%)
Vehicle Maintenance Services	983	1,053	(70)	(6.6%)
Information Technology and Communications	852	784	68	8.7%
Rural Carrier Equipment Maintenance	484	514	(30)	(5.8%)
Miscellaneous Other	1,057	719	338	47.0%
Total Other Expenses	**$ 9,431**	**$ 9,157**	**$ 274**	**3.0%**

Decrease in expenses is denoted by ().
Numbers may not add across due to rounding.
Source: Postal Service FY 2016 Form 10-K at 30.

Comparison to the Postal Service Operating Plan

The Postal Service's FY 2016 Operating Plan, as outlined in its 2016 Integrated Financial Plan (IFP), projected a net loss of $5.9 billion in FY 2016.[19] Compared to its Operating Plan, the total net loss of $5.6 billion was $0.3 billion less than the Postal Service estimated. Total revenue was $1.2 billion more than planned. Table II-13 compares actual FY 2016 results with the estimated results in the Operating Plan.

[17] Postal Service FY 2016 Form 10-K at 29.
[18] Postal Service FY 2016 Form 10-K at 30.
[19] United States Postal Service Fiscal Year 2016 Integrated Financial Plan, November 20, 2015, at 1 (Postal Service 2016 Integrated Financial Plan).

Table II-13

Actual and Operating Plan Income Statements, FY 2016 ($ in Billions)

	FY 2016 Actual	FY 2016 Operating Plan	Variance
Total Revenue	$ 70.5	$ 69.3	$ 1.2
Total Operating Expense	69.9	69.2	0.7
Net Operating Income/(Loss)	$ 0.6	$ 0.1	$ 0.5
RHBF Payment	5.8	5.8	-
Workers' Comp. Adj.	1.2	-	1.2
FERS Supplemental	0.2	0.2	0.0
PIHOP Accounting Estimate	(1.0)		
Total Net Income/(Loss)	**$ (5.6)**	**$ (5.9)**	**$ 0.3**

Decrease in revenue and expense is denoted by (). Increase in net loss is denoted by ().
Numbers may not add across due to rounding.

The Postal Service recorded a $1.1 billion dollar revenue adjustment in FY 2016
Source: USPS Preliminary Financial Information (unaudited), September 2016, November 15, 2016, file "2016.11.15 September FY 2016 Monthly Report to the PRC--Report.pdf."

As seen in Table II-14, revenue from First-Class Mail, Standard Mail, and parcels (Competitive and Market Dominant) was higher than expected. Offsetting these increases was less than planned Other and International Mail revenue.

Table II-14

Actual and Operating Plan Revenue by Class, FY 2016 ($ in Billions)

	FY 2016 Actual	FY 2016 Operating Plan	Variance
First-Class Mail	$ 27.3	$ 27.2	$ 0.1
Periodicals	1.5	1.5	-
Standard Mail	17.9	17.2	0.7
Other	2.8	3.5	(0.7)
Competitive and Other Parcels	18.3	16.9	1.4
International	2.7	3.0	(0.3)
Total Mail Revenue	**$ 70.5**	**$ 69.3**	**$ 1.2**

Decrease in revenue is denoted by ().
Numbers may not add across due to rounding.

Source: November 15, 2016, Preliminary Financial Information, file "2016.11.15 September FY 2016 Monthly Report to the PRC--Report.pdf."

Total volume was 3 billion pieces higher than expected, primarily due to higher than planned volume for Standard Mail and First-Class Mail. The only class that did not meet or exceed expectations was Periodicals, which was 0.1 billion pieces lower than planned. Table II-15 compares the volume by class for FY 2016 with the volume projected in the Operating Plan.

Table II-15
Actual and Operating Plan Volume by Class, FY 2016
($ in Billions)

	FY 2016 Actual	FY 2016 Operating Plan	Variance
First-Class Mail	60.9	60.4	0.5
Periodicals	5.5	5.6	(0.1)
Standard Mail	80.9	78.8	2.1
Other	0.5	0.4	0.1
Competitive and Other Parcels	5.1	4.8	0.3
International	1.0	0.9	0.1
Total Mail Volume	153.9	150.9	3.0

Decrease in amounts is denoted by ().
Numbers may not add across due to rounding.

Source: November 15, 2016, Preliminary Financial Information, file "2016.11.15 September FY 2016 Monthly Report to the PRC--Report.pdf."

Total expenses were $1.6 billion more than projected. Higher than expected compensation expenses contributed to the increase. As shown in Table II-16, the compensation and benefits expense was $1 billion more than planned, primarily due to higher work hours. Basic salaries and benefits made up the majority of the overall increase, $0.2 billion higher than planned.

Total non-personnel expenses were $0.3 billion less than projected, with negative variances in supplies and services ($0.1 billion) and other expenses ($0.2 billion). Overall, all categories for non-personnel expenses were less than budgeted.

Table II-16
Actual and Operating Plan Expenses, FY 2016
($ in Billions)

	FY 2016 Actual	FY 2016 Operating Plan	Variance
Compensation & Benefits	$ 53.2	$ 52.2	$ 1.0
Transportation	7.0	7.0	-
Supplies & Services	2.8	2.9	(0.1)
Depreciation	1.7	1.7	-
Rent/Utilities/Other	5.2	5.3	(0.2)
Total Operating Expenses	$ 69.9	$ 69.1	$ 0.7
PSRHBF Payment	5.8	5.8	-
Workers' Compensation Adj.	1.2	0.4	0.8
FERS Supplemental	0.2	0.2	0.0
Total Expenses	$ 77.1	$ 75.5	$ 1.6

Decrease in expense is denoted by ().
Numbers may not add across due to rounding.

Source: November 15, 2016, Preliminary Financial Information, file "2016.11.15 September FY 2016 Monthly Report to the PRC--Report.pdf."

Analysis of Balance Sheets

This section analyzes the Postal Service's financial situation and use of resources based on Balance Sheets data prepared according to U.S. Generally Accepted Accounting Principles (GAAP). The data compares two points in time, September 30, 2016 (FY 2016) and September 30, 2015 (FY 2015).

The Balance Sheets have three components: assets, liabilities, and net assets. The difference between assets and liabilities is net assets. Working capital is the difference between current assets and current liabilities. The net financial position of Balance Sheets represents the difference between total assets and total liabilities. This indicates whether assets were financed by borrowing (liability) or by capital contributions and accumulated earnings from prior years. Negative net worth (net deficiency) occurs when liabilities are greater than assets.

Table II-17 compares the Postal Service's asset and liability structure for FY 2016 and FY 2015. This analysis is derived from the Postal Service's Balance Sheets. Current assets are the sum of cash and cash equivalents, receivables and supplies, and prepayments. Current assets can be easily converted to cash for financing operations. Non-current assets, mainly buildings and equipment (capital assets), are more difficult to convert to cash in the short term. Likewise, current liabilities are obligations that will come due within 1 year while noncurrent liabilities are long-term financial obligations.

Table II-17
Structure of Assets and Liabilities
($ in Millions)

				% of Total Assets	
	FY 2016	**FY 2015**	**$ Variance**	**FY 2016**	**FY 2015**
Assets					
Cash and Cash Equivalents (includes Restricted Cash)	$ 8,330	$ 6,867	$ 1,463	33.0%	28.6%
Receivables	1,042	930	112	4.1%	3.9%
Supplies and Prepayments	140	118	22	0.6%	0.5%
Total Current Assets	9,512	7,915	1,597	37.7%	33.0%
Total Noncurrent Assets	15,707	16,099	(392)	62.3%	67.0%
Total Assets	**$ 25,219**	**$ 24,014**	**$ 1,205**	**100.0%**	**100.0%**
				% of Total Liabilities	
	FY 2016	**FY 2015**	**$ Variance**	**FY 2016**	**FY 2015**
Liabilities					
Retiree Health Benefits	$ 33,900	$ 28,100	$ 5,800	41.7%	37.8%
Current Portion of Long-Term Debt	10,100	10,100	$ -	12.4%	13.6%
Deferred Revenue-Prepaid Postage	2,253	3,304	$ (1,051)	2.8%	4.4%
Total Current Liabilities	54,615	48,911	$ 5,704	67.3%	65.7%
Workers' Compensation Costs, Noncurrent	18,612	17,410	$ 1,202	22.9%	23.4%
Noncurrent Portion of Long-Term Debt	4,900	4,900	$ -	6.0%	6.6%
Total Noncurrent Liabilities	26,586	26,586	$ -	32.7%	35.7%
Total Liabilities	**$ 81,201**	**$ 74,405**	**$ 6,796**	**100.0%**	**100.0%**

Decrease in amounts is denoted by ().
Numbers may not add across due to rounding.
Source: Postal Service FY 2016 Form 10-K at 40; PRC derived from September, 2016 National Trial Balance.

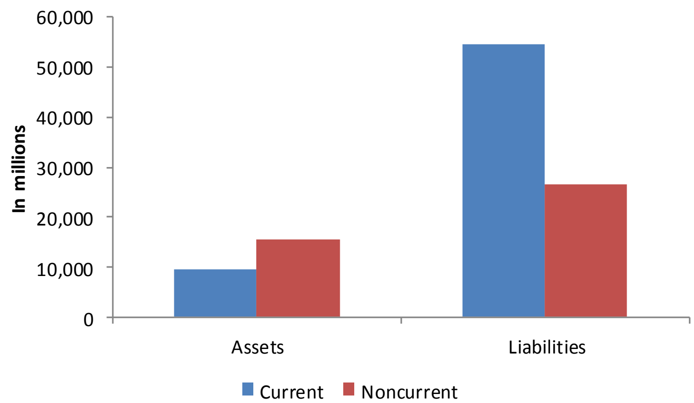
Liabilities at the end of FY 2016 totaled $81.2 billion, 67.3 percent of which were current liabilities. Current liabilities consist largely of RHBF obligations and short term borrowing. The Postal Service continued to accrue the RHBF statutory prefunding obligation which totaled $33.9 billion at the end of FY 2016. This includes accruals for FY 2011 through FY 2016 as the Postal Service was unable to pay down the obligation. This obligation is 41.7 percent of current liabilities. Most of the net liabilities consist of the RHBF payments, workers' compensation liability ($18.6 billion), and the total net debt owed to the Federal Financing Bank ($15 billion).

At the end of FY 2016, the Postal Service recorded a $55.9 billion net deficiency. This results from several years of net operating losses starting in FY 2007. Although FY 2016 and FY 2015 had a net operating income, the slow replacement of fully depreciated capital assets and the high amount of personnel related liabilities led to continued eroded financial sustainability.

Because of its existing outstanding debt the Postal Service must finance all current activity with internally generated cash. This limited its ability to invest in much needed equipment and other productive assets.

Figure II-5 shows the liquidity mismatch in the mix of the Postal Service's asset and liability structure as of September 30, 2016. The shortage of current assets (38 percent of total assets) to cover current liabilities (67 percent of total liabilities) adversely affects the financial condition. Noncurrent assets comprise 62 percent of total assets while noncurrent liabilities only comprise 33 percent of total liabilities.

Figure II-5
Categories of Assets and Liabilities, FY 2016



Source: Postal Service FY 2016 Form 10-K at 40; PRC derived from September 2016 National Trial Balance.

During FY 2016, total assets increased by $1.2 billion primarily from a 21.0 percent increase in the cash balance. Aging capital assets and the continued restriction in capital investment resulted in higher costs in depreciation than investment which resulted in a net decrease in fixed assets of $0.4 billion.

Total liabilities increased by $6.8 billion dollars mainly due to personnel related liabilities such as the RHBF statutory obligation.

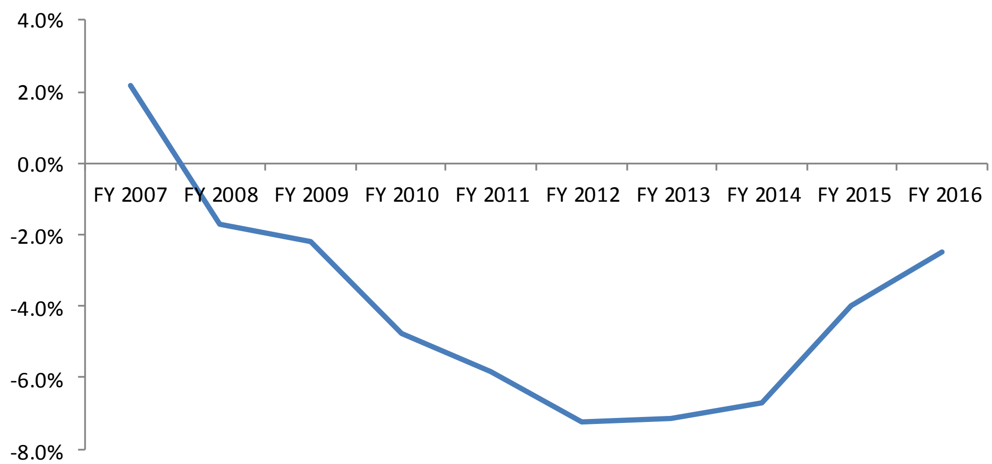
As of September 30, 2016, the Postal Service accumulated a net deficit of $55.9 billion which is a $5.6 billion decline from FY 2015. Negative net worth indicates that the Postal Service has spent both its initial capital and also the capital of its creditors. It debts are no longer secured by its assets.

Assets

During FY 2016, assets grew by $1.2 billion. The two primary reasons for this change were an increase in cash of $1.5 billion offset by a decline in net property plant and equipment of $0.4 billion. The growth in cash reserves is likely the result of limited investment in capital infrastructure and equipment and the nonpayment of the statutory prefunding of RHBF.

Figure II-6 illustrates the Postal Service's capital investment since FY 2007.

Figure II-6
Growth in Capital Assets



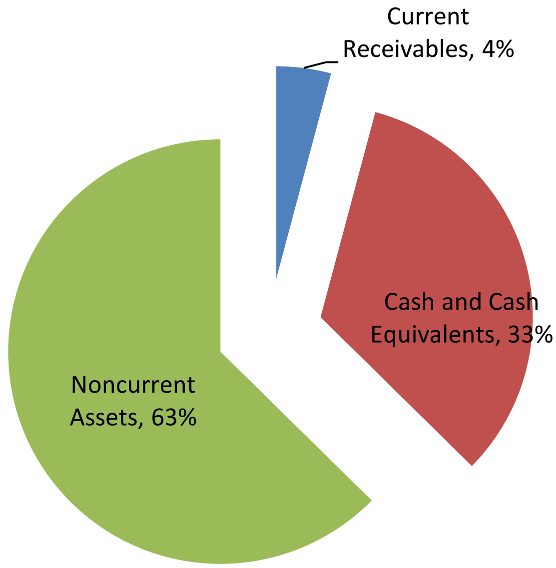
Source: Postal Service FY 2016 Form 10-K at 40; PRC derived from September, 2016 National Trial Balance.

The Postal Service continues to limit its capital expenditures to necessary safety, customer support, and high return investments.[20] In order for the Postal Service to be competitive in today's growing e-commerce market, it will have to increase its capital expenditures. The Postal Service notes that the current fiscal year's increase in compensation expense is in large part due to increased work hours required by package services. Investment in package sorting equipment may eventually reduce costs and make package processing more efficient.

Figure II-7 shows the breakdown of the Postal Service assets as of September 30, 2016.

[20] Postal Service FY 2016 Form 10-K at 32.

Figure II-7
Postal Service Asset Structure, September 30, 2016



Source: Postal Service FY 2016 Form 10-K at 40; PRC derived from September 2016 National Trial Balance.

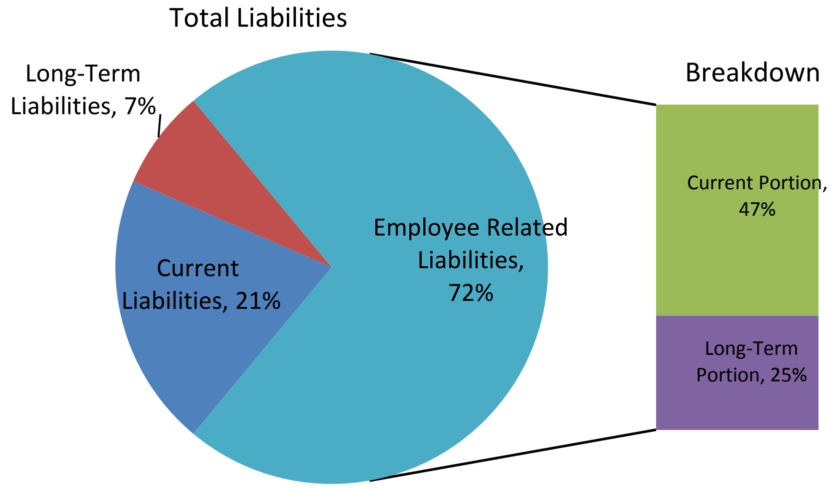
Liabilities

In FY 2016, total liabilities increased by $5.6 billion largely from a higher balance in current liabilities. The RHBF accrual increased by $5.8 billion. The Postal Service was unable to pay the FY 2016 accrual.

The long-term portion of workers' compensation increased by $1.2 billion in FY 2016. The long term portion of workers' compensation liability is highly sensitive to discount and inflation rates in actuarial adjustment and to new and existing claims.

Figure II-8 shows the current breakdown of the Postal Service's liabilities as of September 30, 2016.

Figure II-8
Postal Service Liabilities Structure, September 30, 2016



Source: Postal Service FY 2016 Form 10-K at 40; PRC derived from September 2016 National Trial Balance, November 15, 2016.

Analysis of Off-Balance Sheet Items

In addition to the various liabilities recorded on the Postal Service's Balance Sheets, there are other liabilities for pensions and retiree health benefits that are not recognized in the Postal Service's financial statements. These liabilities are controlled and administered by the Office of Personnel Management (OPM) and relate to the assets and liabilities attributed to: the Civil Service Retirement and Disability Fund (CSRDF) and the RHBF. The CSRDF provides pension benefits to retired and disabled Federal employees, including Postal Service employees covered by CSRS and FERS.[21] The Postal Service is required to make specified annual payments into the RHBF to prefund the retiree health benefit for its current and future retirees.[22]

In addition, the Postal Accountability and Enhancement Act (PAEA) requires the Postal Service to report certain disclosures provided by OPM regarding the funded status of the CSRDF, specifically for postal employees and the Postal Service RHBF. This information is then reported in the Postal Service Form 10-K Statements.

[21] *See* 5 U.S.C. § 8348
[22] *See* 5 U.S.C. § 8909a

CSRS and FERS Pensions

Table II-18 shows the funded status of the Postal Service's pension obligations.

Table II-18
Funded Status of Postal Service Pension Obligations ($ in Billions)
September 30, 2016

CSRS Funded Status				FERS Funded Status				Total USPS Pension Funded Status			
Fiscal Year	Assets	Acturial Liabilities	Net CSRS Funded Status (unfunded)	Fiscal Year	Assets	Actuarial Liabilities	Net FERS Funded Status (unfunded)	Fiscal Year	Assets	Acturial Liabilities	Net CSRS and FERS Funded Status (unfunded)
2006 *	$ 210.8	$ 193.7	$ 17.1	**2006**	$ 95.3	$ 86.6	$ 8.7	**2006 ***	$ 306.1	$ 280.3	**$ 25.8**
2007	193.8	196.9	(3.1)	**2007**	63.5	55.1	8.4	**2007**	257.3	252.0	**5.3**
2008	195.1	204.1	(9.0)	**2008**	69.3	62.8	6.5	**2008**	264.4	266.9	**(2.5)**
2009	195.3	202.6	(7.3)	**2009**	75.2	68.3	6.9	**2009**	270.5	270.9	**(0.4)**
2010	194.6	193.0	1.6	**2010**	80.8	69.9	10.9	**2010**	275.4	262.9	**12.5**
2011	193.0	210.8	(17.8)	**2011**	86.6	84.0	2.6	**2011**	279.6	294.8	**(15.2)**
2012	190.7	209.5	(18.8)	**2012**	91.7	90.8	0.9	**2012**	282.4	300.3	**(17.9)**
2013	186.6	204.4	(17.8)	**2013**	96.5	96.6	(0.1)	**2013**	283.1	301.0	**(17.9)**
2014	182.1	201.5	(19.4)	**2014**	100.9	104.5	(3.6)	**2014**	283.0	306.0	**(23.0)**
2015	177.4	194.1	(16.7)	**2015**	105.2	109.0	(3.8)	**2015**	282.6	303.1	**(20.5)**
Projected 2016	174.4	191.9	(17.5)	**Projected 2016**	112.1	115.9	(3.8)	**Projected 2016**	286.5	307.8	**(21.3)**

Source: Postal Service FY 2006 to FY 2016 Forms 10-K.

* FY 2006 CSRS surplus of $17.1 billion transferred to the PSRHBF per PAEA.

Note: This table provides OPM's estimation of the funded status of the CSRS and FERS programs for USPS, as of the end of each fiscal year. Data are actual amounts for FY 2006-2015 and projected amounts for FY 2016.

Assets include securities of the Civil Service Retirement and Disability Fund (CSRDF). Although CSRDF is a single fund and does not maintain separate accounts for individual agencies, Pub. L. 109-435 requires the asset disclosures shown in this table as if the

Actuarial Liabilities are actual amounts for FY 2006-2015 and projected amounts for FY 2016, as of the end of each fiscal year. These data are prepared by OPM and represent the actuarial present value of the cost of future retiree pension benefits for which

Net funded status equals assets minus liabilities.

Both pension plans had unfunded liabilities in FY 2016. These unfunded liabilities are projected to increase in FY 2017. After the transfer of the FY 2006 CSRDF surplus to the RHBF, the CSRDF has had an unfunded liability at the end of almost every fiscal year. During FY 2017, the OPM must determine the funded status of CSRDF and any surplus must be transferred to the RHBF. However, if there is an unfunded liability, which appears to be increasingly likely, OPM must develop a 25 year amortization of the unfunded liability, which the Postal Service will have to begin paying in FY 2018.[23] If the current trend continues and there are no changes in the law governing the determination of the CSRDF liability, the amortization payment projected for CSRDF could be over $1 billion annually beginning in FY 2017.[24]

Additionally, if there is an unfunded liability in the Postal Service's portion of the FERS pension, OPM is required to develop a 30-year amortization schedule to fund the unfunded liability.[25] In FY 2015, OPM notified the Postal Service of the unfunded FERS liability and directed the Postal Service to pay an additional $0.2 billion per year for the next 30 years. This payment was revised beginning in FY 2016 to $0.3 billion.

[23] *See* 5 U.S.C. § 8348(h).

[24] Postal Service FY 2016 Form 10-K at 33. The beginning date for the payments is under review by the Office of Legal Counsel at the U.S. Department of Justice. *Id.*

[25] *See* 5 U.S.C. § 8423(b)(2).

Analysis of Statements of Cash Flows

At the end of FY 2016, the Postal Service cash and cash equivalents totaled $8.1 billion $1.5 billion higher than FY 2015. With an average daily cash requirement of $0.3 billion, this balance represents 30 days of operating cash.[26] Table II-19 compares the Postal Service's cash flows from FY 2008 to FY 2016.

Table II-19

Postal Service Statements of Cash Flows, FY 2008 - 2016

($ in Millions)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Net income/(loss)	$ (2,806)	$ (3,794)	$ (8,505)	$ (5,067)	$ (15,906)	$ (4,977)	$ (5,508)	$ (5,060)	$ (5,591)
Non-cash items and other cash flows	2,367	5,367	5,213	5,561	15,474	5,912	8,822	7,939	8,327
Cash flows from investing activities:									
Decrease (increase) in restricted cash				(10)	(28)	(79)	66	13	(20)
Purchase of property and equipment	(1,995)	(1,839)	(1,393)	(1,190)	(705)	(667)	(781)	(1,222)	(1,428)
Proceeds from sale of property and equipment	57	33	70	137	148	158	129	120	206
Net cash used in investing activities	(1,938)	(1,806)	(1,323)	(1,063)	(585)	(588)	(586)	(1,089)	(1,242)
Cash flows from financing activities:									
Increase (decrease) in debt	3,000	3,000	1,800	1,000	2,000	-	-	-	-
Payments for capital leases	(29)	(46)	(50)	(51)	(51)	(59)	(58)	(62)	(51)
U.S. government appropriations - expensed	(61)	(64)	(63)	(63)	(129)	(48)	(90)	-	-
Net cash (used) provided by financing activities	2,910	2,890	1,687	886	1,820	(107)	(148)	(62)	(51)
Net increase/(decrease) in cash	533	2,657	(2,928)	317	803	240	2,580	1,728	1,443
Cash balance beginning of year	899	1,432	4,089	966	1,283	2,086	2,326	4,906	6,634
Cash balance end of year	**$ 1,432**	**$ 4,089**	**$ 1,161**	**$ 1,283**	**$ 2,086**	**$ 2,326**	**$ 4,906**	**$ 6,634**	**$ 8,077**
Debt outstanding	$ 7,200	$ 10,200	$ 12,000	$ 13,000	$ 15,000	$ 15,000	$ 15,000	$ 15,000	$ 15,000

Decrease in amounts is denoted by ().
Numbers may not add across due to rounding.

Source: Postal Service FY 2008 to FY 2016 Forms 10-K.

The Postal Service has reached its borrowing limit since 2012. Its debt includes two revolving credit facilities that are fully drawn. Its fixed interest rate debt as of September 30, 2016, consists of short-term borrowings from the Federal Financing Bank of $6.1 billion.

Table II-20 illustrates the current liquidity position of the Postal Service with maximized statutory limit on borrowing depleted and its liquidity limited to cash and cash equivalents.

[26] Postal Service FY 2016 Form 10-K at 31.

Table II-20
Total Postal Service Liquidity
End of FY 2016 Compared to FY 2015

	FY 2016	FY 2015
Cash and Cash Equivalents	$ 8,077	$ 6,634
Current Portion of Debt	10,100	10,100
Long-Term Debt	4,900	4,900
Total Debt	**$ 15,000**	**$ 15,000**
Statutory Debt Limit	15,000	15,000
Available Debt	-	-
Total Liquidity (Cash + Available Debt)	**$ 8,077**	**$ 6,634**

Source: Postal Service FY 2016 Form 10-K at 40.

Chapter 3. Volume, Revenue, and Cost Trends

Overview

This chapter provides an in-depth analysis of the volume, revenue, and cost trends for each of the Postal Service's products and services. The first section focuses on the overall trends for Market Dominant and Competitive products and services. It also describes the calculation of attributable and institutional costs and discusses changes in the percentage of institutional cost to total cost, referred to as institutional cost share.

The second section provides a comparison of volume, revenue, and cost between FY 2015 and FY 2016. It also includes a trend analysis that highlights changes in volume, revenue, and cost that have occurred since FY 2007. FY 2007 is used as the base year because it reflects the mail reclassifications that resulted from the Postal Accountability and Enhancement Act of 2006 (PAEA). In cases where average unit attributable cost changed significantly, the Commission provides an analysis by cost segment and/or component.

Overall Volume, Revenue, and Cost Trends

Market Dominant Products and Services

Table III-1 illustrates the changes in total volume, revenue, attributable cost, and contribution to institutional cost for Market Dominant products and services between FY 2015 and FY 2016.

Table III-1
Market Dominant Volume, Revenue, and Cost

	FY 2016	FY 2015	Variance
Volume (Millions)	149,824	150,198	(0.2)%
Revenue ($ Millions)	50,894	51,647	(1.5)%
Attributable Cost ($ Millions)	28,267	28,283	(0.1)%
Contribution to Institutional Cost ($ Millions)	22,626	23,364	(3.2)%

Negative amount is denoted by ( ).
Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-ACR2015/1; Library Reference USPS-FY16-42

Total Market Dominant revenue decreased by 1.5 percent in FY 2016, after two consecutive years of growth. The decrease in revenue can be primarily attributed to the removal of the temporary surcharge the Commission granted to the Postal Service in January 2014 to offset the loss in total contribution associated with volume losses due to the Great Recession of 2008–2009. The surcharge expired on April 10, 2016. However, the continued loss in Market Dominant volume during FY 2016 also had a negative effect on revenue. Total attributable cost for Market Dominant products also decreased; however, the decrease was slight and significantly less than the decrease in revenue. Total attributable cost for Market Dominant products was 0.1 percent lower than in FY 2015. Consequently, the total Market Dominant contribution to institutional cost declined by $738 million.

In FY 2016, Market Dominant products accounted for 97.1 percent of total mail volume, a drop of 0.3 percent from FY 2015. Revenue from these products as a percentage of total revenue decreased from 74.9 percent to 71.2 percent. Market Dominant attributable cost, as a percentage of total attributable cost, decreased slightly from 70.3 percent in FY 2015 to 69.3 percent in FY 2016.

Several Market Dominant products failed to generate sufficient revenue to cover attributable cost. The total negative contribution to institutional cost from these products amounted to over $1.3 billion, about $64 million more than in FY 2015. Five domestic mail products failed to cover their attributable cost: Standard Mail Flats ($604.1 million), Standard Mail Parcels ($29.5 million), Periodicals Outside County ($505.2 million), Periodicals In-County ($25.3 million), and Package Services Media Mail/Library Mail ($87.8 million). In addition, First-Class Mail Inbound Letter Post had a negative contribution.

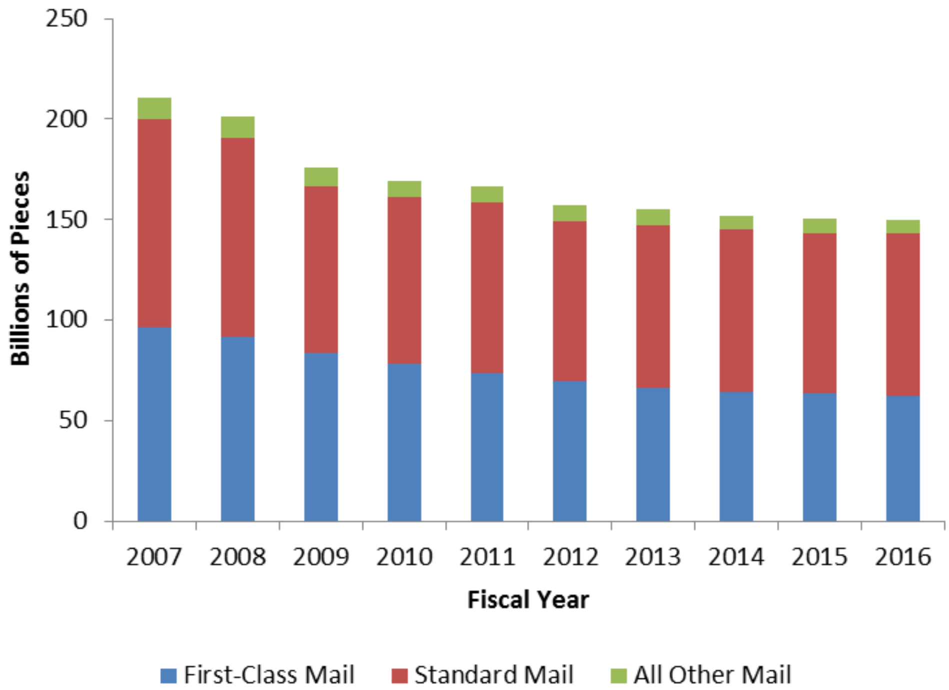
The Commission continues to encourage the Postal Service to reduce cost and to use the pricing flexibility afforded in the PAEA to improve these products' cost coverage.[27]

Market Dominant Volume Trends

Figure III-1 shows the total volume for Market Dominant products over the last 8 years. Since FY 2007, volume has declined by 60.8 billion pieces.

[27] *See* FY 2015 ACD at 42-69; FY 2014 ACD at 33-57; FY 2013 ACD at 5-61; FY 2012 ACD at 15-22, 88-96, 108-117; FY 2010 ACD at 90-94, 103-108, 116-118.

Figure III-1
Market Dominant Volume, FY 2007 - FY 2016



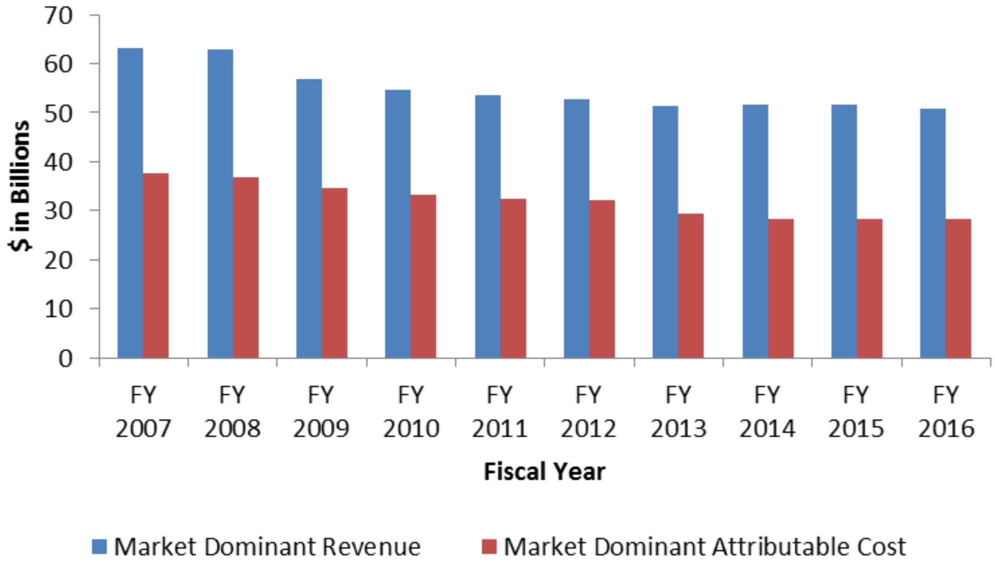
Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1; FY 2007- FY 2014 ACD; Library Reference PRC-LR-1.

First-Class Mail and Standard Mail accounted for 95.6 percent of total Market Dominant volume. First-Class Mail volume declined by 34 billion pieces since FY 2007, the rate of decline averaging 4.7 percent a year. However, over the past 3 years, the decline has slowed significantly averaging only about 2.3 percent annually. Although Standard Mail volume declined by 23 billion pieces since FY 2007, over the last 5 years Standard Mail volume remained relatively steady, with minor fluctuations from year to year. In FY 2016, Standard Mail volume grew 839.7 million pieces, representing an increase of 1.0 percent from FY 2015.

Market Dominant Revenue and Cost Trends

Total Market Dominant revenue and attributable cost have also declined since FY 2007. Total revenue declined by 19.4 percent and total attributable cost declined by 24.6 percent. Figure III-2 compares revenue and attributable cost since FY 2007.

Figure III-2
Market Dominant Revenue and Attributable Cost, FY 2007 - FY 2016

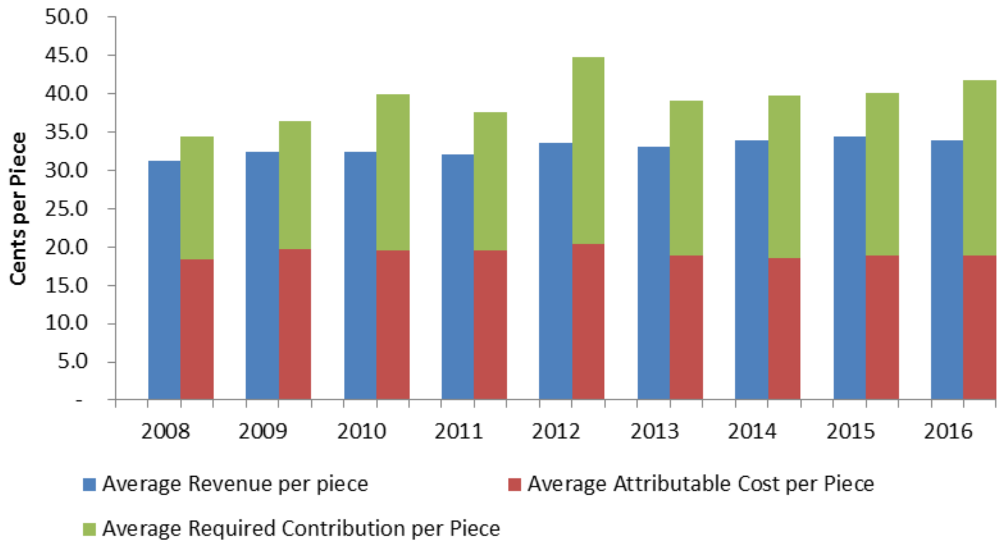


Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1; Docket No. ACR2014, Library Reference PRC-LR-ACR2014/1; FY 2007- FY 2013 ACD; Library Reference PRC-LR-1.

Total Market Dominant revenue decreased slightly in FY 2016. The decrease in revenue can be mostly attributed to the decrease in rates when the exigent surcharge expired in April 2016. The Market Dominant exigent surcharge added $2.1 billion in additional revenue in FY 2015 compared with $1.0 billion in additional revenue in FY 2016.

As shown in Figure III-3, on a unit basis, average revenue and cost increased since FY 2007. Market Dominant average unit revenue increased 4.0 cents and Market Dominant average unit attributable cost increased 1.1 cents over that period. During FY 2016, unit revenue decreased by 0.4 cents, while unit attributable cost remained nearly unchanged, increasing by less than a tenth of a percent. Institutional cost per piece increased by 1.7 cents from FY 2015. Consequently, Market Dominant average total cost per piece increased by 4.2 percent in FY 2016.

Figure III-3
Market Dominant Average Unit Revenue and Cost, FY 2007 - FY 2016



Source: The Postal Regulatory Commission derived from Postal Service *Cost and Revenue Analysis (CRA) Reports* , FY 2007 - FY 2016.

Competitive Products and Services

Both volume and revenue for Competitive products increased in FY 2016. Table III-2 compares the total volume, revenue, and cost of these products and services between FY 2015 and FY 2016.

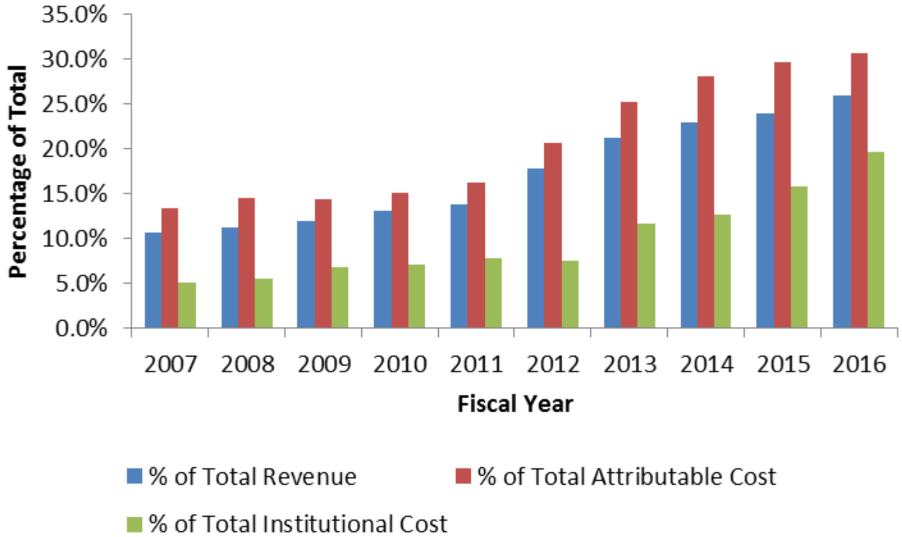
Table III-2
Competitive Volume, Revenue, and Cost

	FY 2016	FY 2015	Variance
Volume (Millions)	4,499	3,959	13.6%
Revenue ($ Millions)	18,495	16,428	12.6%
Attributable Cost ($ Millions)	12,490	11,905	4.9%
Contribution to Institutional Cost ($ Millions)	6,005	4,523	32.8%

Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, PRC-LR-ACR2015/1; Library Reference USPS-FY16-42.

Volume grew 13.6 percent in FY 2016, while revenue grew 12.6 percent or just over $2 billion. Attributable cost grew by 4.9 percent and institutional cost contribution grew 32.8 percent. As shown in Figure III-4, the Competitive products' share of total Postal Service revenue, attributable cost, and contribution to institutional cost have more than doubled since FY 2007.

Figure III-4
Competitive Percentage Share of Total Postal Service Revenue, Cost, and Institutional Cost, FY 2007 - FY 2016



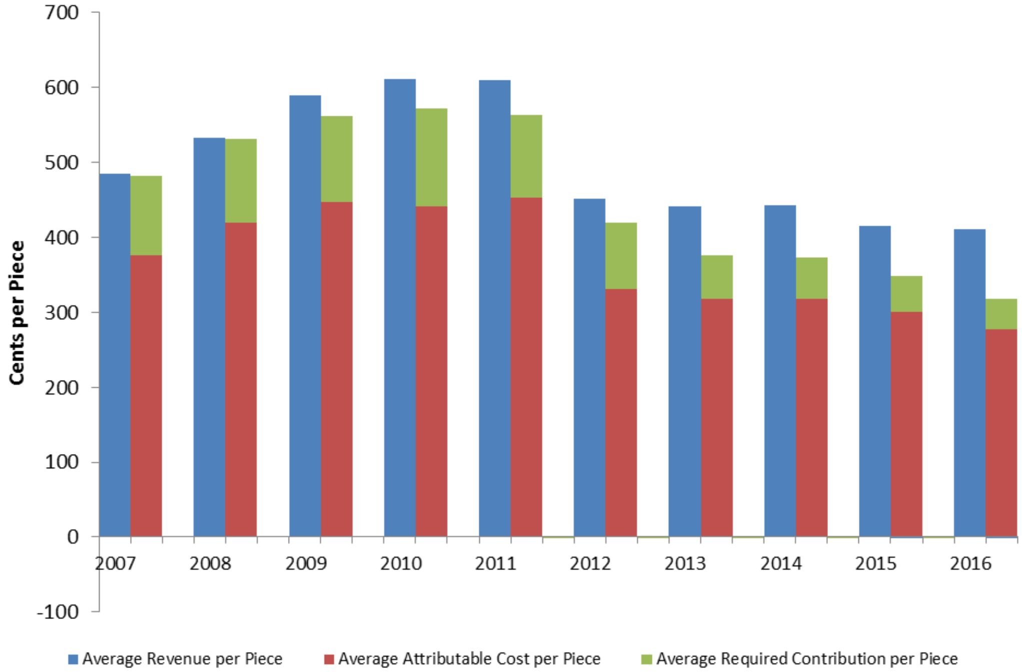
Source: Postal Service *Cost and Revenue Analysis (CRA) Reports* , FY 2007 - FY 2016.

Figure III-5 illustrates the changes in average unit revenue and cost from FY 2007 to FY 2016. Since FY 2007, average unit revenue for Competitive products and services exceeded both the average unit attributable cost and the required average unit institutional cost.[28] In FY 2016, the average unit revenue decreased for the second year in a row, though the decline was less than in FY 2015. The decrease from FY 2015 to FY 2016 was just 0.9 percent compared with a more than 6 percent decline between FY 2014 and FY 2015.

The average unit attributable cost declined 7.7 percent from FY 2015, while the average unit contribution increased 16.8 percent in FY 2016.

[28] The current minimum required contribution to institutional cost for Competitive products is 5.5 percent of total institutional cost. *See* 39 U.S.C. § 3633(a)(3); 39 C.F.R. § 3015.7(c). The "required average unit institutional cost" is the minimum contribution divided by the total volume of Competitive products.

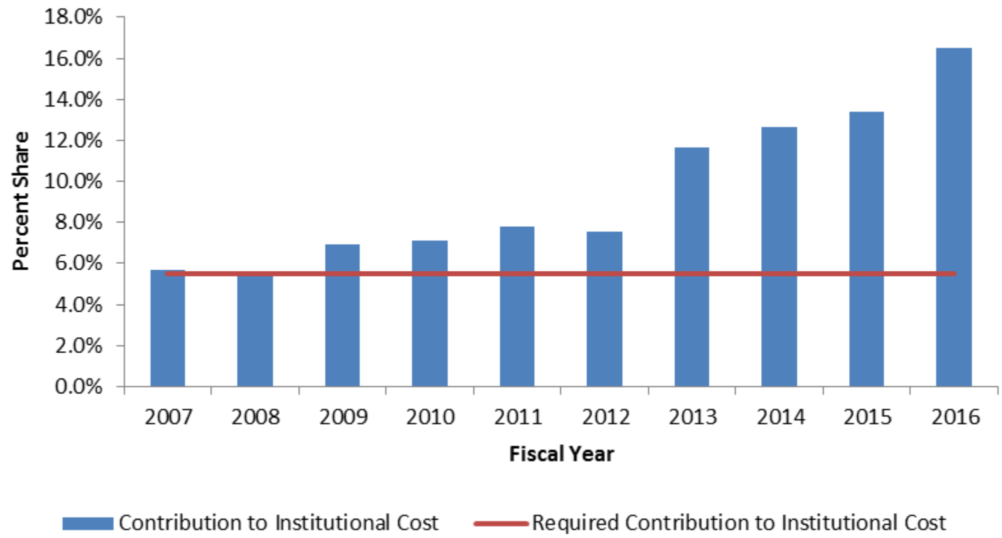
Figure III-5
Competitive Average Unit Revenue and Cost, FY 2007 - FY 2016



Source: Postal Service *Cost and Revenue Analysis (CRA) Reports* , FY 2007 - FY 2016.

The significant increase in Competitive product volume has resulted in total attributable cost for Competitive products increasing in every cost segment, more than doubling since FY 2008. Total contribution to institutional cost from Competitive products continues to increase, exceeding the required contribution level of 5.5 percent each year. As shown in Figure III-6, Competitive products' contribution has increased significantly over the past 5 years.

Figure III-6
Competitive Contribution to Institutional Cost, FY 2007 - FY 2016



Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1; Docket No. ACR2014, Library Reference PRC-LR-ACR2014/1; FY 2007- FY 2013 ACD; Library Reference PRC-LR-1.

Attributable and Institutional Cost Relationships

39 U.S.C. § 3622(c)(2) defines attributable cost as the "direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships plus that portion of all other costs of the Postal Service reasonably assignable to such class or type[.]" In Order No. 3506, the Commission revised the methodology for determining attributable cost to include inframarginal costs, developed as part of the estimation of incremental costs[29]. Before that order, attributable cost only included the sum of volume-variable costs, which rise as volume increases and fall as volume decreases, and product-specific fixed costs, which are costs caused by a specific product, but do not vary with volume.

The Postal Service was unable to fully implement the Commission's order in its FY 2016 *Annual Compliance Repor*t. Specifically, the Postal Service was unable to develop incremental costs for International Mail, certain Standard Mail products, and Negotiated Service Agreements (NSAs). FY 2016 ACR at 7-10. In this chapter, the Commission will continue to use the previous methodology to evaluate product costs for two reasons. First, as noted above, the implementation of Order No. 3506 is not complete, making comparison

[29] Docket No. RM2016-2, Order Concerning United Parcel Service, Inc.'s Proposed Changes to Postal Service Costing Methodologies (UPS Proposals One, Two, and Three), September 9, 2016 (Order No. 3506).

of products' attributable costs unfeasible. Second, the significant change in methodology impedes the Commission's ability to provide meaningful comparison of FY 2016 results with the attributable costs in FY 2015, which were developed before the new methodology for attributable cost was introduced. Consequently, institutional cost, the cost that remains after attributable cost is determined, will include the inframarginal cost.

Attributable cost is distributed to products using distribution keys that reflect the underlying cost driver. The Postal Service assigns attributable cost for each product according to methodologies approved by the Commission. Changes to those methodologies are reviewed by the Commission, and members of the general public are given the opportunity to comment in these dockets.

In addition to the change in the methodology for attributable costs discussed above, in FY 2016, the Commission approved two changes in cost attribution methodology, both of which pertain to International Mail products. The first modification involves a change to Revenue, Pieces, and Weight (RPW) reporting on the System for International Revenue and Volume, Outbound-International Origin-Destination Information System (SIRVO), which affects the revenue reported for certain products.[30] The second involves the distribution of international delivery cost.[31] The Postal Service implemented these changes in its FY 2016 ACR.

Institutional cost cannot be attributed to a specific product or service and is equal to total cost minus total attributable cost. Sometimes referred to as "fixed cost," it is more accurately characterized as "common costs" because it includes costs that are variable, but not causally related to an individual product. Institutional costs include costs for carrier network travel time, the statutory prefunding payment into the RHBF, and various administrative costs. Holding all else equal, a higher mail volume results in a lower institutional cost share and a lower mail volume results in a higher institutional cost share.

The Commission has previously discussed how institutional cost share changes as volume increases and decreases.[32] The Commission has also discussed how changes in operational factors such as volume mix and volume weighted by the average attributable cost of individual products will also change the institutional cost share. There are also non-operational factors such as changes to GAAP and Commission approved costing methodologies which have an effect on the ratio. Institutional costs are primarily driven by the delivery network costs and prior year annuitant health and workers' compensation costs. Therefore, institutional costs will increase or decrease depending on increases in delivery points or changes due to restructuring routes, and estimated accruals for prior

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[30] See Docket No. RM2016-7, Order No. 3377, Order Approving Analytical Principles Used in Periodic Reporting (Proposal One) June 17, 2016.

[31] See Docket No, RM2016-10, Order No. 3621, Order Approving Analytical Principles Used in Periodic Reporting (Proposal Two), November 17, 2016.

[32] Postal Regulatory Commission Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2014, April 1, 2015, at 35-37 (FY 2014 Postal Regulatory Commission Financial Report).

year annuitant health benefits and workers' compensation. Table III-3 shows the causes of the changes in institutional costs each year since 2007. The largest drivers of the changes have been prior year workers' compensation and annuitant health benefits costs rather than changes in operational costs.

Table III-3
Main Sources of Change in Institutional Costs

	FY 2016 ($ 000)	FY 2015 ($ 000)	FY 2014 ($ 000)	FY 2013 ($ 000)	FY 2012 ($ 000)	FY 2011 ($ 000)	FY 2010 ($ 000)	FY 2009 ($ 000)	FY 2008 ($ 000)	FY 2007 ($ 000)
Workers' Compensation	$ 965,985	$ (654,814)	$ 1,290,341	$ (2,600,835)	$ (99,435)	$ (48,990)	$ 1,189,647	$ 960,166	$ 409,104	$ (445,382)
Annuitant Health Benefits	388,908	27,737	332,737	(5,124,055)	11,471,877	(5,109,985)	4,460,307	(3,631,022)	122,966	3,759,186
City and Rural Carriers	387,579	465,085	(98,278)	42,613	314,106	281,666	122,766	(53,811)	141,027	283,759
Annuitant Life Insurance	149,024	102,998	2,664	407	309	(276)	563	686	41	(797)
Transportation	103,181	(31,117)	(23,560)	15,148	21,239	46,419	7,033	(24,245)	75,049	13,007
Supplies and Services	116,728	19,641	43,336	113,029	(56,587)	114,221	(100,798)	(76,169)	(26,340)	(32,088)
Clerks and Mailhandlers	99,575	239,558	54,748	28,205	(35,478)	(110,222)	(203,979)	(255,030)	(181,850)	(33,232)
Other	397,208	(435,196)	(512,303)	187,858	(498,105)	362,786	(160,139)	(194,157)	(188,078)	260,189
Total Change	**$2,608,187**	**$ (266,108)**	**$ 1,089,686**	**$ (7,337,630)**	**$ 11,117,927**	**$ (4,464,383)**	**$ 5,315,400**	**$ (3,273,583)**	**$ 351,920**	**$ 3,804,642**

Negative amount is denoted by ( ).

Source: U.S. Postal Service *Cost Segments and Components Reports,* FY 2007 - FY 2016.

Table III-4 illustrates the calculation of volume-variable and institutional costs. Total volume-variable cost is calculated by multiplying total cost by the volume variability ratio.[33] Average unit attributable cost is calculated by adding the volume-variable cost to the product specific cost and dividing this total by total volume.[34]

[33] The volume variability ratio and the method used to determine it varies depending on the cost segment and the cost drivers.

[34] Unit attributable component costs for products are discussed later in this chapter. Those unit costs are determined after component costs are distributed to products using a distribution key.

Table III-4
Calculation of Average Attributable and Institutional Costs

	[1]	[2]	[3]	[4]	[5]	[6]
				[2] x [3]	[4] / [1]	[2] - [4]
	Total Volume (000)	**Total Cost ($ in 000)**	**Percent Volume Variable**	**Attributable (Volume Variable) Costs ($ in 000)**	**Attributable (Volume Variable) Cost per Piece (Cents)**	**Total Institutional (Fixed) Costs ($ in 000)**
Postmasters	154,235,007	1,599,973	17.6%	281,369	0.002	1,318,604
Supervision	154,235,007	3,307,439	54.1%	1,787,820	0.012	1,519,619
Mail Processing	154,235,007	11,053,585	94.4%	10,431,491	0.068	622,094
City Carrier In-Office	154,235,007	3,522,299	83.5%	2,941,887	0.019	580,412
City Carrier Street	154,235,007	12,385,607	36.3%	4,490,612	0.029	7,894,995
Rural Carriers	154,235,007	7,443,768	34.3%	2,553,458	0.017	4,890,310
Custodial and Maintenance	154,235,007	3,106,226	71.1%	2,207,028	0.014	899,198
Transportation	154,235,007	6,992,446	86.7%	6,065,647	0.039	926,799
Administration	154,235,007	14,132,308	20.3%	2,863,366	0.019	11,268,942
Other Segments	154,235,007	13,577,438	53.0%	7,193,140	0.047	6,384,298
Total	**154,235,007**	**77,121,089**		**40,815,818**	**0.264**	**36,305,271**

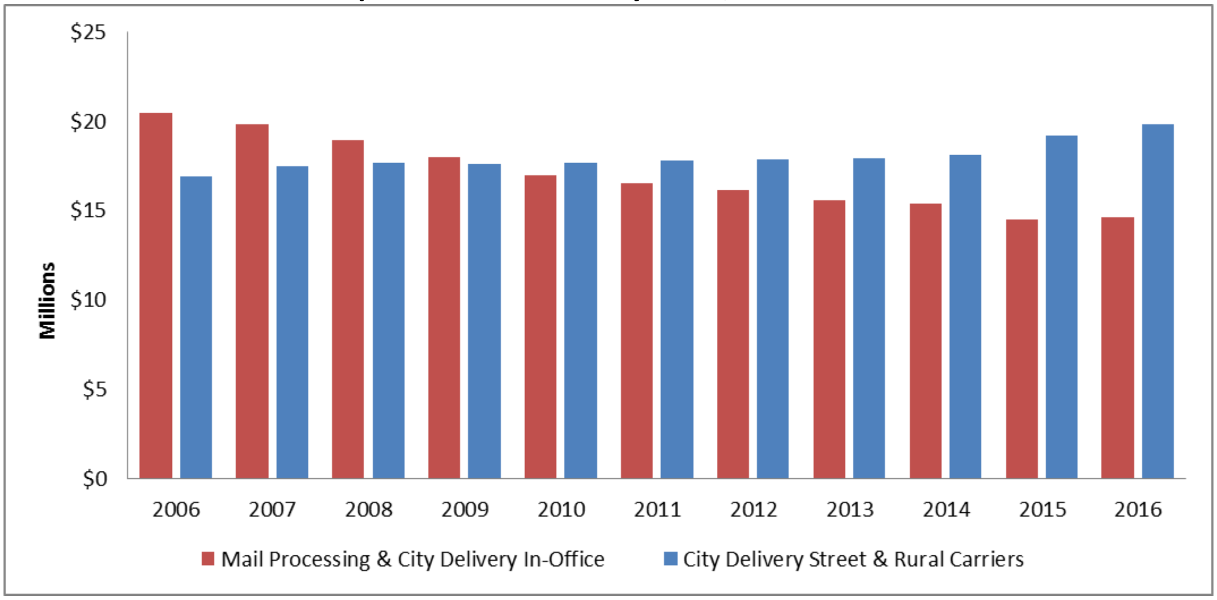
Source: Library Reference USPS-FY16-31.

Figure III-7 shows mail preparation and delivery costs from FY 2006 to FY 2016.[35] From FY 2006 to FY 2015, mail processing cost, including City Delivery In-Office cost, declined in a large part due to cost reduction programs directed at mail processing cost and the continued decline in mail volumes. By FY 2010, delivery costs exceeded mail processing costs. In FY 2016, mail processing cost remained nearly unchanged compared with FY 2015.

Delivery cost, which includes city carrier street time cost and rural carrier cost, also increased from FY 2006. City carrier street time cost increased 14 percent since FY 2006. Because carriers must travel the same delivery route regardless of the amount of mail they carry, city carrier street time cost does not vary significantly with volume. Instead, the number of delivery points is the main cost driver of city carrier street cost. Rural carrier cost also increased, growing 24 percent over the same 11-year period.

[35] For purposes of this analysis, mail preparation includes mail processing and city carrier in-office costs. Delivery includes city carrier street costs and rural carrier costs.

Figure III-7
Mail Preparation and Delivery Costs, FY 2006 - FY 2016



Source: U.S. Postal Service *Cost Segments and Components Reports,* FY 2006 - FY 2016.

In FY 2016, total attributable cost increased as declines in Market Dominant volumes slowed and Competitive product volumes increased. Table III-5 shows the change in attributable cost by major cost segment and component. The largest increase in attributable cost was in domestic transportation, increasing by over $400 million. Compared with FY 2015, highway and air transportation costs increased approximately 5 percent and 15 percent, respectively. These increases are primarily due to substantial growth in shipping and package volumes and the Postal Service's efforts to improve service performance.[36]

Table III-5
Changes in Attributable Cost by Segment and Component ($ in Millions)

	FY 2016	FY 2015	Variance
Mail Processing	$ 17,394	$ 17,402	$ (8)
Window Service	1,369	1,336	33
City Carriers	10,013	10,004	9
Rural Carriers	3,188	3,097	91
Domestic Transportation	5,423	4,983	441
Other Segments	3,428	3,438	(10)
Total Attributable	$ 40,816	$ 40,260	$ 556

Source: Library Reference USPS-FY16-24; Library Reference USPS-FY16-31;
Docket No. ACR2015, Library Reference USPS-FY15-21: Library Reference USPS-FY15-31.

[36] Postal Service FY 2016 Form 10-K at 29.

Market Dominant Volume, Revenue, and Cost Trends by Class

First-Class Mail

Six products are assigned to First-Class Mail: Single-Piece Letters/Postcards; Presorted Letters/Postcards; Flats; Parcels; Outbound Single-Piece First-Class Mail International; and Inbound Letter Post. For comparison purposes in this report, the products have been grouped into letters, flats, and "all others."

FIRST-CLASS MAIL LETTERS COMPARED WITH FY 2015

Table III-6 summarizes the FY 2016 change in total volume and revenue for First-Class Mail Letters. First-Class Mail Letters volume continued to decline in FY 2016, despite the decrease in price resulting from the elimination of the exigent surcharge midway through FY 2016. For Single-Piece Letters, the rate of decline was nearly unchanged from FY 2015. Presorted Letters volume decreased slightly, but the rate of decline exceeds that in FY 2015, when it was 0.2 percent. Revenue for First-Class Mail Single-Piece Letters decreased from FY 2015. The primary reason for the drop in revenue is the elimination of the exigent surcharge which decreased the price of a stamp by 2 cents. The revenue for Presorted Letters was also negatively affected by the elimination of the surcharge, falling 1.0 percent from FY 2015.

Table III-6
First-Class Mail Letters Volume and Revenue ($ in Millions)

	Mail Volume				Mail Revenue			
	(Millions)		Increase or	Percent	($ in Millions)		Increase or	Percent
	FY 2016	FY 2015	Decrease	Change	FY 2016	FY 2015	Decrease	Change
Single-Piece	18,910	19,737	(827)	-4.2%	9,534	10,039	(505)	-5.0%
Presorted	37,746	38,005	(259)	-0.7%	14,889	15,035	(146)	-1.0%
Total Letters	56,656	57,742	(1,086)	-1.9%	24,423	25,074	(651)	-2.6%

Negative amount is denoted by ( ).
Source: Library Reference PRC-LR-ACR2016/1; Docket ACR2015, Library Reference PRC-LR-ACR2015/1.

Table III-7 summarizes the FY 2016 change in total attributable cost for First-Class Mail Letters. Total attributable cost for First-Class Mail Letters declined in FY 2016. Loss of volume was the primary contributor to the reduction in attributable cost; however, the unit attributable cost for First-Class Mail Letters also declined in FY 2016, indicating that the decrease in attributable cost was not entirely caused by the change in volume. It is notable that the overall decrease in unit attributable cost for First-Class Mail Letters is wholly due to the presort category, as the unit attributable cost of the Single-Piece category increased by 4.7 percent from FY 2015. These changes are discussed in further detail below.

Table III-7
First-Class Mail Letters Attributable Costs ($ in Millions)

	Attributable Cost				Unit Attributable Cost			
	($ in Millions)		Increase or	Percent	(Cents per Piece)		Increase or	Percent
	FY 2016	FY 2015	Decrease	Change	FY 2016	FY 2015	Decrease	Change
Single-Piece	5,322	5,304	18	0.3%	28.1	26.9	1.3	4.7%
Presorted	4,404	4,703	(299)	-6.4%	11.7	12.4	(0.7)	-5.7%
Total Letters	9,726	10,007	(281)	-2.8%	16.8	17.3	(0.5)	-2.8%

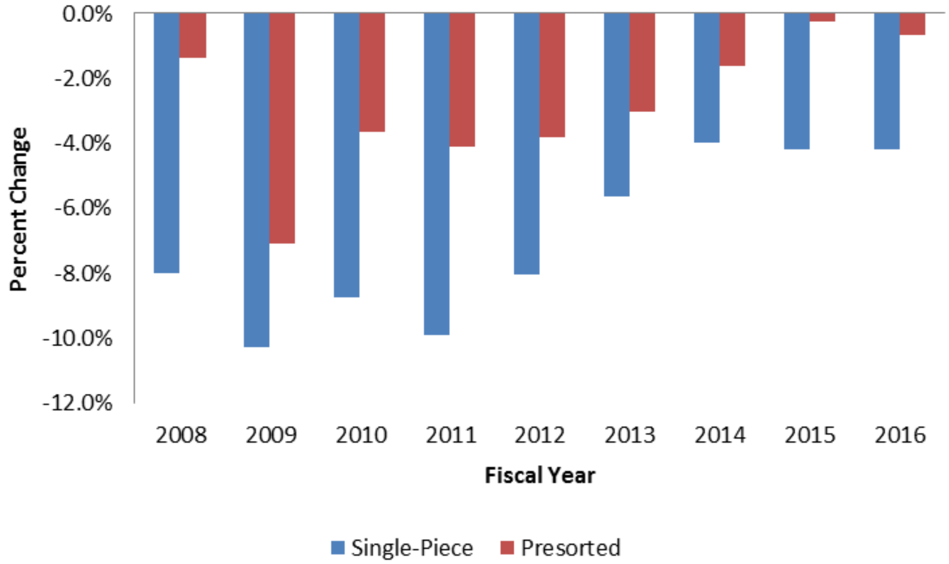
Negative amount is denoted by ( ).
Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1.

TRENDS IN FIRST-CLASS MAIL LETTERS

Changes in the use of postal services continue to erode First-Class Mail volume as consumers switch to electronic channels for banking and payment of services.[37] Figure III-8 illustrates the rate of decline for First-Class Mail volume. Over the last 3 years, the rate of decline for First-Class Mail Single-Piece Letters has remained at approximately 4 percent, while the rate of decline for First-Class Mail Presorted Letters increased slightly after 5 years of decline. The decline in First-Class Mail Presorted Letters volume may also be attributable in part to decreased economic activity compared with FY 2015.[38]

[37] Postal Service FY 2016 Form 10-K at 8.
[38] Real GDP increased 1.6 percent in 2016 compared with an increase of 2.6 percent in 2015. Bureau of Economic Analysis, National Income and Product Accounts Gross Domestic Product: Fourth Quarter and Annual 2016 (Second Estimate).

Figure III-8
First-Class Letters Percentage Change in Volume, FY 2008 - FY 2016

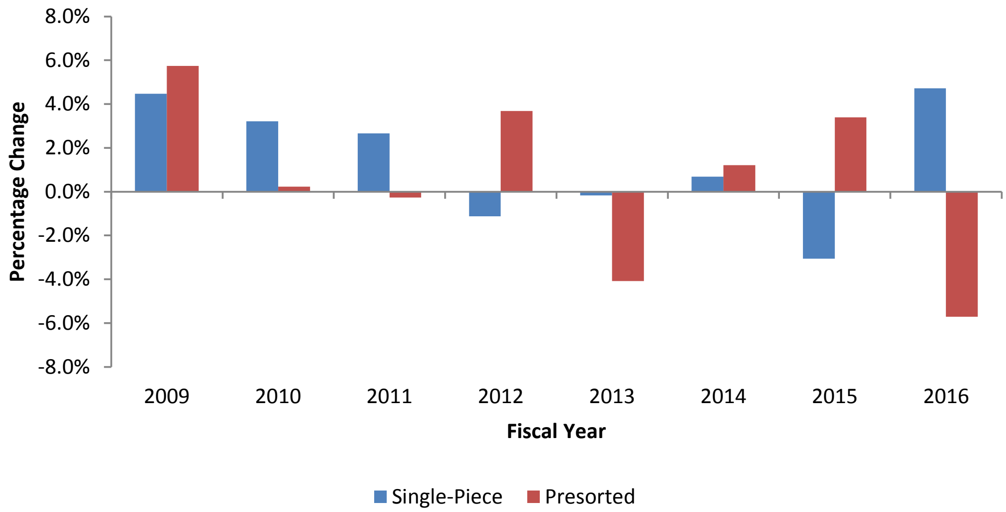


Source: Postal Service *Revenue, Pieces and Weight (RPW) Reports*, FY 2008 - FY 2016.

Figure III-9 shows the change in the average unit attributable cost for First-Class Mail Letters. There is no perceivable trend for First-Class Mail Presorted Letters unit attributable cost. The unit attributable cost has increased 3 of the last 5 years, increasing 3.7 percent in FY 2012, 1.2 percent in FY 2014, and 3.1 percent in FY 2015. The unit attributable cost declined in FY 2013 and FY 2016, 4.1 percent and 5.7 percent, respectively. The Postal Service, while investigating an anomaly in First-Class Flat's unit costs, found an In-Office Cost System (IOCS) coding error that affected First-Class Mail Letters as well. Correcting the error led to a shift in costs from First-Class Presort Letters to First-Class Single Piece Letters.[39]

[39] See USPS-FY16-37, In-Office Cost System Documentation, page 1, December 29, 2016.

Figure III-9
First-Class Mail Letters Percentage Change in Average Unit Attributable Cost
FY 2009 - FY 2016



Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1; Docket No. ACR2014, Library Reference PRC-LR-ACR2014/1; FY 2007- FY 2013 ACD; Library Reference PRC-LR-1.

Table III-8 compares the average unit attributable cost for Presorted Letters by cost component or segment for FY 2012 through FY 2016. The unit attributable cost for Presorted Letters decreased overall in FY 2016. Mail processing and city carrier in-office unit costs for Presorted Letters decreased by more than 10 percent in FY 2016, reversing 2 years of unit cost increases. Both of these segments represent mail processing activities as carrier in-office costs represent time spent sorting mail for delivery. City carrier street unit cost increased in FY 2016 after decreases in FY 2014 and FY 2015, but, rural carrier unit cost remained unchanged after 2 years of increases.

Table III-8
First-Class Mail Presorted Letters Unit Attributable Cost by Segment
FY 2012 - FY 2016

Cost Segment or Component	Unit Attributable Cost						Change in Unit Attributable Cost				
	2016	2015	2014	2013	2012	2011	2016	2015	2014	2013	2012
Mail Processing	5.13	5.87	5.55	5.49	5.78	5.51	-12.6%	5.7%	1.2%	-5.0%	4.9%
City Carrier In-Office	1.45	1.63	1.52	1.40	1.48	1.51	-10.8%	7.2%	8.7%	-5.6%	-2.1%
City Carrrier Street	2.29	2.21	2.38	2.41	2.37	2.19	4.0%	-7.2%	-1.6%	2.1%	8.0%
Rural Carriers	0.82	0.82	0.81	0.78	0.90	0.93	0.0%	2.1%	4.1%	-14.2%	-2.7%
Transportation	1.34	1.27	1.17	1.22	1.23	1.16	6.1%	8.4%	-4.3%	-0.4%	6.0%
All Other	0.52	0.45	0.49	0.53	0.62	0.62	15.5%	-7.2%	-7.2%	-14.4%	-0.1%

Source: The Postal Regulatory Commission derived from Postal Service *Cost Segment and Component Reports,* FY 2011 to FY 2016.

FIRST-CLASS MAIL FLATS COMPARED WITH FY 2015

Table III-9 shows the total volume and revenue for First-Class Mail Flats. First-Class Mail Presorted Flats volume decreased slightly after increasing in FY 2015. Total Flats revenue declined in FY 2016, in part due to the reduction in price resulting from the removal of the Market Dominant exigent surcharge and in part due to the decline in volume.

Table III-9
First-Class Mail Flats Volume and Revenue

	Mail Volume				Mail Revenue			
	(Millions)		Increase or	Percent	($ in Millions)		Increase or	Percent
	FY 2016	FY 2015	Decrease	Change	FY 2016	FY 2015	Decrease	Change
Single-Piece	961	1,057	(96)	-9.1%	1,575	1,736	(161)	-9.3%
Presorted	609	611	(2)	-0.4%	631	627	4	0.7%
Total Flats	1,570	1,669	(99)	-5.9%	2,206	2,363	(156)	-6.6%

Negative amount is denoted by ( ).

Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1.

Table III-10 summarizes the FY 2016 change in attributable cost. Total attributable cost for First-Class Mail Flats fell 1.8 percent from FY 2015. However, this reduction did not keep pace with the reduction in volume. Thus, on a unit basis, costs increased 4.3 percent. As discussed above, the FY 2015 attribution of Single-Piece Flats and Presorted Flats was erroneous due to an IOCS coding error. The correction shifted costs from Presorted Flats to Single-Piece Flats. In total, the Flats product's attributable cost decreased from FY 2015. It is unclear how much of the decrease was due to volume losses and how much was due to the correction. The impact of the correction is more evident when comparing FY 2016 unit costs with the FY 2015 results. The increase in unit attributable cost is due entirely to the large increase in the unit attributable cost of Single-Piece Flats as the decrease in the unit attributable cost of Presorted Flats was not sufficient to offset the unit attributable cost increase of Single-Piece Flats.

Table III-10
First-Class Mail Flats Attributable Costs

	Attributable Cost ($ in Millions) FY 2016	FY 2015	Increase or Decrease	Percent Change	Unit Attributable Cost (Cents per Piece) FY 2016	FY 2015	Increase or Decrease	Percent Change
Single-Piece	1,098	1,000	98	9.8%	114.3	94.6	19.7	20.8%
Presorted	433	559	(127)	-22.7%	71.0	91.5	(20.5)	-22.4%
Total Flats	1,531	1,559	(29)	-1.8%	97.5	93.4	4.0	4.3%

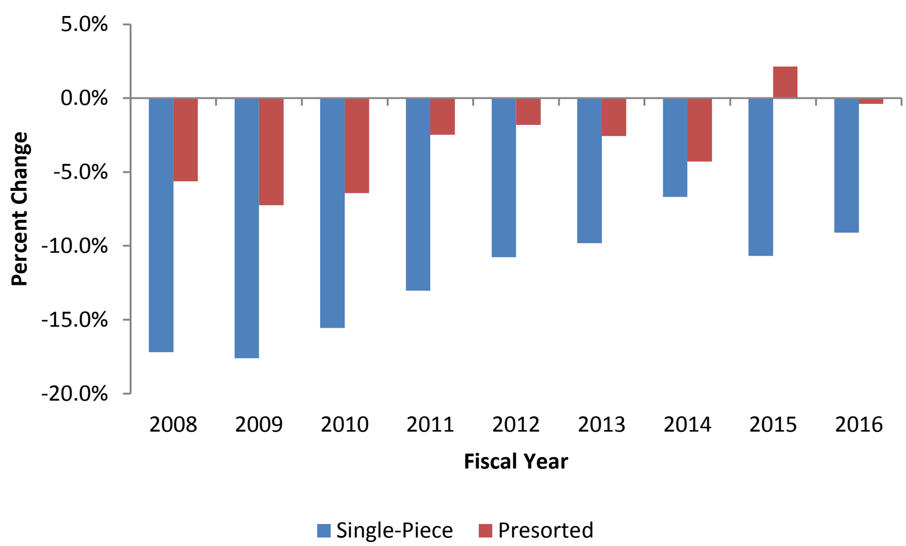
Negative amount is denoted ( ).

Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1.

TRENDS IN FIRST-CLASS MAIL FLATS

Total Flats volume has been on a decline for years, with First-Class Mail Flats being no exception. Figure III-10 compares the percentage change in First-Class Mail Flats volume from FY 2008 to FY 2016. Single-Piece Flats volume continues to erode. First-Class Mail Flats volume decreased by 54 percent since FY 2008. Most of the volume loss can be attributed to First-Class Mail Single-Piece Flats as both the volume and the rate of decrease for that category exceed that of Presorted Flats. Since 2008, Single-Piece Flats have decreased 63 percent, compared with a 21 percent volume decrease for Presorted Flats.

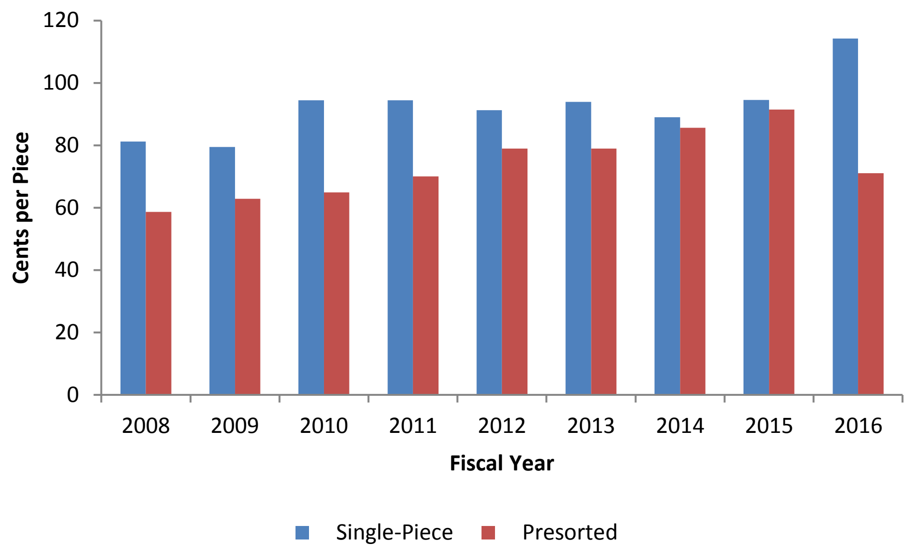
Figure III-10
Percentage Change in First-Class Mail Flats Volume, FY 2008 - FY 2016



Source: Postal Service *Revenue, Pieces, and Weight Reports FY 2008 – FY 2016.*

Figure III-11 compares the average unit attributable cost for both First-Class Mail Single-Piece and Presorted Flats since FY 2008. The average unit attributable cost for First-Class Mail Single-Piece Flats has increased significantly over that time. However, the increase in unit cost for FY 2016 exceeds all annual increases since FY 2008. Conversely, First-Class Mail Presorted Flats unit attributable cost decreased significantly to the lowest level in 5 years.

Figure III-11
First-Class Mail Flats Average Unit Attributable Cost, FY 2008 - FY 2016



Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1;Docket No. ACR2014, Library Reference PRC-LR-ACR2014/1; FY 2007- FY 2013 ACD; Library Reference PRC-LR-1.

Table III-11 compares the average unit attributable cost by cost segment or component of First-Class Mail Single-Piece Flats and First-Class Mail Presorted Flats for FY 2010, FY 2015, and FY 2016. This unit attributable cost includes all of the indirect cost that is piggybacked to the direct cost.[40]

From FY 2010 to FY 2016, unit attributable cost for all cost segments increased with the exception of city carrier in-office unit attributable cost for First-Class Mail Single-Piece Flats. The largest increases in First-Class Mail Presorted Flats and First-Class Mail Single-Piece Flats unit attributable cost have been in delivery (city and rural delivery), transportation, and "all other."

[40] In addition to the direct costs, there are other "indirect" costs associated with the direct cost component or cost segment. Some examples of these indirect costs are Cost Segment 3 Administrative Clerks, Cost Segment 12 Vehicle Service Costs, Cost Segment 15 Rents and Fuel and Utilities, and Cost Segment 18 Servicewide Labor Costs (such as workers' compensation, etc.). These "indirect" costs are referred to as "piggybacked" costs and are developed in Docket No. ACR2015, Library Reference USPS-FY15-24. The unit attributable cost by cost segment or component presented in this report are "piggybacked" costs, unless stated otherwise.

The FY 2016 and FY 2015 First-Class Mail Flats' unit attributable costs are not comparable because the FY 2015 results are erroneous. In FY 2015, the unit mail processing cost was higher for First-Class Mail Presorted Flats than for First-Class Mail Single-Piece Flats. As the Commission noted, such a result is counter-intuitive.[41] The average unit attributable cost of First-Class Mail Presorted Flats should be lower than First-Class Mail Single-Piece Flats because workshared mail requires less handling than single-piece mail. This is particularly true for mail processing cost. The Postal Service concurred with the Commission's assessment and indicated that it would investigate the source of the anomalous unit cost.[42]

Similarly, in FY 2015, city carrier in-office unit attributable cost was higher for First-Class Mail Presorted Flats than for First-Class Mail Single-Piece Flats. The Postal Service acknowledged that the "magnitude of the difference is unexpectedly large." *Id.* However, it explained that the difference in costs is in part due to "a higher fraction of First-Class Mail Presorted Flats' RPW volume being delivered on city carrier routes relative to Single[-]Piece Flats." *Id.*

As noted in the discussion regarding First-Class letters, the Postal Service found a coding error in IOCS data processing. The Postal Service remedied the error as reflected in the FY 2016 unit attributable mail processing and city carrier in-office costs for First-Class Mail Presorted Flats and First-Class Mail Single-Piece Flats. The resulting unit costs are more in line with expectations. In FY 2016, the unit attributable mail processing cost for First-Class Mail Single-Piece Flats exceeded the unit attributable mail processing cost for First-Class Mail Presorted Flats by 24.6 cents. Additionally, the differential between First-Class Mail Presorted Flats and First-Class Mail Single-Piece Flats city carrier in-office unit attributable cost decreased from 6.8 cents in FY 2015 to 1.1 cents in FY 2016.

[41] Docket No. ACR2015, Chairman's Information Request No. 16, February 22, 2016, question 4.

[42] Responses of the United States Postal Service to Questions 1-4 of Chairman's Information Request No. 16, February 29, 2016, question 4.a, (Responses to CHIR No. 16).

Table III-11
First-Class Mail Flats Unit Attributable Cost by Segment or Component
FY 2010, FY 2015, and FY 2016

Cost Segment or Component	2010			2015			2016		
	Single-Piece	Presort	Diff.	Single-Piece	Presort	Diff.	Single-Piece	Presort	Diff.
Mail Processing	57.1	37.8	19.3	51.3	56.4	(5.1)	63.1	38.5	24.6
City Carrier In-Office	11.5	11.4	0.2	8.6	15.4	(6.8)	11.3	12.5	(1.1)
City Carrrier Street	5.8	3.0	2.8	6.7	3.7	3.0	7.6	4.2	3.3
Rural Carriers	2.2	2.4	(0.2)	3.5	2.8	0.7	3.7	2.7	1.0
Transportation	11.0	8.3	2.7	15.7	10.2	5.4	18.8	10.3	8.5
All Other	6.9	2.0	4.9	8.8	3.0	5.8	9.7	2.8	6.9
Total	94.5	64.9	29.6	94.6	91.5	3.1	114.3	71.0	43.3

Negative amount is denoted by ().

Source: The Postal Regulatory Commission derived from Postal Service *Cost Segment and Component Reports* , FY 2010, FY 2015 and FY 2016.

ALL OTHER FIRST-CLASS MAIL COMPARED WITH FY 2015

Table III-12 shows the volume and revenue for First-Class Mail "all others." With the exception of Cards and Outbound Single-Piece First-Class Mail International, volume in every category of First-Class Mail "all others" increased from last year. The declines were in First-Class Mail Postcards and Parcels.

Table III-12
All Other First-Class Mail Volume and Revenue

	Mail Volume				Mail Revenue			
	(Millions)		Increase or	Percent	($ in Millions)		Increase or	Percent
	FY 2016	FY 2015	Decrease	Change	FY 2016	FY 2015	Decrease	Change
Total Cards	2,993	3,008	(16)	-0.5%	865	872	(7)	-0.8%
Parcels	254	200	54	26.9%	712	546	167	30.5%
Outbound Single-Piece First-Class Mail International	172	212	(40)	-19.0%	262	315	(54)	-17.1%
Inbound Letter Post	392	318	74	23.1%	266	251	16	6.3%
Inbound International NSAs	214	155	58	37.4%	324	177	147	83.3%
Total Other First-Class Mail	4,024	3,894	129	3.3%	2,429	2,161	268	12.4%

Negative amount is denoted by ().

Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1.

Table III-13 presents the changes in total attributable cost and average unit attributable cost for "all others" First-Class Mail between FY 2015 and FY 2016. As seen in the table, only the attributable cost of Outbound Single-Piece First-Class Mail International decreased from FY 2015. However, on a unit cost basis, it increased 11.3 percent. Conversely, Inbound Letter Post attributable cost increased, but decreased on a unit basis. First-Class Mail

Parcels average unit attributable cost decreased 11.5 cents over FY 2015, representing a 4.7 percent decrease. Due to the small volume of "all others," less than 1.0 percent of the total volume of First-Class Mail, its impact on the unit attributable cost for the class is minimal.

Table III-13
All Other First-Class Mail Attributable Cost and Average Unit Attributable Cost

	Attributable Cost				Unit Attributable Cost			
	($ in Millions)		Increase or	Percent	(Cents per Piece)		Increase or	Percent
	FY 2016	FY 2015	Decrease	Change	FY 2016	FY 2015	Decrease	Change
Total Cards	405	384	21	5.5%	13.5	13.5	1	5.7%
Parcels	588	486	102	20.9%	231.5	191.5	(11.5)	-4.7%
Outbound Single-Piece First-Class Mail International	153	169	(17)	-9.8%	88.9	79.8	9.0	11.3%
Inbound Letter Post	401	349	52	15.0%	102.3	109.6	(7.2)	-6.6%
Inbound International NSAs	218	154	64	41.8%	102.0	98.8	3.1	3.2%
Total Other First-Class Mail	1,764	1,542	223	14.4%	43.8	39.7	4.1	10.3%

Negative amount is denoted by ().

Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1.

Standard Mail

Standard Mail is comprised of seven products: Letters; Flats; Parcels; Carrier Route; High Density and Saturation Letters; High Density and Saturation Flats/Parcels; and Every Door Direct Mail-Retail. For comparison purposes, the products have been grouped into letters and flats.[43]

STANDARD MAIL LETTERS COMPARED WITH FY 2015

Table III-14 summarizes the FY 2016 change in volume and revenue of letter-shaped Standard Mail. High Density and Saturation Letters and Standard Mail Letters volume increased in FY 2016. Revenue also increased for both categories, although the change in volume and revenue is more significant for High Density and Saturation Letters than Standard Mail Letters. Revenue for both categories increased despite the expiration of the exigent surcharge during FY 2016.

[43] Since the majority of the former Standard Mail Parcels product was moved to the Competitive product list, the remaining parcel volume comprises only 0.1 percent of total Standard Mail volume. Consequently, that volume is not discussed separately. *See* Docket No. MC2010-36, Order No. 689, Order Conditionally Granting Request to Transfer Commercial Standard Mail Parcels to the Competitive Product List, March 2, 2011.

Table III-14
Standard Mail Letter Volume and Revenue, FY 2015 and FY 2014

	Mail Volume (Millions) 2016	2015	Increase or Decrease	Percent Change	Mail Revenue ($ in Millions) FY 2016	FY 2015	Increase or Decrease	Percent Change
Letters	48,859	47,721	1,138	2.4%	10,163	10,057	106	1.1%
High Density & Saturation Letters	6,992	6,478	514	7.9%	1,079	995	85	8.5%
Total Letters	55,851	54,199	1,652	3.0%	11,242	11,052	191	1.7%

Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1.

Table III-15 summarizes the FY 2016 change in attributable cost. Total attributable cost for letter-shaped Standard Mail increased 2.4 percent in FY 2016 after a smaller increase, 1.3 percent, in FY2015. The largest increase was for High Density and Saturation Letters.

Table III-15
Standard Mail Letters Attributable Cost and Average Unit Attributable Cost

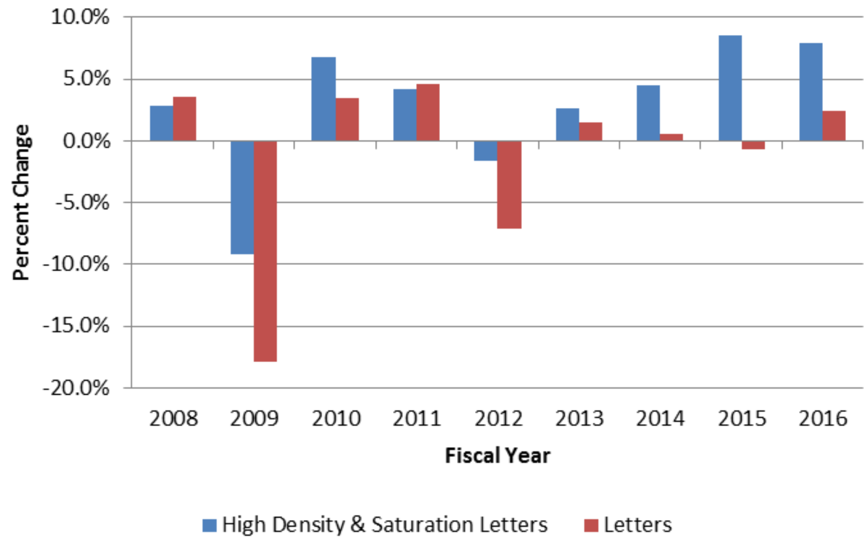
	Attributable Cost ($ in Millions) FY 2016	FY 2015	Increase or Decrease	Percent Change	Unit Attributable Cost (Cents per Piece) FY 2016	FY 2015	Increase or Decrease	Percent Change
Letters	5,023	4,930	93	1.9%	10.3	10.1	0.2	1.9%
High Density & Saturation Letters	492	454	39	8.5%	7.0	6.5	0.6	8.5%
Total Letters	5,516	5,384	132	2.4%	9.9	9.6	0.2	2.4%

Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1.

TRENDS IN STANDARD MAIL LETTERS

As shown in Figure III-12, Standard Mail Letters volume increased in FY 2016 after a small decline in FY 2015. The FY 2016 volume increase is the largest increase since 2011. The rate of growth of High Density and Saturation Letters volume increased each year since FY 2012 and consistently exceeded the rate of growth of Standard Mail Letters.

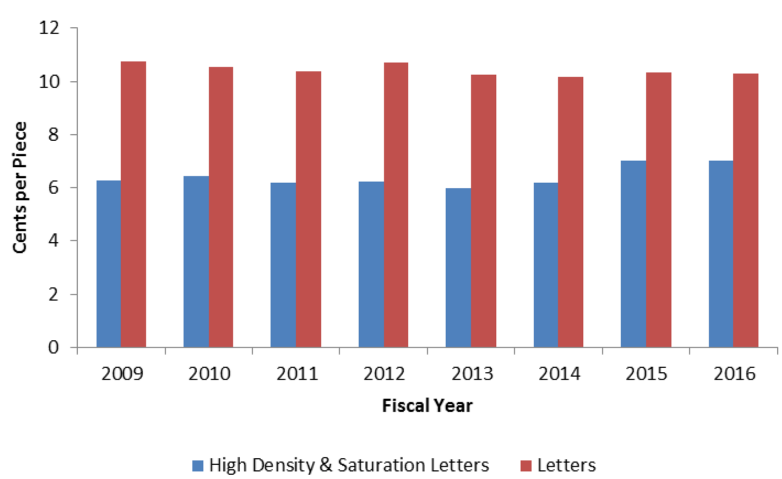
Figure III-12
Standard Mail Letters Volume Percent Change



Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1; Docket No. ACR2014, Library Reference PRC-LR-ACR2014/1; FY 2007- FY 2013 ACD; Library Reference PRC-LR-1.

As shown in Figure III-13, the average unit attributable cost for Standard Mail Letters increased since FY 2008 but remained relatively stable since FY 2009. FY 2016 unit attributable cost for High Density and Saturation Letters and Standard Mail Letters is nearly unchanged from FY 2015.

Figure III-13
Standard Mail Letters Unit Attributable Cost



Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1; Docket No. ACR2014, Library Reference PRC-LR-ACR2014/1; FY 2007- FY 2013 ACD; Library Reference PRC-LR-1.

STANDARD MAIL FLATS COMPARED WITH FY 2015

Table III-16 summarizes the FY 2016 changes in volume and revenue for flat-shaped Standard Mail. Volume declined for every category except Flats, which increased 20.5 percent over last year. The largest decline in volume was in Carrier Route flats, which declined 19.8 percent.

On May 31, 2015, the Postal Service introduced new price categories for Standard Mail Flats, pieces destined for Flats Sequencing System (FSS) zones.[44] The Postal Service intended to provide pricing signals that better reflected the mail processing costs of FSS preparation. For Standard Mail, the new FSS rates were developed by blending Carrier Route prices and presorted 5-Digit/3-Digit prices using the proportion of FSS volumes mailed in each price category.

In Docket No. R2017-1, the Postal Service sought to reverse the changes to the pricing structure of flat-shaped mail due to unintended consequences affecting certain categories. Many mailers who previously paid Carrier Route rates for their FSS volume experienced an above average price increase after the new rates were implemented on May 31, 2015.

The Postal Service explained that after the change in price structure, "FSS volume declined more quickly than the volume in other categories of flat-shaped mail." [45] The Commission approved a Market Dominant price adjustment that reversed the change in pricing structure. *Id.*

The problem the Postal Service identified is borne out by the FY 2016 volume data for Standard Mail Flats and Carrier Route flats. The decrease in Carrier Route flat volume in FY 2016 was more than twice as much as the decrease in FY 2015. Conversely, Standard Mail Flats volume increased by 20.5 percent in FY 2016, compared with a 4.1 percent increase in FY 2015, suggesting a migration of flat-shaped mail from Carrier Route flats to Standard Mail Flats.

Total revenue for flat-shaped Standard Mail decreased in FY 2016 primarily due to the expiration of the exigent surcharge, but loss of volume also contributed to the reduction of revenue. Only Standard Mail Flats revenue increased in FY 2016. The majority of the decrease in revenue is due to the large reduction in Carrier Route flats revenue.

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[44] Similar price categories were also introduced for flat-shaped Bound Printed Matter (BPM) and Periodicals. Docket No. R2015-4, Order No. 2472, Order on Revised Price Adjustments for Standard Mail, Periodicals, and Package Services Products and Related Mail Classification Changes, May 7, 2015.

[45] *See* Docket No. R2017-1, Order No. 3610, Order on Price Adjustments for First-Class Mail, Standard Mail, Periodicals, and Package Services Products and Related Mail Classification Changes, November 15, 2016.

Table III-16
Standard Mail Flats Volume and Revenue

	Mail Volume				Mail Revenue			
	(Millions)		Increase or	Percent	($ in Millions)		Increase or	Percent
	FY 2016	FY 2015	Decrease	Change	FY 2016	FY 2015	Decrease	Change
High Density & Saturation Flats/Parcels	11,101	11,277	(176)	-1.6%	2,021	2,049	(28)	-1.4%
Carrier Route	6,783	8,389	(1,606)	-19.1%	1,831	2,265	(434)	-19.2%
Flats	6,340	5,260	1,080	20.5%	2,380	2,113	267	12.6%
Every Door Direct Mail - Retail	810	833	(22)	-2.7%	146	149	(3)	-1.9%
Total Flats & Parcels	25,034	25,758	(724)	-2.8%	6,378	6,576	(197)	-3.0%

Negative amount is denoted by ().

Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1.

Total attributable cost for flat-shaped Standard Mail decreased in FY 2016 after increasing in FY 2015. Attributable costs increased in FY 2016 for High Density and Saturation Flats/Parcel, Standard Mail Flats and Every Door Direct Mail-Retail. However, a significant reduction in Carrier Route attributable cost resulted in a slight decrease in total Standard Mail Flats and Parcels attributable cost. Unit attributable costs for Total Flats and Parcels increased in FY 2016 despite sizable unit cost reductions for Carrier Route and Flats.

Table III-17
Standard Flats Attributable Cost and Average Unit Attributable Cost

	Attributable Cost				Unit Attributable Cost			
	($ in Millions)		Increase or	Percent	(Cents per Piece)		Increase or	Percent
	FY 2016	FY 2015	Decrease	Change	FY 2016	FY 2015	Decrease	Change
High Density & Saturation Flats/Parcels	1,197	1,181	16	1.4%	10.8	10.5	0.3	3.0%
Carrier Route	1,331	1,727	(395)	-22.9%	19.6	20.6	(1.0)	-4.6%
Flats	2,985	2,633	351	13.3%	47.1	50.1	(3.0)	-6.0%
Every Door Direct Mail - Retail	54	52	3	4.9%	6.7	6.2	0.5	7.8%
Total Flats & Parcels	5,567	5,592	(26)	-0.5%	22.2	21.7	0.5	2.4%

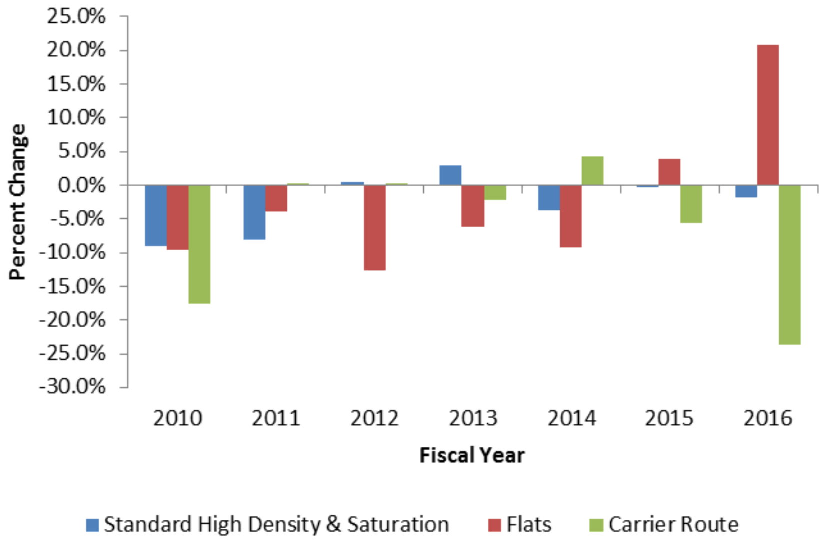
Negative amount is denoted by ().

Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1.

TRENDS IN STANDARD MAIL FLATS

Total volume for flat-shaped Standard Mail continued to decline in FY 2016, decreasing by over 778 million pieces. As shown in Figure III-14, volume change for Standard Mail Flats and Carrier Route flats in FY 2016 are substantially larger than previous volume changes for these categories. Compared with FY 2015, there is no difference in the direction of the change in volume compared with FY 2015 for any category of Standard Mail flat-shaped mail. However, the magnitude of the change for Standard Mail flat-shaped mail categories significantly exceeds that of FY 2015 volume changes.

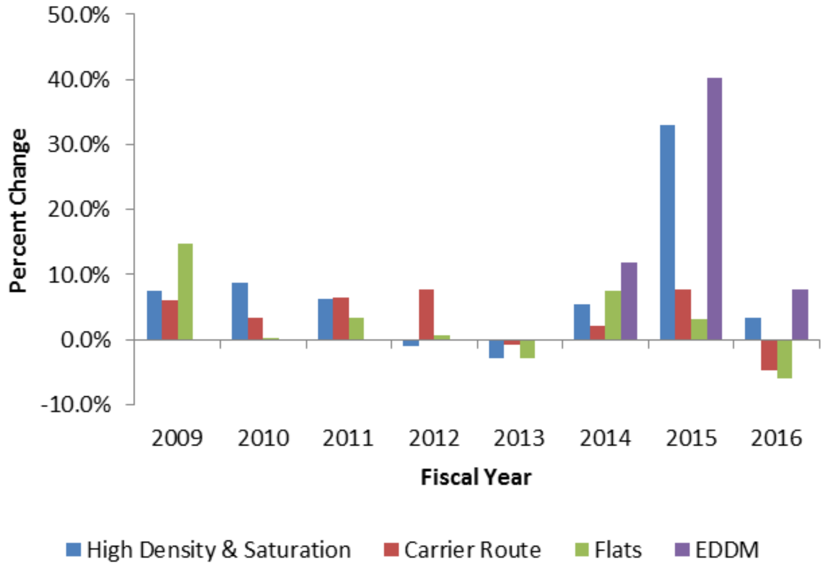
Figure III-14
Standard Mail Flat Percent Change in Volume
FY 2010 - FY 2016



Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1; Docket No. ACR2014, Library Reference PRC-LR-ACR2014/1; FY 2007- FY 2013 ACD; Library Reference PRC-LR-1.

The average unit attributable cost for all flat-shaped Standard Mail products increased significantly over the last 9 years. This growth in the unit attributable cost is illustrated in Figure III-15. Since FY 2008, the average unit attributable cost of Flats has increased 21.1 percent, 30.5 percent for Carrier Route, and 73.4 percent for High Density and Saturation Flats.

Figure III-15
Standard Mail Flats Percent Change in Average Unit Attributable Cost
FY 2009 - FY 2016



Negative amount is denoted by ().

Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1; Docket No. ACR2014, Library Reference PRC-LR-ACR2014/1; FY 2007- FY 2013 ACD; Library Reference PRC-LR-1.

Table III-18 compares the change in the average unit attributable cost by cost segment or component between FY 2016 and FY 2015. Mail Processing unit cost for Carrier Route and Standard Mail Flats declined in FY 2016, while Every Door Direct Mail-Retail (EDDM-R) and High Density and Saturation Flats experienced a unit mail processing cost decrease. This was the third year in which cost has been reported for EDDM-R. The sizeable changes from year to year could be the result of the small size of the category with few IOCS tallies for this type of Standard Mail.

Table III-18
Change in Standard Flat-Shaped Mail Unit Attributable Cost by Cost Segment

	High Density & Saturation	Carrier Route	Flats	EDDM
Mail Processing				
FY 2016	1.2011	5.0007	25.7396	0.1250
FY 2015	1.1600	6.0814	27.9516	0.0357
% Change	3.5%	-17.8%	-7.9%	250.1%
City Carrier In-Office				
FY 2016	1.1343	5.5438	8.8783	1.1000
FY 2015	1.3396	5.4662	10.0017	1.2814
% Change	-15.3%	1.4%	-11.2%	-14.2%
City Carrier Street				
FY 2016	4.9149	3.3316	6.0755	4.4572
FY 2015	4.4615	3.9730	4.8891	3.9724
% Change	10.2%	-16.1%	24.3%	12.2%
Rural Carriers				
FY 2016	2.8591	4.0466	2.3556	0.4718
FY 2015	2.7543	3.4649	2.9070	0.4640
% Change	3.8%	16.8%	-19.0%	1.7%

Source: The Postal Regulatory Commission derived from Library Reference USPS-FY16-24; Docket No. ACR2015, Library Reference USPS-FY15-24.

Periodicals

The Periodicals class is comprised of two products: In-County and Outside County. In-County is typically used by newspapers with smaller weekly circulations for distribution within the county of publication. Outside County consists of publications with a wide variety of circulation sizes, distribution patterns, and frequencies.

PERIODICALS COMPARED WITH FY 2015

Table III-19 summarizes the FY 2016 changes in volume and revenue for Periodicals. In FY 2016, Periodicals volume declined by 252 million pieces, or 4.3 percent, with most of the decrease occurring in Outside County publications. In 2016, the rate of decrease in volume exceeded that of FY 2015 despite a significant drop in prices midway through the fiscal year. A change in the rate structure introduced May 31, 2015, which created FSS price categories, may have impacted the volume of mail in the affected categories. Total revenue for Periodicals declined 5.2 percent in FY 2016. The loss in revenue is due to volume losses as well as the decrease in prices due to the expiration of the exigent surcharge.

Table III-19
Periodicals Volume and Revenue

	Mail Volume				Mail Revenue			
	(Millions)		Increase or	Percent	($ in Millions)		Increase or	Percent
	FY 2016	FY 2015	Decrease	Change	FY 2016	FY 2015	Decrease	Change
In-County	534	571	(37)	-6.4%	62	67	(5)	-7.6%
Outside County	5,052	5,267	(215)	-4.1%	1,445	1,522	(77)	-5.1%
Total	5,586	5,838	(252)	-4.3%	1,507	1,589	(83)	-5.2%

Negative amount is denoted by ().

Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1.

Table III-20 compares Periodicals total attributable cost and average unit attributable cost for FY 2015 and FY 2016. As shown in the table, total Periodicals attributable cost declined by $64 million, representing a 3.0 percent decrease in attributable cost. The majority of the reduction occurred in Outside County, but In-County cost decreased slightly as well. The average unit attributable cost for In-County and Outside County grew 4.9 percent and 1.0 percent, respectively.

Table III-20
Periodicals Attributable and Average Unit Attributable Cost

	Attributable Cost				Unit Attributable Cost			
	($ in Millions)		Increase or	Percent	(Cents per Piece)		Increase or	Percent
	FY 2016	FY 2015	Decrease	Change	FY 2016	FY 2015	Decrease	Change
In-County	87	89	(2)	-1.8%	16.3	15.5	0.8	4.9%
Outside County	1,950	2,012	(62)	-3.1%	38.6	38.2	0.4	1.0%
Total	2,037	2,101	(64)	-3.0%	36.5	36.0	0.5	1.3%

Negative amount is denoted by ().

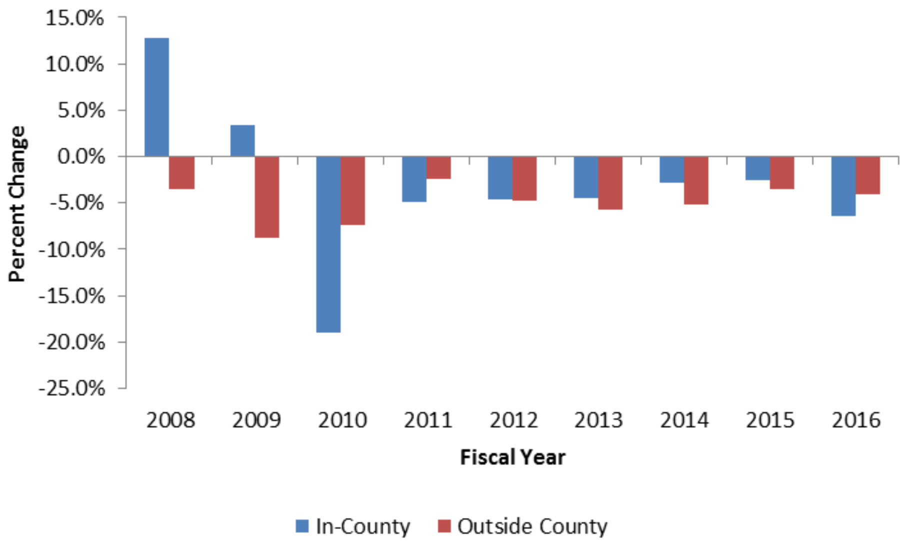
Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1.

TRENDS IN PERIODICALS

As shown in Figure III-16, the volume of Periodicals has continued to decline in large part due to the availability of electronic alternatives. Additionally, advertising migrated from Periodicals to less costly electronic media, further depressing volume.[46]

[46] Postal Service FY 2016 Form 10-K at 8.

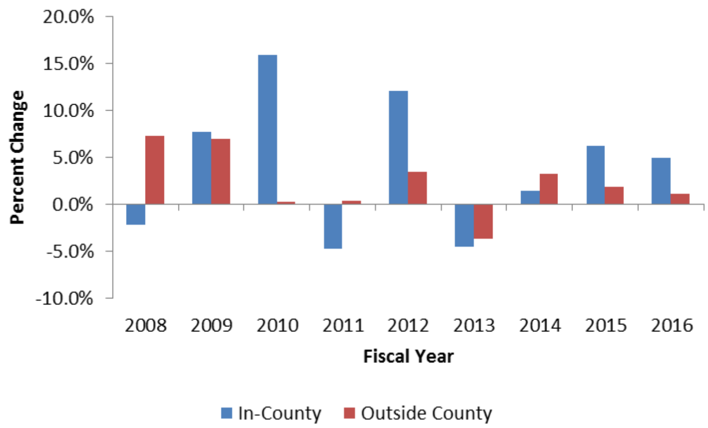
Figure III-16
Periodicals Percent Change in Volume
FY 2008 - FY 2016



Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1; Docket No. ACR2014, Library Reference PRC-LR-ACR2014/1; FY 2007- FY 2013 ACD; Library Reference PRC-LR-1.

The percentage change in the average unit attributable cost for In-County and Outside County Periodicals is shown in Figure III-17. Both In-County and Outside County average unit attributable cost increased each of the past 3 years. The FY 2016 unit attributable cost increases were smaller than the increases in FY 2015. The average unit attributable cost for Outside County has increased each year since FY 2008 except for FY 2013. The unit attributable cost of In-County Periodicals has been more erratic from FY 2008 to FY 2016.

Figure III-17
Periodicals Percent Change in Average Unit Attributable Cost, FY 2008 - FY 2016



Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1; Docket No. ACR2014, Library Reference PRC-LR-ACR2014/1; FY 2007- FY 2013 ACD; Library Reference PRC-LR-1.

Table III-21 disaggregates the average unit attributable cost for Outside County Periodicals for FY 2014 to FY 2016. As shown in the table, the unit cost for city carriers increased significantly in FY 2016. Although the increase is less severe than in FY 2015, the FY 2015 increase was mostly due to a change in the cost methodology for city carrier street time. In FY 2016, transportation cost, primarily in highway transportation, also increased for the second year in a row for Outside County Periodicals. Changes in transportation schemes due to the second phase of the Network Realignment program may be part of the cause for the increase, as most of the increased cost are in Inter-sectional center facility (SCF) and Inter-network distribution center (NDC) highway transportation costs.[47]

[47] Inter-SCF and Inter-NDC highway transportation reflects the costs of transporting mail between plants. In its Advisory Opinion on Mail Processing Network Rationalization Service Changes, the Commission noted that there may be a tradeoff between mail processing and transportation costs resulting from the second phase of Network Realignment. In particular, the Commission noted the potential need for new trips and changes in the frequency of trips between the remaining plants. See Docket No. N2012-1, Advisory Opinion on Mail Processing Network Rationalization Service Changes, September 28, 2012, at 111-116.

Table III-21
Outside County Periodicals Average Unit Attributable Cost by Segment, FY 2014 - FY 2016

	Average Unit Attributable			Change in Average	
Cost Segment	**2014**	**2015**	**2016**	**2015**	**2016**
Mail Processing	19.78	18.89	19.09	-4.5%	1.1%
City Carrier In-Office	6.18	6.30	6.14	1.8%	-2.5%
City Carrrier Street	3.01	3.78	4.08	25.6%	8.1%
Rural Carriers	3.34	3.35	3.36	0.2%	0.5%
Transportation	3.46	4.31	4.65	24.6%	7.9%
All Other	1.10	1.43	3.00	30.2%	109.4%

Source: The Postal Regulatory Commission derived from Postal Service Cost Segment and Components Reports, FY 2014 to FY 2016

Package Services

The Package Services class consists of four products: Alaska Bypass Service; Bound Printed Matter (BPM) Flats; Bound Printed Matter (BPM) Parcels; and Media Mail/Library Mail.

Table III-22 summarizes the FY 2016 changes in volume and revenue for Package Services. Overall, Package Services volume increased in FY 2016. With the exception of Alaska Bypass Service, volumes of Package Service products were higher compared with FY 2015. The volume of Alaska Bypass Service remained unchanged.

Of the four Package Service products, only BPM Parcels volume resulted in increased revenue. However, that increase in revenue was not enough to offset the loss of revenue from the remaining Parcel Post products. Media Mail/Library Mail experienced the largest decrease in revenue at $8 million.

Table III-22
Package Services Volume and Revenue

	Mail Volume				Mail Revenue			
	(Millions)		Increase or	Percent	($ in Millions)		Increase or	Percent
	FY 2016	FY 2015	Decrease	Change	FY 2016	FY 2015	Decrease	Change
Alaska Bypass	1	1	(0)	0.0%	34	34	(0)	-0.7%
Bound Printed Matter Flats	265	260	4	1.7%	210	213	(3)	-1.6%
Bound Printed Matter Parcels	250	228	22	9.7%	290	284	5	1.9%
Media Mail/Library Mail	75	75	0	0.1%	267	274	(8)	-2.9%
Total	591	565	27	4.7%	799	806	(6)	-0.8%

Negative amount is denoted by ().

Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1.

As shown in Table III-23, attributable cost for Package Services grew 1.7 percent, or $13 million, in FY 2016. The largest increase was for Media Mail/Library Mail despite a decrease in volume. Alaska Bypass Service cost, which consists entirely of Cost Segment 14 transportation, also increased significantly. This cost is determined by a new methodology instituted in FY 2014, which uses operational data from the Postal Service's Surface Air Management System – Alaska and the Transportation Cost System to calculate the ratio of hypothetical highway cost to air cost for Alaska Air transportation.[48] This ratio varies from year to year and increased in FY 2015. The large increase in Media/Library Mail was due to higher mail processing and transportation costs.

Table III-23
Package Services Attributable Costs and Average Unit Attributable Cost

	Attributable Cost				Unit Attributable Cost			
	($ in Millions)		Increase or	%	(Cents per Piece)		Increase or	%
	FY 2016	FY 2015	Decrease	Change	FY 2016	FY 2015	Decrease	Change
Alaska Bypass	20	19	1	3.0%	1,537.7	1,493.5	44.2	3.0%
Bound Printed Matter Flats	131	151	(21)	-13.6%	49.3	58.0	(8.7)	-15.0%
Bound Printed Matter Parcels	277	239	38	16.0%	110.8	104.8	6.0	5.7%
Media/Library Mail	354	359	(5)	-1.3%	472.5	479.5	(7.0)	-1.5%
Total	781	768	13	1.7%	132.2	136.0	(3.9)	-2.8%

Negative amount is denoted by ().

Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1.

Table III-24 shows the FY 2016 percent change in unit costs for selected cost segments. As shown in the table, BPM Flats' unit costs increased for delivery activities, while the unit costs for all other segments declined. In total, unit costs for BPM flats declined by 15 percent. The unit cost for BPM Parcels increased by 14 percent in FY 2016. Mail processing unit cost increased by 30.6 percent, offsetting the decreases achieved in the previous 2 years. The unit cost for vehicle service drivers and rural carriers also increased by nearly 20 percent. For Media Mail/Library Mail, overall unit cost decreased slightly in FY 2016, despite large increases to city carrier in-office and vehicle service drivers' unit costs, 49 percent and 36 percent, respectively.

[48] FY 2014 Postal Regulatory Commission *Financial Report* at 57; *see also* Docket No. RM2013-6, Order No. 1983, Order on Analytical Principles Used in Periodic Reporting (Proposals One Through Five), February 4, 2014, at 4-6.

Table III-24
Package Services Percent Change in Unit Attributable Cost by Segment and Component

	BPM Flats	BPM Parcels	Media Mail/ Library Mail
Mail Processing	-7.1%	30.6%	-2.4%
City Carrier In-Office	-33.1%	7.9%	49.2%
City Carrier Street	11.6%	-5.6%	-10.0%
Vehicle Service Driv.	-39.6%	16.6%	35.6%
Rural Carriers	19.4%	18.7%	-2.6%
Motor Vehicle Service	-21.4%	-4.1%	1.7%
Transportation	-39.7%	-2.8%	-2.8%
All Other	-9.0%	13.5%	-2.0%
Total Cost	-15.0%	14.0%	-1.5%

Source: The Postal Regulatory Commission derived from Library Reference USPS-FY16-31; Docket No. ACR2015, Library Reference USPS-FY15-31.

Market Dominant Special Services

The Special Services class consists of 11 products- 8 domestic and 3 international. Ancillary Services and International Ancillary, within the Special Service class, include a number of distinctive included services. As shown in Table III-25, total revenue for Special Services declined $89 million in FY 2016. Most of the decrease can be attributed to three Special Service products: Insurance, Other Ancillary Services[49] and Post Office Box.

[49] Other Ancillary Services consists of USPS Tracking, Return Receipts, Restricted Delivery, Signature Confirmation, Bulk Parcel Return Service, and Special Handling.

Table III-25

Market Dominant Ancillary Services and Special Services Revenue

	Revenue ($ in Millions) FY 2016	FY 2015	Increase or Decrease	Percent Change
Certified Mail	670	659	11	1.7%
COD	2	3	(1)	-34.9%
Insurance	77	89	(12)	-13.7%
Registered Mail	32	38	(6)	-16.5%
Stamped Envelopes & Cards	10	12	(3)	-22.2%
Other Ancillary Services	447	493	(45)	-9.2%
Money Orders	157	161	(4)	-2.4%
Post Office Box	284	311	(27)	-8.7%
Other Services	175	177	(2)	-1.2%
Total Services	1,854	1,943	(89)	-4.6%

Negative amount is denoted by ( ).
Source: Library Reference PRC-LR-ACR2016/1; Library Reference PRC-LR-ACR2015/1.

Table III-26 shows that attributable cost for Special Services increased $42 million in FY 2016, subsequent to a $148 million decline in FY 2015. The increase in attributable cost is primarily due to an increase in attributable cost for the Certified Mail product and the Other Services product, $36 million and $24 million, respectively.

Table III-26

Market Dominant Ancillary and Special Services Attributable Cost

	Attributable Cost ($ in Millions) FY 2016	FY 2015	Increase or Decrease	Percent Change
Certified Mail	521	485	36	7.4%
COD	5	3	2	63.3%
Insurance	43	50	(7)	-14.8%
Registered Mail	16	27	(11)	-40.1%
Stamped Envelopes & Cards	10	8	2	20.0%
Other Ancillary Services	207	222	(16)	-7.0%
Money Orders	117	105	12	11.0%
Post Office Box	230	228	1	0.5%
Other Services	77	54	24	43.9%
Total Services	1,225	1,184	42	3.5%

Negative amount is denoted by ( ).
Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1.

Competitive Volume, Revenue, and Cost by Product

Competitive products include both domestic and international products. Domestic Competitive products include: Priority Mail Express, Priority Mail, Parcel Select, Parcel Return Service, First-Class Package Service, Retail Ground, Address Enhancement Services, Greeting Cards, Gift Cards and Stationery; Competitive Ancillary Services, Premium Forwarding Service, Post Office Box Service, and Shipping and Mailing Supplies. There were also a total of 146 Domestic Competitive NSA products in effect during FY 2016.

International Competitive products include: Outbound International Expedited Services, Outbound Priority Mail International, Inbound Air Parcel Post (at UPU rates), Outbound Single-Piece First-Class Package International Service, International Surface Air Lift, International Priority Airmail, International Direct Sacks – M-Bags, International Money Transfer Service – Outbound, International Money Transfer Service – Inbound, and International Ancillary Services. In FY 2016, there were also 427 International Outbound NSAs and 20 International Inbound NSAs.

To facilitate comparison, the products have been grouped into several broad categories. Table III-27 summarizes the FY 2016 changes in volume and revenue for Competitive products and services. Total volume for Competitive products increased almost 13.7 percent in FY 2016 as every category except Priority Mail Express and Competitive International Mail experienced volume growth. The products with the two largest increases in volume were First-Class Package Service, which increased 9.6 percent, and ground parcels,[50] which increased 24.8 percent.

Total Competitive product revenue increased 12.6 percent, or $2.1 billion, in FY 2016. Every Competitive category, except International, had increased revenue, with ground parcels, Priority Mail, and First-Class Package Service providing the bulk of the increase. Increased volume was the primary reason for the significant increase in revenue.

[50] Ground parcels include Standard Post, Parcel Select, and Parcel Return Service.

Table III-27
Competitive Products Volume and Revenue

	Mail Volume (Millions)				Mail Revenue ($ in Millions)			
	FY 2016	FY 2015	Increase or Decrease	Percent Change	2016	FY 2015	Increase or Decrease	Percent Change
Priority Mail Express	33	36	(3)	-7.5%	809	779	30	3.9%
First-Class Package Service	776	708	68	9.6%	2,076	1,689	387	22.9%
Priority Mail	1,004	992	12	1.2%	7,785	7,276	509	7.0%
Ground Parcels	2,457	1,969	489	24.8%	5,192	3,925	1,266	32.3%
International	228	254	(25)	-10.0%	1,792	1,970	(178)	-9.0%
Domestic Services					833	789	44	5.6%
Total Competitive	4,499	3,959	540	13.7%	18,496	16,428	2,068	12.6%

Negative amount is denoted by ( ).
Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1.

Table III-28 summarizes the FY 2016 changes in attributable cost. Total attributable cost for Competitive products increased 4.9 percent, or $586 million, in FY 2016. The rapidly increasing volume resulted in higher total cost for almost every cost segment and component. The largest increases in attributable costs were in Priority Mail, ground parcels, and First-Class Package Service. The average unit attributable cost increased for every category except for ground parcels and International. The average unit attributable cost for ground parcels declined for the second consecutive year, though by a much smaller margin. Ground parcels average unit attributable cost declined in FY 2015 and FY 2016. However, the decrease was significantly larger in FY 2015 than in FY 2016, 10 percent and 1 percent, respectively.

Table III-28
Competitive Attributable Costs

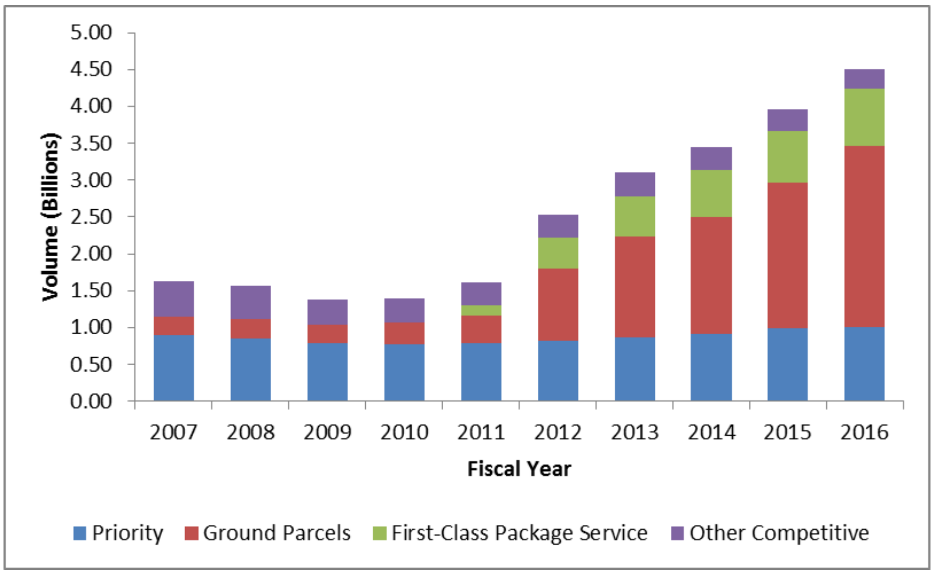
	Attributable Cost ($ in Millions)				Unit Attributable Cost (Cents per Piece)			
	FY 2016	FY 2015	Increase or Decrease	% Change	FY 2016	FY 2015	Increase or Decrease	% Change
Priority Mail Express	357	364	(7.7)	-2.1%	1,079.6	1,023.7	55.9	5.5%
First-Class Package Service	1,469	1,369	99.8	7.3%	189.2	163.0	26.2	16.1%
Priority Mail	6,128	5,766	362.0	6.3%	610.2	527.6	82.6	15.7%
Ground Parcels	3,055	2,783	272.6	9.8%	124.3	125.6	(1.2)	-1.0%
International	1,049	1,195	(145.5)	-12.2%	459.2	543.9	(84.6)	-15.6%
Domestic Services	426	428	(2.7)	-0.6%				
Total Competitive	12,490	11,905	585.8	4.9%	277.6	277.0	0.6	0.2%

Negative amount is denoted by ( ).
Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1.

Trends in Competitive Products

Competitive product volume growth has exceeded 10 percent each year since the FY 2012 transfer of several Market Dominant products to the Competitive product list. The growth in purchases of retail e-commerce has been the primary driver of volume increases for these products.[51] The Postal Service's marketing of Competitive products, especially Priority Mail, has also contributed to this growth. Figure III-18 highlights the growth in Competitive categories since FY 2007.

Figure III-18
Competitive Volume by Product, FY 2007 - FY 2016



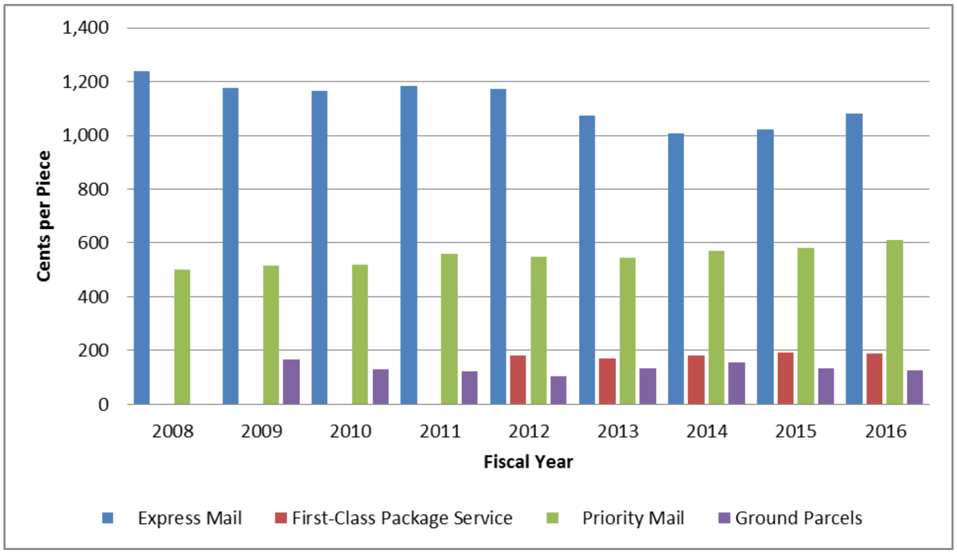
Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1; Docket No. ACR2014, Library Reference PRC-LR-ACR2014/1; FY 2007- FY 2013 ACD; Library Reference PRC-LR-1.

As the volume of Competitive products has grown, so has the attributable cost, which now comprises 30 percent of total attributable cost. This is double the percentage of total Competitive attributable cost in FY 2008. However, comparing total attributable cost overtime is somewhat problematic due to changes in mail-mix resulting from mail classification changes that transferred products from the Market Dominant to the Competitive product list. These include the transfer of Commercial First-Class Mail Parcels to a new Lightweight Commercial Parcels category,[52] Standard Mail lightweight parcels to the Competitive ground parcels category, and the transfer of Single-Piece Parcel Post from

[51] Postal Service FY 2016 Form 10-K at 17.
[52] The Postal Service renamed the "Lightweight Commercial Parcels" category to "Commercial First-Class Package Service." See Docket No. MC2011-29, Order Approving Proposed Classification Change, October 11, 2011 (Order No. 903) at 2.

Market Dominant products to the Competitive Standard Post product. Figure III-19 shows the average unit attributable cost by category from FY 2008 to FY 2016.

Figure III-19
Competitive Unit Attributable Cost by Category, FY 2008 - FY 2016

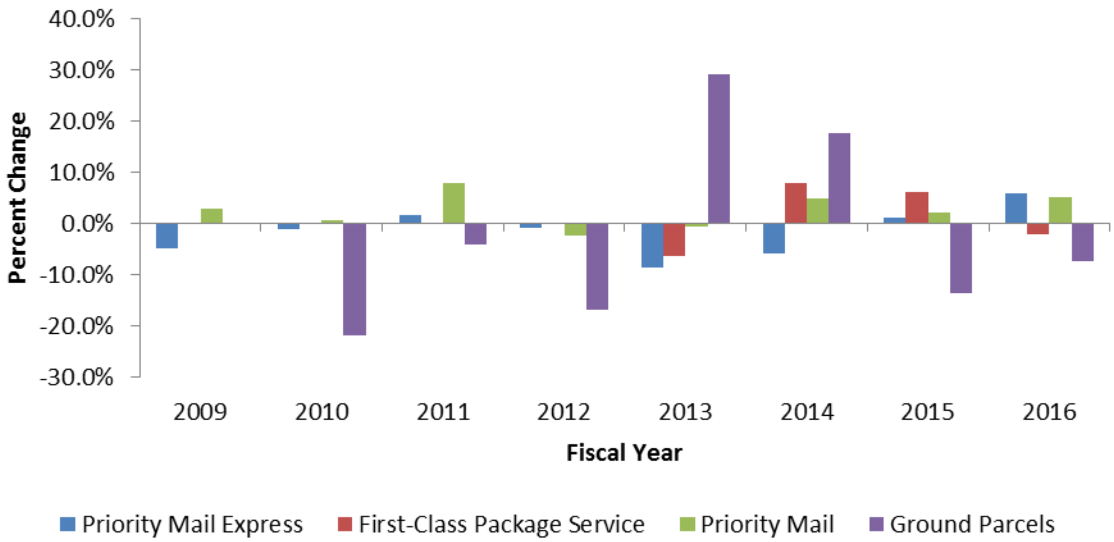


Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1; Docket No. ACR2014, Library Reference PRC-LR-ACR2014/1; FY 2008 - FY 2013 ACD; Library Reference PRC-LR-1.

The unit attributable cost of the First-Class Package Service and ground parcel categories decreased compared with FY 2015, with ground parcels showing the largest decline. Priority Mail Express and Priority Mail unit attributable cost increased in FY 2015, largely driven by significant increases in highway and, in particular, air transportation costs.

Figure III-20 shows the percent change in unit attributable cost by category from FY 2009 to FY 2016. It shows that while the unit attributable cost of Priority Mail Express and Priority Mail increased compared with FY 2015, the percent increase in unit attributable cost was less than in FY 2015.

Figure III-20
Competitive Percent Change in Unit Attributable Cost by Category
FY 2009 - FY 2016



Source: Library Reference PRC-LR-ACR2016/1; Docket No. ACR2015, Library Reference PRC-LR-ACR2015/1; Docket No. ACR2014, Library Reference PRC-LR-ACR2014/1; FY 2009- FY 2013 ACD; Library Reference PRC-LR-1.

Chapter 4. Sustainability, Liquidity, Activity, and Financial Solvency

Introduction

This chapter analyzes the Postal Service's financial status in terms of sustainability, liquidity, and performance using financial ratios. This type of analysis can function as a strategic management tool that provides a concise and systematic way to organize financial data (e.g., Balance Sheets, Income Statements, and Statements of Cash Flows) into meaningful information. As with any approach to understanding the financial status of entities, evaluating multiple financial dimensions and indicators is preferable. The financial status of the Postal Service is affected by a combination of environmental, economic, and organizational factors, including the decisions and actions of management and the Postal Service Board of Governors.[53]

The Commission acknowledges that financial analyses used in the private sector are not exactly the same for Federal Government entities because revenue streams, equity structures, and management incentives differ. Due to these and other ways Federal Government entities differ from the private sector, the standard measurements used to assess the financial health of private sector firms generally are not directly applicable to Federal Government entities. Additionally, in the private sector, stakeholders use financial analysis to make investment and credit decisions, and success is often measured by the company's stock valuation. In contrast Federal Government entities are mission-oriented and measure success through the provision of service and do not have direct shareholders. Another useful part of a financial analysis for a Federal Government entity is financial performance. Although not a primary indicator of success, financial performance influences the ability of service-related entities, such as the Postal Service, to fulfill their missions and objectives.

The objectives of this chapter are to:

- Compare and analyze the financial statements over a period of time[54]
- Measure the sustainability and liquidity of the Postal Service

[53] For example, the Market Dominant exigent surcharge expired after the Postal Service had collected all of the allowable $4.6 billion. This resulted in a decline in revenue in FY 2016. The Postal Service management's response to this decline in revenue will affect the financial condition of the Postal Service as will any constraints on management flexibility.

[54] Financial statements are analyzed from FY 2006, the fiscal year prior to the enactment of the Postal Accountability and Enhancement Act (PAEA), through FY 2016, the most recent audited fiscal year.

- Analyze the annual growth rate and growth patterns of the Postal Service's income and assets over time through trend analyses
- Analyze the Postal Service's overall financial performance

Financial ratios are used to interpret accounting information. The historic accounting information used in ratio analysis is not adjusted for inflation. Forecasts of an entity's future revenue may not reflect its actual future revenue and cash flows because of changing demographics, industry dynamics, and government regulation unless these factors are explicitly accounted for in the development of the forecast.

The Major Mailers Association, National Association of Presort Mailers, and National Postal Policy Council jointly filed initial comments implying that using financial ratios to interpret the Postal Service's accounting information inappropriately analyzes the financial condition of the Postal Service as if it were a publicly-traded, for-profit, private corporation.[55] The Commission recognizes that the Postal Service is a Federal Government entity operating as an independent establishment in the Executive Branch. However, the ratios provide an objective, quantitative measure of an entity's financial health and its ability to satisfy its financial obligations. Ratio analysis helps assess profitability and informs stakeholders of an entity's performance based on its current earnings. For example, computing a solvency ratio, such as debt ratio, reveals the correlation between assets and liabilities. Both the ability to meet its short-term financial obligation (liquidity) and the ability to meet long-term financial obligations (solvency) are critical in evaluating the Postal Service's current financial situation.

Comparing ratios for the current fiscal year to previous years and historic averages also provides valuable insight when analyzing past performance and can help identify weaknesses and highlight improvements.

The Postal Service's defaults on payments to the RHBF have skewed the results of the financial ratio analysis presented in this chapter. To provide clarity, ratios affected by the defaults are computed both with and without the inclusion of the cumulative defaulted payment.

The PAEA mandated fixed annual RHBF prefunding payments from FY 2007 through FY 2016. As of FY 2016, the Postal Service has defaulted on $33.9 billion in RHBF prefunding payments as shown in Table IV-1.

[55] Comments of the Major Mailers Association, National Association of Presort Mailers, and the National Postal Policy Council, PRC Docket No. ACR2016 (Feb. 2, 2017), at 17-18.

Table IV-1
RHBF Funding Status, FY 2007 - FY 2016

Fiscal Year	Beginning of Year Assets	Transfer from CSRS Pension Fund	One-Time Transfer from USPS Escrow	USPS Prefunding Payment	Interest Earned	End of Year Assets	End of Year Actuarial Liabilities	End of Year Net Funded Status (Unfunded)	Missed USPS Prefunding Payments
2007	$ 0.0	$ 17.1	$ 3.0	$ 5.4	$ 0.3	$ 25.7	$ 80.8	$ (55.0)	$ 0.0
2008	25.7			5.6	1.3	32.6	86.1	(53.5)	0.0
2009	32.6			1.4	1.5	35.5	87.5	(52.0)	0.0
2010	35.5			5.5	1.5	42.5	91.1	(48.6)	0.0
2011	42.5			0.0	1.6	44.1	90.3	(46.2)	0.0
2012	44.1			0.0	1.6	45.7	93.6	(47.9)	11.1
2013	45.7			0.0	1.6	47.3	95.6	(48.3)	5.6
2014	47.3			0.0	1.5	48.9	97.7	(48.8)	5.7
2015	48.9			0.0	1.5	50.3	105.2	(54.8)	5.7
2016	50.3			0.0	1.5	51.8	103.9	(52.1)	5.8
Subtotal				17.9	13.9				33.9

Source: Postal Service FY 2007 to FY 2016 Forms 10-K; 5 U.S.C. §8909a.

As of FY 2016, the defaulted RHBF payments[56] constitute 62 percent of the Postal Service's overall current liabilities and 356 percent of its current assets. This large amount of defaulted RHBF payments as a percentage of current assets skews the results of ratios computed with these payments included as current liabilities.

No later than June 30, 2017, OPM is required to calculate the Postal Service's total retiree health benefits obligation and set the annual payment amounts required to liquidate the unfunded portion by FY 2056.[57] The Postal Service will be required to pay the annual amortized portion set by OPM to liquidate the unfunded retiree health benefits obligation set by OPM and the normal costs for its current employees. The employer share of retiree health benefit premiums will be paid out of the RHBF. Assuming all payments are timely, Table IV-2 provides the impact on the balance in the RHBF solely from the cash outflows and inflows estimated by OPM for the next 5 years. These estimated payments are subject to change by OPM after its periodic re-evaluation of the retiree health benefit liability and related fluid factors. For example, the increase in the postal career work force is likely to increase the retiree health benefit liability and subsequently the estimated payments of normal costs and amortization. The fund balance shown below does not include changes due to discount rates, actuarial gains or losses, or interest on assets.

[56] The defaulted RHBF payments for FY 2012 through FY 2016 are classified as short term obligations payable within 1 year. "Office of Personnel Management (OPM) may establish a payment schedule by June 30, 2017, under which the Postal Service would be obligated to pay down this liability, including a progress payment due in 2017." Postal Service FY 2017 Quarter 1 Form 10-Q at 12.

[57] *See* 5 U.S.C. § 8909(a).

Table IV-2
Estimated RHBF Funding Status Excluding Interest and Actuarial (Gains) Losses
FY 2017 - FY 2021

Fiscal Year	Beginning of Year Assets	RHB Normal Cost	Amortization of RHB Unfunded Liability	Estimated Payments into PSRHBF	Retiree Premiums out of PSRHBF	End of Year Assets
2017	$ 51.9	$ 2.9	$ 2.9	$ 5.8	$ 3.9	$ 53.8
2018	53.8	3.1	2.9	6.0	4.1	55.7
2019	55.7	3.3	2.9	6.2	4.4	57.5
2020	57.5	3.5	2.9	6.4	4.6	59.3
2021	59.3	3.6	2.9	6.5	4.9	60.9

Source: Postal Service FY 2016 Form 10-K at 27 and 28.

To provide clarity, ratios affected by the defaulted RHBF payments are computed in this report both with and without the cumulative defaulted RHBF payments.

Financial Sustainability Analysis

This section focuses on three key financial ratios which analyze the Postal Service's overall financial health: debt ratio, fixed asset to net worth ratio, and current liability ratio.

Table IV-3 shows the three sustainability ratios calculated using the reported amounts on the Postal Service's Balance Sheets, and compares them to the previous year's value and the historical 10-year average (FY 2006–FY 2015).

Table IV-3
Sustainability Ratio Analysis of Postal Service Financial Statements

Ratios	9/30/2016 Value	9/30/2015 Value	Change	Description of Ratio	Postal Service Historic 10 Year Average Value
Debt Ratio (debt to assets ratio)	3.22	3.10	0.12	This ratio is calculated by dividing total liabilities (i.e. long-term and short-term liabilities) by total assets. It shows how much the company relies on debt to finance assets.	1.88
Fixed Assets to Net Worth Ratio	(0.27)	(0.31)	0.04	This ratio indicates the extent to which the entity's cash is frozen in the form of fixed assets, such as property, plant, and equipment.	0.21
Current Liability Ratio	0.67	0.66	0.02	This ratio is calculated by dividing current liabilities by total (i.e., current and noncurrent) liabilities.	0.55

Negative amount is denoted by ().
Numbers may not add across due to rounding.
Source: Ratios computed from amounts reported on Postal Service FY 2016 Form 10-K at 40.

Table IV-4 shows two of the sustainability ratios calculated in the same manner as Table IV-3 after excluding missed payments to the RHBF. Table IV-4 isolates the impact of the accrual of missed payments to the RHBF on the Postal Service liabilities. The fixed assets to net worth ratio has not been included as this ratio is not affected by the accrual related to the RHBF.

Table IV-4
Sustainability Ratio Analysis of Postal Service Financial Statements Excluding Defaulted RHBF Payments

Ratios	9/30/2016 Value	9/30/2015 Value	Change	Description of Ratio	Postal Service Historic 10 Year Average Value
Debt Ratio (debt to assets ratio)	1.88	1.93	(0.05)	This ratio is calculated by dividing total liabilities (i.e., long-term and short-term liabilities) by total assets. It shows how much the company relies on debt to finance assets.	1.54
Current Liability Ratio	0.44	0.45	(0.01)	This ratio is calculated by dividing current liabilities by total (i.e., current and noncurrent) liabilities.	0.48

Negative amount is denoted by ().
Numbers may not add across due to rounding.
Source: Ratios computed from amounts reported on Postal Service FY 2016 Form 10-K at 40.

Debt Ratio

Debt ratio is the amount of debt the entity has on its Balance Sheets in comparison to its assets and is one of the primary ratios used to assess financial stability. The higher the ratio, the greater the risk that the entity's debt level may impede its ability to effectively respond to challenges and opportunities. A low debt ratio indicates assets are available to secure future financing to grow operations with little or no financial risk.

As it pertains to the Postal Service, debt ratio provides information about its ability to absorb reductions in asset value that may arise from the sale, disposition, or depreciation of assets. The ratio generally indicates the relationship between two main sources of capital: equity and borrowed capital. It generally calculates the relationship between liabilities and the overall capital (*i.e.*, the sum of equity and liabilities).

At the end of FY 2016, the debt ratio for the Postal Service rose to 3.22, which is higher than the 3.10 debt ratio for FY 2015. The Postal Service's FY 2016 debt ratio of 3.22 was almost twice as high as the average 10-year debt ratio of 1.88. The ratio indicates that the Postal Service does not possess sufficient capital. This is viewed in light of the fact that the Postal Service has already maximized its statutory borrowing capacity.

If the effects of the accruing nonpayment of the RHBF and the long-term workers' compensation obligations are removed from the analysis, the Postal Service's debt ratio appears lower. This can be seen by the comparatively lower debt ratio of 1.88 when the missed payments into the RHBF are excluded. *See* Table IV-4. This ratio is the same as the average 10-year ratio with the inclusion of RHBF further demonstrating the impact of the accrual of the missed payments in current liabilities for the last five fiscal years starting in FY 2012. The values of the debt ratio with and without the inclusion of the RHBF were similar through FY 2012. The debt ratio change, excluding the missed RHBF payments, was also decreased by 0.05 from the prior year. To reduce its debt ratio to historic averages, the Postal Service would have to increase its current cash position or investments in capital assets and reduce its obligations.

Fixed Asset to Net Worth Ratio

The fixed asset to net worth ratio analyzes fixed assets as a percentage of net worth to determine liquidity. Net worth is the residual amount representing the excess of an entity's assets over its liabilities. The Postal Service's fixed assets consist primarily of buildings and equipment which cannot be easily converted into cash. The Postal Service accumulated deficits in excess of its fixed assets, resulting in a negative fixed asset to net worth ratio. This signifies an inability to rapidly respond to financial emergencies or easily obtain cash for further investment and growth. As shown in Table IV-3, the ratio improved slightly over the prior year, but remained negative in FY 2016.

Current Liability Ratio

The current liability ratio is a useful measurement when reviewing an entity's debt structure as it indicates the amount of current debt required to be paid within 1 year. As of September 30, 2016, the Postal Service's short-term liabilities were 67.0 percent of total liabilities, an increase of 2.0 percent from the prior year. An increasing ratio value is generally a negative sign indicating growth in the proportion of total current liabilities compared to total liabilities.

The accrual of the unpaid statutory RHBF prefunding payments is included in current obligations and accounts for the vast majority of the increase in current liabilities. Current liabilities include the $33.9 billion in statutory prefunding accruals to the RHBF and $10.1 billion of the $15.0 billion in outstanding debt.

Financial Liquidity Analysis

Liquidity-related ratios are one of the most widespread indicators of an entity's solvency focusing on working capital.[58] There are three liquidity-related ratios: current ratio, quick ratio, and cash ratio which supplement the Income Statement and Statement of Cash Flows measuring the ability to pay short term obligations. The three ratios for the Postal Service are shown in Table IV-5.

[58] James Pratt, *Financial Accounting in an Economic Context, Eight Edition,* 246 part 3 (2011), states that "Dun & Bradstreet, a widely used service that rates the creditworthiness of a large number of U.S. businesses, includes both the current ratio and the quick ratio as solvency measures" and "Working capital, the current ratio and the quick ratio are also used by auditors. For example, an AICPA list of 'red flags' alerting auditors to possible management fraud includes 'inadequate working capital.'"

Table IV-5
Liquidity Ratio Analysis of Postal Service Financial Statements

Ratios	9/30/2016 Value	9/30/2015 Value	Change	Description of Ratio	Postal Service Historic 10 Year Average Value
Current Ratio	0.17	0.16	0.01	A current ratio is calculated by dividing current assets by current liabilities. It indicates an entity's ability to meet short term debt obligations.	0.16
Quick Ratio	0.17	0.16	0.01	This quick ratio is calculated by dividing liquid assets (cash, cash equivalents and short term investments, current receivables) by current liabilities. It is a measure of an entity's ability to meet its short term obligations using its most liquid assets (near cash or quick assets).	0.15
Cash Ratio	0.15	0.14	0.01	Cash ratio is calculated by dividing absolute liquid assets (cash, cash equivalents, and short-term investments) by current liabilities.	0.11

Numbers may not add across due to rounding.
Source: Ratios computed from amounts reported on Postal Service FY 2016 Form 10-K at 40.

Table IV-6 shows the three liquidity ratios in the same manner as Table IV-5, excluding missed payments to the RHBF. This isolates the impact of the accrual of missed payments to the RHBF on the Postal Service's liquidity.

Table IV-6
Liquidity Ratio Analysis of Postal Service Financial Statements Excluding Defaulted RHBF Payments

Ratios	9/30/2016 Value	9/30/2015 Value	Change	Description of Ratio	Postal Service Historic 10 Year Average Value
Current Ratio	0.46	0.38	0.08	This ratio is calculated by dividing current assets by current liabilities. It indicates an entity's ability to meet short term debt obligations.	0.21
Quick Ratio	0.45	0.37	0.08	This ratio is calculated by dividing liquid assets (cash, cash equivalents and short term investments, current receivables) by current liabilities. It is a measure of an entity's ability to meet its short term obligations using its most liquid assets (near cash or quick assets).	0.20
Cash Ratio	0.40	0.33	0.07	This ratio is calculated by dividing absolute liquid assets (cash, cash equivalents, and short-term investments) by current liabilities.	0.15

Numbers may not add across due to rounding.
Source: Ratios computed from amounts reported on Postal Service FY 2016 Form 10-K at 40.

Current Ratio

The current ratio indicates the degree to which current assets are meeting current liabilities. At the end of FY 2016, the current ratio was 0.17. That level is an improvement of 0.01 from the end of the prior fiscal year. This is a slight improvement over the 10-year historic average reflecting the yearly increase in the cash balance. Accrual of the current fiscal year's defaulted payment into the RHBF increased current liabilities by 11.0 percent. At the same time, the Postal Service's current assets increased by 20.0 percent, primarily due to the growth of cash and cash equivalents.

Excluding the missed payments into the RHBF will result in a higher current ratio of 0.46. *See* Table IV-6. This is an improvement of 0.08 over the prior fiscal year, but remained lower than the historic 10-year average of 0.21.

Quick Ratio

The quick ratio is an indication of the liquidity of the entity in the near future and reflects whether sufficient funds are available to meet short term obligations to creditors. At the close of FY 2016, the quick ratio equaled 0.17, an increase of 0.01 from FY 2015 and 0.02 above the 10-year historic average. This means that the Postal Service's cash and accounts receivables grew at a faster rate than its current liabilities.

Cash Ratio

The cash ratio measures the amount of cash, cash equivalents, or short term investments available to cover current liabilities. The cash ratio is calculated by dividing total liquid assets by current liabilities. The FY 2016 cash ratio had a value of 0.15, an improvement over FY 2015, but like the two previous ratios, the cash ratio indicates that the Postal Service does not have enough cash and/or cash equivalents (the most liquid assets) to meet all current liabilities.

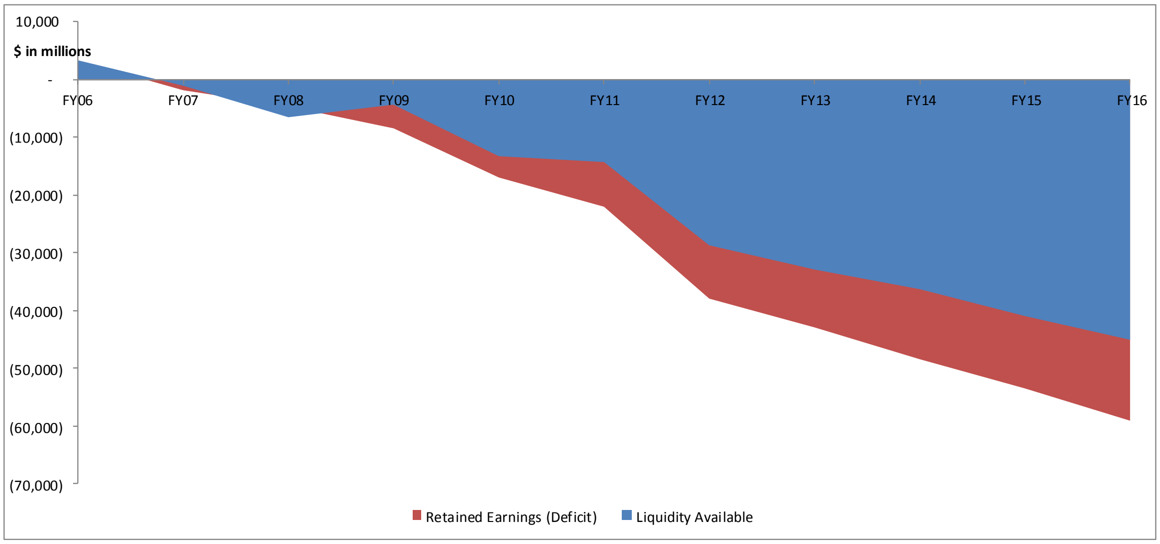
The improved liquidity-related ratios were largely a result of the increased amount of cash on hand held by the Postal Service. Although there is improvement in the Postal Service liquidity ratios, its working capital has deteriorated.

WORKING CAPITAL ANALYSIS

The Postal Service's FY 2016 working capital was negative $45.1 billion. Working capital is the amount by which the value of current assets exceeds current liabilities and is a liquid financial cushion available for emergencies and other unplanned needs. The Postal Service had no working capital at the end of FY 2016. The net deterioration of $4.1 billion in working capital from the prior fiscal year was largely due to the growth in employee-related liabilities, including the statutory accruals for payments into the RHBF. Working capital, excluding the missed payments into the RHBF, was negative $11.2 billion. This represents a deterioration of $1.59 billion over the prior fiscal year.

Figure IV-1 highlights the increasing deficit in retained earnings that began in FY 2007. Available liquidity is calculated as a combination of working capital and remaining borrowing capacity.

Figure IV-1
Postal Service Liquidity and Retained Deficit Trends



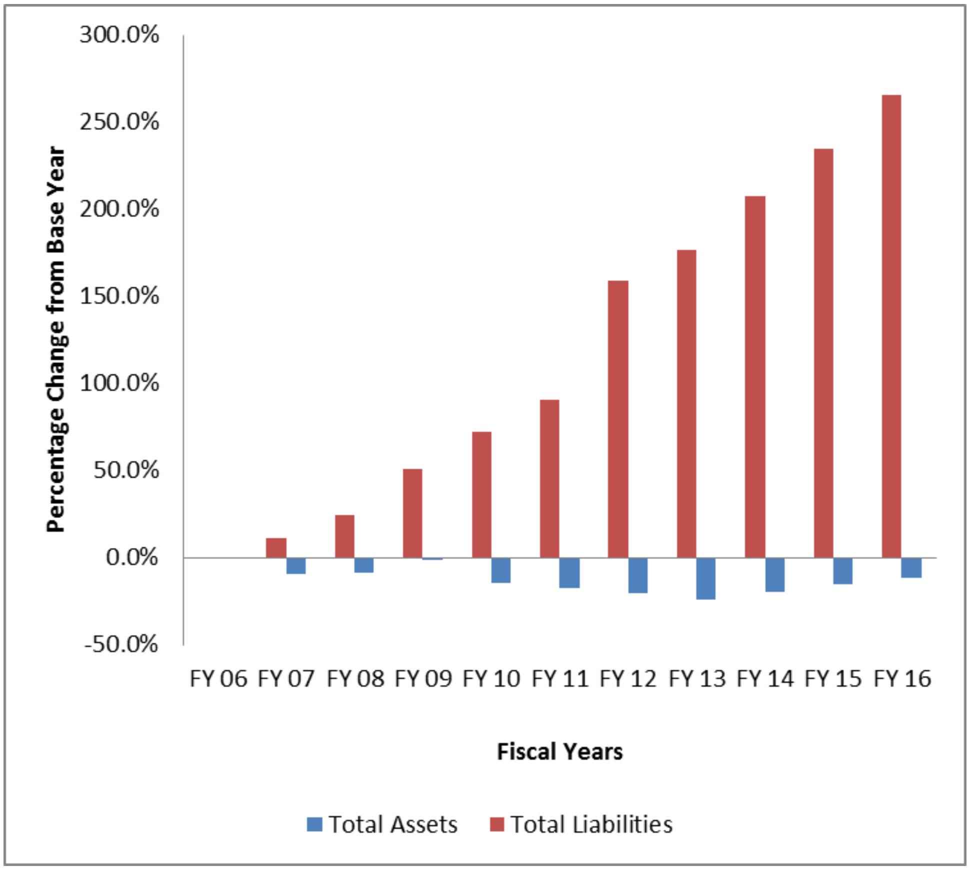
Source: Postal Service Form 10-K and USPS Annual Report, FY 2006-FY2016

Financial Activity Analysis

Trend Analysis

Trend analysis compares the Postal Service's financial statements over a number of years to evaluate its performance and the changes over a period of time from a base year. FY 2006 is used as the base year, as it is the first year within the past 10-year period in which the Postal Service reported a net operating income. Figure IV-2 shows the trends for assets and liabilities since the base year. For each fiscal year, the total change from the base year is expressed as a percentage.

Figure IV-2
Change in Assets and Liabilities Since FY 2006

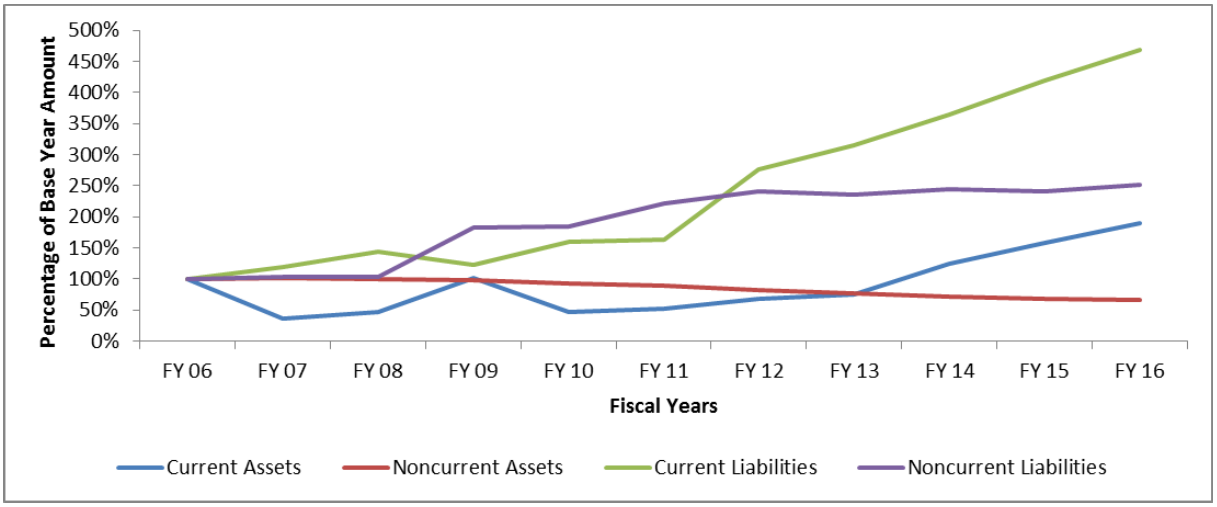


Source: Postal Service FY 2006 to FY 2016 Forms 10-K and USPS Annual Reports

The Postal Service's assets began declining in FY 2007 and continued to decline through FY 2013, with a slight improvement in FY 2009 and the last three fiscal years. Conversely, liabilities have risen steadily since the base year FY 2006. The Postal Service's liabilities in FY 2016 more than doubled since the base year. Current assets (primarily cash and cash equivalents) increased from the base year as the safety net of available borrowing was depleted. After taking depreciation into account, FY 2016 net property, plant, and equipment values decreased 33.8 percent from the base year. This is primarily due to a lack of capital investments and because fully depreciated assets have not been replaced.

Figure IV-3 shows that current and noncurrent liabilities trended upwards from the base year, largely due to increasing balances in employee-related liabilities such as mandatory RHBF payments and future workers' compensation obligations. Current assets, comprised primarily of cash and cash equivalents, increased insignificantly when compared to the trend in current liabilities. Noncurrent assets, consisting largely of property and equipment, held relatively flat with a slight downward trend reflecting limited capital spending and depreciating fixed assets.

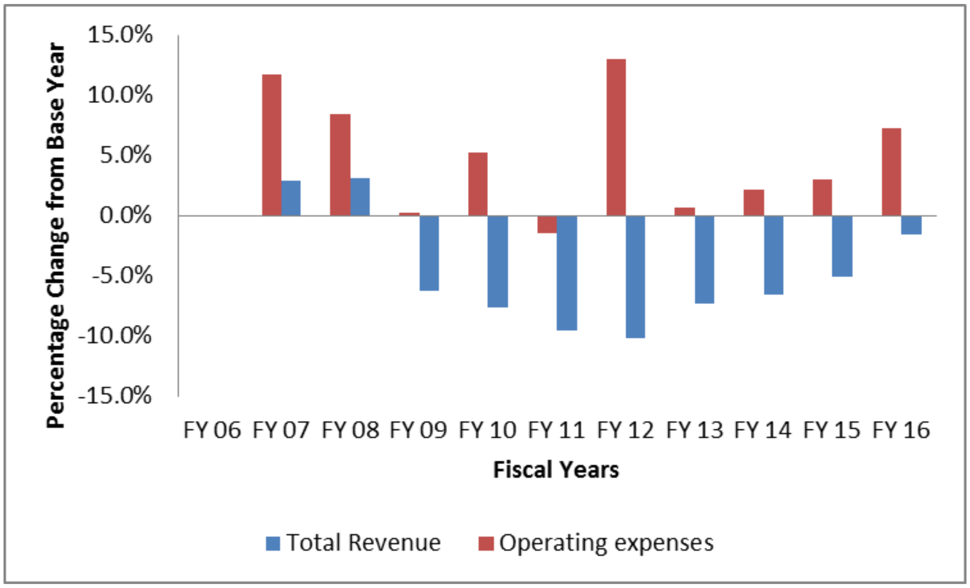
Figure IV-3
Trends in Assets and Liabilities Since FY 2006



Source: Postal Service FY 2006 to FY 2016 Forms 10-K and USPS Annual Reports

Figure IV-4 shows the trends for revenue and expenses from the base year FY 2006. Revenue decreased 1.6 percent from the base year while operating expenses increased 7.3 percent from the base year. The FY 2016 percentages reflect an unfavorable impact on net income because operating expenses increased significantly and revenue decreased slightly when compared to the base year. However, total revenue has been increasing since FY 2012. The accrual of the RHBF payments contributed to the 456.2 percent increase in retiree health benefit expenses. Compensation and benefits decreased by 8.8 percent from the base year.

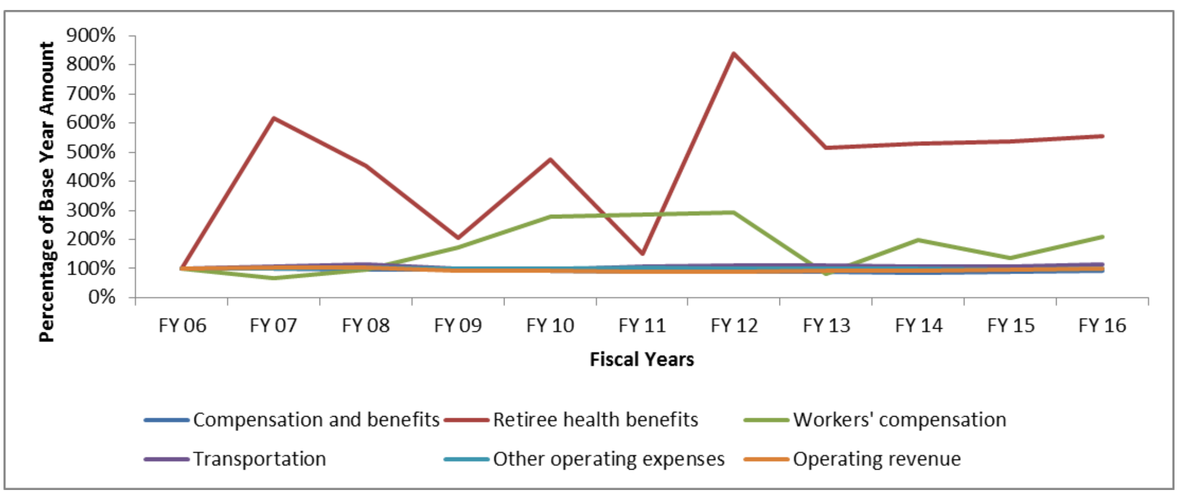
Figure IV-4
Change in Revenue and Expenses Since FY 2006



Source: Postal Service FY 2006 to FY 2016 Forms 10-K and USPS Annual Reports

Operating revenue has trended relatively flat since FY 2006. Similar to the growth in current liabilities, retiree health benefit payments including the mandatory RHBF accruals and workers' compensation expense have trended upwards from the base year. *See* Table IV-5.

Figure IV-5
Trends in Operating Revenue and Operating Expenses Since FY 2006



Source: Postal Service FY 2006 to FY 2016 Forms 10-K and USPS Annual Reports

Financial Solvency Analysis

ALTMAN Z-SCORE

The financial strength of an entity can be evaluated through the use of a variety of metrics. In conjunction with financial ratios, these metrics are used to gauge an entity's long-term viability.

The Major Mailers Association, National Association of Presort Mailers, and National Postal Policy Council jointly filed initial comments questioning the applicability of the Altman Z-Score in analyzing the financial condition of the Postal Service.[59] They contend that the model is outdated and that a model derived from a sample of manufacturing firms subject to bankruptcy law is not valid for a service firm.[60] They also question whether a model derived from a sample of publicly-traded private firms is relevant to a government agency. They further state that the Commission's presentation is incomplete because it excludes the fifth ratio, Sales to Total Assets.[61]

Although the model was developed in 1968 as a tool to examine the likelihood that a publicly-traded private company may file for bankruptcy,[62] it has since been used as a measure to analyze the financial health of state and local governments and continues to be widely accepted as a measure of an entity's financial health.[63] The Altman Z-Score model used in the analysis is the revised Z-Score Model adapted specifically for non-manufacturing firms to calculate the score without the capital turnover ratio (sales/total assets) so as to minimize the potential effect of different methods of financing assets.[64]

The Postal Service's Altman Z-Score gives insight into the Postal Service's financial health in light of the fact that the Postal Service has reached its maximum statutory borrowing limit of $15 billion accessed from the Federal Financing Bank. Cash generated from operations is the only source of income available to satisfy daily operating expenses and invest in capital assets.

The Altman Z-Score is a quantitative model designed to predict the financial distress of a business. It uses a blend of four traditional financial ratios and a statistical method known

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[59] Comments of the Major Mailers Association, National Association of Presort Mailers, and the National Postal Policy Council, PRC Docket No. ACR2016 (Feb. 2, 2017), at 2.
[60] *Id.* at 18, 19.
[61] *Id.*
[62] The Postal Service, as a governmental unit, is not considered a "person" who may be a debtor under the Bankruptcy Code. See 11 U.S.C. §§109(d); 101(41). The Altman Z-Score is used as a metric that may be instructive in comparing the Postal Service with other business entities which may be subject to bankruptcy. Use of the Altman Z-Score does not suggest that the Postal Service has the potential to file for bankruptcy.
[63] See Fischer, Mary, et al, Fiscal Health Analysis Of Texas And Its Municipalities, Journal of Business and Economics Research – Second Quarter 2015, Volume 13, Number 2.
[64] *Id.*

as multiple discriminant analysis. The Altman Z-Score is interpreted against discrimination ranges, which provide context as to what an individual Altman Z-Score means to an entity's financial health. A lower Altman Z-Score reflects higher odds of bankruptcy[65] and financial distress. In particular, the discrimination ranges divide Altman Z-Scores into three zones:

- 1.1 or Less = Distress Zone
- 1.1 to 2.6 = Grey Zone
- 2.6 or More = Safe Zone

As shown in Table IV-7, the Postal Service's Altman Z-Score was negative 6.4 at the end of FY 2016. The Postal Service's FY 2016 Altman Z-Score was slightly worse than the FY 2015 score of negative 6.1.

Table IV-7
Altman Z-Score - FY 2016

Ratio	Calculation	Ratio Value on 9/30/2016	Weighting Factor	Product (col. 3 * col. 4)
1	2	3	4	5
T1	Working Capital/Total Assets	(1.8)	1.2	(2.1)
T2	Retained Earnings/Total Assets	(2.2)	1.4	(3.1)
T3	Earnings/Total Assets	(0.2)	3.3	(0.7)
T4	Capital/Total Liabilities	(0.7)	0.6	(0.4)
Altman Z-Score				(6.4)

Negative amount is denoted by ().
Numbers may not add across due to rounding.
Source: Ratios computed from amounts reported on Postal Service FY 2016 Form 10-K at 40.

In FY 2006, the Postal Service had a positive Altman Z-Score of 0.2 and positive scores for all ratio values except for the Working Capital/Total Assets ratio. *See* Table IV-8.

[65] Although the Postal Service has reached its borrowing limit, it is ineligible for Federal bankruptcy protection under current law. *See* 11 U.S.C. §§ 101(41), 109.

Table IV-8
Altman Z-Score - FY 2006

Ratio	Calculation	Ratio Value on 9/30/2006	Weighting Factor	Product (col. 3 * col. 4)
1	2	3	4	5
T1	Working Capital/Total Assets	(0.3)	1.2	(0.4)
T2	Retained Earnings/Total Assets	0.2	1.4	0.3
T3	Earnings/Total Assets	0.0	3.3	0.1
T4	Capital/Total Liabilities	0.3	0.6	0.2
Altman Z-Score				0.2

Negative amount is denoted by ().

Numbers may not add across due to rounding.

Source: Ratios computed from amounts reported on USPS FY 2006 Annual Report at 42.

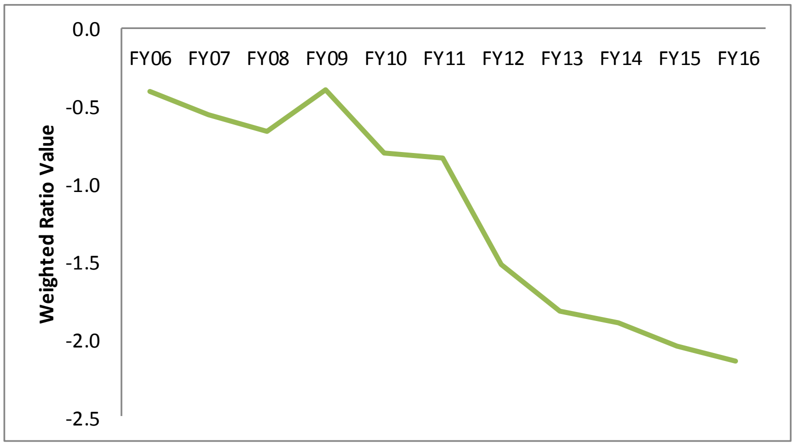
Deconstructing the Altman Z-Score

Working Capital to Total Assets

The Working Capital to Total Assets ratio measures a company's efficiency and its short-term financial health by comparing its net current assets to its total assets. Working capital is a company's current assets less its current liabilities. Therefore, a change in the total amount of current assets without a change of the same amount in current liabilities will result in a change in the amount of working capital. Similarly, a change in the total amount of current liabilities without an identical change in the total amount of current assets will cause a change in working capital.

Positive working capital means that the company is able to meet its short-term obligations. Negative working capital means that a company's current assets cannot meet its short-term liabilities; it could have problems paying back creditors in the short term, ultimately adversely affecting its financial position. Companies with healthy, positive working capital should not have problems paying their bills. The Postal Service's working capital to total assets ratio is shown in Figure IV-6.

Figure IV-6
Change in Weighted Ratio: Working Capital/Total Assets Since FY 2006



Source: Postal Service FY 2006 to FY 2016 Forms 10-K and USPS Annual Reports

An increasing Working Capital to Total Assets ratio over time is usually a positive sign, showing improving liquidity. This ratio increased briefly for the Postal Service from FY 2008–FY 2009 and has declined in succeeding fiscal years. A decreasing Working Capital to Total Assets ratio is usually a negative sign, indicating greater amount of total current liabilities, reducing the amount of working capital available. The steep decline in this ratio post FY 2012 may have resulted from the accruing of the defaulted prefunding retiree health payments.

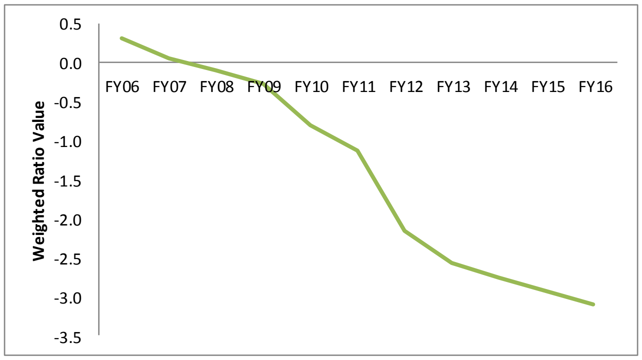
Retained Earnings to Total Assets

The retained earnings of a company are the percentage of net earnings retained for future use. They are "retained" to be reinvested in the firm or used to pay down debt. Retained earnings are calculated as follows:

- Previous year's retained earnings + current year's net income (net loss)

The ratio of retained earnings to total assets helps measure the extent to which a company relies on debt, or leverage. The lower the ratio, the more a company is funding assets by borrowing instead of through retained earnings, which again increases the risk of financial distress if the firm cannot meet its debt obligations. The Retained Earnings to Total Assets ratio measures the company's ability to accumulate earnings using its total assets. The Postal Service's retained earnings to total assets is shown in Figure IV-7.

Figure IV-7
Change in Weighted Ratio: Retained Earnings/Total Assets Since FY 2006



Source: Postal Service FY 2006 to FY 2016 Forms 10-K and USPS Annual Reports

This ratio has steadily declined for the Postal Service since FY 2006. A decreasing Retained Earnings to Total Assets ratio is usually a negative sign, indicating possible problems with a company's profitability. As an entity grows and matures, this ratio is expected to increase. Recurring losses suffered after FY 2007 by the Postal Service has eroded its retained earnings as reflected in the continued decline in this ratio.

Earnings to Total Assets

Earnings to Total Assets is a variation on return on assets, which is net income divided by total assets. This ratio assesses a firm's ability to generate profits from its assets. The Postal Service's earnings to total assets is shown in Figure IV-8.

Figure IV-8
Change in Weighted Ratio: Earnings/Total Assets Since FY 2006

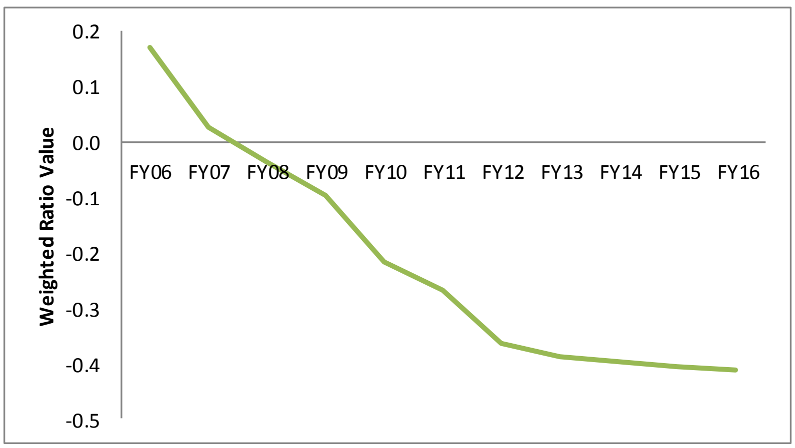
Source: Postal Service FY 2006 to FY 2016 Forms 10-K and USPS Annual Reports

FY 2006 showed a positive ratio during the Postal Reorganization Act (PRA) regime when revenue were required to cover costs (break-even). The effects of the Great Recession of 2008–2009 are captured in the large decrease in the ratio over those years. The exigent surcharge in FY 2014 improved profitability through FY 2016.[66]

Capital to Total Liabilities

The ratio of Capital to Total Liabilities shows the extent to which an entity's value can decline before its liabilities exceed its assets. Generally, a higher capital balance indicates a greater likelihood of future survival. The Postal Service's capital to total liabilities is shown in Figure IV-9.

Figure IV-9
Change in Weighted Ratio: Capital/Total Liabilities Since FY 2006



Source: Postal Service FY 2006 to FY 2016 Forms 10-K and USPS Annual Reports

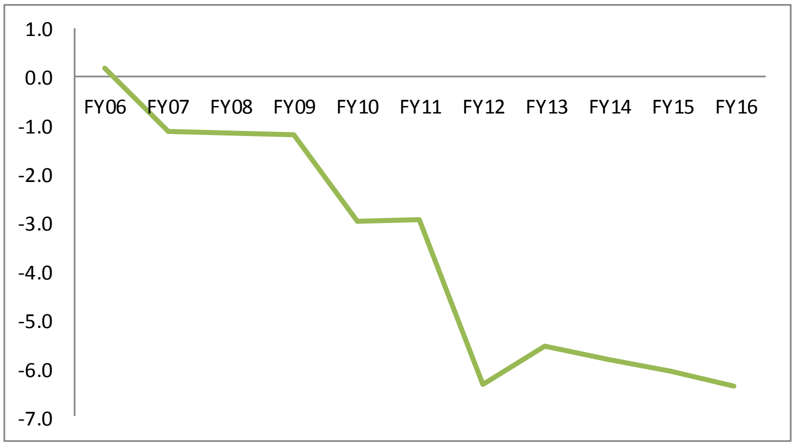
For purposes of the Altman Z-Score, capital is calculated as the book value of equity which for the Postal Service is capital contributions and retained earnings. The Postal Service's recurring net losses and increasing liabilities are reflected in the decline in this ratio.

Shift in Altman Z-Score

When analyzing the Altman Z-Score, it is important to analyze the trend over time. In the case of the Postal Service, the steady decline, as shown in Figure IV-10, is a reflection of the erosion of retained earnings caused by consecutive net losses and the RHBF prefunding statutory obligation.

[66] *See* Docket No. R2013-11, Order No. 1926, Order Granting Exigent Price Increase, December 24, 2013.

Figure IV-10
Change in Altman Z-Score Since FY 2006



Source: Postal Service FY 2006 to FY 2016 Forms 10-K and USPS Annual Reports

Appendix A.

FY 2016 Volume, Revenue, Cost, and Cost Coverage by Class, Current Classification (Products)

Appendix A
Fiscal Year 2016 Volume, Revenue, Cost, and Cost Coverage by Class
Current Classification (Products)

	Volume (000)	Revenue ($ 000)	Attributable Cost ($ 000)	Contribution to Institutional Cost ($ 000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
COMPETITIVE MAIL								
Priority Mail Express	33,043	809,413	356,733	452,680	2,449.578	1,079.604	1,369.974	226.9%
Priority Mail	1,004,246	7,784,881	6,127,926	1,656,955	775.196	610.201	164.995	127.0%
Ground Parcels	2,457,488	5,191,580	3,055,287	2,136,292	211.256	124.326	86.930	169.9%
First-Class Package Service	776,203	2,075,729	1,468,552	607,177	267.421	189.197	78.224	141.3%
Competitive International Mail	228,447	1,791,647	1,049,099	742,548	784.273	459.231	325.042	170.8%
Competitive Domestic Services		833,078	425,518	407,560				195.8%
Competitive International Services		9,083	7,325	1,757				124.0%
Total Competitive Mail and Services	**4,499,428**	**18,495,410**	**12,490,441**	**6,004,969**	**411.061**	**277.601**	**133.461**	**148.1%**
MARKET DOMINANT MAIL								
First-Class Mail								
Single-Piece Letters and Cards	19,705,721	9,819,199	5,553,780	4,265,419	49.829	28.184	21.646	176.8%
Presort Letters and Cards	39,943,145	15,468,949	4,576,888	10,892,061	38.727	11.459	27.269	338.0%
Flats	1,570,219	2,206,568	1,530,758	675,811	140.526	97.487	43.039	144.1%
Parcels	253,945	712,064	587,983	124,081	280.401	231.540	48.862	121.1%
Outbound Single-Piece Mail Intl	171,873	261,571	152,774	108,797	152.188	88.888	63.301	171.2%
Inbound Single-Piece Mail Intl	605,360	590,247	618,734	(28,488)	97.503	102.209	(4.706)	95.4%
Total First-Class Mail	62,250,262	29,058,598	13,020,917	16,037,681	46.680	20.917	25.763	223.2%
Standard Mail								
High Density & Saturation Letters	6,991,880	1,079,362	492,367	586,995	15.437	7.042	8.395	219.2%
High Density & Saturation Flats & Parcels	11,100,927	2,020,866	1,196,734	824,132	18.204	10.780	7.424	168.9%
Carrier Route	6,783,061	1,831,122	1,331,279	499,843	26.996	19.627	7.369	137.5%
Letters	48,858,797	10,162,967	5,023,146	5,139,821	20.801	10.281	10.520	202.3%
Flats	6,340,264	2,380,486	2,984,593	(604,107)	37.546	47.074	(9.528)	79.8%
Parcels	44,767	53,777	83,272	(29,495)	120.128	186.014	(65.886)	64.6%
Every Door Direct Mail - Retail	810,238	146,125	54,055	92,070	18.035	6.672	11.363	270.3%
Inbound NSA Mail Intl	0	0	0	0				
Total Standard Mail	80,929,933	17,674,705	11,165,446	6,509,258	21.840	13.796	8.043	158.3%
Periodicals								
Within County	534,172	61,732	87,018	(25,286)	11.557	16.290	(4.734)	70.9%
Outside County	5,052,010	1,444,981	1,950,201	(505,220)	28.602	38.602	(10.000)	74.1%
Total Periodicals	5,586,182	1,506,713	2,037,219	(530,506)	26.972	36.469	(9.497)	74.0%
Package Services								
Alaska Bypass	1,282	33,517	19,714	13,803	2,614.376	1,537.729	1,076.647	170.0%
Inbound Surface Parcel Post (at UPU Rates)	0	0	0	0	0.000	0.000	0.000	0.0%
Bound Printed Matter Flats	264,935	209,618	130,558	79,060	79.120	49.279	29.841	160.6%
Bound Printed Matter Parcels	249,957	289,659	276,853	12,805	115.884	110.761	5.123	104.6%
Media and Library Mail	74,999	266,585	354,337	(87,752)	355.453	472.458	(117.005)	75.2%
Total Package Services	591,173	799,378	781,463	17,916	135.219	132.189	3.031	102.3%
U.S. Postal Service Mail	421,035							
Free Mail	45,316		37,068	(37,068)		81.799		
Total Market Dominant Mail	**149,823,902**	**49,039,395**	**27,042,113**	**21,997,281**	**32.731**	**18.049**	**14.682**	**181.3%**
Market Dominant Services								
Ancillary Services								
Certified Mail		670,497	521,116	149,381				128.7%
COD		2,029	4,941	(2,912)				41.1%
Insurance		76,946	42,845	34,101				179.6%
Registered Mail		31,637	16,251	15,386				194.7%
Stamped Envelopes		9,083	9,512	(429)				95.5%
Stamped Cards		605	253	352				238.8%
Other Ancillary Services		447,461	206,810	240,651				216.4%
Money Orders		156,747	116,707	40,040				134.3%
Post Office Box Service		283,969	229,569	54,400				123.7%
Caller Service		94,351	23,140	71,210				
Other Special Services		37,569	12,800	24,769				
International Services		43,339	41,145	2,194				105.3%
Total Market Dominant Services		1,854,232	1,225,091	629,141				
Other Income		2,050,269		2,050,269				
Other International Mail Attributable			58,170					
Total Mail and Services	**154,323,329**	**71,439,306**	**40,815,814**	**30,681,661**	**46.292**	**26.448**	**19.881**	**175.0%**
Institutional Costs			36,305,275					
Appropriations: Revenue Forgone		59,209						
Investment Income		31,910						
Total Revenues		**71,530,424**						
Total Costs			**77,121,089**					
Net Income (Loss)		**(5,590,665)**						

Source: Library Reference PRC-FinRpt16-NP1

Appendix A.2
Fiscal Year 2016 Volume, Revenue, Cost, and Cost Coverage by Class
Current Classification (Products)
With FY 2016 Incremental Cost Adjustments

	Volume (000)	Revenue ($ 000)	Variable/Prod.Spec Cost ($ 000)	Incremental Cost With Final Adj ($ 000)	Contribution to Institutional Cost ($ 000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
COMPETITIVE MAIL									
Priority Mail Express	33,043	809,413	356,733	375,496	433,917	2,449.578	1,136.387	1,313.190	215.6%
Priority Mail	1,004,246	7,784,881	6,127,926	6,204,357	1,580,524	775.196	617.812	157.384	125.5%
Ground Parcels	2,457,488	5,191,580	3,055,287	3,089,194	2,102,386	211.256	125.705	85.550	168.1%
First-Class Package Service	776,203	2,075,729	1,468,552	1,471,812	603,917	267.421	189.617	77.804	141.0%
Competitive Domestic Services		833,078	425,518		407,560				195.8%
TOTAL DOMESTIC COMPETITIVE COSTS	4,270,981	16,694,680	11,434,016	11,720,343	4,974,337	390.886	274.418	116.468	142.4%
Competitive International Mail	228,447	1,791,647	1,049,099		742,548	784.273	0.000	325.042	170.8%
Competitive International Services		9,083	7,325		1,757				
Total Competitive Mail and Services	**4,499,428**	**18,495,410**	**12,490,441**	**11,720,343**	**5,716,885**	**411.061**	**277.601**	**127.058**	**148.1%**
MARKET DOMINANT MAIL									
First-Class Mail									
Single-Piece Letters and Cards	19,705,721	9,819,199	5,553,780	5,757,027	4,062,172	49.829	29.215	20.614	170.6%
Presort Letters and Cards	39,943,145	15,468,949	4,576,888	4,648,648	10,820,302	38.727	11.638	27.089	332.8%
Flats	1,570,219	2,206,568	1,530,758	1,533,614	672,954	140.526	97.669	42.857	143.9%
Parcels	253,945	712,064	587,983	589,716	122,348	280.401	232.222	48.179	120.7%
Outbound Single-Piece Mail Intl	171,873	261,571	152,774		108,797	152.188		63.301	171.2%
Inbound Single-Piece Mail Intl	605,360	590,247	618,734		(28,488)	97.503		(4.706)	95.4%
Total First-Class Mail	62,250,262	29,058,598	13,020,917	12,818,784	15,758,086	46.680	20.592	25.314	226.7%
Standard Mail									
High Density & Saturation Letters	6,991,880	1,079,362	492,367	495,114	584,248	15.437	7.081	8.356	218.0%
High Density & Saturation Flats & Parcels	11,100,927	2,020,866	1,196,734	1,217,017	803,849	18.204	10.963	7.241	166.1%
Carrier Route	6,783,061	1,831,122	1,331,279	1,335,144	495,978	26.996	19.683	7.312	137.1%
Letters	48,858,797	10,162,967	5,023,146	5,141,729	5,021,238	20.801	10.524	10.277	197.7%
Flats	6,340,264	2,380,486	2,984,593	2,998,597	(618,111)	37.546	47.295	(9.749)	79.4%
Parcels	44,767	53,777	83,272	83,281	(29,503)	120.128	186.032	(65.904)	64.6%
Every Door Direct Mail - Retail	810,238	146,125	54,055		92,070	18.035		11.363	270.3%
Inbound NSA Mail Intl	0	0	0		0				
Total Standard Mail	80,929,933	17,674,705	11,165,446	11,814,097	6,349,769	21.840	14.598	7.846	149.6%
Periodicals									
Within County	534,172	61,732	87,018	87,049	(25,317)	11.557	16.296	(4.739)	70.9%
Outside County	5,052,010	1,444,981	1,950,201	1,955,769	(510,788)	28.602	38.713	(10.111)	73.9%
Total Periodicals	5,586,182	1,506,713	2,037,219	2,043,466	(536,105)	26.972	36.581	(9.597)	73.7%
Package Services									
Alaska Bypass	1,282	33,517	19,714	19,714	13,803	2,614.376	1,537.729	1,076.647	170.0%
Inbound Surface Parcel Post (at UPU Rates)	0	0	0		0	0.000	0.000	0.000	0.0%
Bound Printed Matter Flats	264,935	209,618	130,558	130,586	79,032	79.120	49.290	29.831	160.5%
Bound Printed Matter Parcels	249,957	289,659	276,853	277,081	12,578	115.884	110.852	5.032	104.5%
Media and Library Mail	74,999	266,585	354,337	354,891	(88,306)	355.453	473.196	(117.743)	75.1%
Total Package Services	591,173	799,378	781,463	782,835	17,107	135.219	132.421	2.894	102.1%
U.S. Postal Service Mail	421,035								
Free Mail	45,316		37,068	37,071	37,071		81.806		
Total Market Dominant Mail	**149,823,902**	**49,039,395**	**27,042,113**		**21,625,927**	**32.731**		**14.434**	**181.3%**
Market Dominant Services									
Ancillary Services									
Certified Mail		670,497	521,116	525,737	144,760				127.5%
COD		2,029	4,941	4,941	(2,912)				41.1%
Insurance		76,946	42,845	42,846	34,099				179.6%
Registered Mail		31,637	16,251	16,252	15,385				194.7%
Stamped Envelopes		9,083	9,512	9,841	(758)				92.3%
Stamped Cards		605	253	253	352				238.8%
Other Ancillary Services		447,461	206,810	208,902	238,559				214.2%
Money Orders		156,747	116,707	171,686	(14,939)				91.3%
Post Office Box Service		283,969	229,569	246,049	37,920				115.4%
Caller Service		94,351	23,140	23,141	71,210				407.7%
Other Special Services		37,569	12,800	6,792	30,776				553.1%
International Services		43,339	41,145		2,194				105.3%
Total Market Dominant Services		1,854,232	1,225,091	1,269,177	556,647				
Other Income		2,050,269			2,050,269				
Other International Mail Attributable			58,170						
Total Mail and Services	**154,323,329**	**71,439,306**	**40,815,814**		**29,949,728**	**46.292**		**19.407**	**175.0%**
Institutional Costs			36,305,275						
Appropriations: Revenue Forgone		59,209							
Investment Income		31,910							
Total Revenues		**71,530,424**							
Total Costs			**77,121,089**						
Net Income (Loss)		**(5,590,665)**							

Source: Library Reference PRC-FinRpt16-NP1