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

Fiscal Year 2014

April 1, 2015

Contents

Purpose of this Report

Prior to Fiscal Year (FY) 2013, the Postal Regulatory Commission's *Annual Compliance Determination* (ACD) included a chapter on the overall financial health of the Postal Service. In the ACD, the Commission analyzed data, including total volumes, revenues, costs, and contribution to institutional costs by product, and reviewed the Postal Service's financial highlights and challenges. However, the report did not include an analysis of relevant financial data provided in the Postal Service's Form 10-K[1] filing and *Annual Compliance Report* (ACR). As a result, the Commission developed a separate *Financial Analysis* report to include components needed to provide greater clarity, transparency, and accountability.

The *Financial Analysis* provides a review of the Postal Service's FY 2014 financial and operating results. It primarily uses information gathered from the FY 2014 Form 10-K and measures it against FY 2013 and the FY 2014 *Integrated Financial Plan*. The *Cost and Revenue Analysis* report, the *Cost Segments and Components* report, and the *Revenue, Pieces, and Weight* report are also used to develop and analyze the FY 2014 financial results. In addition, the Commission's analysis of reports filed under its Periodic Data Reporting rules (Title 39 of the Code of Federal Regulations, section 3050.28) provide a broad understanding of the Postal Service's FY 2014 financial statements.

Appendix A of this report includes the volumes, revenues, attributable costs, and contribution to institutional costs for FY 2014 by product. It is available in two library references: a public version, Library Reference PRC–LR–ACR2014/1, and a non-public version, Library Reference PRC–LR–ACR2014/NP1. Additionally, Library Reference PRC–LR–ACR2014/2 details the data and calculations used to prepare the financial ratios highlighted in Chapter 4.

[1] The Form 10-K consists of the Income Statement, the Balance Sheet, Changes in Net Deficiency, and Cash Flow Statement.

Financial Facts at a Glance

- In FY 2014, the Postal Service recorded its eighth consecutive financial loss, bringing the total net deficit since FY 2007 to $51.7 billion. This growing net deficit has negatively affected liquidity, depleted available borrowing capacity, and resulted in net liabilities far exceeding net assets. The Postal Service's total net loss of $5.5 billion in FY 2014 exceeded the net loss recorded in FY 2013 by $500 million. This is primarily due to increases in workers' compensation costs and Retiree Health Benefit Fund (RHBF) payments.

- In FY 2014, the Postal Service also recorded a $1.4 billion net operating income, its first since FY 2008. The net operating income reflects the financial results of total revenues without any prior period adjustments and without any non-operational expenses, such as retiree health benefits and workers' compensation.

- First-Class revenue was $29.6 billion, a 0.5 percent increase over FY 2013. Standard Mail revenue was $17.5 billion, a 3 percent increase over FY 2013. Consumer price index (CPI) cap rate increases and the Market Dominant exigent rate surcharge resulted in higher revenues. The rate increases and surcharges were implemented in the second quarter of FY 2014 and were the primary reasons for the improvement in the net operating income. Reductions in work hours and average hourly compensation rates lowered operating costs and also contributed to the improved net operating income.

- The volume and revenue of Competitive products both increased by more than 10 percent in FY 2014. The contribution to institutional costs from Competitive products was $4.3 billion, $0.5 billion higher than in FY 2013. However, Competitive products constitute only 2 percent of total volumes and generate a lower markup than First-Class Mail. Although operating net income improved and Standard Mail volume increased in 3 of the last 5 years, the steady decline in volume from First-Class Mail—the Postal Service's most profitable product—continues to affect overall revenue and jeopardizes the Postal Service's ability to cover total costs.

Using a qualitative assessment of the Postal Service's finances, the Commission has determined that:

- Postal Service liquidity is insufficient to significantly improve operational efficiency.
- Liquid assets (current assets) are insufficient to meet the payment of current liabilities.
- The Postal Service has no further access to borrowing under current law.

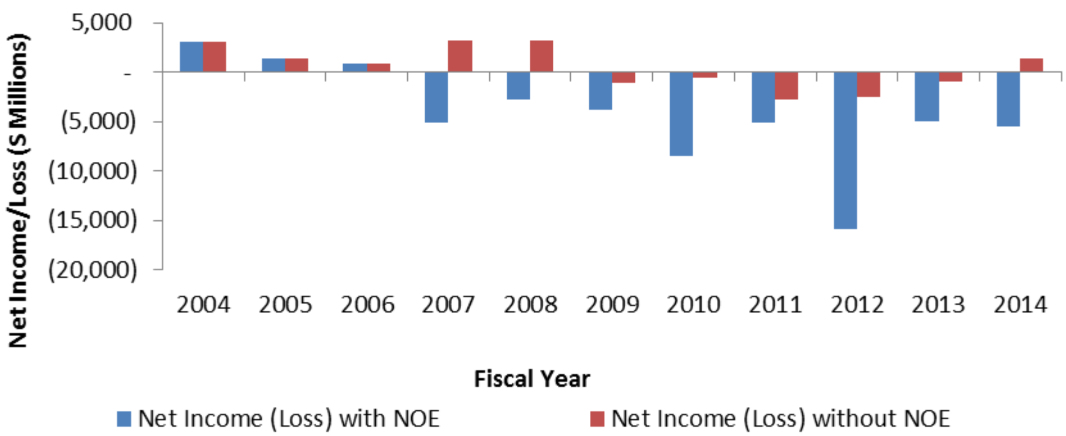
Chapter 1. Report Overview

Financial Changes

The Postal Service has made significant efforts to reduce operating expenses and improve efficiency to ensure expenses are better aligned with mail volumes. Operating losses have declined since FY 2011, resulting in the first operating income since FY 2008. Lower than expected declines in First-Class Mail volume, coupled with implementation of the Market Dominant CPI cap rate increase and the exigent rate surcharge, contributed significantly to FY 2014 net operating income.

Figure I-1 shows the net income or loss results for the last 10 years, both with and without non-operating expenses. The Commission considers the non-cash adjustments to workers' compensation and the payment to the RHBF as non-operating expenses.[2]

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



Note: Non-operating expenses include all non-cash workers' compensation costs and the accrued payment to the RHBF.
Source: Postal Service Forms 10-K and Postal Service *Annual Reports*.

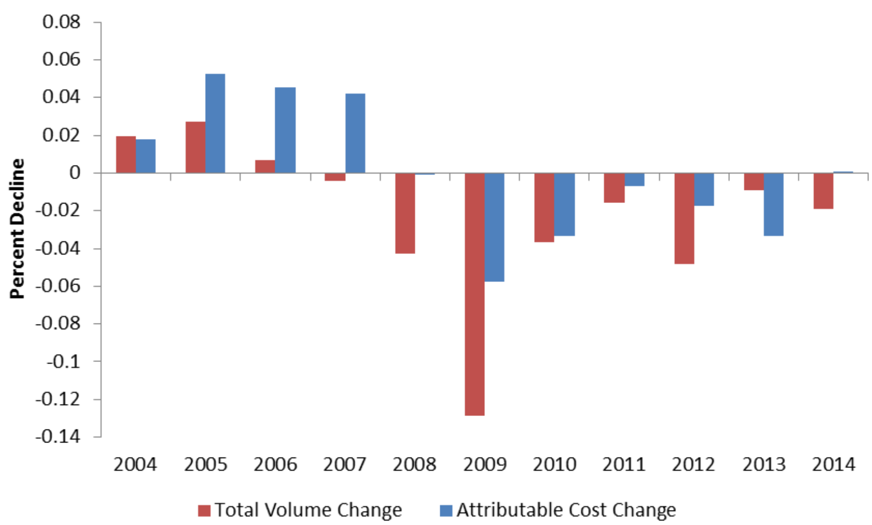
Continuing losses have eroded the Postal Service's liquidity significantly. The Postal Service reached its $15 billion statutory borrowing limit in FY 2012. The net book value of its assets remains significantly lower than its liabilities, and it has been unable to make the statutorily required payments to the RHBF for the last 4 years. Capital spending on assets is constrained to those expenditures considered essential for the continuance of operations.

[2] The Postal Service refers to these non-operational expenses as "non-controllable factors" and the net operating income/(loss) as a "controllable income/(loss)." Postal Service Form 10-K at 14.

The Postal Service has implemented several cost reduction programs in an effort to conserve or increase liquidity. These cost reductions include reducing work hours and the number of career employees by closing and consolidating mail processing facilities under the Postal Service's Network Rationalization Initiative, which is also associated with revisions to Market Dominant products service standards. The Postal Service also has reduced post office hours, reduced the number of delivery routes, and consolidated delivery offices.[3] Other cost reductions include, where feasible, the substitution of highway transportation for air transportation.[4]

Figure I-2 compares the percentage change in volume with the percentage change in attributable costs. In FY 2013, the percentage decline in attributable costs[5] exceeded the percentage decline in mail volume. In all years except FY 2013, the percentage decline in mail volume exceeds the change in attributable costs. In FY 2014, total attributable costs remained nearly the same as in FY 2013. However, mail volume continued to decline.

Figure I-2
Mail Volume and Attributable Cost Percentage Change from Prior Year



Source: Postal Service *Cost and Revenue Analysis*, FY 2004-FY 2014.

[3] Postal Service FY 2014 Form 10-K at 31.

[4] *Id*. at 29.

[5] Attributable costs are direct and indirect Postal Service costs that can be clearly associated with a particular mail product. It is the sum of volume-variable cost plus product-specific cost. United States Postal Service *Glossary of Postal Terms* at 19.

Other Highlights

Other highlights for FY 2014 include:

- The volume of First-Class Mail continues to decline steadily while the volume declines in Standard Mail appear to have stabilized.
- Total Market Dominant products' revenue increased 0.6 percent.
- Total Competitive products' revenue increased 11.2 percent.
- For the seventh consecutive year, certain products did not cover their attributable costs and generated a total negative contribution of $1.1 billion.
- Total expenses increased $1.1 billion, although total attributable costs decreased.
- The average unit attributable costs have declined over the past 5 years, while the average unit total costs have increased.
- The percentage of total costs that are considered institutional costs is increasing.
- Volume, revenue, and contribution to institutional costs from Competitive products have doubled since FY 2007.

Chapter 2. Postal Service Financial Status

Introduction

This chapter analyzes the Postal Service's financial status. It evaluates relationships between the essential components of the Postal Service's financial statements in order to obtain a better understanding of the Postal Service's viability, stability, and profitability. The chapter begins with an overview of the Postal Service's Form 10-K report for FY 2014.

As noted above, Form 10-K consists of the Income Statement, the Balance Sheet, Changes in Net Deficiency, and Cash Flow Statement. The Income Statement measures the Postal Service's financial performance (profit and loss) over a 1-year period; the Balance Sheet summarizes the Postal Service's assets and liabilities at the end of each fiscal year; the Changes in Net Deficiency Statement combines the accumulated net deficit from operations and initial capital contributions; and the Cash Flow Statement measures the Postal Service's intake and outflow of cash during the fiscal year.

The Commission's review of the Postal Service's accounting information in this report involves an analysis of the financial statements for FY 2013 and FY 2014. The Commission examines various factors that affect the Postal Service's financial status, and discusses operational status and allocation of resources. To provide a basis for comparison, the Commission has selected key financial data from past fiscal years.

The Income Statement analysis reviews overall income and loss, and compares revenues and expenses to those reported last year. Additionally, the Postal Service's FY 2014 Operating Plan is assessed against FY 2014 Net Operating Income to ascertain whether its targets have been met.

The Balance Sheet analysis begins with a discussion of the changes in the total net deficiency, which occurs because Postal Service liabilities exceed assets. The remainder of the section summarizes the Postal Service's assets and liabilities at the end of the fiscal year.

The Debt and Cash Flow section analyzes the Postal Service's intake and outflow of cash during the year.

Income Statement Analysis

To conduct a detailed financial analysis of the Postal Service's Income Statement, the Commission separately identifies elements of the reported operating revenues and operating expenses. In FY 2013, the Postal Service made a $1.3 billion adjustment to total Market Dominant revenue to recognize revenue omitted from a recalculation of the usage of Forever stamps included in Postage in the Hands of the Public during the past years.

There was no similar extraordinary adjustment in FY 2014. For comparison purposes, in the FY 2013 column in Table II-1 below, this $1.3 billion adjustment is subtracted from operating revenue and added back after the Net Income (Loss) from Operations to reconcile the Net Loss reported in the Postal Service FY 2014 Form 10-K. Operating expenses are adjusted to exclude the payment to the RHBF and the non-cash adjustments to the workers' compensation liability. However, those adjustments and expenses are properly recognized as accounting entries; they are broken out to show an in-depth analysis of the financial results for FY 2014. Table II-1 represents the Commission's Income Statement breakdown.

Table II-1
Postal Service Income Statement Restated to Facilitate Analysis, FY 2014 and FY 2013
($ Millions)

	FY 2014	FY 2013	Variance	FY 2014 Plan	Variance from Plan
Operating revenue as reported by the Postal Service	$67,831	$67,318	$513	$67,980	$(149)
Less: Adjustment for postage related to Forever stamps	–	(1,316)	1,316	–	
Net Operating Revenue	**67,831**	**66,002**	**1,829**	**67,980**	**(149)**
Operating expense as reported by the Postal Service	73,178	72,128	1,050	72,362	816
Less: statutory accrual into RHBF	(5,700)	(5,600)	(100)	(5,700)	–
Non-cash change to workers' compensation liability	(1,182)	311	(1,493)	-	(1,182)
Net Operating Expense	**66,296**	**66,839**	**(543)**	**66,662**	**(366)**
Interest income	24	24	(0)	23	1
Interest expense	184	191	(7)	194	(10)
Net Income (Loss) from Operations	**1,375**	**(1,004)**	**2,379**	**1,147**	**228**
Adjustment for postage related to Forever stamps	–	1,316	(1,316)	–	–
Statutory accrual into RHBF	5,700	5,600	100	5,700	–
Non-cash change to workers' compensation liability	1,182	(311)	1,493	–	1,182
Net Loss	**$(5,507)**	**$(4,977)**	**$(530)**	**$(4,553)**	**$(954)**

Source: Postal Service National Trial Balance, September 2014, November 24, 2014; Postal Service National Trial Balance, September 2013, November 15, 2013; Postal Service FY 2014 *Integrated Financial Plan*, November 25, 2013.

The Postal Service recorded a net operating income of almost $1.4 billion in FY 2014. This is $2.4 billion higher than the operating loss of $1 billion recorded in FY 2013. Revenue increases of $1.8 billion resulted from the Market Dominant[6] and Competitive products price[7] increases in addition to an exigent rate surcharge[8] on Market Dominant prices.

[6] Docket No. R2013-10, Order Approving Amendments to Notice of Market Dominant Price Adjustment, December 11, 2013 (Order No. 1902).

[7] Docket No. CP2014-5, Order Approving Changes in Rates in General Applicability for Competitive Products, December 12, 2013 (Order No. 1903).

[8] Docket No. R2013-11, Order Granting Exigent Price Increase, December 24, 2013 (Order No. 1926).

Operating expenses were lower by $0.5 billion in FY 2014, primarily driven by a decrease in costs for compensation and benefits.

After accounting for the non-cash adjustment to the workers' compensation liability and the RHBF payment, the $1.4 billion net operating income becomes a total net loss of $5.5 billion. This figure is $0.5 billion greater than the total net loss in FY 2013. The increase in the total net loss is driven primarily by the decrease in the workers' compensation discount rate in FY 2014. This resulted in a $1.5 billion increase in the non-cash adjustment to the workers' compensation liability.

Revenues Compared with Prior Year

This section discusses overall revenue by class for Market Dominant and Competitive Mail. Chapter 3 presents a more detailed discussion of revenues by class.

Table II-2 reflects FY 2014 and FY 2013 revenue by mail class.

Table II-2
Revenue by Market Dominant Mail Class, FY 2014 and FY 2013 ($ Millions)

	FY 2014	FY 2013	$ Variance	% Variance
First-Class Mail	$29,568	$29,428	$140	0.5%
Standard Mail	17,497	16,985	511	3.0%
Periodicals	1,625	1,658	(33)	-2.0%
Package Services	836	1,136	(299)	-26.3%
Other	2,060	2,046	(5)	-0.2%
Total Market Dominant Mail	**51,586**	**51,254**	**333**	**0.6%**
Change in estimate of prepaid postage	–	1,316	(1,316)	-100.0%
Total Adjusted Market Dominant Revenue	**$51,586**	**$52,569**	$(983)	**-1.9%**

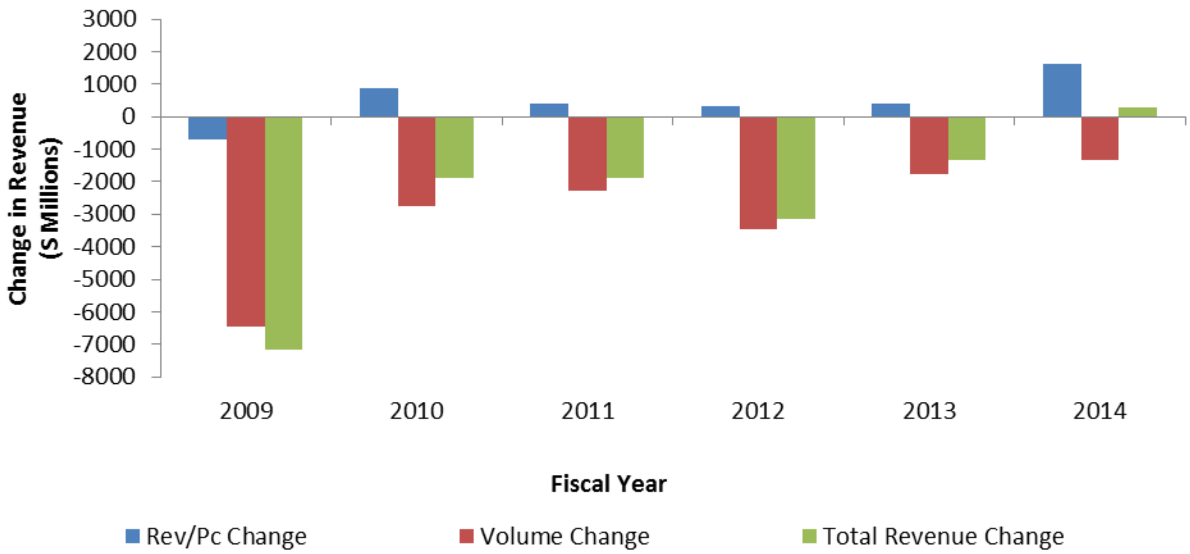
Source: Library Reference PRC–LR–ACR2014/1, Postal Service *Revenue, Pieces and Weight Report*, FY 2013.

Total Market Dominant revenues from operations increased 0.6 percent from FY 2013. The large decline in Package Services revenue, which affected the total revenue for Market Dominant products, is due to the transfer of Single-Piece Parcel Post from the Market Dominant product list to the Competitive product list in FY 2012, effective as of January 27, 2013.[9] Total revenue increased for both First-Class and Standard Mail despite the reduction in mail volume. The increases in revenue stem mainly from the CPI-based rate increases and the additional exigent rate surcharge, which became effective on January 26, 2014.

[9] Docket No. MC2012-13, Order Conditionally Granting Request to Transfer Parcel Post to the Competitive Product List, July 20, 2012 (Order No. 1411).

As shown in Figure II-1, the average revenue per piece[10] in FY 2014 grew significantly and covered the loss in revenue due to declines in mail volume. In the 5 years previous to FY 2014, the change in revenue per piece was not sufficient to offset the loss of revenue due to volume declines.

Figure II-1
Change in Revenue Due to Changes in Average Revenue per Piece and Total Mail Volumes



Note: Change in revenues does not include fees assigned to each class or other Market Dominant revenue.
Source: Postal Regulatory Commission derived from Postal Service *Revenue, Pieces and Weight Reports*, FY 2009-2014.

The exigent rate surcharge significantly increased revenue over FY 2013. Table II-3 (next page) shows a total of $2 billion in additional revenue generated from increases in average revenue per piece. The exigent rate surcharge accounted for almost $1.3 billion of the increase.

Table II-4 on the next page compares revenues for Competitive products between FY 2014 and FY 2013. Overall, Competitive products' revenue increased $1.5 billion from FY 2013, a 11.2 percent increase. Both increasing volume and the Competitive product price increase (effective January 27, 2014) contributed to the higher revenue. Of the total $1.5 billion of increased revenue, slightly less than $1 billion resulted from increased Competitive product volume. The revenue of only two products, Priority Mail Express (formerly Express Mail) and Competitive International Mail, declined due to volume losses. Total revenue increased for every other Competitive product.

[10] 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. Generally, however, rate changes are the predominant factor affecting changes in revenue per piece.

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

	Increase in Revenue from Revenue/Piece	Revenue from Exigent Surcharge	Increase in Revenue from Other Change Revenue/Piece	Decrease in Revenue from Volume	Change in Revenue
First-Class Mail	$1,120,980	$745,944	$375,037	$(1,008,881)	$112,099
Standard Mail	745,837	481,746	264,090	(235,201)	511,469
Periodicals	51,056	42,437	8,619	(83,739)	(32,824)
Package Services	41,430	22,367	19,063	(339,783)	(298,574)
Total	**$1,959,302**	**$1,292,494**	**$666,809**	**$(1,667,603)**	**$292,170**

Note: Revenue change figures do not include revenue changes for Ancillary and Special Services.
Source: Library Reference PRC–LR–ACR2014/1, Notice of the United States Postal Service of Filing Revenue Collection Report for Quarter 4 of Fiscal Year 2014, November 18, 2014, file *ExigSrchgRevCUMULATIVE(2Q+3Q+4Q14).xls*, tab Summary Total through Quarter 4 FY 2014.

Table II-4
Revenue for Competitive Products ($ Millions)

	FY 2014	FY 2013	$ Variance	% Variance
Priority Mail	$6,884	$6,374	$510	8.0%
Total Ground	3,160	2,469	691	28.0%
First-Class Packages	1,462	1,192	270	22.7%
Priority Mail Express	760	794	(34)	-4.3%
International	2,319	2,222	96	4.3%
Other	695	689	6	0.9%
Total	**$15,280**	**$13,741**	**$1,539**	**11.2%**

Source: Library Reference PRC–LR–ACR2014/1, Postal Service *Revenue, Pieces and Weight Report*, FY 2013.

Expense Analysis Compared with Prior Year

As shown in Table II-5 on the next page, total expenses, including the non-operational expense for the payment to the RHBF and the non-cash adjustments to the workers' compensation liability, increased 1.5 percent, or $1.1 billion, in FY 2014 over FY 2013. The primary driver for the increase was the non-cash adjustment to workers' compensation liability. Actuarial adjustments to past cases and fluctuations in interest rates are the primary cause of the increases or decreases in the liability. A reduction in interest rates over 2014 resulted in most of the increase in the liability adjustment, and accounted for the entire increase in total workers' compensation expenses.[11]

Personnel expenses include workers' compensation, retirement, and health benefit expenses. In addition, personnel expenses reflect certain system-wide benefit expenses, such as the cash payment for workers' compensation and the current year's annuitant health benefit premiums. These account for 68.8 percent of all expenses. Total personnel

[11] Postal Service FY 2014 Form 10-K at 29.

and personnel-related expenses, including the non-operating personnel expenses of the RHBF payment and the non-cash adjustment to the workers' compensation liability, account for 78.2 percent of total operating expenses.

Table II-5
Total Expenses, FY 2014 and FY 2013 ($ Millions)

	FY 2014	FY 2013	$ Variance	% Variance
Compensation and Benefits Expenses				
Salaries and benefits	$45,674	$46,327	$(653)	-1.4%
Workers' compensation	1,372	1,372	–	0.0%
Annuitant health benefits—current payment	2,985	2,850	136	4.8%
Other personnel-related	326	380	(55)	-14.3%
Subtotal of Personnel Expenses	**50,357**	**50,929**	**(572)**	**-1.1%**
Transportation	6,586	6,735	(149)	-2.2%
Other expenses	9,353	9,174	179	1.9%
Total Operating Expenses	**66,296**	**66,838**	**(542)**	**-0.8%**
System-Wide Personnel Expenses				
Workers' compensation non-cash adjustments	1,182	(311)	1,493	-480.1%
Statutory accrual into RHBF	5,700	5,600	100	1.8%
Total Expenses	**$73,178**	**$72,127**	**$1,051**	**1.5%**

Source: Postal Service National Trial Balance, September 2014, November 24, 2014; Postal Service National Trial Balance, September 2013, November 15, 2013.

Purchased transportation expenses, which declined almost $0.2 billion, account for 9 percent of total expenses and decreased 2.2 percent from last year. The remaining 12.8 percent of expenses is attributable to other expenses, which include depreciation, rents and utilities, and supplies and services. This final category rose $179 million, 1.9 percent more than last year.

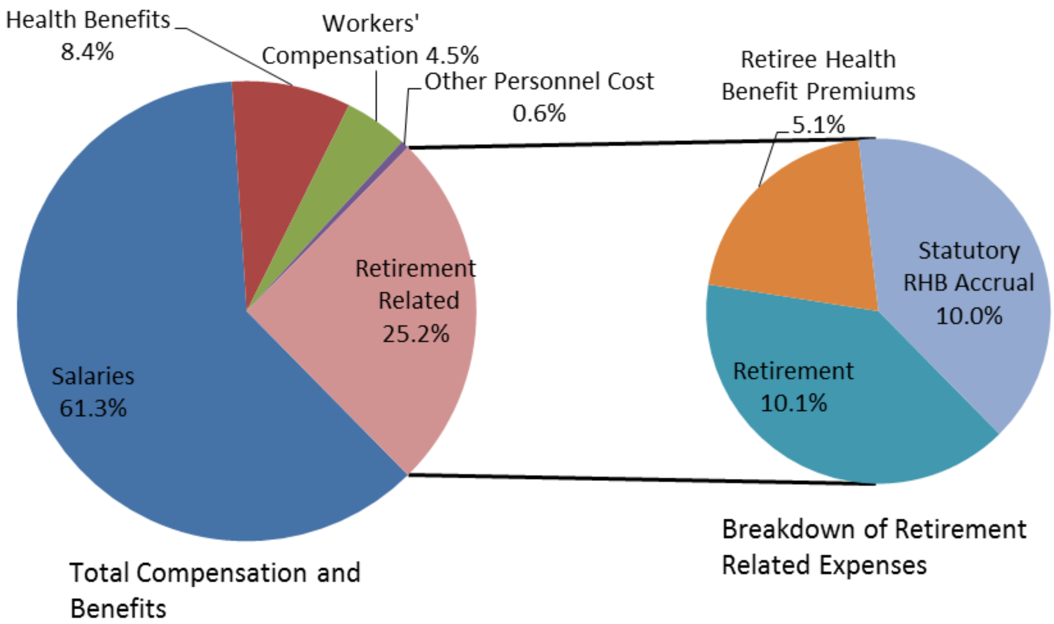
PERSONNEL EXPENSES

Figure II-2 (next page) shows the composition of various elements of personnel costs. Compensation accounts for the largest portion of personnel expenses, representing 61.3 percent of total personnel costs. Retirement benefits are the next largest component, at 25.2 percent of total personnel expenses.

Expenses related to retirement, exclusive of retiree health benefits, comprise 10.1 percent of total personnel expenses and include costs for the Federal Employees Retirement System, the Civil Service Retirement System, and Social Security.

Retiree health benefit expenses consisting of the current year premiums for annuitant health benefits and the statutory RHBF payments are the second largest subcategory, accounting for 15.1 percent of total personnel expenses.

Figure II-2
Personnel Expenses, FY 2014 and FY 2013



Source: Postal Service National Trial Balance, September 2014, November 24, 2014.

Table II-6 shows that total compensation for FY 2014 was $526 million lower than in FY 2013. Employee separation incentives totaling $336 million were paid in FY 2013 and constitute 63.9 percent of the reduction in compensation expenses in FY 2014. The remaining $190 million difference results from a decrease of approximately 2.3 million work hours and the increasing use of non-career employees.

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

	FY 2014	FY 2013	$ Variance	% Variance
Total compensation	$35,113	$35,639	$(526)	-1.5%
Retirement	5,758	5,738	20	0.3%
Health benefits—current employees	4,804	4,951	(147)	-3.0%
Workers' compensation	1,372	1,372	–	0.0%
Retiree health benefits—current year premiums	2,985	2,850	136	4.8%
Other compensation	326	379	(54)	-14.2%
Total Personnel Expenses	**50,357**	**50,929**	**(572)**	**-1.1%**
Less: Statutory accrual into RHBF	5,700	5,600	100	1.8%
Non-cash change to workers' compensation liability	1,182	(311)	1,493	-480.1%
Subtotal Personnel Expenses (Table II-5)	**$57,239**	**$56,218**	**$1,021**	**1.8%**

Source: Postal Service National Trial Balance, September 2014, November 24, 2014; Postal Service National Trial Balance, September 2013, November 15, 2013.

The number of lower-paid non-career employees has increased substantially over the last 2 years; the number of career full- and part-time employees continues to decline, but at a slower pace than last year. Increased demand for parcels and increased maintenance needs have contributed to the smaller reductions in employee levels. As shown in Table II-7, the significant reduction in career employees in FY 2013 was caused in large part by a separation incentive offered to employees represented by the American Postal Workers Union. The incentive did not extend into FY 2014. While implementation of the Post Office Structure Plan[12] resulted in a separation incentive for Postmasters in FY 2014, the rate of reduction in career employees over the past few years slowed significantly in FY 2014.

Table II-7
Postal Service Employee Complement, FY 2012-FY 2014

	FY 2014	FY 2013	Change 2014 over 2013	FY 2012	Change 2013 over 2012
Career employees	488,299	491,016	(2,717)	528,458	(37,442)
Postal support employees	24,781	28,795	(4,014)	20,281	8,514
City carrier assistants	36,081	30,428	5,653	–	30,428
Mailhandler assistants	5,475	5,382	93	–	5,382
Other non-career	63,240	62,089	1,151	80,289	(18,200)
Total On-Roll Employees	**617,876**	**617,710**	**166**	**629,028**	**(11,318)**

Source: *On-Roll and Paid Employee Statistics* reports, September 2014 and 2013.

The reduction in career employees and the increase in lower-paid non-career employees have affected the Productive Hourly Wage Rate. Table II-8 shows that this rate for mailhandlers and city carriers declined, respectively, 3.6 percent and 5.4 percent over the last 2 years. The Productive Hourly Wage Rate for all cost segments has declined over this period, except for rural carriers and the maintenance crafts.

Table II-8
Productive Hourly Wage Rates ($ per Work Hour)

Segment/Subsegment	FY 2014	FY 2013	FY 2012	% Change 2012 to 2014
Supervisors and technicians	$49.39	$49.61	$50.03	-1.3%
Clerks, CAG[a] A-J	40.34	39.68	41.00	-1.6%
Mailhandlers	39.92	40.23	41.39	-3.6%
Clerks and Mailhandlers, CAG A-J	40.23	39.81	41.10	-2.1%
City delivery carriers	41.26	42.83	43.61	-5.4%
Vehicle drivers	42.51	41.68	43.21	-1.6%
Rural carriers	35.85	35.15	34.69	3.2%
Building services	40.12	39.74	40.99	-2.1%
Operating equipment	51.28	49.62	48.82	5.1%

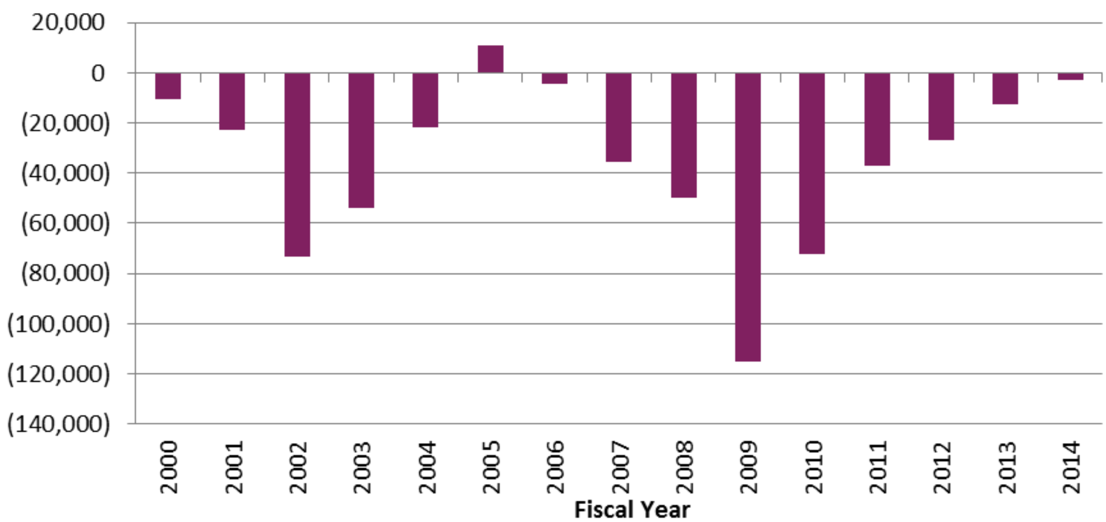
[12] The Post Office Structure Plan matches Post Office retail hours with workload. It is intended to achieve cost savings with limited reductions in access and service. *See* Docket No. N2012-2, Advisory Opinion on Post Office Structure Plan at 2, August 23, 2012.

Segment/Subsegment	FY 2014	FY 2013	FY 2012	% Change 2012 to 2014
Building equipment	47.59	46.33	45.59	4.5%
Motor vehicle service	45.39	44.94	45.16	0.5%
City and rural carriers	39.49	40.41	40.69	-3.0%
Headquarters	62.31	63.83	63.02	-1.2%

[a] Cost Ascertainment Group (CAG) is a method that classifies Post Offices according to volume of revenue generated.
Source: Library Reference PRC–LR–ACR2014/1.

The Postal Service's reduction of work hours in FY 2014 is the smallest rate of decline since FY 2006. Figure II-3 shows the change in work hours since FY 2000. The Postal Service has implemented numerous savings initiatives over the past 14 years that have translated into reductions in overall work hours, but thus far have affected only certain crafts.

Figure II-3
Change in Work Hours, FY 2000 to FY 2014



Source: Postal Service Form 10-K and *Annual Reports*, FY 2004-FY 2014.

The Post Office Structure Plan and the closing and/or consolidation of processing facilities have reduced work hours for Postmasters, clerks, mailhandlers, and equipment maintenance personnel. However, other areas required more work hours.

Growth in Shipping and Packages, where handling is more labor intensive, resulted in increases of approximately 6.4 million delivery hours from FY 2013 (*see* Table II-9, next page). Vehicle maintenance was another area of work hour growth. Lack of capital investment in prior years combined with an aging vehicle fleet has increased the need for maintenance and repairs.

Table II-9
Work Hours by Function (Thousands of Work Hours)

	FY 2014	FY 2013	FY 2012
Mail processing	198,076	202,607	209,188
Delivery Service			
City delivery	394,123	390,518	388,035
Rural delivery	179,466	176,697	177,715
Maintenance			
Plant and equipment	65,227	65,832	68,022
Vehicle	27,646	26,779	25,925
Other	242,366	247,362	253,246
Total	**1,106,903**	**1,109,795**	**1,122,132**

Source: Postal Service National Workload Reporting System, September 2014 and 2013.

Health benefits for current employees declined by 3 percent in FY 2014, primarily due to a decrease in the number of career employees and contractual reductions in the Postal Service's share of health benefits premiums.

Almost all of the accounts for pension-related retirement costs declined with the drop in the number of career employees. However, the increase in the number of non-career employees, who are not eligible to participate in the Federal Employees Retirement System, is greater than the decline in the number of career employees, and is the primary reason for the increase in the Social Security portion of total retirement costs.

The cost of health benefits for Postal Service annuitants increased by $136 million from FY 2013. This was because the number of annuitants and survivors increased from FY 2013 and the cost of premium health benefits continued to increase.

The largest increase in cost was in workers' compensation. This expense consists of a cash payment to the U. S. Department of Labor for the current year cost of medical and compensation benefits. This payment remained constant between FY 2013 and FY 2014. Changes to the valuation of the liability for workers' compensation, which do not require cash payments, are expensed each year changes occur. These changes include actuarial re-valuations 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. Changes in these non-cash adjustments to the workers' compensation liability accounted for all of the increase in cost. Therefore, the Postal Service's cash payment to the Department of Labor for FY 2014 remained the same as FY 2013. Table II-10 (next page) 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 2014 and FY 2013
($ Millions)

	FY 2014	FY 2013	$ Variance	% Variance
Non-cash changes in the discount rate	$485	$(1,745)	$2,230	-127.8%
Cost of new cases	1,956	1,789	167	9.3%
Actuarial valuation of new cases and revaluation of existing cases	45	949	(904)	-95.3%
Subtotal	**2,486**	**993**	**1,493**	**150.4%**
Administrative fee	68	68	–	0.0%
Total Workers' Compensation Expense	**2,554**	**1,061**	**1,493**	**140.7%**
Less medical claims payments	(1,372)	(1,372)	–	0.0%
Total Non-cash Workers' Compensation Expense	**1,182**	**(311)**	**1,493**	**480.1%**

Source: Postal Service FY 2014 Form 10-K at 29.

As the Postal Service stated in its FY 2014 Form 10-K, future estimates of cash payments are discounted to present-day dollars by applying current interest rates to the workers' compensation liability. As shown in Table II-11, these rates have fluctuated significantly over the past 4 years.

Table II-11
Impact of Change in Discount Rate on Workers' Compensation Expense, FY 2008-FY 2014

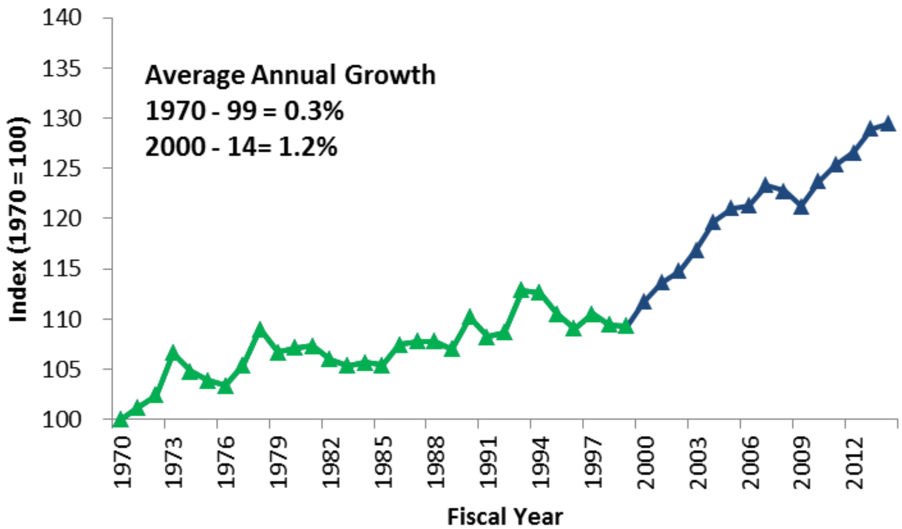
	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Discount rate (%)	5.6	4.9	2.9	2.3	2.1	3.0	2.8
Impact of discount rate changes ($ millions)	154	718	2,010	978	346	(1,745)	485

Source: Postal Service FY 14 Form 10-K at 62, FY 13 Form 10-K at 40, and FY 10 Form 10-K at 24.

In general, as interest rates rise—as they did in FY 2013—the amount of current funds needed to settle all current workers' compensation claims declines. When interest rates decline—as they did during most of FY 2014—the amount of current funds needed to settle the same claims increases.

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. Figure II-4 on the next page shows the growth in TFP since 1970.

Figure II-4
Postal Service Total Factor Productivity, 1970-2014



Source: Postal Service annual TFP tables, FY 2014.

The 0.4 percent growth in TFP in FY 2014 is the fifth consecutive year of productivity growth, but the smallest since FY 2006.

Total workload declined 1.2 percent more than in FY 2013. Capital and labor inputs continued to decrease as the Postal Service reduced work hours and average wage rates. Capital usage continues to drop because of restrictions in capital investment resulting from lack of liquidity. Correspondingly, the growth rate in materials usage has increased for the second consecutive year. Much of this growth is related to increased costs for vehicle supplies and maintenance for the upkeep of the aging postal vehicle fleet, as well as an increase in advertising and other supplies. The increase in materials usage was not enough to offset the decrease in capital and labor usage inputs. Overall total resource usage continued to decline, though at a slower rate than previous years.

NON-PERSONNEL EXPENSES

Transportation costs accounted for 41.3 percent of non-personnel costs in FY 2014. Table II-12 (next page) compares total transportation costs by category for FY 2014 and FY 2013.

Total transportation expenses declined by $149 million. A renegotiated air transportation contract and the move to comparatively cheaper highway transportation significantly reduced air transportation cost from that of FY 2013. The new air transportation contract lowered the transportation rates the Postal Service paid, and also allowed the carrier to pass on the savings from lower jet fuel prices. The lower fuel prices enabled the Postal Service to save approximately $150 million in FY 2014.[13]

Table II-12
Transportation Cost by Category, FY 2014 and FY 2013 ($ Millions)

Category of Transportation	FY 2014	FY 2013	$ Variance	% Variance
Highway	$3,523	$3,409	$114	3.3%
Air	2,092	2,378	(287)	-12.1%
International	934	905	29	3.2%
Other	37	42	(5)	-11.8%
Total Transportation	**$6,586**	**$6,735**	**$(149)**	**-2.2%**

Source: Postal Service FY 2014 Form 10-K at 30.

As the Postal Service used more ground transportation, highway transportation costs grew by $114 million from last year, offsetting some of the decline in air transportation costs.

Table II-13 shows that other non-personnel expenses increased by $179 million. The bulk of the increase was in supplies and services, mainly due to increases in advertising ($34 million), Competitive product supplies, and a change in the accounting for fees from a contract with eBay, Inc.

Table II-13
Other Non-Personnel Expenses, FY 2014 and FY 2013 ($ Millions)

	FY 2014	FY 2013	$ Variance	% Variance
Supplies and services	$2,550	$2,400	$150	6.3%
Depreciation and amortization	1,843	1,901	(58)	-3.1%
Rent and utilities	1,613	1,582	31	2.0%
Vehicle maintenance services	1,108	1,040	68	6.5%
Information technology and communications	791	720	71	9.9%
Rural carrier equipment maintenance	556	558	(2)	-0.4%
Miscellaneous other	892	973	(81)	-8.3%
Total Other Expenses	**$9,353**	**$9,174**	**$179**	**2.0%**

Source: Postal Service FY 2014 Form 10-K at 30.

The cost of maintaining the Postal Service's aging vehicle fleet has increased substantially and now constitutes most of the increase in total maintenance service. Additionally, expanding use of mobile communications and improved information technology increased those expenses 9.9 percent, which is $71 million greater than FY 2013.

[13] Postal Service FY 2014 Form 10-K at 29.

Comparison to the Postal Service Operating Plan

Compared with the Postal Service's FY 2014 Operating Plan, actual net operating income was slightly higher than the estimated figure for FY 2014. The improvement over the Operating Plan was almost entirely due to lower-than-expected non-personnel expenses, which were $556 million lower than budgeted. These amounts offset lower-than-expected revenue and higher personnel costs than those initially forecast by the Postal Service. While Market Dominant volumes were 1 percent higher than forecast, Competitive product volumes were almost 1.7 percent lower. (Competitive products have higher average revenues per piece than Market Dominant products.) This drove revenues $149 million lower than forecast. Personnel costs were $180 million higher than the Operating Plan because the Postal Service did not meet work hour reduction forecasts across all labor categories.

Except for First-Class Mail, revenues for all Market Dominant classes were below the Operating Plan targets. During FY 2014, First-Class Mail volumes were more than 3.2 percent—more than 2 billion pieces higher—than estimated. Standard Mail volumes were 0.6 percent less than forecast. The revenue from the higher First-Class Mail volumes was enough to offset the lower revenues from Standard Mail, Periodicals, and Package Services. The higher First-Class Mail volume and revenue correspond to a stronger economy than forecast in the Operating Plan, especially in retail sales and employment.

Total FY 2014 operating expenses were $366 million, 0.5 percent below the amount forecast in the Operating Plan.

Table II-14 (next page) illustrates that compensation and benefits were $328 million higher than predicted in the Operating Plan. The fiscal year Operating Plan included contractual wage increases and cost of living adjustments negotiated between the Postal Service and its employee bargaining unions. Higher-than-planned work hours across all functional categories of labor increased compensation costs by $328 million over the amount budgeted in the Operating Plan.

Balance Sheet Analysis

This section analyzes the Postal Service's financial situation and use of resources based on Balance Sheet data prepared according to standards of the U.S. Generally Accepted Accounting Principles. The data compares two points in time, September 30, 2014 (FY 2014) and September 30, 2013 (FY 2013).

Table II-14
FY 2014 Expenses Compared with Operating Plan ($ Millions)

	FY 2014	FY 2014 Plan	$ Variance	% Variance
Compensation and Benefits Expenses				
Salaries and benefits	$45,867	$45,539	$328	0.7%
Workers' compensation	1,372	1,394	(22)	-1.6%
Annuitant health benefits—current payment	2,985	3,091	(106)	-3.4%
Other personnel related	133	154	(21)	-13.4%
Subtotal of Personnel Expenses	**50,357**	**50,178**	**179**	**0.4%**
Transportation	6,586	6,759	(173)	-2.6%
Other expenses	9,353	9,725	(372)	-3.8%
Total Operating Expenses	**66,296**	**66,662**	**(366)**	**-0.5%**
System-wide Personnel Expenses				
Workers' compensation non-cash adjustments	1,182	–	1,182	0.0%
Annuitant health benefits—RHBF	5,700	5,700	–	0.0%
Total Expenses	**$73,178**	**$72,362**	**$816**	**1.1%**

Source: Postal Service Monthly Financial Statement, September, 2014, December 5, 2014.

A balance sheet has 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 bottom line of a balance sheet always 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 (capital deficiency) occurs when liabilities are greater than assets.

Table II-15 (next page) compares the Postal Service's asset and liability structure for FY 2014 and FY 2013. This analysis is derived from the Postal Service's Balance Sheet. Current assets, which can be easily converted to cash for financing operations, are the sum of cash and cash equivalents, receivables and supplies, and prepayments. Non-current assets, mainly depreciating 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 and non-current liabilities are long-term financial obligations.

Table II-15 shows that the majority of the Postal Service's assets are non-current assets; they comprise 73 percent of total assets. This high percentage reflects the nature of postal operations, which, for routine operations, rely on a vast delivery network of retail and processing facilities and a sizeable vehicle fleet. The current assets of $6.2 billion as a percentage of total assets increased almost 10 percent from FY 2013 due to an increase in cash on hand. Because the Postal Service exhausted its statutory borrowing limit in FY 2012, it now relies on revenues to fund capital expenditures. The Postal Service holds more cash on hand than in previous years, but its working capital has decreased.

Table II-15
Structure of Assets and Liabilities ($ Millions)

Indicator	Value				Change for the Period Analyzed	
	$ Millions		% of the Balance Total		$ Millions Variance	% Variance
	9/30/2014	9/30/2013	End of the Period Analyzed 9/30/2014	Beginning of the Period Analyzed 9/30/2013		
[1]	[2]	[3]	[4]	[5]	[6]	[7]
Assets						
Cash, cash equivalents and short-term investments	$5,152	$2,638	22.4%	12.2%	$2,514	95.3%
Receivables	930	984	4.1%	4.5%	(54)	-5.5%
Supplies and prepayments	122	122	0.5%	0.6%	0	0.0%
1. Current assets, total	6,204	3,744	27.0%	17.3%	2,460	65.7%
2. Non-current assets	16,758	17,897	73.0%	82.7%	(1,139)	-6.4%
3. Total Assets	22,962	21,641	100.0%	100.0%	1,321	6.1%
Liabilities and Equity						
Workers' compensation	1,320	1,322	1.9%	2.2%	(2)	-0.2%
Retiree health benefits	22,417	16,766	32.8%	27.3%	5,651	33.7%
Short-term portion of debt	9,800	9,800	14.3%	15.9%	0	0.0%
1. Current liabilities	42,542	36,683	62.3%	59.7%	5,859	16.0%
Workers' compensation	17,102	15,918	25.0%	25.9%	1,184	7.4%
Long-term portion of debt	5,200	5,200	7.6%	8.5%	0	0.0%
2. Non-current Liabilities	25,751	24,781	37.7%	40.3%	970	3.9%
3. Total liabilities	68,293	61,464	100.0%	100.0%	6,829	11.1%
4. Capital deficiency	(45,331)	(39,823)	-197.4%	-184.0%	(5,508)	13.8%
Assets; Liabilities and Equity	22,962	21,641	100.0%	100.0%	1,321	6.1%

Source: Postal Service FY 2014 and FY 2013 Form 10-K.

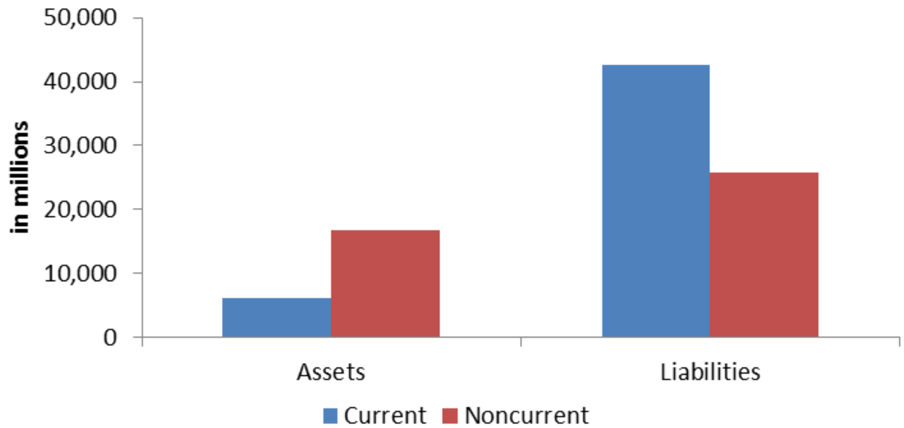
Current liabilities, consisting largely of RHBF obligations and short-term borrowing, contributed to a larger portion of total liabilities (62.3 percent) than non-current liabilities (37.7 percent). The Postal Service has not yet paid RHBF statutory prefunding obligations for FY 2011 through FY 2014, which total $22.4 billion and comprise 52.7 percent of current liabilities. The bulk of net liabilities consist of the RHBF payments, workers' compensation liability ($18.4 billion), and the total net debt the Postal Service owes to the Federal Financing Bank[14] ($15 billion).

In FY 2014, the Postal Service's total liabilities exceeded the total value of assets by $45.3 billion. This large net deficiency results from annual net operating losses since FY 2006, the slow replacement of fully depreciated capital assets, and the high amount of employee-related liabilities.

[14] The Federal Financing Bank is a government corporation created by Congress in 1973 to centralize and reduce the cost of federal borrowing and federally assisted borrowing from the public.

All current activity is financed with internally generated cash, which severely limits the Postal Service's capability to invest in productive assets. The initial capital contributions, coupled with small surpluses in the years prior to FY 2006, are not sufficient to fund all the Postal Service's current obligations. Figure II-5 shows the Postal Service's asset and liability structure as of September 30, 2014.

Figure II-5
Asset and Liability Structure as of September 30, 2014



Source: Postal Service FY 2014 Form 10-K.

According to the data in Figure II-5, non-current assets comprised about two-thirds (73 percent) of the Postal Service's total assets; current assets comprised about one-third. In FY 2014, assets increased to almost $23 billion, $1.3 billion higher than in FY 2013.

The Commission did not analyze accumulated earnings either at the beginning or at the end of the period. The value of net assets on September 30, 2014, was negative $45.3 billion. This is the amount by which Postal Service's total obligations exceed the book value of assets.

Significant growth was also seen in "equity and liabilities" on the Postal Service's Balance Sheet. The difference in the percentage of the increase in total equity and liabilities is shown in brackets:

- Employee-related liabilities, current: $5.6 billion [79.9 percent]
- Employee-related liabilities, non-current: $1.1 billion [16.6 percent]

Net property, plant, and equipment assets decreased by almost $1.2 billion compared with the Balance Sheet for September 30, 2013. Accumulated deficit decreased by $5.5 billion.

During the period analyzed, current receivables (receivables from the U.S. Government and foreign countries) decreased by $54 million.

Under current accounting rules, the Postal Service does not record goodwill or other intangible assets. Thus, amounts of net worth and net tangible assets are equal on the last day of the period analyzed. Net tangible assets were negative $45.3 billion, declining by $5.5 billion from FY 2013.

Negative net worth (net assets) indicates that the Postal Service not only reached its statutory borrowing limit, but also spent all of its initial capital. Its debts are therefore no longer secured by its assets. The net worth (net assets) value is one tool to estimate an entity's value; it is a key value in the estimation of the Postal Service's financial condition.

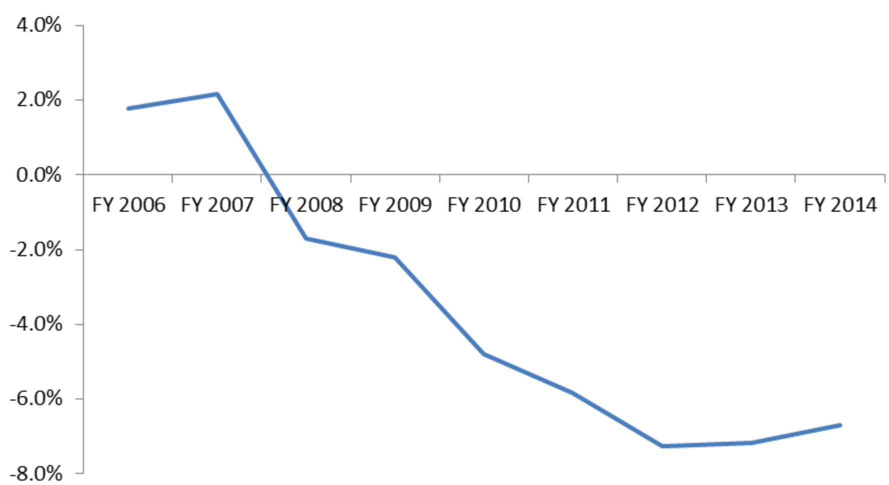
Assets

During the last year, assets grew by $1.3 billion, a 6.1 percent increase, to $22.9 billion. The $2.5 billion increase in cash and cash equivalents represent 98.6 percent of increases in total assets.

Decreases of $1.2 billion in property, plant, and equipment represent 95.6 percent of the decrease in total assets. The decrease in the net value of property, plant, and equipment is mainly due to the capital constraints the Postal Service has experienced for the past few years. Although current operations can be maintained with existing assets, the Postal Service will need to start reinvesting in new equipment and vehicles and replacing its current assets to remain viable in the long term.

As seen in Figure II-6, the Postal Service has undertaken only limited capital investments in the last 4 years due to its lack of available working capital. This has hindered growth and productivity enhancements in key infrastructure assets required for primary postal operations. The Postal Service experienced a negative 6.7 percent growth in capital assets.

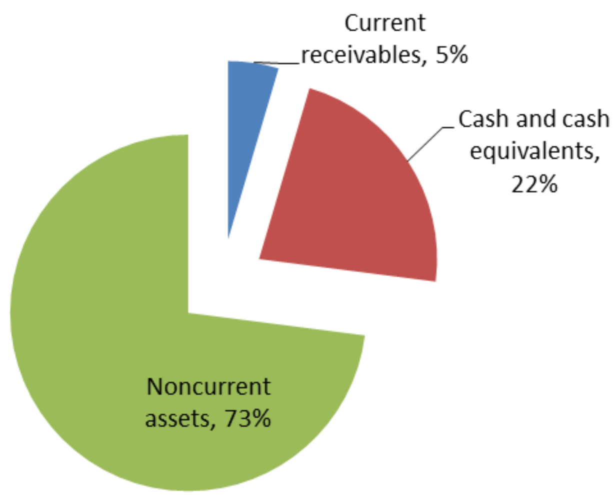
Figure II-6
Growth in Capital Assets



Source: Postal Service FY 2006-FY 2014 Forms 10-K.

Capital investments in physical resources are necessary to increase and maintain productivity. For the Postal Service to effectively compete in the e-commerce market, it will need to make capital investments in suitable delivery vehicles. It also needs to replace its existing aging vehicles to accommodate the shift in mail mix toward a larger share of packages relative to letter- and flat-shaped pieces of mail. The Postal Service must also invest in new and efficient mail processing technologies and equipment. However, its ability to make these investments is diminished by the lack of available working capital. Figure II-7 shows the structure of the Postal Service assets as of September 30, 2014.

Figure II-7
Postal Service Asset Structure, September 30, 2014



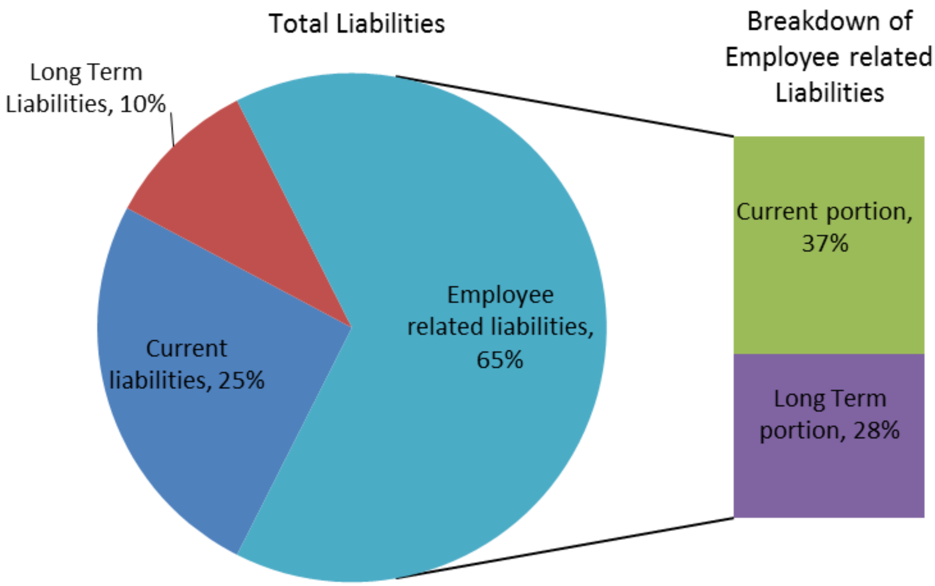
Source: Postal Service FY 2014 Form 10-K.

Liabilities

In FY 2014, total liabilities increased by $6.8 billion. The majority of the increase occurred in current liabilities. The RHBF increased by $5.6 billion, accounting for 79 percent of the increase in total liabilities.

The long-term portion of workers' compensation liability is highly sensitive to discount and inflation rates in actuarial estimation, and to new and existing claims. Lower discount rates during FY 2014 increased the long-term workers' compensation liability. Total workers' compensation liability increased by $1.2 billion, accounting for a 16.6 percent increase in total liabilities. Figure II-8 (next page) shows the structure of Postal Service liabilities as of September 30, 2014.

Figure II-8
Postal Service Liabilities Structure, September 30, 2014



Source: Postal Service FY 2014 Form 10-K.

Debt and Cash Flow Analysis

At the end of FY 2014, the Postal Service cash and cash equivalents totaled $4.9 billion, almost $2.6 billion higher than FY 2013. This is higher than the $4.5 billion cash forecast in the Operating Plan and double the end-of-year FY 2013 cash balance. The total cash available represents approximately 19 days of operating expenses at an average daily expense rate of $250 million. Table II-16 on the next page compares the Postal Service's cash flow from FY 2007 to FY 2014.

The Postal Service's cash and cash equivalents represent the total liquidity available. The Postal Service reached its statutory borrowing limit in FY 2012 and is no longer able to finance operations or capital with debt financing. In the past 4 years, because of low levels of liquidity, the Postal Service has been unable to make the payments on the RHBF obligations. As a result of the increased revenues generated by the exigent surcharge on Market Dominant products, the cash and cash equivalents balance is at its highest level in 4 years. Its fixed interest rate debt as of September 30, 2014, consists of short-term borrowings from the Federal Financing Bank of $5.8 billion due within 1 year and an additional $5.2 billion due after May 2, 2016. In addition to fixed-rate notes, the Postal Service has two revolving floating interest rate short-term credit lines; these expire at the end of April 2016. Other note provisions expire at the end of the next fiscal year allowing for borrowing with 2 days' prior notice. These two revolving credit lines were fully drawn on September 30, 2014.

Table II-16
Postal Service Cash Flow FY 2007 to 2014 ($ Millions)

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Net income/(loss)	(5,142)	(2,806)	(3,794)	(8,505)	(5,067)	(15,906)	(4,977)	(5,508)
Non-cash items and other cash flows	2,539	2,367	5,367	5,213	5,561	15,474	5,912	8,822
Cash Flows from Investing Activities								
Decrease (increase) in restricted cash	2,958				(10)	(28)	(79)	66
Purchase of property and equipment	(2,715)	(1,995)	(1,839)	(1,393)	(1,190)	(705)	(667)	(781)
Proceeds from sale of property and equipment	257	57	33	70	137	148	158	129
Net cash used in investing activities	500	(1,938)	(1,806)	(1,323)	(1,063)	(585)	(588)	(586)
Cash Flows from Financing Activities								
Increase (decrease) in debt	2,100	3,000	3,000	1,800	1,000	2,000	0	0
Payments for capital leases	(19)	(29)	(46)	(50)	(51)	(51)	(59)	(58)
U.S. Government appropriations—expensed	(76)	(61)	(64)	(63)	(63)	(129)	(48)	(90)
Net cash (used) provided by financing activities	2,005	2,910	2,890	1,687	886	1,820	(107)	(148)
Net increase/ (decrease) in cash	(98)	533	2,657	(2,928)	317	803	240	2,580
Cash balance (end of year)	997	899	1,432	4,089	966	1,283	2,086	2,326
Cash Balance End of Year	899	**1,432**	**4,089**	**1,161**	**1,283**	**2,086**	**2,326**	**4,906**
Debt outstanding	4,200	7,200	10,200	12,000	13,000	15,000	15,000	15,000

Source: Postal Service FY 2007-FY 2014 Forms 10-K.

Table II-17 (next page) compares the total liquidity available to the Postal Service in FY 2014 and FY 2013. Because the Postal Service had maximized the entire statutory limit of available debt by FY 2012, its total liquidity is limited to the available cash and cash equivalents. It ended FY 2014 with $9.8 billion in principal debt payments due within a year.

Table II-17
Total Postal Service Liquidity End of FY 2014 Compared with FY 2013
($ Millions)

	FY 2014	FY 2013
Cash and cash equivalents	$4,906	$2,326
Current portion of debt	9,800	9,800
Long-term debt	5,200	5,200
Total Debt	**15,000**	**15,000**
Statutory debt limit	15,000	15,000
Available debt	–	–
Total Liquidity (Cash + Available Debt)	**4,906**	**2,326**

Source: Postal Service FY 2014 Form 10-K Statement at 43.

Chapter 3. Volumes, Revenues, and Cost Trends

Overview

This chapter provides an in-depth analysis of the volumes, revenues, and cost trends for each class of mail. 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 costs to total costs (institutional cost share).

The second section provides a comparison of volume, revenue, and costs between FY 2013 and FY 2014. It also includes a trend analysis that highlights changes in volumes, revenues, and costs that have occurred since FY 2008. FY 2007 is used as the base year because it reflects mail reclassifications after the passage of the Postal Accountability and Enhancement Act in 2006. In cases where average unit attributable cost changed significantly, the Commission provides an analysis by cost segment and/or component.

Overall Volume, Revenue, and Costs Trends

Market Dominant Products and Services

Table III-1 compares total Market Dominant volumes, revenues, attributable costs, and contribution to institutional costs for FY 2014 and FY 2013.

Table III-1
Market Dominant Volume, Revenue, and Costs ($ Millions)

	FY 2014	FY 2013	Difference	% Change
Volume	151,927	155,195	(3,268)	-2.1%
Revenue	51,586	51,255	331	0.6 %
Attributable cost	28,205	29,289	(1,084)	-3.7%
Contribution to institutional cost	23,381	21,966	1,415	6.4 %

Source: FY 2014 and FY 2013 Postal Regulatory Commission *Financial Report*, Appendix A.

Total Market Dominant revenue increased in FY 2014 despite a decline of more than 3 billion pieces in total Market Dominant volume. As noted in Chapter 2, all of the increase in revenue was driven by the exigent rate surcharge implemented in January of 2014. Total attributable cost of Market Dominant products was $1 billion lower in FY 2014 than in FY 2013. Cost reductions related to mail processing personnel were the primary reason for the decrease in overall attributable costs. The total Market Dominant contribution to institutional costs increased by $1.4 billion.

In FY 2014, Market Dominant products accounted for 97.8 percent of total mail volume, a slight drop from FY 2013. Revenue from these products as a percentage of total revenue fell from 77.6 percent to 76 percent. Market Dominant attributable costs as a percentage of total attributable costs fell from 74.7 percent in FY 2013 to 72 percent in FY 2014.

Several Market Dominant products failed to generate sufficient revenue to cover attributable costs. The total negative contribution to institutional costs from these products amounted to almost $1.1 billion. Standard Mail Regular Flats ($411 million), Standard Mail Regular Parcels ($30.5 million), and Periodicals ($508.8 million) accounted for 88 percent of the negative contribution. Other products that did not cover attributable costs include First-Class Mail Inbound Single-Piece Letter Post, Package Services, Media Mail/Library Mail, and Special Services Stamp Fulfillment Service.

The Commission has paid particular attention to these products in past ACDs, encouraging the Postal Service to reduce their costs and use the pricing flexibility afforded in the Postal Accountability and Enhancement Act to improve the products' finances.[15]

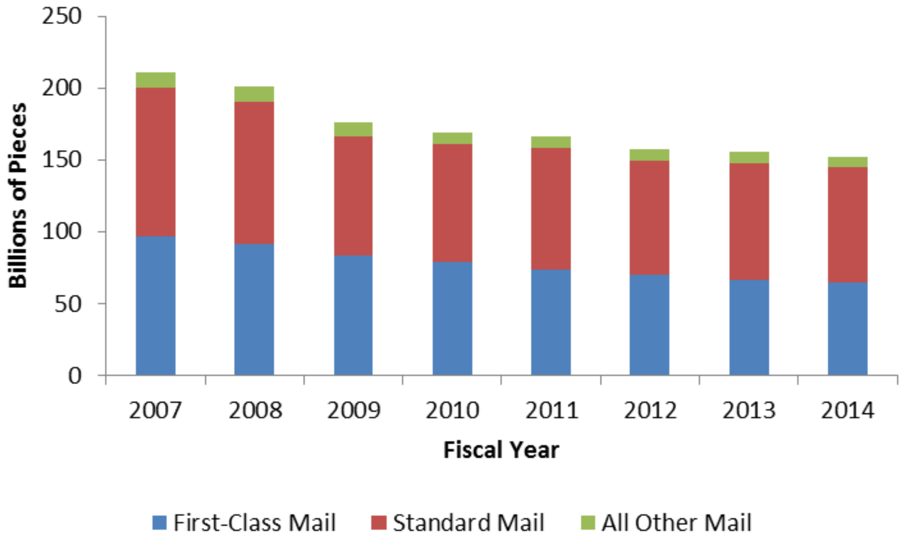
Market Dominant Volume Trends

Figure III-1 (next page) shows the total volume loss for Market Dominant products over the last 7 years. Since FY 2007, volumes declined by 58.7 billion pieces. The greatest single-year decline in total Market Dominant volumes, 12.7 percent, was in FY 2009. The rate of decline has since fluctuated, ranging from 1.4 percent to 5.5 percent. In FY 2014, total Market Dominant volumes fell 2.1 percent.

In FY 2014, First-Class Mail volumes declined by 32 billion pieces and Standard Mail volumes declined by 23 billion pieces. Between FY 2007 and FY 2014, First-Class Mail volume declined steadily at an average annual rate of 4.7 percent. In Standard Mail, the volume decline was more pronounced in certain years, less pronounced in others. Standard Mail volume fell 20.3 percent between FY 2007 and FY 2009 and 2.6 percent between FY 2009 and FY 2014. Total Standard Mail volume has increased in 3 of the last 5 years.

[15] *See* FY 2013 ACD at 5-61; FY 2012 ACD at 15-22, 88-96, 108-117; FY 2011 ACD at 103-106, 113-120, 131-32; FY 2010 ACD at 90-94, 103-08, 116-118.

Figure III-1
Market Dominant Volumes, FY 2007 to FY 2014

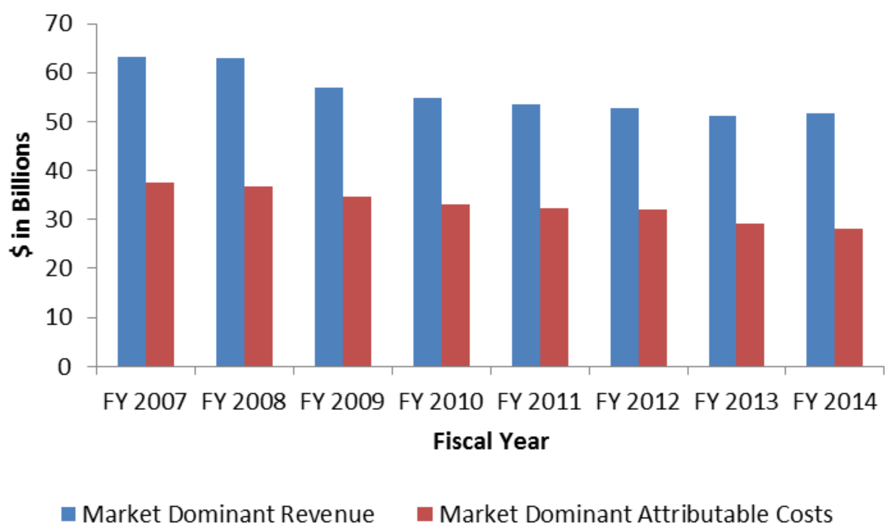


Source: FY 2014 and FY 2013 Postal Regulatory Commission *Financial Report*, Appendix A; Postal Regulatory Commission Library Reference PRC–LR–1, FY 2007-FY 2012 ACD.

Market Dominant Revenue and Cost Trends

Total Market Dominant revenues and attributable costs have declined significantly since FY 2007. Total revenues have declined by 18.3 percent and total attributable costs have declined by 24.8 percent. *See* Figure III-2.

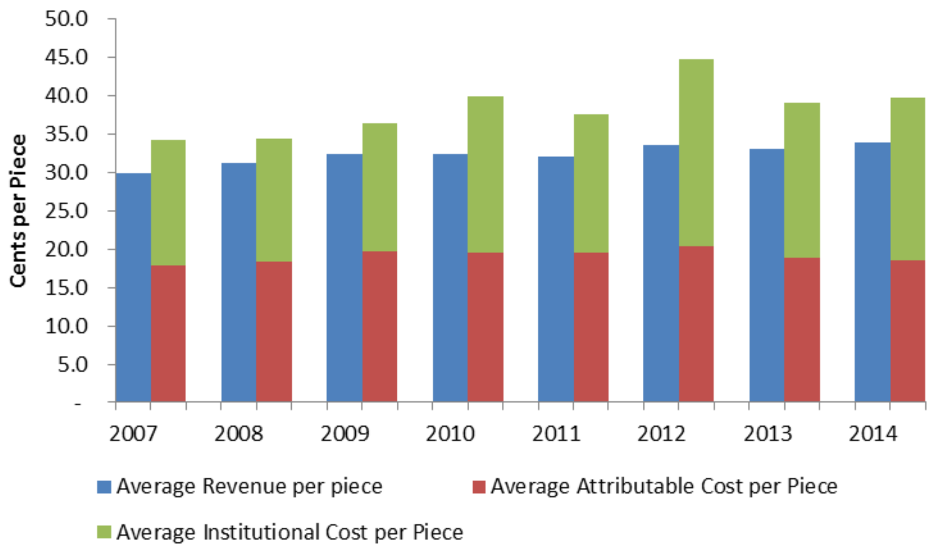
Figure III-2
Market Dominant Revenue and Attributable Costs, FY 2007-FY 2014



Source: FY 2014 and FY 2013 Postal Regulatory Commission *Financial Report*, Appendix A; Postal Regulatory Commission Library Reference PRC–LR–1, FY 2007-FY 2012 ACD.

As shown in Figure III-3, on a unit basis, average revenue and cost have increased. From FY 2007 to FY 2014, Market Dominant average unit revenue increased 4 cents while the Market Dominant average unit attributable cost increased less than 1 cent. Since FY 2009, however, the Market Dominant average unit attributable cost has steadily declined; it is almost 1.2 cents lower in FY 2014 than in FY 2009. Comparatively, Market Dominant average unit total cost has increased 3.3 cents since FY 2009.

Figure III-3
Market Dominant Average Unit Revenue and Cost, FY 2007-FY 2014



Source: Postal Regulatory Commission derived from Postal Service FY 2007-FY 2014 *Cost and Revenue Analysis Reports*.

Attributable Costs

Attributable costs are "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[.]" *See* Title 39 of the United States Code, section 3622(c)(2). Attributable costs include volume-variable costs (costs that increase or decrease to some extent as volume increases or decreases) and product-specific costs (costs that are caused by a specific product, but do not vary with volume). Institutional or fixed costs are the costs that remain after attributable costs are calculated. Table III-2 (next page) illustrates the calculation of volume-variable and fixed costs, assuming no product-specific costs. Total attributable costs are calculated by multiplying total costs by the volume variability ratio.[16] Average unit attributable costs are calculated by dividing total attributable costs by total volume. Institutional costs are total costs minus total attributable costs.

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

Table III-2
Calculation of Attributable and Institutional Costs

	[1]	[2]	[3]	[4] [2] x [3]	[5] [4] / [1]	[6] [2] - [4]
	Total Volume (000)	Total Cost ($ in 000)	Volume Variable	Attributable (Vol. Variable) Costs ($ in 000)	Attributable (Vol. Variable) Cost per Piece (Cents)	Total Institutional (Fixed) Costs ($ in 000)
Postmasters	155,374,884	$1,938,772	17.7%	$343,750	0.002	$1,595,022
Supervision	155,374,884	3,123,479	54.5%	1,701,804	0.011	1,421,675
Mail processing	155,374,884	10,558,536	94.0%	9,927,679	0.064	630,858
City carrier in-office	155,374,884	3,556,057	84.7%	3,013,212	0.019	542,845
City carrier street	155,374,884	11,655,178	37.5%	4,373,861	0.028	7,281,317
Rural carriers	155,374,884	6,980,733	33.6%	2,345,458	0.015	4,635,275
Custodial and maintenance	155,374,884	3,061,791	71.0%	2,172,539	0.014	889,252
Transportation	155,374,884	6,586,090	87.0%	5,731,356	0.037	854,734
Administration	155,374,884	13,098,595	23.5%	3,010,493	0.019	10,088,102
Other segments	155,374,884	12,802,688	49.3%	6,310,428	0.041	6,492,260
Total	**155,374,884**	**$73,361,920**		**$38,930,580**	**0.251**	**$34,431,340**

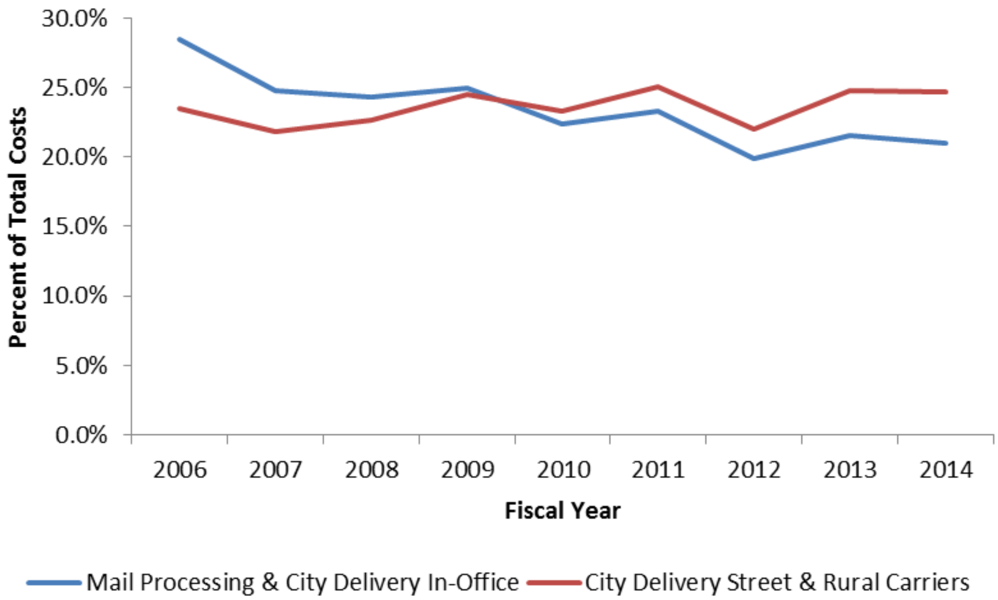
Source: Docket No. ACR2014, Library Reference USPS–FY14–31.

Mail processing costs have declined more than 30 percent since FY 2006. These costs are 94 percent volume-variable. Consequently, the decline in total mail volume has contributed significantly to the reduction in total mail processing costs. The change in mail mix, with the share of workshared mail growing, has also reduced mail processing costs because workshared mail requires less handling by Postal Service employees. In addition, the Postal Service has introduced several cost-saving initiatives aimed at lowering these costs.

In contrast, city carrier street time costs have increased 7.3 percent since FY 2006. These costs are 37.5 percent volume-variable. The city carrier street time costs do not vary significantly with volume because carriers must travel the same delivery route regardless of the amount of mail they are carrying. City carrier in-office costs are the carrier costs related to time spent sorting mail. These costs are 84.7 percent volume-variable. That portion of city delivery costs has decreased 8.5 percent since FY 2006. Figure III-4 (next page) shows that the proportion of mail processing costs to total costs has been decreasing while the proportion of delivery costs to total costs has been increasing.

Attributable costs are distributed to products using distribution keys that reflect the underlying cost driver. The Postal Service calculates attributable costs according to methodologies approved by the Commission. Those methodologies are reviewed by the Commission, and members of the general public are encouraged to comment in such dockets.

Figure III-4
Comparison of Mail Processing and Delivery Costs to Total Costs



Source: U.S. Postal Service *Cost Segments and Components Reports*, FY 2006-FY 2014.

In FY 2014, the Commission approved several changes to cost attribution. These changes are reflected in the costs allocated to products in the Cost and Revenue Analysis model described in Docket No. ACR2014, Library Reference USPS–FY14–32 and USPS–FY14–31.[17] The changes include Postal Service proposals that are either pending before the Commission or concluded in FY 2014, data sources used to develop attributable costs, and corrections of previous years' errors.

Changes in attributable costs for FY 2014 include:

- The Commission approved using scans to assign clerk labor costs, city carrier in-office costs, and rural carrier costs of delivery directly to the host product rather than through an adjustment within the *Cost and Revenue Analysis "D" Report*. *See* Docket No. RM2014-6, Proposal Eight, September 10, 2014 (Order No. 2180).

- The Postal Service reallocated a portion of the costs from Miscellaneous Postal Supplies and Services to Miscellaneous Operating Costs—Federal Reserve and Commercial Banks. The Commission approved a new attribution and distribution methodology assigning these costs to products. *See* Docket No. RM2015-4, Proposal Eleven, February 9, 2015 (Order No. 2350).

[17] The non-public version of these library references is USPS–FY14–14 and USPS–FY14–13.

- The Commission approved new quarterly distribution factors developed from census data. These new factors were used to assign FedEx Night Turn transportation costs to products. *See* Docket No. RM2014-4, Proposal Two, June 25, 2014 (Order No. 2101).

- The Commission approved updates to Cost Segment 14, Highway Transportation, cost variabilities. *See* Docket No. RM2014-6, Proposal Six, September 10, 2014 (Order No. 2180).

- The Postal Service proposed a new cost attribution methodology related to Customer Care Centers. The centers, which had been staffed by a contractor, are now staffed by Postal Service clerks. Cost Segment 3 now includes a new cost component (Component 424) with the new cost distribution to products. *See* Docket No. RM2015-5, Proposal Twelve, November 7, 2014 (Order No. 2246). (Commission decision pending.)

- The Postal Service corrected cost distributions for Cost Segment 12, Motor Vehicle Service, Vehicle Hire. It found that, prior to FY 2014, the allocation of vehicle hire costs to various categories were inadvertently hard-coded and the allocations costs were maintained in the same proportion as prior years. The Postal Service has corrected the error to allow the proportions to change each year with the change in vehicle usage. The largest impact of these changes was on vehicle hire costs for rural carriers.

- The Postal Service developed a new equipment distribution key for the Passive Adaptive Scanner System and the Delivery Sortation System. Additionally, distribution factors were developed for both systems for Cost Segment 11, Equipment Maintenance Labor; Cost Segment 16, Equipment Parts and Supplies; and Cost Segment 20, Equipment Depreciation.

- Every Door Direct Mail–Retail was introduced as a product in FY 2013. It is similar to Standard Mail High Density and Saturation Flats/Parcels. The Postal Service discovered that many of these products were mismarked or misidentified in the City Carrier Cost System and Rural Carrier Cost System. A correction was devised whereby Every Door Direct Mail–Retail and High Density and Saturation Flats/Parcel tallies were aggregated and assigned to each product based on Revenues, Pieces, and Weight proportions.

Institutional Costs

Institutional costs cannot be attributed to a specific product or service. Often referred to as “fixed costs,” they include costs for the postmaster general’s salary, delivery route time, and the payment for the RHBF. When mail volumes are growing, the institutional cost share will decrease unless the average unit attributable cost is falling or total fixed costs are increasing. The opposite occurs when mail volumes are declining. The institutional cost share will increase unless average unit attributable costs are increasing or total fixed costs are decreasing.

All the examples in Tables III-3, III-4, and III-5 assume that there are no product-specific costs. Table III-3 presents two examples of how the institutional cost share changes as volume increases or decreases, assuming average unit attributable costs and total fixed costs remain constant. In these examples, hypothetical volumes are multiplied by the average unit attributable cost (from column [5] of Table III-2) to calculate the total attributable costs. Total institutional costs are taken from column [6] of Table III-2. Total costs are equal to total attributable costs plus total institutional costs. The institutional cost share is the ratio of total institutional cost to total costs. As seen in the examples, the ratio of institutional costs to total costs decreases when volume is increasing and increases when volume is decreasing.

Table III-3
Changes in Institutional Cost Share, Examples One and Two

Example 1: Increasing Volume, Attributable Cost per Piece, and Total Institutional Costs Held Constant					
[1]	[2]	[3]	[4]	[5]	[6]
		[1] x [2]		[3] + [4]	[4] / [5]
Hypothetical Volume	Attributable (Volume-Variable) Cost per Piece	Hypothetical Total Attributable (Volume-Variable) Costs	Total Institutional (Fixed) Costs	Hypothetical Total Costs	Hypothetical % Institutional (Fixed)
100,000,000	0.251	25,055,903	34,431,340	59,487,242	57.9%
150,000,000	0.251	37,583,854	34,431,340	72,015,194	47.8%
225,000,000	0.251	56,375,781	34,431,340	90,807,121	37.9%

Example 2: Decreasing Volume, Attributable Cost per Piece, and Total Institutional Costs Held Constant					
[1]	[2]	[3]	[4]	[5]	[6]
		[1] x [2]		[3] + [4]	[4] / [5]
Hypothetical Volume	Attributable (Volume-Variable) Cost per Piece	Hypothetical Total Attributable (Volume-Variable) Costs	Total Institutional (Fixed) Costs	Hypothetical Total Costs	Hypothetical % Institutional (Fixed)
100,000,000	0.251	25,055,903	34,431,340	59,487,242	57.9%
50,000,000	0.251	12,527,951	34,431,340	46,959,291	73.3%
25,000,000	0.251	6,263,976	34,431,340	40,695,315	84.6%

Sources: [2] & [4] Table II-2; [3] = [1] x [2]; [5] = [3] + [4]; [6] = [4] /[5].

The next two examples, shown in Table III-4 on the next page, demonstrate that, given stable total fixed costs, the average unit attributable cost must change in order for the institutional cost share to remain constant as volume changes. In these examples, total institutional costs are held constant. Therefore, in order for the institutional cost share to remain constant, total attributable costs must also remain the same. Unit attributable cost is calculated by dividing total attributable costs by total volume. In the examples, note that average unit attributable cost decreases as volume increases and increases as volume decreases.

Table III-4
Changes in Institutional Cost Share, Examples Three and Four

Example 3: Increasing Volume, Total Institutional Costs, and Institutional Cost Percentage Held Constant					
[1]	[2]	[3]	[4]	[5]	[6]
		[1] x [2]	From Table III-2	[3] + [4]	[4] / [5]
Hypothetical Volume	Hypothetical Attributable (Volume-Variable) Cost per Piece	Hypothetical Total Attributable (Volume-Variable) Costs	Total Institutional (Fixed) Costs	Hypothetical Total Costs	Hypothetical % Institutional (Fixed)
100,000,000	0.251	25,055,903	34,431,340	59,487,242	57.9%
150,000,000	0.167	25,055,903	34,431,340	59,487,242	57.9%
225,000,000	0.111	25,055,903	34,431,340	59,487,242	57.9%

Example 4: Decreasing Volume, Total Institutional Costs, and Institutional Cost Percentage Held Constant					
[1]	[2]	[3]	[4]	[5]	[6]
		[1] x [2]		[3] + [4]	[4] / [5]
Hypothetical Volume	Hypothetical Attributable (Volume-Variable) Cost per Piece	Hypothetical Total Attributable (Volume-Variable) Costs	Total Institutional (Fixed) Costs	Hypothetical Total Costs	Hypothetical % Institutional (Fixed)
100,000,000	0.251	25,055,903	34,431,340	59,487,242	57.9%
50,000,000	0.501	25,055,903	34,431,340	59,487,242	57.9%
25,000,000	1.002	25,055,903	34,431,340	59,487,242	57.9%

Sources: [4] Table III-2; [2] = ([5] x (1 - [6]))/[1]; [3] = [5] - [4]; [5] = [4]/[6].

The final two examples, shown in Table III-5 on the next page, show what occurs when average unit attributable cost and the institutional cost share are held constant. Total institutional costs increase as volume increases and declines as volume declines.

A recent paper sponsored by the Commission reviewed the ratio of attributable and institutional costs to total costs over time.[18] The paper noted several factors, categorized as "operational factors" and "non-operational factors," that could affect the variability ratio. The operational factors were volume, volume mix, and weighted volume, which is volume weighted by the average unit attributable cost. Non-operational factors included exogenous factors (accounting changes and changes in the law) and changes in cost methodology.

[18] "The Postal Service Variability Ratio and Some Implications" by Robert Cohen and John Waller, October 7, 2014.

Table III-5
Example of Changes in Institutional Cost Share, Examples Five and Six

Example 5: Increasing Volume, Attributable Cost per Piece, and Institutional Percentage Held Constant					
[1]	[2]	[3] [1] x [2]	[4]	[5] [3] + [4]	[6] [4] / [5]
Hypothetical Volume	Attributable (Volume-Variable) Cost per Piece	Hypothetical Total Attributable (Volume-Variable) Costs	Hypothetical Total Institutional (Fixed) Costs	Hypothetical Total Costs	Hypothetical % Institutional (Fixed)
100,000,000	0.251	25,398,587	33,898,939	59,297,526	57.2%
150,000,000	0.251	38,097,881	50,848,408	88,946,289	57.2%
225,000,000	0.251	57,146,821	76,272,612	133,419,433	57.2%

Example 6: Decreasing Volume, Attributable Cost per Piece, and Institutional Percentage Held Constant					
[1]	[2]	[3] [1] x [2]	[4]	[5] [3] + [4]	[6] [4] / [5]
Hypothetical Volume	Attributable (Volume-Variable) Cost per Piece	Hypothetical Total Attributable (Volume-Variable) Costs	Hypothetical Total Institutional (Fixed) Costs	Hypothetical Total Costs	Hypothetical % Institutional (Fixed)
100,000,000	0.251	25,398,587	33,898,939	59,297,526	57.2%
50,000,000	0.251	12,699,294	16,949,469	29,648,763	57.2%
25,000,000	0.251	6,349,647	8,474,735	14,824,381	57.2%

Sources: [2] Table III-2; [3] = [1] x [2]; [4] = [3]/(1 - [6]); [5] = [3] + [4].

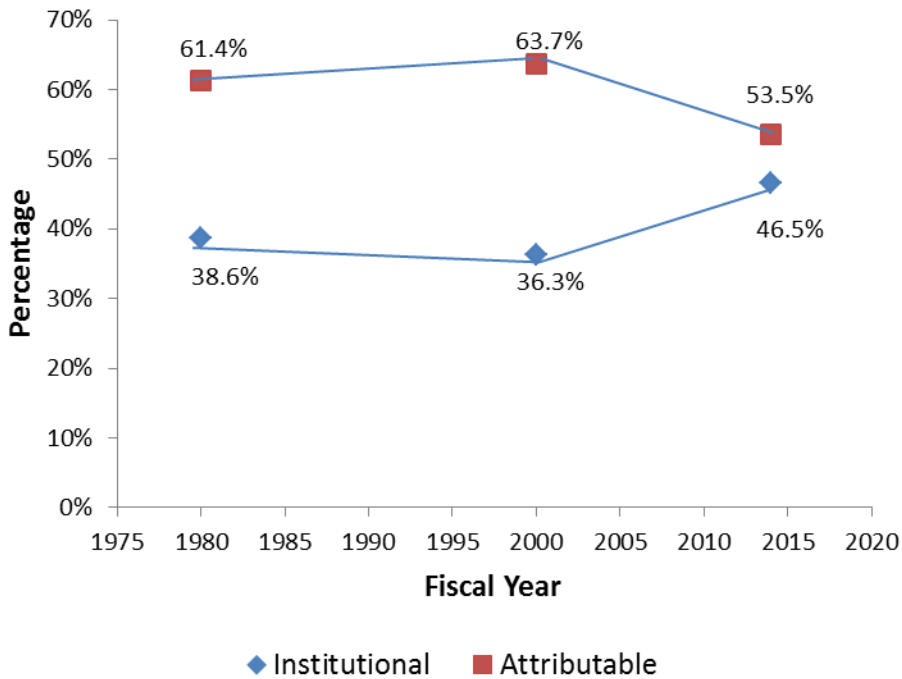
The paper found that, overall, the variability ratio has remained stable over the past 23 years, deviating only 4 percent from the median value over the period examined. However, it noted two distinct trends, one lasting from FY 1980 to FY 2000, and the other beginning in FY 2001.

During the first trend, the institutional cost share decreased less than 4 percent, even though volume increased by 90 percent. The Commission's review of the underlying data shows that during this time frame the average unit attributable cost, adjusted for inflation, declined 17.7 percent while total institutional costs, also adjusted for inflation, increased 46 percent. The decline in average unit attributable cost was largely due to an increase in workshared mail; the increase in institutional costs was due to several changes in the law that increased retirement-related costs.

During the second trend, total volume began to level off and eventually declined in FY 2007. Total volume in FY 2014 was 25 percent lower than in FY 2000. The institutional cost share was 28 percent lower than in FY 2000. The Commission's review of the underlying data shows that during this time frame the average unit attributable cost, adjusted for inflation, declined 7.9 percent. Total institutional costs, also adjusted for inflation, increased 4.9 percent. The decline in average unit attributable cost was due, in part, to the significant decline in First-Class Mail Single-Piece Letters/Postcards volume, which has considerably more work content per piece than First-Class Mail Presorted Letters/Postcards or Standard Mail. Consequently, declines in the product's volume lower average unit attributable cost.

Figure III-5 illustrates both of these trends.

Figure III-5
Trends in Institutional Cost Share



Source: Postal Service *Cost and Revenue Analysis Reports*, FY 1980-FY 2014.

A significant portion of the increase in total institutional costs is related to the Postal Accountability and Enhancement Act requirement that the Postal Service fund the liability for retiree health benefits under a 10-year schedule that averages almost $5.6 billion per year. The Postal Service proposed the attribution methodology for these benefits; the Commission accepted it in FY 2007.[19]

The total costs of retiree health benefits are the statutory payment into the RHBF and the current year's premium costs for the benefits.[20] The component costs are divided into a "current year" amount, which has the same variability as total labor costs, and a "prior

[19] *See* FY 2007 ACD, Appendix B. *See also* Docket No. ACR2007, Supplement to Library Reference USPS–FY07–2; Docket No. ACR2009, Supplement to Library Reference USPS–FY09–2.

[20] Estimated costs of additional pension obligations are also included for current employees covered by the Civil Service Retirement System.

year" institutional cost. The current year amount is estimated by determining the present value of the benefits earned during the fiscal year by current employees for retiree health benefits. The dollar value of the earned retiree health benefits is estimated by the Office of Personnel Management and reported as "normal costs" of retiree health benefits. In FY 2014, the $3.2 billion in current year costs were allocated to products on the basis of total labor costs. The $5.5 billion in prior year costs were institutional.[21]

Competitive Products and Services

Volume and revenue for Competitive products increased in FY 2014. Table III-6 compares the total volume, revenue, and cost of these products and services between FY 2013 and FY 2014. Volume was 10.9 percent greater in FY 2014, with concurrent increases in revenue, costs, and contribution to institutional costs. Total revenue grew by 11 percent, and total attributable costs and total contribution to institutional costs grew by 11 percent and 11.6 percent, respectively.

Table III-6
Total Competitive Products' Volume, Revenue, and Cost ($ Millions)

	FY 2014	FY 2013	Difference	% Change
Volume	3,448	3,108	340	10.9%
Revenue	15,280	13,741	1,539	11.2%
Attributable cost	10,970	9,881	1,089	11.0%
Contribution to institutional cost	4,310	3,860	450	11.7%

Source: FY 2014 and FY 2013 Postal Regulatory Commission *Financial Reports*, Appendix A.

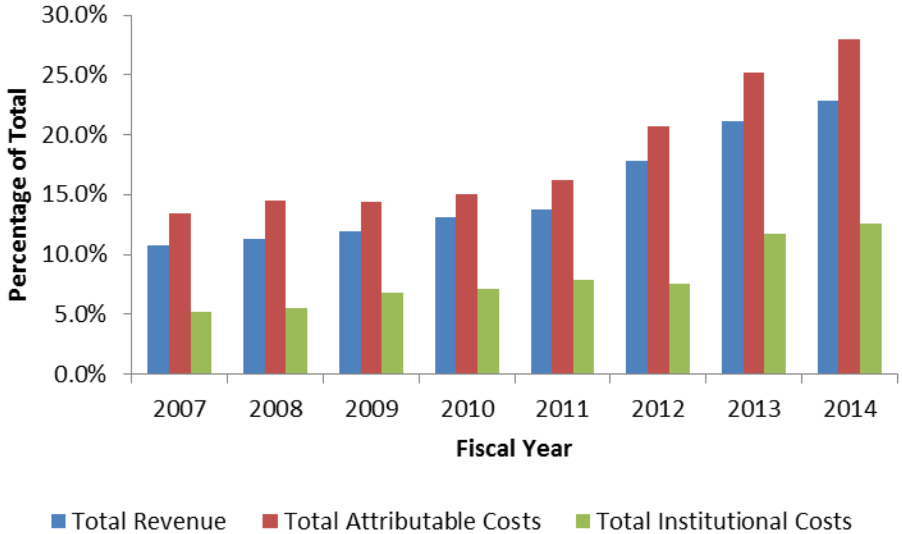
As seen in Figure III-6 on the next page, the Competitive products' share of total Postal Service revenues, attributable costs, and contribution to institutional costs has doubled since FY 2007.

Figure III-7, also on the next page, illustrates the changes in average unit revenue and cost from FY 2007 to FY 2014. Since FY 2009, average unit revenue for Competitive products and services has exceeded both the average unit attributable cost and the required average unit institutional cost. The decrease in average unit revenue in FY 2011 is the result of transfers of Market Dominant Parcels from First-Class Mail, Standard Mail, and Package Services to the Competitive product list. The average unit revenue of the transferred products, even after price increases, was lower than that of most other Competitive products.

After 2 years of declines, the average unit revenue of Competitive products and services increased 0.2 percent, or almost 1 cent, in FY 2014. The Postal Service implemented an average price increase of 2.4 percent in January 2014.

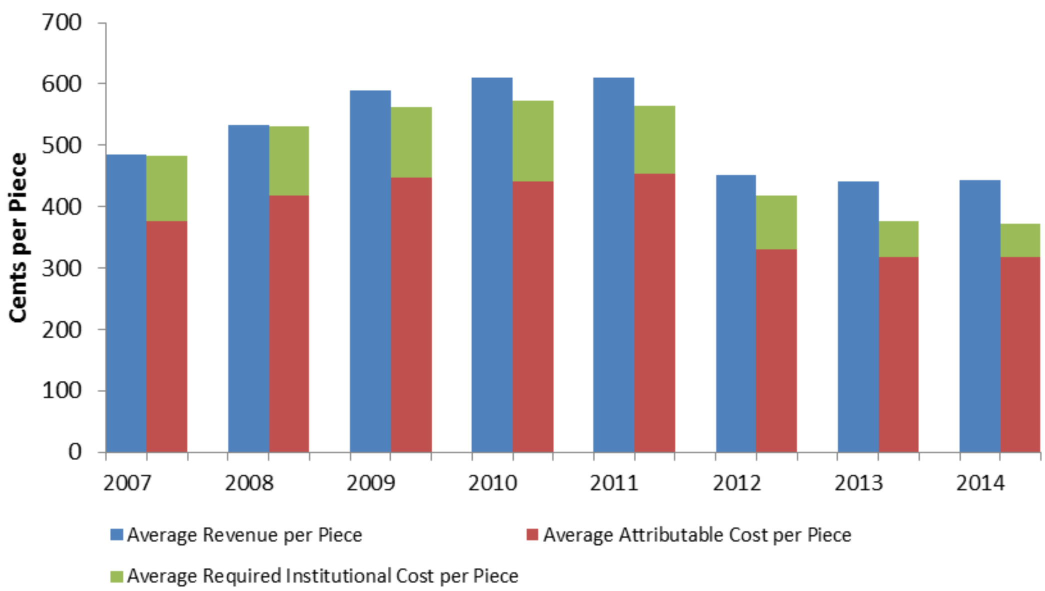
[21] *Id.*

Figure III-6
Competitive Products' Percentage Share of Total Postal Service Revenue, Costs, and Contribution to Institutional Costs



Source: U.S. Postal Service *Cost and Revenue Analysis Reports*, FY 2007-FY 2014.

Figure III-7
Competitive Average Unit Revenue and Cost, FY 2007-FY 2014

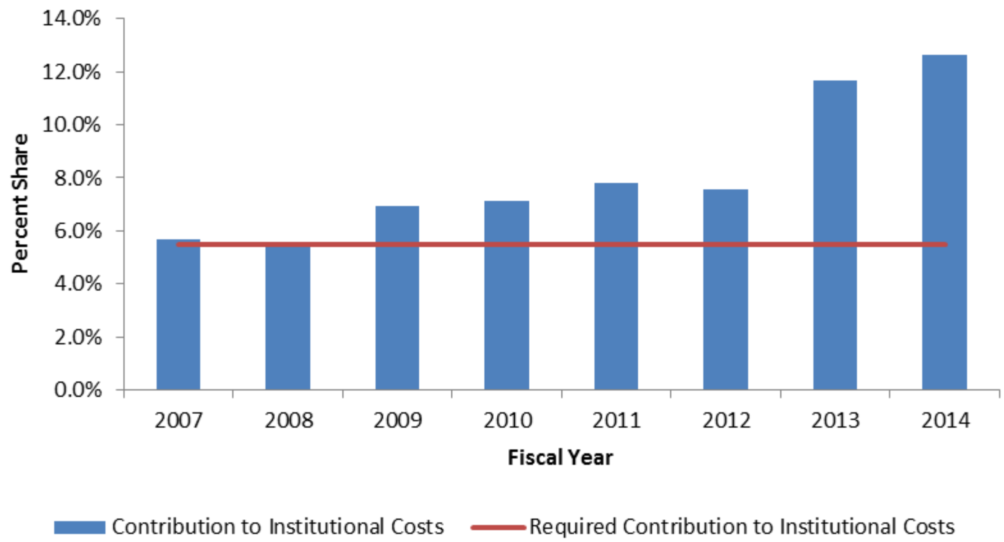


Source: Postal Regulatory Commission derived from U. S. Postal Service *Cost and Revenue Analysis Reports*, FY 2007-FY 2014.

The total average unit attributable cost increased 0.1 percent, yielding a decrease of 0.3 percent in average unit contribution for FY 2014. Attributable costs for Competitive products have increased in most cost segments, including mail processing, delivery, transportation and administration, and area operations.

Total contribution to institutional costs from Competitive products has grown since FY 2007, exceeding the required contribution level of 5.5 percent each year. As shown in Figure III-8, the products' contribution has increased significantly over the last 3 years.

Figure III-8
Competitive Products' Contribution to Institutional Cost



Source: FY 2014 and FY 2013 Postal Regulatory Commission *Financial Report*, Appendix A; Postal Regulatory Commission Library Reference PRC–LR–1, FY 2007-FY 2012 ACD.

Market Dominant Volume, Revenue, and Costs 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 disaggregated into letters, flats, and "all others."

FIRST-CLASS MAIL LETTERS COMPARED WITH FY 2013

Table III-7 on the next page summarizes the FY 2014 change in total volume and revenue for First-Class Mail letters. Although volume continued to decline, total revenue increased by $342 million in FY 2014. The higher revenue was the result of rate increases going into effect during this fiscal year. First-Class Mail presorted letters accounted for $310 million of the increase.

Table III-7
First-Class Mail Letters Volume and Revenue

	Mail Volume (Millions)				Mail Revenue ($ Millions)			
	FY 2014	FY 2013	Increase or Decrease	Change	FY 2014	FY 2013	Increase or Decrease	Change
Single-Piece	20,599	21,452	(853)	-4.0%	10,253	10,222	31	0.3%
Presorted	38,098	38,725	(627)	-1.6%	14,691	14,346	345	2.4%
Total Letters	**58,697**	**60,177**	**(1,480)**	**-2.5%**	**24,944**	**24,568**	**376**	**1.5%**

Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

Table III-8 summarizes the FY 2014 change in total attributable costs for First-Class Mail letters. Attributable costs remained relatively unchanged this fiscal year. Reductions in attributable costs for mail processing and city delivery were partially offset by increases in the attributable costs for rural delivery. Additionally, a new costing methodology for attributing credit and debit card fees increased attributable costs for First-Class Mail Single-Piece Letters/Postcards.[22] The average unit attributable cost increased slightly in FY 2014 for all First-Class Mail letters.

Table III-8
Attributable Cost and Average Unit Attributable Cost, First-Class Mail Letters

	Attributable Cost ($ Millions)				Unit Attributable Costs (Cents per Piece)			
	FY 2014	FY 2013	Increase or Decrease	Change	FY 2014	FY 2013	Increase or Decrease	Change
Single-Piece	5,710	5,905	(195)	-3.3%	27.7	27.5	0.2	0.7%
Presorted	4,573	4,605	(32)	-0.7%	12.0	11.8	0.1	1.2%
Total Letters	**10,283**	**10,510**	**(227)**	**-2.2%**	**17.5**	**17.5**	**0.1**	**0.3%**

Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

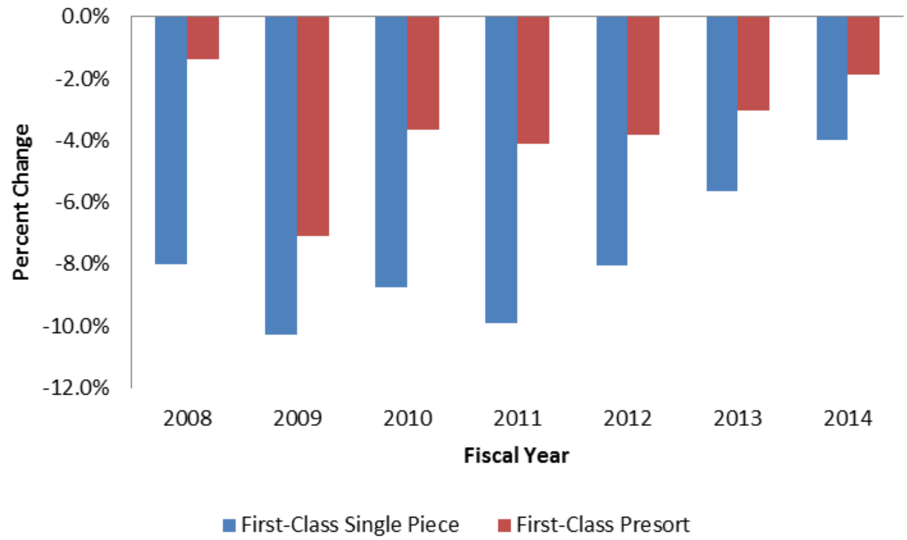
Trends in First-Class Mail Letters

The primary driver of the volume declines for First-Class Mail letters is the increased use of electronic media (*i.e.*, Internet diversion), although decreased business and consumer activity also plays a role.[23] As Figure III-9 (next page) illustrates, the rate of decline for First-Class Mail letter volume has diminished since FY 2010. This may be due to increasing business activity, employment, and consumer sales activity or less Internet diversion—or a combination of all factors.

[22] Docket No. RM2015-4, Order Approving Analytical Principle Used in Periodic Reporting (Proposal Eleven), February 9, 2015 (Order No. 2350).

[23] Postal Service FY 2014 Form 10-K at 8.

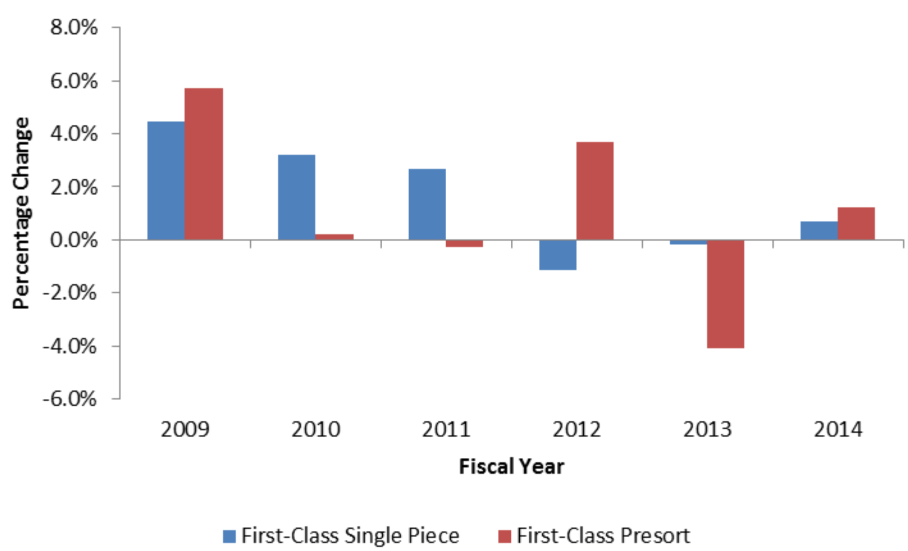
Figure III-9
Percentage Change in Volume for First-Class Mail Letters, FY 2008-FY 2014



Source: Postal Service *Revenue, Pieces, and Weight Reports*, FY 2008-FY 2014.

As shown in Figure III-10, the percentage change in the average unit attributable cost of First-Class Mail letters has fluctuated over time. The change for First-Class Mail presorted letters has been particularly erratic. In FY 2011, the average unit attributable cost increased 3.7 percent. It declined 4.1 percent the following year.

Figure III-10
Percentage Change in Average Unit Attributable Cost, First-Class Mail Letters



Source: FY 2014 and FY 2013 Postal Regulatory Commission *Financial Reports*, Appendix A; Postal Regulatory Commission Library Reference PRC–LR–1, FY 2007-FY 2012 ACD.

Table III-9 compares the average unit attributable cost, by cost segment, for FY 2010 through FY 2014. In FY 2012, the average unit costs in all cost segments, except city carrier in-office and rural carriers, increased. City carrier street cost increased 8.3 percent. In FY 2013, the average unit attributable cost declined for all cost segments, except city carrier street cost. In FY 2014, the average total unit attributable cost for First-Class Mail presorted letters increased 1 percent. Increases in city carrier in-office and rural carriers were offset by decreases in city carrier street and transportation.

Table III-9
First-Class Mail Presorted Letters Unit Attributable Cost by Segment, FY 2012-FY 2014

	Unit Attributable Cost					Change in Unit Attributable Cost			
Cost Segment	**2010**	**2011**	**2012**	**2013**	**2014**	**2011**	**2012**	**2013**	**2014**
Mail processing	3.48	3.38	3.51	3.35	3.34	-2.8%	3.9%	-4.8%	-0.1%
City carrier in-office	1.11	1.10	1.07	1.01	1.10	-1.5%	-2.2%	-5.5%	8.3%
City carrrier street	1.62	1.62	1.81	1.84	1.80	0.0%	11.8%	2.0%	-2.5%
Rural carriers	0.72	0.74	0.72	0.62	0.64	2.7%	-2.1%	-14.4%	3.8%
Transportation	0.99	1.12	1.19	1.18	1.13	13.3%	6.1%	-0.3%	-4.1%
All other	4.01	3.94	4.10	3.88	3.99	-1.7%	3.9%	-5.2%	2.8%

Source: Postal Regulatory Commission derived from Postal Service *Cost Segment and Component Reports*, FY 2010-FY 2014.

FIRST-CLASS MAIL FLATS COMPARED WITH FY 2013

As shown in Table III-10, total volume and total revenue for First-Class Mail flats continued to decline. Although rate increases implemented in FY 2014 resulted in an increase in revenue for First-Class Mail presorted flats, the increase was not enough to offset the total revenue lost due to volume declines in First-Class Mail single-piece flats.

Table III-10
First Class Mail Flats Volume and Revenue

	Mail Volume (Millions)				Mail Revenue ($ Millions)			
	FY 2014	**FY 2013**	**Increase or Decrease**	**Change**	**FY 2014**	**FY 2013**	**Increase or Decrease**	**Change**
Single-piece	1,184	1,269	(85)	-6.7%	1,905	1,940	(35)	-1.8%
Presorted	599	626	(27)	-4.3%	594	580	15	2.6%
Total Flats	**1,783**	**1,894**	**(112)**	**-5.9%**	**2,499**	**2,519**	**(20)**	**-0.8%**

Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

Table III-11 on the next page summarizes the FY 2014 change in attributable costs. Total attributable costs for First-Class Mail flats were less than in FY 2013, despite increases in costs for First-Class Mail presorted flats.

Table III-11
First-Class Mail Flats Attributable Costs and Average Unit Attributable Cost

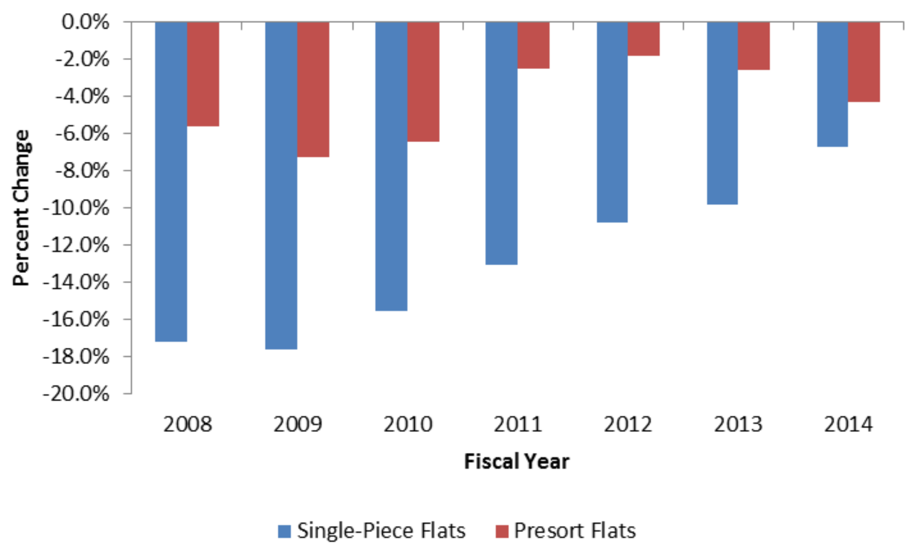
	Attributable Cost ($ Millions)				Unit Attributable Costs (Cents per Piece)			
	FY 2014	FY 2013	Increase or Decrease	Change	FY 2014	FY 2013	Increase or Decrease	Change
Single-Piece	1,053	1,192	(139)	-11.6%	89.0	93.9	(5.0)	-5.3%
Presorted	513	494	19	3.9%	85.7	78.9	6.8	8.6%
Total Flats	**1,566**	**1,686**	**(120)**	**-7.1%**	**87.9**	**89.0**	**(1.1)**	**-1.3%**

Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

Trends in First-Class Mail Flats

Figure III-11 compares the percentage change in First-Class Mail flats volume from FY 2008 to FY 2014. First-Class Mail single-piece flat volumes continued to decline in FY 2014. However, like First-Class Mail letters, the rate of decline is less than previous years. In contrast, the rate of decline for presorted flats has accelerated since FY 2012.

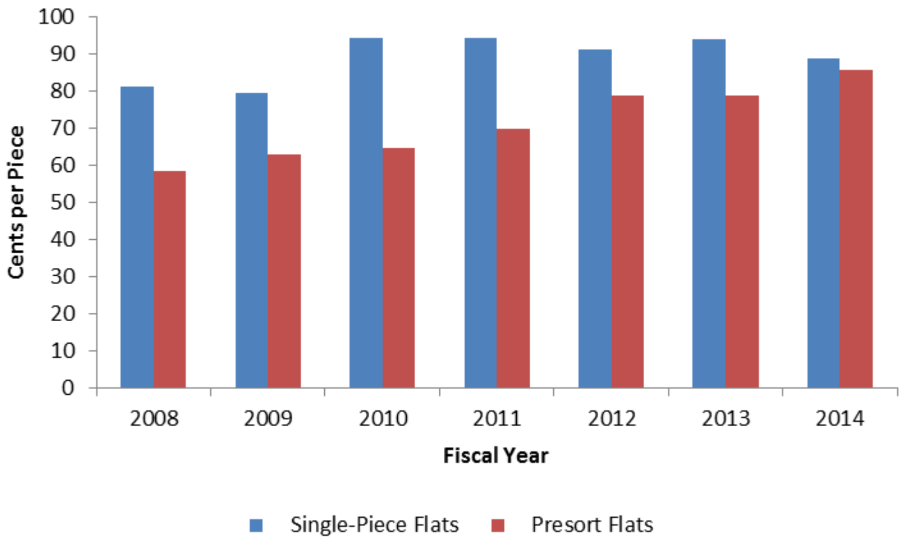
Figure III-11
Percentage Change in First-Class Mail Flat Volume



Source: Postal Service *Revenue, Pieces, and Weight Reports*, FY 2008-FY 2014.

As seen in Figure III-12 (next page), the average unit attributable cost for First-Class Mail single-piece flats in FY 2010 was 29.9 cents higher than the average unit attributable cost for First-Class Mail presorted flats. In FY 2014, this difference had shrunk to 3.3 cents.

Figure III-12
First-Class Mail Flats Average Unit Attributable Cost



Source: FY 2014 and FY 2013 Postal Regulatory Commission *Financial Report*, Appendix A; Postal Regulatory Commission Library Reference PRC–LR–1, FY 2007-FY 2012 ACD.

Table III-12 compares the average unit attributable cost by cost segment of First-Class Mail single-piece and presorted flats. In FY 2010, the cost of mail processing was 11.2 cents higher for single-piece flats than for presorted flats; in FY 2014, the cost for single-piece flats was 2.1 cents *lower* than for presorted flats. This seemingly anomalous relationship is the result of a decline in the average unit attributable cost of mail processing for single-piece flats and an increase for presorted flats. In FY 2010, the average unit attributable city carrier in-office cost was virtually the same for both types of flats; in FY 2014, the cost for single-piece flats was 6.1 cents *lower* than presorted flats.

Table III-12
First-Class Mail Presort Flats Unit Attributable Cost by Segment, FY 2012-FY 2014

	2010			2014		
Cost Segment	**Single-Piece**	**Presort**	**Diff.**	**Single-Piece**	**Presort**	**Diff.**
Mail processing	37.2	23.7	13.6	33.2	32.9	0.4
City carrier in-office	8.7	8.6	0.1	6.4	12.5	(6.1)
City carrrier street	4.4	2.3	2.1	5.8	2.5	3.2
Rural carriers	1.7	1.9	(0.1)	2.5	2.1	0.3
Transportation	11.0	8.3	2.7	13.1	9.0	4.1
All other	31.4	20.1	11.3	28.0	26.7	1.3
Total	**94.5**	**64.9**	**29.6**	**89.0**	**85.7**	**3.3**

Source: Postal Regulatory Commission, derived from Postal Service *Cost Segment and Component Reports*, FY 2010-FY 2014.

Other First-Class Mail Compared with FY 2013

As Table III-13 shows, every other category of First-Class Mail volume, with the exception of Inbound Letter Post, declined in FY 2014. Total revenue also declined due to reductions in Postcards and Outbound Single-Piece First-Class Mail International. The significant decline for the latter could be related to a large decline in weight per piece, which could be related to a significant change in the mix of the mail. The increase in revenue for Parcels can be fully attributed to the rate increases implemented in January 2014.

Table III-13
All Other First-Class Mail Volume and Revenue

	Mail Volume (Millions)				Mail Revenue ($ Millions)			
	FY 2014	FY 2013	Increase or Decrease	Change	FY 2014	FY 2013	Increase or Decrease	Change
Total Postcards	3,123	3,468	(345)	-10.0%	885	944	(59)	-6.3%
Parcels	233	247	(14)	-5.7%	593	580	13	2.2%
Outbound Single-Piece First-Class Mail International	216	231	(16)	-6.9%	308	458	(149)	-32.6%
Inbound Letter Post	242	223	19	8.4%	175	145	30	20.5%
Inbound International NSAs[a]	159	164	(6)	-3.5%	164	137	28	20.2%
Total Other First-Class Mail	**3,973**	**4,335**	**(362)**	**-8.4%**	**2,125**	**2,263**	**(139)**	**-6.1%**

[a] Negotiated service agreements
Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

As shown in Table III-14 on the next page, total attributable costs declined for all other First-Class Mail categories except for Inbound Letter Post. The average unit attributable cost increased for three of the five categories. The average unit attributable cost of Outbound Single-Piece First-Class Mail International declined by 35.9 percent. A review of the costs indicates that, much like the revenue decline, a significant drop in the weight per piece has caused a decline in the costs of processing and transportation of this mail. The Commission will continue to monitor this development during FY 2015.

Standard Mail

Standard Mail is a Market Dominant class that consists 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 disaggregated into letters and flats.[24]

[24] Since Standard Mail Parcels has 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.

Table III-14
Other First-Class Mail Attributable Costs and Average Unit Attributable Cost

	Attributable Cost ($ Millions)				Unit Attributable Costs (Cents per Piece)			
	FY 2014	FY 2013	Increase or Decrease	Change	FY 2014	FY 2013	Increase or Decrease	Change
Total Postcards	451	487	(36)	-7.4%	14.4	14.0	0.4	2.8%
Parcels	543	583	(40)	-6.9%	232.8	235.9	(3.0)	-1.3%
Outbound Single-Piece First-Class Mail International	188	316	(127)	-40.3%	87.4	136.4	(48.9)	-35.9%
Inbound Letter Post	249	228	21	9.4%	102.9	102.0	0.9	0.9%
Inbound International NSAs	143	148	(5)	-3.3%	90.2	90.1	0.2	0.2%
Total	**1,575**	**1,761**	**(187)**	**-10.6%**	**39.6**	**40.6**	**(1.0)**	**-2.5%**

Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

STANDARD MAIL LETTERS COMPARED WITH FY 2013

Table III-15 summarizes the FY 2014 change in volume and revenue for Standard letters. Volumes for both Standard letter products continued to increase and were the only Standard Mail products that showed any volume growth. Revenues also increased in FY 2014.

Table III-15
Standard Mail Letter Volume and Revenue, FY 2014 and FY 2013

	Mail Volume (Millions)				Mail Revenue ($ Millions)			
	FY 2014	FY 2013	Increase or Decrease	Change	FY 2014	FY 2013	Increase or Decrease	Change
Letters	48,072	47,791	281	0.6%	9,956	9,478	478	5.0%
High Density and Saturation Letters	5,970	5,712	258	4.5%	884	809	75	9.3%
Total Letters	**54,042**	**53,502**	**539**	**1.0%**	**10,840**	**10,287**	**553**	**5.4%**

Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

Table III-16 (next page) summarizes the FY 2014 change in attributable costs. Overall total attributable costs for Standard letters decreased. High Density and Saturation Letters product's costs increased, as volume growth led to higher mail processing, city delivery street time, and related indirect costs. These increases were offset by reductions in the costs for the Letters product, which makes up a larger portion of total Standard letters . The overall average unit attributable cost for Standard letters declined slightly.

Table III-16
Standard Mail Letter Attributable Costs and Average Unit Attributable Cost

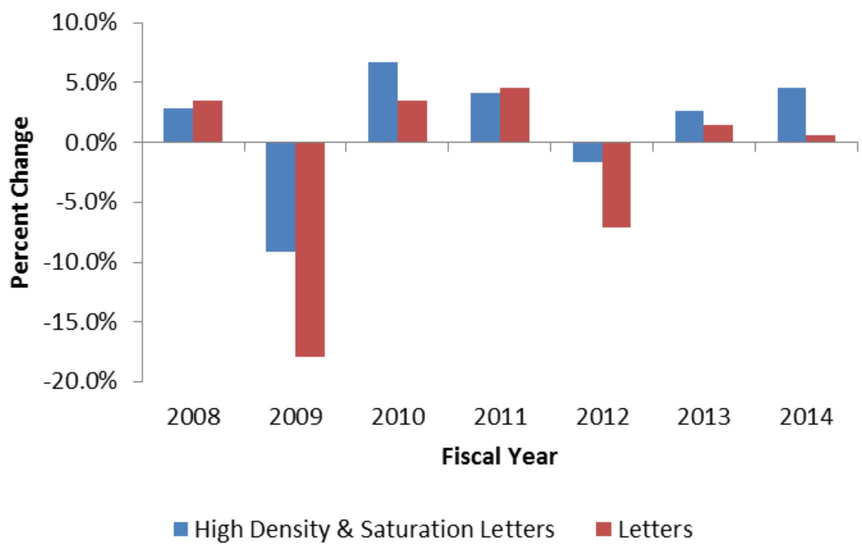
	Attributable Cost ($ Millions)				Unit Attributable Costs (Cents per Piece)			
	FY 2014	FY 2013	Increase or Decrease	Change	FY 2014	FY 2013	Increase or Decrease	Change
Letters	4,948	4,996	(48)	-1.0%	10.3	10.5	(0.2)	-1.5%
High Density and Saturation Letters	370	341	28	8.3%	6.2	6.0	0.2	3.6%
Total Letters	**5,317**	**5,337**	**(20)**	**-0.4%**	**9.8**	**10.0**	**(0.1)**	**-1.4%**

Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

Trends in Standard Mail Letters

As seen in Figure III-13, Standard letter volumes have grown each year except for FY 2009 and FY 2012.

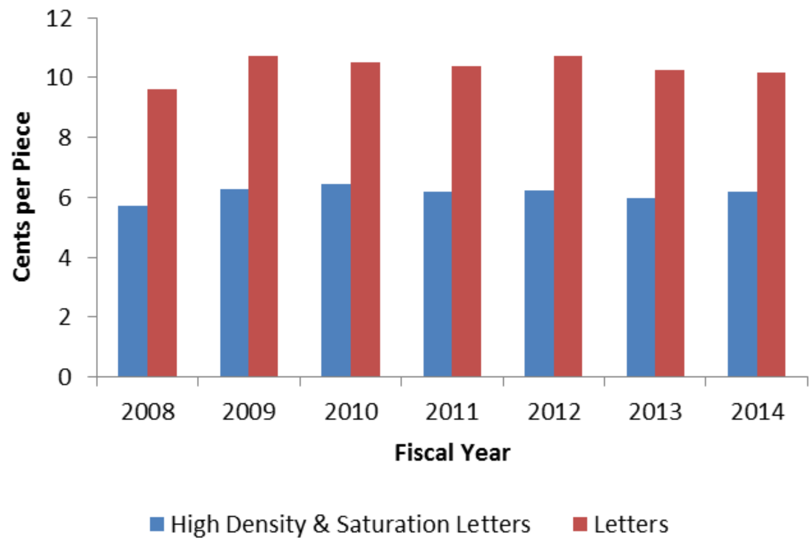
Figure III-13
Standard Mail Letter Volumes Percentage Change



Source: FY 2014 and FY 2013 Postal Regulatory Commission *Financial* Reports, Appendix A; Postal Regulatory Commission Library Reference PRC–LR–1, FY 2007-FY 2012 ACD.

The average unit attributable cost for both categories of Standard letters has increased since FY 2008. Figure III-14 on the next page illustrates this increase.

Figure III-14
Percentage Change in Standard Mail Letter Unit Attributable Cost



Source: FY 2014 and FY 2013 Postal Regulatory Commission *Financial* Reports, Appendix A; Postal Regulatory Commission Library Reference PRC–LR–1, FY 2007-FY 2012 ACD.

STANDARD MAIL FLATS COMPARED WITH FY 2013

Table III-17 summarizes the FY 2014 change in volume and revenue for Standard flats. Almost 90 percent of the volume decline occurred in Carrier Route and Flats.[25] Total revenue also declined, as the reduction in volume of Carrier Route and Flats offset much of the increase in prices from the CPI cap rate increases and the exigent rate surcharge.

Table III-17
Standard Mail Flat Volume and Revenue

	Mail Volume (Millions)				Mail Revenue ($ Millions)			
	FY 2014	FY 2013	Increase or Decrease	Change	FY 2014	FY 2013	Increase or Decrease	Change
High Density and Saturation Flats/Parcels	11,295	11,338	(43)	-0.4%	2,013	1,934	80	4.1%
Carrier Route	9,030	9,508	(478)	-5.0%	2,381	2,378	3	0.1%
Flats	5,054	5,568	(514)	-9.2%	2,041	2,138	(97)	-4.5%
Every Door Direct Mail–Retail	890	975	(85)	-8.7%	149	138	11	7.6%
Total Flats & Parcels	**26,270**	**27,388**	**(1,119)**	**-4.1%**	**6,585**	**6,588**	**(4)**	**-0.1%**

Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

[25] The volume and revenue data in Table III-17 include a very small amount of Parcels in High Density and Saturation and Carrier Route. Most of the volume transferred to the Competitive product Lightweight Parcel Select in FY 2012. The total volume of Parcels in High Density and Saturation and Carrier Route Flat Mail is less than 0.1 percent.

As shown in Table III-18, total attributable costs for Standard flats declined slightly, primarily due to the declining volume of Carrier Route and Flats. The average unit attributable cost for all categories of Standard flats increased more than 20 percent in FY 2014.

Table III-18
Standard Flats Attributable Costs and Average Unit Attributable Cost

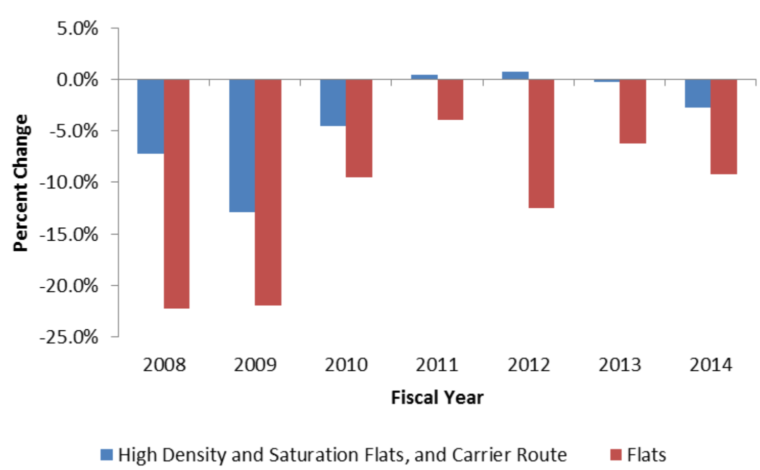
	Attributable Cost ($ Millions)				Unit Attributable Costs (Cents per Piece)			
	FY 2014	FY 2013	Increase or Decrease	Change	FY 2014	FY 2013	Increase or Decrease	Change
High Density and Saturation Flats/ Parcels	887	843	38	4.6%	7.9	7.4	0.4	5.7%
Carrier Route	1,735	1,779	(93)	-5.2%	19.2	18.7	0.5	2.7%
Flats	2,452	2,514	(24)	-0.9%	48.5	45.2	3.4	7.5%
Every Door Direct Mail–Retail	39	38	1	2.2%	4.4	3.9	0.5	11.9%
Total Flats & Parcels	**5,114**	**5,174**	**(78)**	**-1.5%**	**19.5**	**18.9**	**0.6**	**3.1%**

Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

Trends in Standard Mail Flats

The total volume of Standard flats declined by more than 1 billion pieces in FY 2014. As seen in Figure III-15, there was a significant decline in Standard Flats—which has been declining since FY 2009, with an average annual decline of almost 10 percent over the past four years. The decline in volume for the other flat categories has not been as severe. In FY 2011 and FY 2012, these volumes slightly increased.

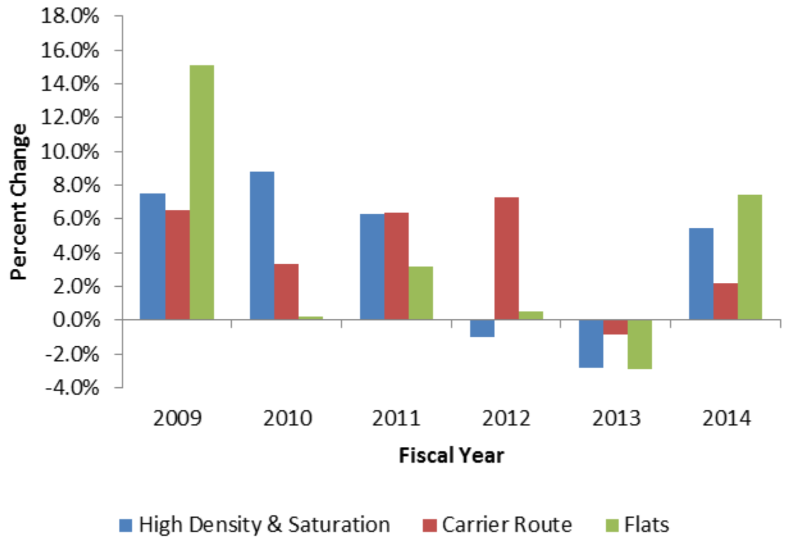
Figure III-15
Percentage Change in Standard Mail Flats Volumes



Source: FY 2014 and FY 2013 Postal Regulatory Commission *Financial Report*, Appendix A; Postal Regulatory Commission Library Reference PRC–LR–1, FY 2007-FY 2012 ACD.

As seen in Figure III-16, the average unit attributable cost for all Standard flats products has grown over the past 6 years. Since FY 2008, the cost has grown 25 percent, with the largest growth in Standard Mail Flats. The average unit attributable cost for all Standard flats products has increased more than 20 percent since FY 2008. The unit cost increase for Flats is 27.1 percent, 24.9 percent for Carrier Route, and 26.1 percent for High Density and Saturation Flats.

Figure III-16
Percentage Change in Standard Mail Flats Average Unit Attributable Cost
FY 2009 to FY 2014



Source: FY 2014 and FY 2013 Postal Regulatory Commission *Financial Reports*, Appendix A; Postal Regulatory Commission Library Reference PRC-LR-1, FY 2007-FY 2012 ACD.

Table III-19 on the next page compares the change in the average unit attributable cost by cost segment for FY 2009 and FY 2014. It presents these years because they represent the 2 years with the largest increases in average unit attributable cost. All Standard flats products experienced double-digit increases in city carrier costs in FY 2009. The average unit attributable cost increased more than 12 percent in every cost segment for Standard flats. City carrier in-office average unit cost increased 21.5 percent for Flats, 21.6 percent for Carrier Route, and 15.5 percent for High Density and Saturation Flats. City carrier street average unit cost also increased significantly for all three products.

In FY 2014, the average unit attributable cost for mail processing, city carrier in-office, and rural carriers increased more than 5 percent for both Flats and High Density and Saturation Flats. The average unit transportation cost increased more than 10 percent for all three products. Although the average unit transportation cost increased 25.5 percent for High Density and Saturation Flats, it constitutes less than 2 percent of the overall average unit attributable cost for that product.

Table III-19
Change in Standard Mail Flats Unit Attributable Cost by Cost Segment, FY 2009 and FY 2014

	FY 2009			FY 2014		
	Flats	Carrier Route	High Density & Saturation	Flats	Carrier Route	High Density & Saturation
Mail processing	12.6%	-2.4%	-2.6%	8.0%	-1.9%	9.6%
City carrier in-office	21.5%	21.6%	15.5%	8.1%	-0.6%	5.8%
City carrrier street	19.9%	15.2%	18.5%	5.7%	0.7%	-3.5%
Rural carriers	12.1%	5.3%	-1.8%	7.2%	2.5%	9.4%
Transportation	14.3%	-26.5%	40.4%	15.8%	11.2%	25.5%
All other	15.5%	5.2%	6.3%	11.4%	-0.2%	8.3%

Source: Postal Regulatory Commission, derived from Postal Service *Cost Segment and Component Reports* FY 2010 to FY 2014.

PERIODICALS

The Periodicals class comprises two products: Within County and Outside County. Within 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 2013

Table III-20 summarizes the FY 2014 change in volume and revenue for Periodicals. In FY 2014, volume declined by 314 million pieces, or 4.9 percent, primarily in Outside County Periodicals. As a share of total volume, Periodicals declined slightly in FY 2014 and now constitutes 3.9 percent of total volume.

Revenue for Periodicals declined 2 percent in FY 2014. While the January 2014 CPI cap and exigent rate surcharge price change increased revenue from Within County publications, the decline in revenue due to lower volume in Outside County publications more than offset the increase in revenue caused by the rate increase. The drop in Periodicals revenue has reduced its share of total revenue by 0.1 percent to 2.4 percent of total revenue.

Table III-20
Periodicals Volume and Revenue

	Mail Volume (Millions)				Mail Revenue ($ Millions)			
	FY 2014	FY 2013	Increase or Decrease	Change	FY 2014	FY 2013	Increase or Decrease	Change
Within County	586	603	(17)	-2.8%	67	66	1	1.9%
Outside County	5,459	5,756	(297)	-5.2%	1,558	1,592	(34)	-2.1%
Total	**6,045**	**6,359**	**(314)**	**-4.9%**	**1,625**	**1,658**	**(33)**	**-2.0%**

Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

As shown in Table III-21, Periodicals' total attributable costs declined in FY 2014. Reductions in volume were the primary cause. The average unit attributable cost increased 3 percent.

Table III-21
Periodicals Attributable and Average Unit Attributable Cost

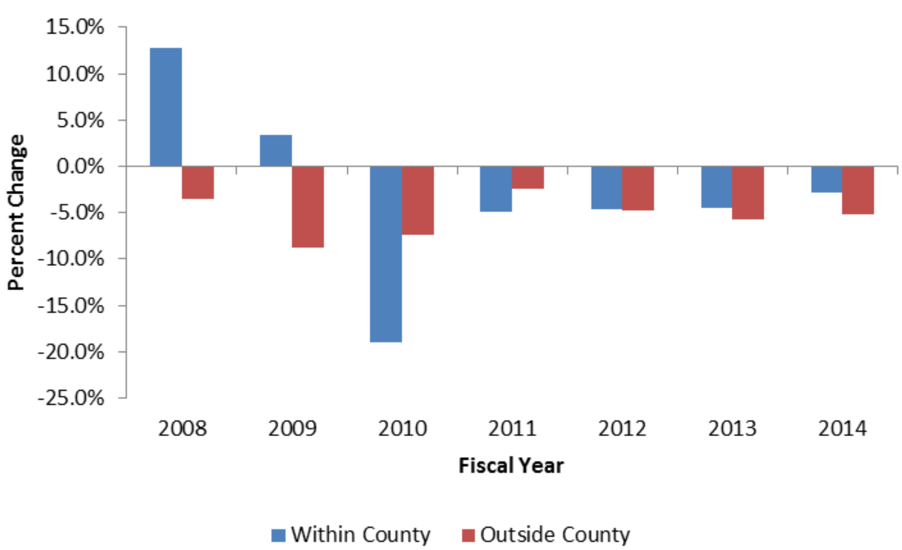
	Attributable Cost ($ Millions)				Unit Attributable Costs (Cents per Piece)			
	FY 2014	FY 2013	Increase or Decrease	Change	FY 2014	FY 2013	Increase or Decrease	Change
Within County	86	87	(1)	-1.5%	14.6	14.4	0.2	1.4%
Outside County	2,048	2,092	(44)	-2.1%	37.5	36.3	1.2	3.2%
Total	**2,134**	**2,179**	**(45)**	**-2.1%**	**35.3**	**34.3**	**1.0**	**3.0%**

Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

Trends in Periodicals

As seen in Figure III-17, the volume of Periodicals continued to decline due in large part to the availability of electronic alternatives. Advertising has migrated from Periodicals to less costly electronic media, further depressing volumes.[26]

Figure III-17
Percentage Change in Periodicals Volumes, FY 2008-FY 2014

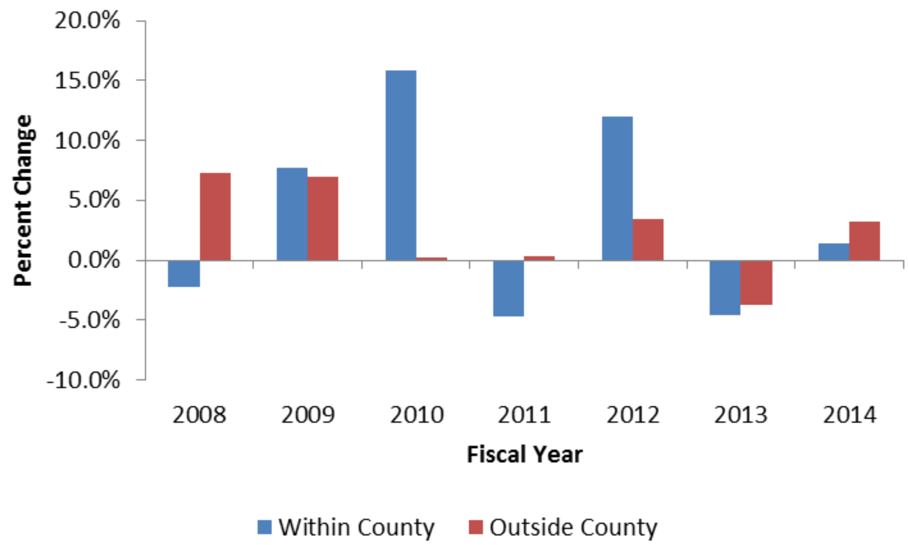


Source: Postal Service *Revenue, Pieces, and Weight Reports*, FY 2008-FY 2014.

[26] Postal Service FY 2014 Form 10-K at 19.

Figure III-18 tracks the percentage change in the average unit attributable cost for Within County and Outside County Periodicals over the past 7 years. The Within County average unit attributable cost does not present a clear trend over time. This could be due to the small amount of volume and the inability of the Postal Service's cost systems to accurately estimate the cost for these publications. Outside County Periodicals shows a consistent increase in average unit cost over time, with FY 2013 as the only exception. The decrease in FY 2013 resulted from the lower productive hourly wage rates discussed in Chapter 2.

Figure III-18
Percentage Change in Periodicals Average Unit Attributable Cost



Source: FY 2014 and FY 2013 Postal Regulatory Commission *Financial Reports*, Appendix A; Postal Regulatory Commission Library Reference PRC–LR–1, FY 2007-FY 2012 ACD.

Table III-22 disaggregates the average unit attributable cost for Outside County Periodicals for FY 2012 to FY 2014.

Table III-22
Periodicals Average Unit Attributable Cost by Segment, FY 2012-FY 2013

	Average Unit Attributable Cost			Change in Avg. Unit Attributable Cost	
	2012	2013	2014	2013	2014
Mail processing	12.41	11.69	12.25	-5.8%	4.8%
City carrier in-office	4.86	4.63	4.69	-4.7%	1.2%
City carrrier street	2.20	2.24	2.30	1.6%	2.6%
Rural carriers	2.50	2.51	2.65	0.2%	5.5%
Transportation	3.53	3.52	3.46	-0.3%	-1.9%
All other	12.23	11.76	12.19	-3.9%	3.6%

Source: Postal Regulatory Commission derived from Postal *Service Cost Segment and Component Reports*, FY 2010-FY 2014.

Package Services

The Package Services class consists of five products: Alaska Bypass Service, Bound Printed Matter (BPM) Flats, BPM Parcels, Media Mail/Library Mail, and Inbound Surface Parcel Post [at Universal Postal Union (UPU) rates].

Table III-23 summarizes the FY 2014 change in volume and revenue for Package Services. The transfer of Single-Piece Parcel Post Mail to the Competitive product list[27] accounted for the bulk of declines in volumes and revenues in FY 2014. BPM Flats increased by 20 million pieces over the prior year's volume, while the volumes of BPM Parcels and Media/Library Mail continued to decline.

Table III-23
Package Services Volume and Revenue

	Mail Volume (Millions)				Mail Revenue ($Millions)			
	FY 2014	FY 2013	Increase or Decrease	Change	FY 2014	FY 2013	Increase or Decrease	Change
Alaska Bypass	1	1	(0)	-0.4%	33	32	2	5.1%
Single-Piece Parcel Post	–	28	(28)	-100.0%	–	308	(308)	-100.0%
BPM Flats	250	230	20	8.8%	203	186	17	9.0%
BPM Parcels	212	216	(4)	-2.0%	273	276	(2)	-0.8%
Media Mail/ Library Mail	86	95	(8)	-8.7%	308	317	(8)	-2.6%
Inbound Surface Parcel Post (at UPU Rates)	1	1	(0)	0.0%	18	18	0	0.8%
Total	**550**	**571**	**(21)**	**-3.6%**	**836**	**1,136**	**(300)**	**-26.4%**

Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

When the loss in revenue from the transfer of Single-Piece Parcel Post is not considered, total revenue for Package Services increased compared with last year. All of the increase in revenue occurred in BPM Flats. The CPI cap rate increase and the exigent rate surcharge increased revenue by $41 million, while revenue lost due to the decline in volumes totaled $20 million. BPM Flats and Inbound Surface Parcel Post (at UPU rates) gained revenue from additional volume—almost $17 million for the former and approximately $0.2 million for the latter.

As shown in Table III-24 (next page), attributable costs for Package Services declined from the prior year by almost $45 million, not including the $331 million lost from the transfer

[27] Docket No. MC2012-13, Order Conditionally Granting Request to Transfer Parcel Post to the Competitive Product List, Order No. 1411, July 20, 2012 (Order No. 1411).

of Single-Piece Parcel Post Mail to the Competitive products list. The largest reduction in costs was in Media Mail/Library Mail.

Table III-24
Package Services Attributable Costs and Average Unit Attributable Cost, FY 2013 and FY 2014

	Attributable Cost ($ Millions)				Unit Attributable Costs (Cents per Piece)			
	FY 2014	FY 2013	Increase or Decrease	Change	FY 2014	FY 2013	Increase or Decrease	Change
Alaska Bypass Service	16	10	6	59.0%	1,269.8	795.9	474.0	59.6%
Single-Piece Parcel Post	–	331	(331)	-100.0%	–	1,182.1	(1,182)	-100.0%
BPM Flats	134	130	4	3.0%	53.8	56.8	(3.0)	-5.3%
BPM Parcels	251	263	(12)	-4.6%	118.5	121.6	(3.1)	-2.6%
Media Mail/ Library Mail	328	372	(44)	-11.9%	380.2	394.0	(13.8)	-3.5%
Inbound Surface Parcel Post (at UPU Rates)	13	11	2	19.6%	1,419.9	1,187.3	232.6	19.6%
Total	**743**	**1,118**	**(375)**	**-33.5%**	**135.0**	**195.8**	**(60.7)**	**-31.0%**

Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

A change in the development of the Alaska Bypass Service cost adjustment was responsible for the significant change in its attributable costs. Prior to FY 2014, the computation of the ratio of hypothetical highway cost to air cost for Alaska Air transportation was based on U.S. Department of Transportation data, surface densities, linehaul, and terminal handling cost. The new methodology uses operational data from the Postal Service's Surface Air Management System–Alaska and the Transportation Cost System to compute the same ratio. This methodology increases the adjustment factor significantly and assigns a greater amount of attributable air transportation costs to Alaska Bypass Service.[28]

On an average unit attributable cost basis, only Alaska Bypass Service and Inbound Surface Parcel Post (at UPU rates) increased over the prior period. The increase in Alaska Bypass Service is due to the change in the computation of the Alaska Air adjustment factor described above. The average unit attributable cost of all other Package Services products declined across most cost segments.

[28] *See* Docket No. RM2013-6 at 4-6, Order No. 1983.

Market Dominant Services

The Special Services class consists of 12 products, including Ancillary Services, eight domestic “stand-alone” products, and three international products. Although it comprises several services, Ancillary Services is classified as a single product.

Special Services include Certified Mail, Insurance, Money Orders, Post Office Box Service, and other products that enhance Market Dominant products. As shown in Table III-25, total revenue increased almost $11 million in FY 2014. Most of the increases were in Other Ancillary Services (USPS Tracking, Return Receipts, and Restricted Delivery), Money Orders, and Other Special Services.

Table III-25
Market Dominant Ancillary and Special Services Revenue

Ancillary and Special Services	Revenue ($ Millions)			
	FY 2014	FY 2013	Increase or Decrease	Change
Certified Mail	687	715	(28)	-3.9%
Collect on Delivery	4	4	(1)	-18.8%
Insurance	92	108	(17)	-15.5%
Registered Mail	35	35	(1)	-1.5%
Stamped Envelopes & Cards	12	12	(1)	-5.6%
Other Ancillary Services	525	515	10	2.0%
Money Orders	165	155	10	6.6%
Post Office Box Service	365	359	7	1.9%
Other services	175	146	30	20.5%
Total Services	**2,060**	**2,049**	**11**	**0.5%**

Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

Table III-26 shows that attributable costs for Special Services declined by $4 million in FY 2014. This slight reduction stems mostly from continued declines in demand for services such as Insurance and Collect on Delivery. Also, additional transfers of PO Boxes from the Market Dominant product list to the Competitive product list have reduced the Market Dominant portion of PO Box cost. Some services have experienced cost increases. Although Certified Mail transactions and revenues have declined, a change in costing methodology has increased the amount attributed to the product. Other Ancillary Services’ attributable costs have increased due to higher use of the service.

Table III-26
Market Dominant Services Attributable Cost

Ancillary and Special Services	Attributable Cost ($ Millions)			
	FY 2014	FY 2013	Increase or Decrease	Change
Certified Mail	542	535	7	1.3%
Collect on Delivery	3	4	(1)	-27.8%
Insurance	63	76	(12)	-16.3%
Registered Mail	29	28	1	2.3%

Ancillary and Special Services	Attributable Cost ($ Millions)			
	FY 2014	FY 2013	Increase or Decrease	Change
Stamped Envelopes & Cards	8	7	1	21.5%
Other Ancillary Services	260	243	17	7.0%
Money Orders	100	103	(4)	-3.5%
Post Office Box Service	282	294	(12)	-4.1%
Other services	45	33	12	34.8%
Total Services	**1,331**	**1,323**	**9**	**0.7%**

Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

Competitive Volume, Revenue, and Costs by Product

Competitive Products consist of both domestic and international products. In FY 2014, domestic Competitive products include Priority Mail Express; Priority Mail; Parcel Select; Parcel Return Service; First-Class Package Service; Standard Post; Address Enhancement Services; Greeting Cards and Stationery; Competitive Ancillary Services; Premium Forwarding Service; Post Office Box Service; and Shipping and Mailing Supplies. There are also a total of 136 Domestic Competitive negotiated service agreement (NSA) products.

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 2014, there were also 262 International Outbound NSA products and 20 International Inbound NSA products.

To facilitate comparison, the products have been grouped into several broad categories. Table III-27 (next page) summarizes the FY 2014 change in volume and revenue for Competitive products and services. Total Competitive products' volume increased almost 10 percent in FY 2014, as volume for every product except Priority Mail Express and international mail increased. The largest volume growth occurred in First-Class Mail Package Service and Ground Parcels, increasing almost 17 percent and 15 percent, respectively. Priority Mail volume also increased 5.6 percent over FY 2013.

Total Competitive product revenue increased more than 11 percent, or $1.5 billion, in FY 2014. First-Class Mail Package Service, Priority Mail, and Ground Parcels are the largest contributors to this growth in revenue. The Competitive product price increases implemented in January 2014 increased revenues by $541 million. The increase in volumes accounted for the bulk of the total revenue growth, creating $990 million of additional revenue.

Table III-27
Competitive Products Volume and Revenue

	Mail Volume (Millions)				Mail Revenue ($ Millions)			
	FY 2014	FY 2013	Increase or Decrease	Change	FY 2014	FY 2013	Increase or Decrease	Change
Priority Mail Express	36	39	(3)	-7.4%	760	794	(34)	-4.3%
First-Class Package Service	635	544	90	16.6%	1,462	1,192	270	22.7%
Priority Mail	920	871	49	5.6%	6,884	6,374	510	8.0%
Ground Parcels	1,576	1,371	205	14.9%	3,160	2,469	691	28.0%
International	281	282	(1)	-0.3%	2,319	2,222	96	4.3%
Domestic Services					695	689	6	0.9%
Total	**3,448**	**3,108**	**340**	**10.9%**	**15,280**	**13,741**	**1,539**	**11.2%**

Note: Ground Parcels consist of Parcel Select, Parcel Return Service, and Standard Post.
Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

Table III-28 summarizes the FY 2014 change in attributable costs. In FY 2014, total attributable costs for Competitive products have increased more than 11 percent, or more than $1 billion, with significant increases in virtually every cost segment and component.

Table III-28
Competitive Products Attributable Cost

	Attributable Cost ($ Millions)				Unit Attributable Costs (Cents per Piece)			
	FY 2014	FY 2013	Increase or Decrease	Change	FY 2014	FY 2013	Increase or Decrease	Change
Priority Mail Express	366	420	(54)	-12.9%	1,008.8	1,072.9	(64.0)	-6.0%
First-Class Package Service	1,155	1,002	153	15.3%	182.0	184.0	(2.1)	-1.1%
Priority Mail	5,234	4,861	373	7.7%	568.9	557.9	11.0	2.0%
Ground Parcels	2,472	1,985	487	24.6%	156.9	144.8	12.1	8.4%
International	1,385	1,271	114	8.9%	492.0	450.4	41.5	9.2%
Domestic Services	359	343	16	4.5%				
Total	**10,970**	**9,881**	**1,089**	**11.0%**	**318.2**	**317.9**	**0.2**	**0.1%**

Source: Library Reference PRC–LR–ACR2014/1, PRC–FinRpt13–LR1.

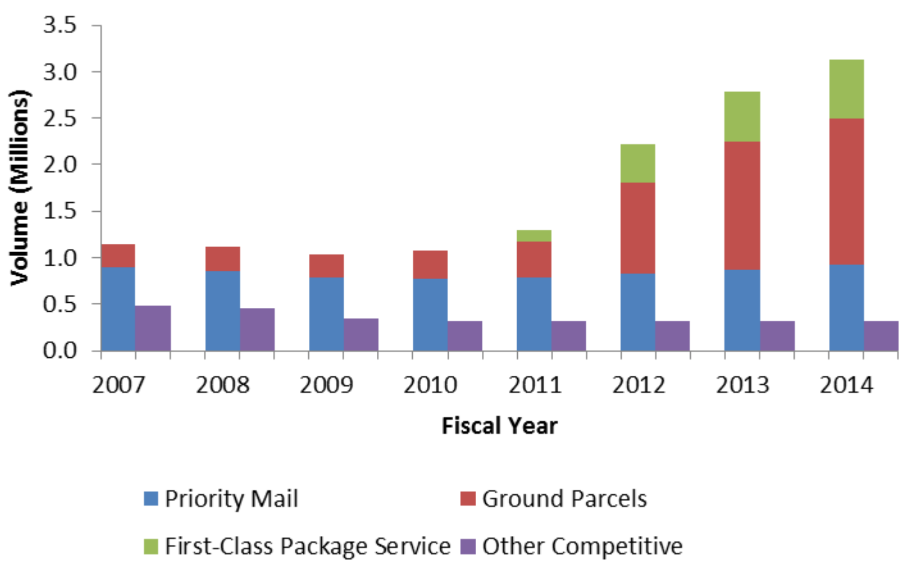
As shown in Table III-28, total attributable costs for every Competitive product except Priority Mail Express increased in FY 2014. The largest increases were in Priority Mail and Ground Parcels, where total attributable costs grew almost 8 percent and 25 percent, respectively. In addition to increased costs due to higher volumes, Priority Mail costs for advertising increased $40 million in FY 2014, and accounted for the entire increase in total advertising costs for the year.

Average unit attributable costs declined slightly for Competitive products, largely due to declines in Priority Mail Express and First-Class Package Service. Average unit attributable cost for Ground Parcels increased 8.4 percent, while the average unit attributable cost of the International category increased 9.2 percent. Together, these categories account for 53.9 percent of all Competitive volume.

Trends in Competitive Products

As shown in Figure III-19, the growth in Competitive product volume has been primarily driven by the significant increases in the volume of Ground Parcels and First-Class Package Service. The FY 2012 transfer of Standard Mail lightweight parcels to Parcel Select more than doubled Parcel Select volume. The transfer of First-Class commercial parcels to the Competitive product list, also in FY 2012, contributed to the growth in Competitive product volumes as well. Since FY 2012, the bulk of the volume growth for Competitive products has been in Ground Parcels and First-Class Package Service.

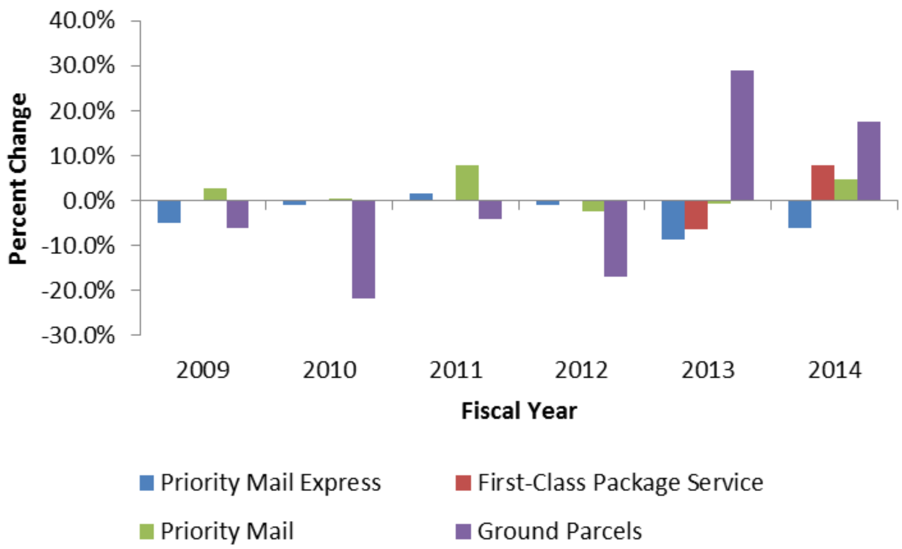
Figure III-19
Competitive Product Volume by Product, FY 2007-FY 2014



Source: Postal Service *Revenue, Pieces and Weight Reports*, FY 2007-FY 2014.

Attributable costs of Competitive products have grown and now comprise 28 percent of total attributable costs, compared with 11.5 percent in FY 2008. As shown in Figure III-20 on the next page, unit attributable costs remained fairly stagnant until FY 2012, as there were significant reductions in the unit attributable cost of Ground Parcels. This is due to the transfer of Standard Mail lightweight parcels, which had a much lower unit attributable cost, to the Parcel Select product in FY 2012. The Ground Parcel unit attributable cost grew significantly in both FY 2013 and FY 2014, as the transfer of Single-Piece Parcel Post to the Competitive product Standard Post, which has a high unit attributable cost, began in FY 2013. The higher unit attributable cost is primarily due to the higher transportation costs for Standard Post.

Figure III-20
Percentage Change in Competitive Product Unit Attributable Cost by Product
FY 2009-FY 2014



Source: FY 2014 and FY 2013 Postal Regulatory Commission *Financial Report*, Appendix A; Postal Regulatory Commission Library Reference PRC–LR–1, FY 2007-FY 2012 ACD.

Chapter 4. Profitability, Solvency, Activity, and Financial Stability

Introduction

This chapter analyzes the Postal Service's financial status in terms of profitability, solvency, activity, and financial stability using accounting ratios. It explains the meaning of key ratios, debt ratio, fixed asset to net worth ratio, and current liability ratio.

A financial analysis evaluating an agency's financial strength, defined as the Altman Z-Score, is also used to calculate the possibility of bankruptcy.

The objectives of this chapter are:

- Compare and analyze the financial statements for the past 10 fiscal years, from FY 2004 to FY 2014
- Measure the profitability, solvency, and financial stability position of the Postal Service
- Forecast the annual growth rate of income of the Postal Service with the help of trend analysis
- Analyze the Postal Service's overall financial performance

RATIO ANALYSIS

Ratio analysis is used to conduct a quantitative analysis of information in a financial statement. Ratios are calculated from current fiscal year numbers and are then compared with previous years and historic averages to determine the Postal Service's financial performance.

KEY RATIOS

Financial analysis used in the private sector may not be directly relevant to government agencies because revenue streams, equity structures, and management incentives differ. It is also difficult to determine a single measurement that signifies financial health for a government agency. Financial performance, although not a primary indicator of success, influences the fulfillment of missions and objectives for government agencies with a service-related mission, such as the Postal Service.

The users, stakeholders, and the business environment vary between the Federal Government and the private sector. Stakeholders of private-sector entities use financial analysis to make investment and credit decisions, and success is often measured by the company's stock valuation. In contrast, Federal agencies are mission-oriented and measure success through the provision of service. Furthermore, unlike private-sector firms, Federal agencies do not have direct shareholders whose income and wealth is affected by management decisions.

Financial analysis can be useful in both the Federal Government and the private sector. It can be used as a strategic management tool that provides the public with a concise and systematic way to organize the data in financial statements (*e.g*., balance sheets, income statements, and statements of cash flows) into meaningful information. The information derived from these indicators would provide the data needed to evaluate an agency's financial condition, which is vital if the agency is to be able to provide services on a continuous basis.

Financial viability is affected by a combination of environmental, economic, and organizational factors, including the decisions and actions of management and the governing board. For example, the decline in volume of high-contribution margin First-Class Mail (a negative environmental trend) can lead to the erosion of a healthy cost coverage base. However, Postal Service management's response to this decline and constraints on management flexibility also affect financial condition.

Financial ratios are used to interpret accounting information. The ratios explain an agency's financial health and ability to satisfy its financial obligations. Ratio analysis helps assess profitability and informs stakeholders of an agency'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 of an agency to meet its short-term financial obligation (liquidity) and the ability to meet its long-term financial obligations (solvency) are critical in evaluating the Postal Service's current financial situation.

Ratio analysis also provides valuable insight when analyzing an agency's past performance, and can help identify weaknesses and highlight improvements. At present, many agencies use ratio analysis to estimate future trends and as the foundation of budget planning to guide growth and development. This section focuses on three key financial ratios to analyze the Postal Service's overall financial health: debt ratio, fixed asset to net worth ratio, and current liability ratio.

Financial data used in ratio analysis are derived from accounting information not adjusted for inflation. Forecasts of an agency's future revenue may not reflect its actual future revenues and cash flows because of changing demographics, industry dynamics, and government regulation.

Debt Ratio

The debt ratio indicates the proportion of an agency's debt to its total assets. It gives stakeholders a quick measure of the amount of debt compared with assets that the agency has on its balance sheets. It is one of the main measures describing financial stability. The higher the ratio, the greater the risk associated with the agency's operation. A low debt ratio indicates conservative financing with an opportunity to borrow in the future at no significant financial risk.

The debt ratio provides information about the Postal Service's ability to absorb asset reductions arising from losses. It indicates the relationship between two main sources of capital: equity and borrowed capital. It calculates the relationship between liabilities to the overall capital (*i.e.*, the sum of equity and liabilities). Table IV-1 shows that at the end of FY 2014, the debt ratio for the Postal Service was 2.97, slightly higher than FY 2013.

Table IV-1
Ratio Analysis of Postal Service Financial Statements

Ratios	Value			Description of Ratio	Postal Service Historic 10-Year Avg. Value
	9/30/14	9/30/13	Change		
Debt ratio (debt to assets ratio)	2.97	2.84	0.13	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 (similar to debt-to-equity ratio).	1.50
Fixed assets to net worth	-0.36	-0.44	0.08	Indicates the extent to which the entity's cash is frozen in the form of fixed assets, such as property, plant, and equipment.	1.87
Current liability ratio	0.62	0.60	0.03	Calculated by dividing current liabilities by total (*i.e.*, current and noncurrent) liabilities.	0.53

Source: Postal Service Forms 10-K and Postal Service *Annual Reports*.

The Postal Service's FY 2014 debt ratio has a critical value approximately twice as high as the average 10-year value of 1.50. This ratio indicates that the Postal Service does not possess sufficient capital (equity) and cannot raise investment funds beyond basic earnings or borrowing. The accruing nonpayment of the RHBF and the long-term workers' compensation obligations have skewed the Postal Service's liabilities in relation to its assets. 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 obligation to the RHBF and workers' compensation.

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 and the profitability of operations. Net worth is the residual amount representing the excess of an agency's assets over its liabilities. The Postal Service's fixed assets consist primarily of buildings and equipment, which cannot be easily converted into cash. A high fixed asset to net worth ratio signifies an inability to respond to financial emergencies rapidly or obtain cash easily for further investment and growth. The Postal

Service has accumulated deficits in excess of its fixed assets, resulting in negative fixed assets to net worth ratio.

It is a common rule that non-current investments should be made with the help of the most stable source of financing (*i.e.*, an agency's equity). The non-current asset to net worth ratio indicates whether or not this rule is followed. A positive ratio indicates that the principle is being followed; a negative ratio indicates it is not. In this case, as shown in Table IV-1, the FY 2014 ratio is a slight improvement over FY 2013, but still remains at negative 0.36 because the Postal Service did not have a net surplus on the last day of the period analyzed.

Current Liability Ratio

This current liability ratio indicates the amount of current debt payments required to be paid within 1 year. For the Postal Service, it reflects that the share of short-term liabilities to total liabilities is 62 percent, an increase of 3 percent from the start of FY 2014.

The accrual of the unpaid statutory RHBF prefunding payments is included in current obligations, accounting for the increase in current liabilities. The increase in workers' compensation liability resulting from lower discount rates increased long-term obligations comparative to the start of the year. Understanding the Postal Service's liabilities is critical, especially if the cash flows generated from operations render the Postal Service unable to meet its current debt. This inability to finance current debt requirements is the core of the Postal Service's liquidity issues.

The current liability ratio equaled 0.62 on September 30, 2014. This means that short-term and long-term liabilities are 62 percent and 38 percent, respectively, in the structure of the Postal Service's liabilities.

The main financial state indicator values and Postal Service activity results are classified by qualitative assessment according to the results of the analysis for the year.

The following Postal Service's financial characteristics are causes for concern:

- The cash ratio is equal to 0.12 on September 30, 2014, the last day of the period analyzed (a low cash on hand for current payments).
- FY 2014 net loss from financial and operational activities was $5.5 billion.
- The current ratio (0.15) is significantly lower than the standard value 2.
- Liquid assets (current assets) are not enough to meet current liabilities (quick ratio[29] is equal to 0.14), while the acceptable value is 1.
- Critical return on assets[30] is -24.7 percent during FY 2013 to FY 2014.
- The Postal Service has negative net worth (no equity on the last day of the period analyzed).
- There is not enough long-term resources for financing activity (no working capital).

[29] The "quick ratio" is defined in Table IV-5, below.
[30] Return on assets is a measure of an entity's profitability in generating revenue from existing assets.

The majority of the FY 2014 financial ratios deviate greatly from the average of the last 10 years.

ALTMAN Z-SCORE

The Altman Z-Score was calculated to predict the probability of the Postal Service running out of cash to pay its creditors.

Financial analysis evaluates the financial strength of an agency 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. However, sometimes the agency's ratios reflect conflicting views. To help eliminate confusion, New York University Professor Edward Altman developed the Z-Score in 1968 as a tool to explicitly address the likelihood that a company could go bankrupt.

A quantitative model designed to predict the financial distress of a business, the Altman Z-Score uses a blend of the traditional financial ratios and a statistical method known as multiple discriminant analysis. The formula has achieved general acceptance by management accountants and auditors.

The Altman Z-Score is applied here to predict the probability of bankruptcy of an entity with the attributes of the Postal Service. A factor model for a private non-manufacturer is used to evaluate the Postal Service's financial stability:

Altman Z-Score = T1+T2+T3+T4 as denoted in Tables IV-2 through IV-4.

The Postal Service's Altman Z-Score was -5.7 on September 30, 2014. That means that there is a high probability that the Postal Service will go into financial distress.

Table IV-2
Altman Z-Score, FY 2014

Ratio	Calculation	Ratio Value on 9/30/2014	Weighting Factor	Product [3]+[4]
[1]	[2]	[3]	[4]	[5]
T1	Working Capital/Total Assets	(1.6)	1.2	(1.9)
T2	Retained Earnings/Total Assets	(2.0)	1.4	(2.8)
T3	Earnings/Total Assets	(0.2)	3.3	(0.7)
T4	Capital/Total Liabilities	(0.7)	0.6	(0.4)
Altman Z-Score				**(5.7)**

Source: Postal Service FY 2014 Form 10-K.

Table IV-3
Altman Z-Score, FY 2007

Ratio	Calculation	Ratio Value on 9/30/2007	Weighting Factor	Product [3]+[4]
[1]	[2]	[3]	[4]	[5]
T1	Working Capital/Total Assets	(0.5)	1.2	(0.6)
T2	Retained Earnings/Total Assets	0.0	1.4	0.1
T3	Earnings/Total Assets	(0.2)	3.3	(0.7)
T4	Capital/Total Liabilities	0.0	0.6	0.0
Altman Z-Score				**(1.1)**

Source: Postal Service FY 2007 Form 10-K.

Table IV-4
Altman Z-Score, FY 2004

Ratio	Calculation	Ratio Value on 9/30/2004	Weighting Factor	Product [3]+[4]
[1]	[2]	[3]	[4]	[5]
T1	Working Capital/Total Assets	(0.4)	1.2	(0.4)
T2	Retained Earnings/Total Assets	0.2	1.4	0.2
T3	Earnings/Total Assets	0.1	3.3	0.3
T4	Capital/Total Liabilities	0.2	0.6	0.1
Altman Z-Score				**0.2**

Source: Postal Service FY 2004 Form 10-K.

Discrimination Ranges

- 1.1 or less: Distress Zone
- 1.1 to 2.6: Grey Zone
- 2.6 or more: Safe Zone

Most commonly, a lower Altman Z-Score reflects higher odds of bankruptcy. The four performance ratios in the calculation are combined into a single score by weighting. The coefficients are estimated from a set of entities that have previously declared bankruptcy. A matched sample of entities is collected and matched by industry and estimated assets.

According to calculations shown in Tables IV-2, IV-3, and IV-4, on September 30, 2014, the Altman Z-Score equaled -5.7 for the Postal Service. This is a slight setback from the FY 2013 score of -5.5, but a significant deterioration from the FY 2007 score of -1.1 and the FY 2004 score of -0.2.

The deterioration in the Postal Service's viability relates to the erosion of retained earnings caused by consecutive net losses, the statutory obligation to prefund RHBF benefits, and decreasing retained earnings/Total Asset ratio.

A comparatively lower Working Capital/Total Assets ratio results from a constriction in capital spending to add new investments to its almost fully depreciated existing assets. The significant drop in these two measures causes the negative fluctuation to the Postal Service Altman Z-Score when comparing FY 2014 with FY 2004 or even FY 2007.

TREND ANALYSIS

Trend analysis is used for comparing the Postal Service's financial statements over a number of years to evaluate the performance of key items. Trend analysis involves the calculation of the percentage relationship of each item in the financial statement to the same item in the base year.

FY 2004 was selected as a base year because it is the first year within the past 10-year period in which the Postal Service reported a net operating income. In Figure IV-1, FY 2004 is the base year, so its percentages are all 100. The percentages in the other fiscal years were calculated by dividing each amount in a particular year by the corresponding amount in the base year and multiplying by 100.

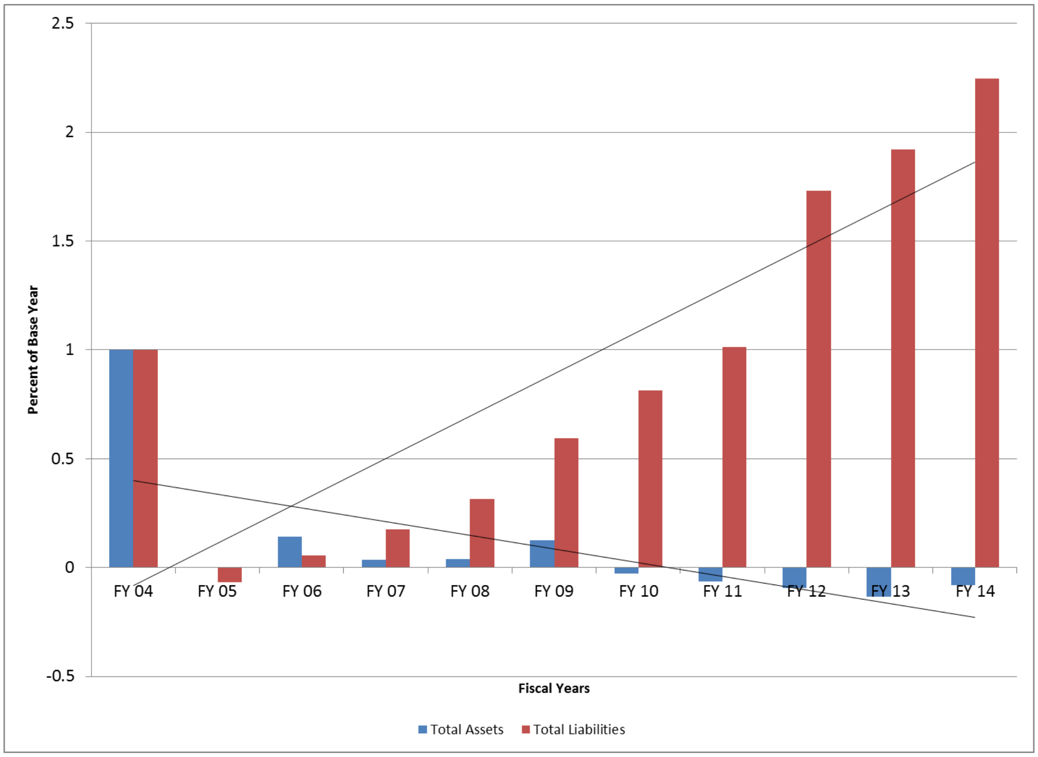
A trend percentage less than 100 indicates the balance has decreased from the base year level in that particular year. A trend percentage greater than 100 means that the balance in that year has increased over the base year. A negative trend represents a negative number.

Figure IV-1 on the next page shows that the Postal Service's assets declined in FY 2010 from the base year and that the trend has continued through the current fiscal year. Moreover, liabilities have risen steadily. The Postal Service's liabilities in the current fiscal year have more than doubled from the base year amount. Current assets (primarily cash and cash equivalents) have increased from the base year as the safety net of available borrowing has been depleted. FY 2014 property, plant, and equipment net of depreciation has decreased 27.4 percent from the base year, primarily due to capital investments and fully depreciated assets that have not been replaced.

Current and non-current liabilities have trended upward from the base year, largely due to increasing balances in employee-related liabilities such as mandatory RHBF payments and future workers' compensation obligations that remain unpaid. Total liabilities have risen to more than twice the amount from the base year.

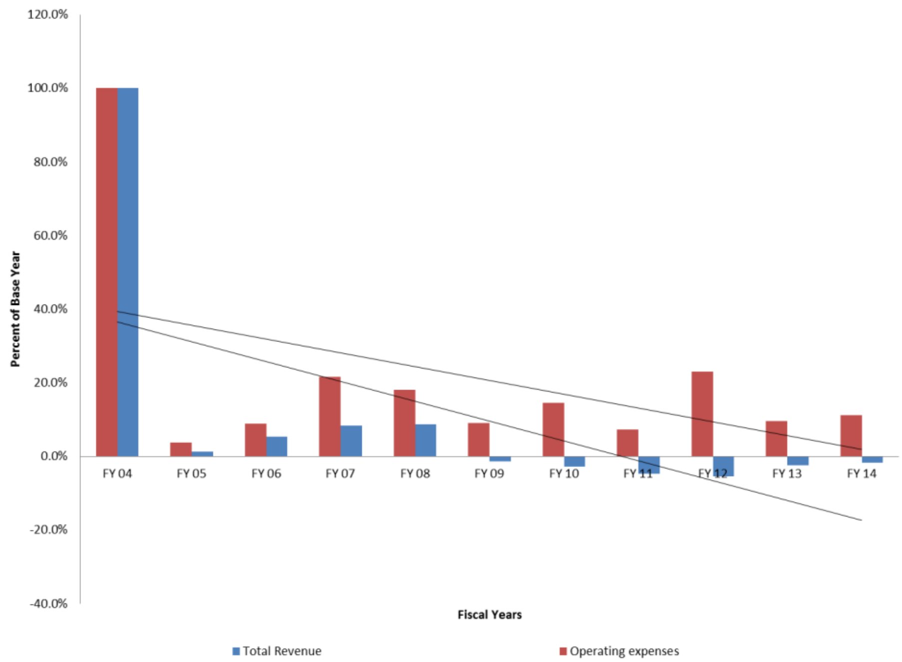
Figure IV-2, also on the next page, shows revenue has decreased 1.7 percent over the 10-year period while operating expenses increased 11.1 percent. These FY 2014 trend percentages reflect an unfavorable impact on net income because the percent increase in operating expenses is higher than the percent decrease in revenue compared with the base year. However, the trend in total revenue is up from FY 2012, as the loss in revenue is slowing down. The accrual of mandatory statutory RHBF payments has contributed to the roughly 561.5 percent increase in the RHBF expense. Fluctuations in discount rates affecting workers' compensation have doubled the amount in the current year from the base year. Compensation has decreased by 7.2 percent from the base year.

Figure IV-1
Index of Assets and Liabilities, FY 2004-2014



Source: Postal Service Forms 10-K and Postal Service *Annual Reports*.

Figure IV-2
Index of Revenues and Expenses, FY 2004-2014



Source: Postal Service Forms 10-K and Postal Service *Annual Reports*.

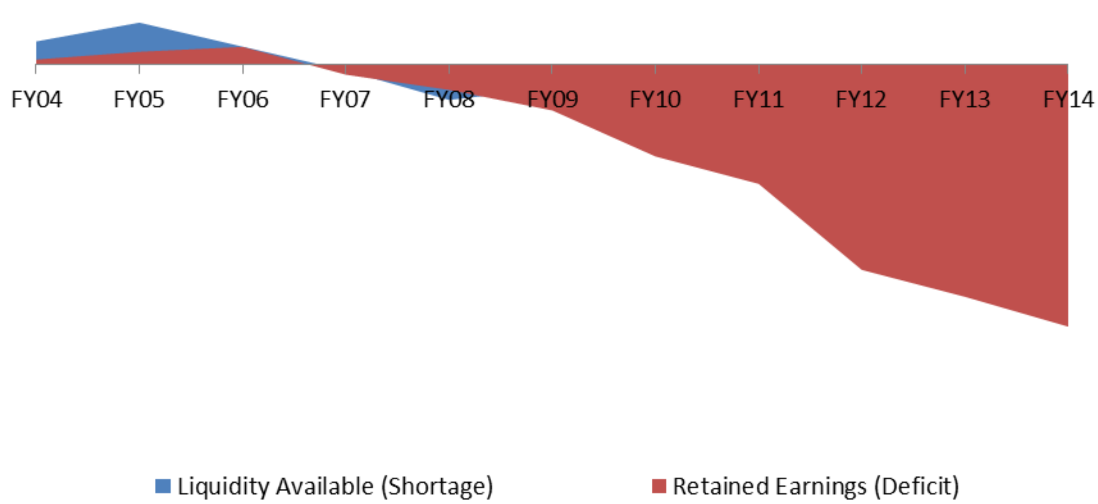
WORKING CAPITAL ANALYSIS

Working capital is the amount by which the value of an agency's current assets exceeds its current liabilities. The Postal Service has no working capital as of September 30, 2014. Its current obligations exceed current assets by $36.3 billion. The net increase of $3.4 billion from the start of the fiscal year is largely due to the growth in employee-related liabilities, including the statutory accruals for payments into the RHBF.

Working capital serves as a liquid reserve; it indicates an agency's short-term solvency and determines if it can pay its current liabilities when due.

Figure IV-3 highlights the deficit, starting in FY 2007 and growing to its current cumulative balance of $48.5 billion. Available liquidity is calculated as a combination of working capital and remaining borrowing capacity.

Figure IV-3
Postal Service Liquidity and Retained Deficit Trends



Source: Postal Service Forms 10-K and Postal Service *Annual Reports*.

LIQUIDITY RATIOS

Liquidity-related ratios are one of the most widespread indicators of an agency's solvency. There are three liquidity-related ratios:

- Current ratio: One of the most commonly used liquidity ratios, current ratio shows to what degree an agency's current assets are meeting current liabilities.

- Quick ratio: This ratio describes an agency's solvency in the near future. The quick ratio reflects whether sufficient funds are available to meet short-term obligations to creditors.

- Cash ratio: Cash ratio is calculated by dividing absolute liquid assets by current liabilities.

All three ratios for the Postal Service are calculated in Table IV-5.

Table IV-5
Ratio Analysis of Postal Service Financial Statements

Ratios	Value			Description of Ratio	Postal Service Historic 10-Year Avg. Value
	9/30/14	9/30/13	Change		
Current ratio	0.15	0.1	0.04	Calculated by dividing current assets by current liabilities. Indicates ability to meet short-term debt obligations.	0.18
Quick ratio	0.14	0.10	0.04	Calculated by dividing liquid assets (cash, cash equivalents and short-term investments, current receivables) by current liabilities. Indicates ability to meet short-term obligations using most liquid assets (near cash or quick assets).	0.17
Cash ratio	0.12	0.07	0.05	Calculated by dividing absolute liquid assets (cash, cash equivalents and short-term investments) by current liabilities.	0.11

Source: Postal Service Forms 10-K and Postal Service *Annual Reports*.

At the end of the period analyzed, the current ratio amounted to 0.15. This is an improvement of 0.04 from September 30, 2013, but slightly lower than the 10-year historic average level. Additionally, the quick ratio totaled to 0.14, an improvement of 0.04 over the prior year, but is slightly lower than the 10-year historic average level.

Similarly, the cash ratio had a value of 0.12 on September 30, 2014, an improvement, but still indicating a deficit of the most liquid assets (cash and cash equivalents) to meet all current liabilities.

The improved liquidity-related ratios are largely a result of the Postal Service’s increased cash on hand after it exhausted its borrowing capacity. Along with the improvement in the liquidity ratios, the Postal Service’s working capital also shows slight positive signs. The decelerating erosion of its current assets could be a result of the assets reaching full depreciation, as opposed to an indicator of new capital investment.

Appendix A. FY 2014 Volume, Revenue, Cost, and Cost Coverage by Class, Current Classification (Products)

	Volume (000)	Revenue ($ 000)	Attributable Cost ($ 000)	Contribution: Institutional Cost ($ 000)	Revenue/Piece (Cents)	Cost/Piece (Cents)	Contribution: Institutional Cost/Piece (Cents)	Cost Coverage
COMPETITIVE MAIL								
Priority Mail Express	36,231	759,843	365,505	394,338	2,097.246	1,008.833	1,088.413	207.9%
Priority Mail	920,083	6,883,898	5,234,390	1,649,508	748.182	568.904	179.278	131.5%
Total Ground	1,575,596	3,160,337	2,472,029	688,308	200.580	156.895	43.686	127.8%
First-Class Package Service	634,615	1,461,842	1,154,758	307,083	230.351	181.962	48.389	126.6%
Competitive International Mail	281,480	2,310,543	1,380,635	929,908	820.854	490.491	330.363	167.4%
Competitive Domestic Services		695,096	358,522	336,575				193.9%
Competitive International Services		8,355	4,121	4,234				202.7%
Total Competitive Mail and Services	**3,448,005**	**15,279,914**	**10,969,960**	**4,309,953**	**443.152**	**318.154**	**124.998**	**139.3%**
MARKET DOMINANT MAIL								
First-Class Mail								
Single-Piece Letters and Cards	21,524,331	10,577,441	5,976,836	4,600,605	49.142	27.768	21.374	177.0%
Presort Letters and Cards	40,296,319	15,251,275	4,756,722	10,494,553	37.848	11.804	26.043	320.6%
Flats	1,782,673	2,499,132	1,566,097	933,035	140.190	87.851	52.339	159.6%
Parcels	233,115	593,028	542,759	50,269	254.393	232.828	21.564	109.3%
Outbound Single-Piece Mail International	215,536	308,384	188,415	119,969	143.078	87.417	55.661	163.7%
Inbound Single-Piece Mail International	400,772	338,754	392,372	(53,618)	84.525	97.904	(13.379)	86.3%
Total First-Class Mail	**64,452,747**	**29,568,013**	**13,423,200**	**16,144,813**	**45.875**	**20.826**	**25.049**	**220.3%**

	Volume (000)	Revenue ($ 000)	Attributable Cost ($ 000)	Contribution: Institutional Cost ($ 000)	Revenue/Piece (Cents)	Cost/Piece (Cents)	Contribution: Institutional Cost/Piece (Cents)	Cost Coverage
STANDARD MAIL								
High Density and Saturation Letters	5,970,133	883,644	369,706	513,938	14.801	6.193	8.608	239.0%
High Density and Saturation Flats/Parcels	11,295,026	2,013,262	887,226	1,126,036	17.824	7.855	9.969	226.9%
Carrier Route	9,030,124	2,381,176	1,735,280	645,896	26.369	19.217	7.153	137.2%
Letters	48,071,726	9,956,164	4,947,532	5,008,632	20.711	10.292	10.419	201.2%
Flats	5,054,395	2,041,417	2,452,431	(411,014)	40.389	48.521	(8.132)	83.2%
Not Flat-Machinables and Parcels	65,846	72,008	102,539	(30,532)	109.358	155.726	(46.368)	70.2%
Every Door Direct Mail	890,148	149,000	39,302	109,698	16.739	4.415	12.324	379.1%
Inbound NSA Mail International	154	83	-	83				
Total Standard Mail	**80,377,552**	**17,496,754**	**10,534,016**	**6,962,738**	**21.768**	**13.106**	**8.663**	**166.1%**
PERIODICALS								
Within County	586,130	67,238	85,689	(18,452)	11.471	14.620	(3.148)	78.5%
Outside County	5,458,584	1,558,102	2,048,483	(490,381)	28.544	37.528	(8.984)	76.1%
Total Periodicals	**6,044,715**	**1,625,340**	**2,134,172**	**(508,832)**	**26.889**	**35.306**	**(8.418)**	**76.2%**
PACKAGE SERVICES								
Alaska Bypass	1,290	33,133	16,380	16,754	2,568.678	1,269.844	1,298.834	202.3%
Inbound Surface Parcel Post (at UPU Rates)	906	18,076	12,861	5,216	1,995.758	1,419.904	575.855	140.6%
Bound Printed Matter Flats	249,745	202,860	134,279	68,581	81.227	53.767	27.460	151.1%
Bound Printed Matter Parcels	211,977	273,492	251,151	22,341	129.020	118.480	10.539	108.9%
Media Mail/Library Mail	86,304	308,330	328,095	(19,766)	357.258	380.160	(22.902)	94.0%
Total Package Services	**550,222**	**835,891**	**742,766**	**93,125**	**151.919**	**134.994**	**16.925**	**112.5%**
U.S. Postal Service Mail	454,258							
Free Mail	47,386		39,504	(39,504)		83.367		
Total Market Dominant Mail	**151,926,879**	**49,525,998**	**26,873,659**	**22,652,339**	**32.599**	**17.689**	**14.910**	**184.3%**

	Volume (000)	Revenue ($ 000)	Attributable Cost ($ 000)	Contribution: Institutional Cost ($ 000)	Revenue/Piece (Cents)	Cost/Piece (Cents)	Contribution: Institutional Cost/Piece (Cents)	Cost Coverage
MARKET DOMINANT SERVICES								
Ancillary Services								
Certified Mail		687,317	542,238	145,079				126.8%
Collect on Delivery		3,598	2,673	925				134.6%
Insurance		91,613	63,451	28,161				144.4%
Registered Mail		34,933	28,625	6,308				122.0%
Stamped Envelopes		9,928	7,841	2,086				126.6%
Stamped Cards		1,681	576	1,105				291.8%
Other Ancillary Services		525,230	259,635	265,595				202.3%
Money Orders		165,264	99,651	65,613				165.8%
Post Office Box Service		365,287	281,913	83,373				129.6%
Caller Service		97,902	21,930	75,971				446.4%
Other Special Services		36,449	9,932	26,517				367.0%
International Services		41,099	12,774	28,325				321.7%
Total Market Dominant Services		**2,060,300**	**1,331,241**	**729,059**				
Other Income		911,950	59,331	852,619				
Total Mail and Services	**155,374,884**	**67,778,162**	**39,234,191**	**28,543,970**	**43.622**	**25.251**	**18.371**	**172.8%**
Institutional Costs			34,127,728					
Appropriations: Revenue Forgone		52,457						
Investment Income		23,702						
Total Revenues		**67,854,321**						
Total Costs			**73,361,920**					
Net Income (Loss)		**(5,507,599)**						

Source: Library Reference PRC–FinRpt14–NP1.

Appendix B. Acronyms

Acronym	Meaning
ACD	*Annual Compliance Determination*
ACR	*Annual Compliance Report*
BPM	Bound Printed Matter
CPI	consumer price index
FY	Fiscal Year
NSA	negotiated service agreement
RHBF	Retiree Health Benefit Fund
TFP	total factor productivity
UPU	Universal Postal Union