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ORDER NO. 6459

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Michael Kubayanda, Chairman;
Mark Acton, Vice Chairman;
Ann C. Fisher;
Ashley E. Poling, and
Robert G. Taub

Periodic Reporting
(Proposal Seven)

Docket No. RM2023-2

ORDER ON ANALYTICAL PRINCIPLES USED IN PERIODIC REPORTING (PROPOSAL SEVEN)

(Issued March 17, 2023)

I. INTRODUCTION

On December 12, 2022, the Postal Service filed a petition pursuant to 39 C.F.R. § 3050.11 requesting that the Commission initiate a rulemaking proceeding to consider changes to analytical principles relating to periodic reports.[1] The Petition identifies the proposed analytical changes filed in this docket as Proposal Seven. Proposal Seven proposes an accounting treatment for the forgiveness of the Postal Service's retiree health benefit (RHB) prefunding liabilities effected by the Postal Service Reform Act of

[1] Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Seven), December 12, 2022 (Petition).

2022 (PSRA).[2] On December 12, 2022, the Commission issued a notice initiating this proceeding, providing for the submission of comments, and appointing a Public Representative.[3] Comments were received from Mailer Associations,[4] the Greeting Card Association (GCA),[5] and the Public Representative.[6]

II. BACKGROUND

The PSRA was enacted on April 6, 2022 and had certain specific effects on the Postal Service's finances. Section 102 of the PSRA repealed the statutory requirement that the Postal Service annually prepay future RHB prefunding liabilities and also cancelled all past due RHB prefunding payment liabilities.[7] After enactment of the PSRA, the Postal Service filed a letter, dated August 12, 2022, with the Commission's Secretary informing both the Commission and other potentially interested stakeholders of its plans for reflecting the PSRA's removal of the Postal Service's RHB prefunding liabilities for regulatory purposes when submitting its FY 2022 Annual Compliance Report (ACR) in December 2022 and its Form 10-K in November 2022.[8]

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[2] Petition at 1. *See* Docket No. RM2023-1, Order Granting Petition, in Part, for Reconsideration, December 9, 2022, at 1-2 (Order No. 6363); Postal Service Reform Act of 2022, Pub. L. 117-108, 136 Stat. 1127 (2022).

[3] Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (Proposal Seven), December 13, 2022 (Order No. 6369).

[4] Comments of Mailer Associations in Opposition to the Petition of the United States Postal Service, December 27, 2022 (Mailer Associations Comments). The Mailer Associations consist of the Alliance of Nonprofit Mailers, the American Catalog Mailers Association, the Association for Postal Commerce, the Major Mailers Association, the National Association of Presort Mailers, the National Postal Policy Council, and N/MA – The News/Media Alliance. Mailer Associations Comments at 1 n.1.

[5] Comments of the Greeting Card Association, December 27, 2022 (GCA Comments).

[6] Public Representative Comments, December 27, 2022 (PR Comments).

[7] PSRA section 102 repealed former 5 U.S.C. § 8909a(d) requiring the Postal Service to make the amortization and normal cost payments and replaced it with a new requirement that the Postal Service pay into the Postal Service Retiree Health Benefit Fund (PSRHBF) for current retiree health care costs equal to cost of annual claims minus the premiums paid.

[8] Letter to Erica A. Barker, Secretary and Chief Administrative Officer, August 12, 2022 (Postal Service Letter), available at *https://www.prc.gov/docs/122/122469/Lttr%20re%20PSRA%20Effects%20ACR%20CRA.pdf*.

The PSRA's removal of prefunding liabilities resulted in a one-time reversal of $57.0 billion accrued but unpaid RHB prefunding liabilities between September 2012 and September 2021.[9] For accounting purposes, and based upon accounting standards, the Postal Service indicated its intent to have its Statement of Operations reflect a one-time reduction in FY 2022 Operating Expenses due to this reversal, resulting in a substantial effect on bottom-line FY 2022 Net Income/Loss. *Id.*

However, for regulatory purposes, the Postal Service's Cost and Revenue Analysis (CRA) report starts with the costs in the General Ledger, which are then classified in the CRA as either attributable or institutional costs. The total of costs in the General Ledger in a year should match total costs in the CRA for that same year. *Id*. at 2. The Postal Service's letter noted that the application of its intended accounting treatment reducing operating expenses in the Financial Statements would result in negative total institutional costs in the CRA, an anomalous result for regulatory purposes, rendering irrelevant the level of all other institutional costs for the year and making "evaluation of compliance with the appropriate share provision …impossible."[10] Further, such accounting treatment would impede calculation of the imputed federal income tax.[11] To avoid these outcomes, the Postal Service proposed to omit the $57.0 billion negative expense from its Reallocated Trial Balance, and hence from the CRA and the ACR. Postal Service Letter at 2. The Postal Service stated that given the one-time nature of the specific accounting transactions, costs in FY 2023 and later years would not be affected. *Id.* at 3. The Postal Service explained that this is an extremely rare circumstance where the appropriate accounting treatment does not constitute the appropriate regulatory treatment. *Id*. It also proposed that for FY 2022 RHB normal

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[9] Postal Service Letter at 1 (citing a note on submitted financial information and the Postal Service's Quarterly Report Form 10-Q, submitted August 9, 2022).

[10] Postal Service Letter at 2; appropriate share is the required share of the total institutional costs of the Postal Service that Competitive products must collectively cover each year. *See* 39 U.S.C. § 3633(a)(3).

[11] Postal Service Letter at 2. The Postal Service must annually compute what its Federal income tax would be on Competitive products' taxable income. *See* 39 U.S.C. § 3634.

cost ($2.150 billion) and amortization payments ($0.5 billion) were to be treated consistently between the General Ledger and the CRA. *Id.* The Postal Service stated that these amounts are a reversal of accruals earlier in FY 2022 so that at the end of the year there would be no expense for those costs and amortization payments.[12]

The Commission responded by letter on October 7, 2022, to the Postal Service Letter, endorsing most of the substance of the method proposed by the Postal Service and describing the method that the Commission expected the Postal Service to apply to account for the liability forgiven by the PSRA.[13]

On November 4, 2022, GCA initiated a proceeding in Docket No. RM2023-1 pursuant to 39 C.F.R. § 3050.11 with a filing entitled "Petition for Reconsideration and Initiation of Proceeding" that contended that the Postal Service's proposed treatment is "clearly a change in analytical principles" and must be assessed in a rulemaking docket pursuant to 5 U.S.C. § 553 to provide the opportunity for public comment that GCA believed was mandatory.[14] The Postal Service responded in opposition to the GCA Petition.[15] It stated that the Commission never concluded the proposed treatment

[12] *Id.* The appropriate treatment of FY 2022 RHB normal cost is before the Commission for consideration in Docket No. RM2023-3. *See* Docket Nos. RM2023-1 and RM2023-3, Motion for Reconsideration or, in the Alternative, Petition to Initiate a Proceeding Regarding the Appropriate Analytical Principle for Retiree Health Benefit Normal Costs, December 19, 2022; Docket Nos. RM2023-1 and RM2023-3, Order Denying Request for Reconsideration and Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (NPPC et al. Proposal One), January 25, 2023 (Order No. 6430).

[13] Letter from Erica A. Barker, Secretary and Chief Administrative Officer to Richard T. Cooper Managing Counsel, Corporate and Postal Business Law, October 7, 2022 (Commission Letter), available at *https://www.prc.gov/docs/123/123096/Response%20Letter.pdf.*

[14] Docket No. RM2023-1, Petition for Reconsideration and Initiation of Proceeding, November 4, 2022, at 1 (GCA Petition). The GCA Petition also incorporated arguments in a letter submitted by a group of mailers in response to the Commission's Letter of October 7, 2022. Letter to Erica A. Barker, Secretary and Chief Administrative Officer, October 13, 2022, styled Motion for Reconsideration of Response to the Postal Service's Proposed Changes to Accepted Analytical Principles, available at *https://www.prc.gov/docs/123/123145/Motion%20for%20Reconsideration_PropChange_.pdf*. The motion did not conform to Commission procedures for filing motions. Representatives of 13 mailer organizations, including GCA, signed the letter.

[15] Docket No. RM2023-1, Response of the United States Postal Service in Opposition to GCA Petition for Reconsideration and Initiation of Proceeding, November 10, 2022 (Postal Service Response).

constitutes a change in accepted analytical principles. Postal Service Response at 3. It contended that the reversal of the unpaid prefunding liabilities was unprecedented and that there were no prescribed procedures for establishing new procedures under new circumstances such as these. *Id*. at 3-4.

Upon review of the GCA Petition and the other related filings, the Commission issued Order No. 6363, which stated that its acceptance of the Postal Service's plan presented in the Postal Service Letter was based upon the expectation that the gain brought on by the reversal of the unpaid prefunding liabilities would not be treated as a revenue or cost. Order No. 6363 at 7. However, in the Postal Service's most recent ACR, the Postal Service treated the $57.0 billion PSRA adjustment as a credit to account number 51265.000, and thus allocated to the Cost Segment and Components report, for which the existing accepted analytical principles must be applied in accordance with 39 C.F.R. § 3050.1. *Id.* at 8-9.

The Commission noted that in accordance with 39 C.F.R. § 3050.1(a), "an accepted analytical principle refers to an analytical principle that was applied by the Commission in its most recent Annual Compliance Determination (ACD) unless a different analytical principle subsequently was accepted by the Commission in a final rule." *Id*. at 9. Given that the Postal Service's proposed treatment did not align with the existing accepted analytical principles concerning the treatment of the Cost Segment and Components report, the Commission determined that it could no longer endorse the treatment proposed by the Postal Service without a change in accepted analytical principles. *Id.*

Order No. 6363 explained:

> If the $56.9 billion adjustment cannot be recorded in 'Miscellaneous Items' in the CRA report and must remain as an offset to trial balance account 51265.000 (thus being reallocated to Cost Segment 18), currently accepted analytical principles dictate that this reallocation be treated in the same manner as Cost Segment 18, Component 203 was during the FY 2021 ACD. This treatment would result in including the $56.9 billion as offsetting institutional costs. *See* Sum Desc, CS 18-21 at 20. Such treatment results in

> the unusual circumstance of institutional costs likely being negative for FY 2022 (as the gain of $56.9 billion is greater than the Postal Service's expected total institutional cost for FY 2022). As noted by the Commission and Mailers, this unusual circumstance would, among other things,[16] nullify the density-based rate authority for a year (as the institutional cost ratio is used as a proxy for uncontrollable network costs).

Id. at 9-10 (citations in original).

Upon reconsideration, the Commission therefore withdrew its October 7, 2022 letter approval of the Postal Service's proposed approach and directed the Postal Service to file a petition seeking a change in an accepted analytical principle to account for the PSRA-forgiven defaulted accruals differently than other items in Cost Segment 18 for FY 2022 if it wished to proceed with its proposed approach. *Id.* at 10-11. In response to Order No. 6363, the Postal Service filed its Petition in the instant docket to initiate a proceeding to consider Proposal Seven.

III. PROPOSAL SEVEN

A. Request

Proposal Seven proposes a change in methodology to make a one-time adjustment in the Postal Service's ACR to exclude from FY 2022 institutional costs $57.0 billion of unpaid RHB prefunding liabilities for the period between September 2012 and September 2021 that were reversed by the PSRA. Petition, Proposal Seven at 1. Proposal Seven, in other words, would exclude forgiven unpaid RHB prefunding payments from institutional costs for FY 2022. *Id.*

[16] Negative institutional costs would directly impede the calculation of the appropriate share of the Postal Service's institutional costs (*see* 39 U.S.C. § 3633(a)(3)) and the calculation of the assumed Federal income tax on Competitive products (*see* 39 C.F.R. § 3060.40(c)).

The Postal Service notes that in the years following the passage of the Postal Accountability and Enhancement Act (PAEA),[17] and consistent with generally accepted accounting principles, it accrued expenses in each year for scheduled RHB prefunding payments as required by law. Petition, Proposal Seven at 4. The Postal Service contends that such treatment was rational because in those years the lawfully required payments were treated like any other expenses for that year. *Id*. The Postal Service, however, differentiates this steady series of annual prefunding required payments from the "sudden and unprecedented occurrence of a one-time reversal of a *decade's* worth of unpaid prefunding expenses from prior years." *Id*. (emphasis in original).

The Postal Service notes the broad agreement among all parties that if it treated the PSRA forgiveness of the RHB payments as an offset to institutional costs, then institutional costs for FY 2022 would be a "very large negative number." *Id*. at 5. The Postal Service explains this creates regulatory issues with the appropriate share provision and the calculation of the imputed Federal income tax required by 39 U.S.C. § 3634. *Id*.

The Postal Service also notes the inadvertent effect (or as it characterizes it, the outcome mailers seek to ensure) of nullifying the density-based rate authority calculated as part of the FY 2022 ACR process. *Id*. at 6. It says that nullifying the density adjustment authority due to the PSRA forgiveness of RHB prefunding payments would interfere with and disrupt the regulatory rationale behind the density-based authority. *Id.* at 5-7. The Postal Service, therefore, proposes two possible methods to effectuate its proposal to account for the PSRA-forgiven RHB prefunding payments.

B. Proposal Seven Alternative One

The Postal Service prefers Alternative One of its two proposals. Alternative One would "zero out" Component 203 in the Cost Segment 18 tab of its Reallocated Trial Balance by omitting the reallocation of the negative $56,975,093,943.28 from Trial

[17] *See* Postal Accountability and Enhancement Act, Pub. L. 109-435, 120 Stat. 3198 (2006).

Balance account 51265.000 into Component 203. *Id*. at 8. The Postal Service contends that this would result in "total costs at the bottom of the CRA that differed by that same amount from the sum of the Total Operating Expenses, Impact of Postal Service Reform Legislation, and Interest Expense rows of the Postal Service's Statements of Operations in the 10-K." *Id*. Under this methodology, institutional costs for FY 2022 would not be "inappropriately affect[ed]" compared to how they would be without Proposal Seven. *Id*.

C. Proposal Seven Alternative Two

Alternatively, the Postal Service suggests reallocation of the $56,975,093,943.28 negative expense from Trial Balance account 51265.000 to the Miscellaneous Items row in the CRA but excluding it from the row "All Other" that identifies institutional cost. *Id*. at 9.

D. Impact of Either Alternative

Overall, the Postal Service identifies that the impact of Proposal Seven "is to exclude the one-time massive negative RHB expense accrual triggered by the PSRA from overwhelming routine FY 2022 institutional costs…[and to] avoid the inappropriate detrimental regulatory consequences of the 'nonsensical' result of negative institutional costs previously and correctly recognized by the Commission." *Id.* at 10.

IV. COMMENTS

The Mailer Associations contend that "[t]he Commission should deny the Postal Service's request, because it would not 'improve the quality, accuracy, or completeness of Postal Service data' as is statutorily required," citing 39 U.S.C. § 3652(e)(2). Mailer Associations Comments at 1. They argue that "the proposal would present a distorted picture of the Postal Service's financial position by ignoring the very real – and indeed, in the Postal Service's own words, 'massive' – impact of the PSRA on the Postal Service's FY 2022 institutional costs." *Id.* at 1-2. The Mailer Associations further contend that the Postal Service provides no sound basis for changing the established analytical principle. *Id*. at 2. They claim that potentially negative institutional costs, while atypical, are not nonsensical and are the appropriate result of Congressional action. *Id*. at 3. They further assert that negative institutional costs associated with a prior year's personnel benefit adjustment is not unprecedented and point to a negative $1.8 billion worker's compensation net adjustment included in institutional costs in FY 2021. *Id*. at 5. They state that the impact must be reflected in the CRA. *Id.* at 6. The Mailer Associations further argue that proper accounting of the $57.0 billion negative expense does not impair compliance with the appropriate share provision. *Id.* They assert that it merely results in the FY 2022 minimum contribution of competitive products being met by default. *Id.* They further assert that there is no reason to believe the contribution would be insufficient in FY 2022 if the $57.0 billion were excluded from institutional costs. *Id*.

The Mailer Associations also object to the Postal Service's claim that "'nullifying the density authority due to the PSRA forgiveness of RHB prefunding payments would interfere and disrupt the regulatory rationale behind the density-based authority.'" *Id*. at 7. The Mailer Associations argue that "[t]his claim is specious" and that there is nothing "nonsensical" about the Postal Service not earning additional density rate authority. *Id*. They assert that the density-based rate authority addresses increases in the unit costs of delivering mail but does not entitle the Postal Service to receipt of density authority every year. *Id.* They claim that if events reduce the unit costs of delivering mail, using a straightforward application of the formula, the Postal Service will not receive any density rate authority. *Id*.

GCA agrees with arguments of the Mailer Associations. GCA Comments at 1. It presents other arguments to demonstrate that the Postal Service's petition should be denied. *Id*. GCA cites to several objectives of 39 U.S.C. § 3622(b) that, it argues, would be violated by ignoring the $57.0 billion deficit reduction. *Id.* at 2-4. First, GCA argues that the Postal Service accrued these costs, and they formed part of the rates mailers paid. *Id.* at 3. GCA asserts that if customers are charged costs which the Postal Service does not incur, then the rates are unjust and therefore contrary to Objective 8. *Id*. GCA further claims Objective 9 would be violated because that provision requires an appropriate allocation of institutional costs between product sectors, but to allocate to any sector a cost which no longer exists cannot be an appropriate allocation. *Id*. It also points to Objective 5 and states that the Commission relied on the unpaid RHB liabilities in finding that the Postal Service lacked financial stability in the 10-year review. *Id.* GCA argues that with the removal of a large part of the deficit, it is not now possible to argue that Objective 5 requires the Commission to ignore that deficit reduction. *Id.* at 3-4. GCA concludes that ignoring the massive reduction in institutional costs will not be a "one-time" occurrence and may affect the entire future of postal ratemaking because the Postal Service's financial stability has been improved by the amount of the deficit reduction. *Id*. at 4.

The Public Representative states that "[t]he issue is the regulatory treatment of this reversal and the effects said treatment has on the institutional costs calculated in the FY 2022 CRA report, and all subsequent calculations that use institutional costs; specifically noted are the appropriate share provision, imputed Federal income tax for Competitive products, and density-based rate authority." PR Comments at 8.

She recognizes the Mailer Associations' argument that including the reversal in institutional costs would nullify the density-based rate authority, but she does not believe the drivers of the need for density-based authority are affected by the passage of the PSRA or the removal of prior years' RHB expenses. *Id.* at 9. She states that the “density authority is specifically intended to offset unavoidable increases in per-unit costs caused by the decline in mail density” and that “[t]he Postal Service incurred the same costs during FY 2022 that it would have regardless of the passage of the PSRA.” *Id.* She also states that “negative institutional costs will impede on the Postal Service’s ability to calculate the appropriate share of institutional costs in accordance with 39 U.S.C. § 3633(a)(3)) and the Federal income tax on Competitive products in accordance with 39 C.F.R. § 3060.40(c).” *Id*.

The Public Representative notes the $57.0 billion reversal is a non-cash adjustment. *Id.* No reimbursement for prior years’ RHB expenses has been received. *Id.* She recognizes the RHB reversal improves the balance sheet but does not impact operating costs except for the one-time anomalous adjustment to FY 2022 Total Net Income that negates actual costs accrued and misrepresents FY 2022 operating results. *Id*. at 9-10.

The Public Representative recommends the Postal Service’s Alternative Two approach by reallocating Trial Balance account number 51265.000 to a separate “Miscellaneous Items” worksheet (tab) in the Reallocated Trial Balance file. *Id.* at 10. She notes it offers more transparency allowing the reversing entry to be traced from the Trial Balance to the CRA report. *Id*. She states that the first approach could create confusion as the CRA report of total costs would not reconcile to the total costs in the Statement of Revenue and Expenses. *Id*.

V. COMMISSION ANALYSIS

Pursuant to 39 U.S.C. § 3652(e)(2) and 39 C.F.R. § 3050.11(a), proposed changes to analytical principles are evaluated to ensure that they “improve the quality, accuracy, or completeness of the data or analysis of data” contained in the Postal

Service's periodic reports.[18] In this instance, the Commission evaluates whether the Postal Service's proposed change in analytical principles, for the purposes of accounting for the PSRA forgiveness of RHB prefunding payment requirements, represents such an improvement. As detailed below, the Commission determines that the one-time legislative forgiveness of the $57.0 billion RHB liability is best characterized as a one-time noncash, nonexchange gain that is akin to debt forgiveness. *See infra* pp. 21-22. This noncash, nonexchange gain stands in contrast to incurred revenues or expenses, which in turn are included in the calculation of either attributable costs or institutional costs. For the reasons discussed below, the Commission concludes that a change in the analytical principles is necessary in accordance with 39 C.F.R. § 3050.11(a) to accurately and completely account for the one-time noncash, nonexchange gain resulting from forgiveness of the RHB liability and to avoid distorting the Postal Service's financial position and institutional costs. Accurately and completely accounting for this gain will improve the quality of the FY 2022 ACR.

The Commission begins by reviewing prior legislation initiating the RHB prefunding requirements and the PSRA's repudiation of the RHB prefunding requirements, as relevant to the proposal. The Commission then discusses the current accounting treatment of the removal of the liability of past due RHB prefunding payments, considers the Postal Service's proposed treatment of the removal in the CRA report, and adopts a modified version of the Postal Service's second alternative proposed analytical principle change that allows for accurate and transparent reporting of the $57.0 billion noncash, nonexchange gain, allows for its reconciliation in the Postal Service's CRA, accurately reflects its character as a noncash, nonexchange event, and

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[18] *See* 39 C.F.R. § 3050.11(a) (stating "[t]o improve the quality, accuracy, or completeness of the data or analysis of data contained in the Postal Service's annual periodic reports to the Commission, the Commission, acting on its own behalf, may issue a notice of proceeding to change an accepted analytical principle. In addition, any interested person, including the Postal Service or a public representative, may submit a petition to the Commission to initiate such a proceeding."). The Commission notes that 39 U.S.C. § 3652(e)(2) contains essentially an identical standard ("to improve the quality, accuracy, or completeness of Postal Service data required by the Commission").

does not produce a distorted picture of the Postal Service's institutional costs and financial position.

A. Prior Legislation

1. PAEA Prefunding Requirements

The PAEA made significant changes in the laws dealing with the funding of RHB, requiring the Postal Service to make substantial statutorily mandated payments to prefund RHB for future retirees into the PSRHB Fund through 2016, and actuarially determined payments (amortization and normal costs) beginning in 2017. In requiring these payments, the intent of the PAEA was to have future RHB expenses fully funded by FY 2017, and beginning in FY 2017, to require annual payments to ensure future retiree health obligations remained fully funded. The Postal Service did not make any of the mandated annual RHB payments since FY 2011, and as a result, had a total unpaid balance of $57.0 billion in RHB liabilities at the end of FY 2021.[19] This $57.0 billion liability included the statutory RHB assessments of $33.9 billion from FY 2012 through FY 2017 and $23.1 billion in actuarially determined RHB assessments ($4.3 billion of amortization and $18.8 billion of normal costs) from FY 2017 through FY 2021. As discussed on page 16, *infra*, these amounts accumulated on the balance sheet each year that the expenses, which include a mixture of attributable and institutional costs, were not paid.

2. PSRA Repudiation of RHB Prefunding and Forgiveness of Obligations

The PSRA repealed the required prefunding of the PSRHBF, eliminating all past due amounts accrued as a liability, and defined a new formula for payments into the PSRHBF. Unlike the payments under the PAEA, the new payments are not meant to

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[19] United States Postal Service, 2022 Report on Form 10-K, November 10, 2022, at 46 (Postal Service FY 2022 Form 10-K).

prefund post-retirement health benefits for future retirees and instead reflect a pay-as-you-go approach to paying for current retiree health benefits. PSRA § 102. Under the requirements of the PSRA, the Postal Service is now required to pay into the PSRHBF for current retiree health care expenses equal to the excess of the cost of annual claims over premiums. *Id.* The Postal Service will not, however, be required to make these payments until Office of Personnel Management computes whether "top up" payments are due (which will occur not later than June 30, 2026) or the PSRHBF is exhausted. *Id.* Once RHB payments are required, the Postal Service will continue to have no obligation to pay for future RHB, and the only obligation the Postal Service will incur under the PSRA is the expenses for current RHB in a given fiscal year. *Id.*

B. Postal Service Filings Based on Existing Methodology

1. Accounting Treatment of the Forgiven Obligations

In accordance with standard accounting principles, the Postal Service recorded an expense on its Statements of Operations for the RHB unpaid amounts in the years in which they were incurred and recorded a liability on its Balance Sheets in the same amount. To recognize the cancellation of the unpaid RHB amounts due to Section 102 of the PSRA, the Postal Service FY 2022 Form 10-K and supporting documents treated the reversal as a negative expense, which as explained earlier in Order No. 6363, flows into the CRA in the form of a negative institutional cost. The Commission Letter explained that this noncash event is not an expense or expense adjustment, but akin to a gain. Commission Letter at 2-3. Consistent with that interpretation, Proposal Seven seeks a modification to the CRA that would not recognize the effect of removal of the liability as a negative cost.

2. Analysis of Impact of Current Accounting Treatment

If the forgiveness of the RHB liability is treated as a negative expense, it would result in negative institutional costs. Negative institutional costs would directly impede the calculation of the appropriate share of the Postal Service's institutional costs (*see* 39 U.S.C. § 3633(a)(3)), would directly impede the calculation of the assumed Federal income tax on Competitive products (*see* 39 C.F.R. § 3060.40(c)) and would nullify the density-based rate authority for a year (as the institutional cost ratio is used as a proxy to calculate uncontrollable network costs). Density-based rate authority grants additional rate authority to the Postal Service based on unit cost increases caused by the decline in mail density as the Postal Service delivers fewer mail pieces to more delivery points. 39 C.F.R. § 3030, subpart D. The effects of uncontrollable network costs on unit costs as density declines are entirely unrelated to the amount of previously accrued, unpaid RHB liability, now removed by the PRSA.

C. Proposal Seven

Proposal Seven seeks a modification to the CRA that would not recognize the effect of removal of the liability as a negative expense. The Postal Service offers two alternatives for recording the PSRA adjustment.

1. Postal Service Alternative One

In Alternative One, the Postal Service proposes to "zero out" Component 203 in the Cost Segment 18 tab of its Reallocated Trial Balance by omitting the reallocation of the negative $56,975,093,943.28 ($57.0 billion) from Trial Balance account 51265.000 into Component 203. Petition, Proposal Seven at 8.

a. Differences Between Postal Service Alternative One and Current Accounting Treatment

The Postal Service's CRA report starts with the expenses in the General Ledger which are then classified in the CRA as either attributable or institutional costs.[20] The

[20] Docket No. RM2003-3, Final Rule on Periodic Reporting Requirements, November 3, 2003, at 21-22 (Order No. 1386).

total of expenses in the General Ledger in a year should match total costs in the CRA for that same year. Application of the current accounting treatment, which would record the $57.0 billion as a reduction in operating expenses in the Financial Statements, would result in negative total institutional costs in the CRA.

Application of Alternative One excluding the $57.0 billion currently included as a negative institutional cost on the CRA would result in "total costs at the bottom of the CRA that differed by that same amount from the sum of the Total Operating Expenses, Impact of Postal Service Reform Legislation, and Interest Expense rows of the Postal Service's Statements of Operations in the 10-K." Petition, Proposal Seven at 8.

b. Analysis of Impact of Postal Service Alternative One

The Mailer Associations contend that the proper accounting treatment of the $57.0 billion should be as a negative expense on the CRA. Mailer Associations Comments at 6. The Mailer Associations view the Postal Service's proposal as making the removal of the RHB liability disappear, implying that it would fail to be recognized in the CRA, which in turn would not be reconciled to the Postal Service Form 10-K. *Id.* at 5-6.

The Commission agrees with the Mailer Associations that the PSRA adjustment must be included in the CRA to ensure the accuracy of regulatory analysis. In general, for the CRA to be complete and accurate, Net Income on the CRA should reconcile with Net Income on the Postal Service Form 10-K in any given fiscal year. As noted in the Commission Letter, the Commission recognizes the importance of reconciling the CRA to the Postal Service Form 10-K. Commission Letter at 3-4. The Commission's alternative (Modified Alternative Two), detailed below, will result in a more complete and accurate report by requiring the non-cash benefit from the cancellation of prior unpaid RHB expenses to be reported on the FY 2022 CRA; retaining the noncash, nonexchange character of the transaction; and resulting in the same Net Income calculated on the CRA as is reported on Postal Service FY 2022 Form 10-K. The decision in this Order, in response to the Mailer Associations Comments that these effects must be recognized in the CRA and regulatory filings, reinforces the requirement that the recognition of the effects of the removal of the liability in the CRA be reconciled to the Postal Service FY 2022 Form 10-K.

GCA contends that ignoring the legislative removal of these costs would violate several of the 39 U.S.C. § 3622(b) objectives. GCA Comments at 3. However, those objectives are not the standard for evaluating a proposed change in an analytical principle related to periodic reporting. Further, the section 3622(b) objectives provide a framework for rate design in a system for the regulation of market dominant rates as a whole. In contrast, the standard applicable to this proceeding is whether a proposed change in analytical principles “improves the quality, accuracy or completeness of the data or analysis of data contained in the Postal Service’s periodic reports.” 39 C.F.R. § 3050.11(a).

Additionally, GCA claims that mailers paid rates based on the accrued RHB costs. GCA Comments at 3. The rates in effect until August 29, 2021, however, were subject to a price cap system based solely on the increase in the Consumer Price Index for All Urban Consumers (CPI-U).

Rates in effect since August 29, 2021 (effective 32 days before the end of the FY 2021) are subject to a price cap system partially based on the increase in the CPI-U, but also allowing for some additional pricing flexibility and authority, including a density-based rate authority and retirement-based rate authority. The rate adjustments effective August 29, 2021 (approved in Docket No. R2021-2) included the first step of a 5-year phase-in of the retirement-based rate authority, which was based on the unpaid RHB amortization expenses in addition to Civil Service Retirement System and Federal Employees Retirement System amortization expenses. *See* C.F.R. part 3030, subpart E(c). As a result, rates were increased by a marginally greater amount as a result of the RHB amortization expenses. However, the phase-in process for the retirement-based rate authority recalibrates the additional authority each year, incorporating updated retirement amortization expenses. After the first year of the phase-in process, the RHB amortization expenses were eliminated, which resulted in a smaller retirement-based rate authority in the second year, and it will continue to do so for the remainder of the phase-in period. As a result, when fully implemented the cumulative amount of retirement-based rate authority will be nearly identical to what it would have been if RHB amortization expenses had not been included in the first year of the phase-in.[21]

2. Postal Service Alternative Two

Alternatively, the Postal Service suggests reallocation of the $56,975,093,943.28 ($57.0 billion) negative expense from Trial Balance account 51265.000 to an undefined additional cost segment, “Miscellaneous Costs” that would be included in the Miscellaneous Items row in the CRA but would be excluded from the row “All Other” that identifies institutional cost. Petition, Proposal Seven at 9.

a. Differences Between Postal Service Alternative Two and Current Accounting Treatment

The Postal Service’s FY 2022 CRA report includes the $57.0 billion as a negative institutional cost in the row for “All Other” costs. Application of Alternative Two, however, would reallocate the $57.0 billion currently included on the CRA to the reporting category of “Miscellaneous Items” on the CRA. “Miscellaneous items”[22] on the CRA are treated as independent from product or class levels and recorded as a separate line item when calculating total income.

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[21] The Commission performed an analysis of the difference between the cumulative amount of retirement-based rate authority with RHB expenses included in the first year, and an alternative scenario with RHB expenses excluded in the first year. Assuming that all else is equal, after the first year of phase-in, the retirement-based rate authority was approximately 0.213 percent higher as a result of the inclusion of RHB expenses. Holding inputs for future years constant and including the effects of compounding, the difference in cumulative retirement-based rate authority decreases steadily through the remaining 4 years of the phase-in period to approximately 0.003 percent when fully phased-in.

[22] Docket No. ACR2022, Library Reference USPS-FY22-1, December 29, 2022, PDF file “USPS-FY22-1 Preface.PCRA.Report.pdf,” at 3.

b. Analysis of Impact of Postal Service Alternative Two

The Mailer Associations contend that the proper accounting treatment of the $57.0 billion should be as a negative expense on the CRA. Mailer Associations Comments at 6. The Mailer Associations and GCA analogize RHB expenses to other personnel expenses, including workers' compensation, and argue that personnel expenses are appropriate institutional costs that should not be removed because they are negative for FY 2022. Mailer Association Comments at 5; GCA Comments at 2.

For purposes of the CRA, RHB expenses have been treated like workers' compensation in that they are a labor-related expense divided into a current-year amount with the same variability and distribution as all labor expenses and a prior-year amount that is institutional. Postal Service FY 2022 Form 10-K at 44. Prior year workers' compensation costs reflect changes in discount rates and/or changes in actuarial valuation of injuries occurring in past years. *Id.* Unlike the calculation of the prior year's workers' compensation costs, the PSRA adjustment is not for the accrual of the change in the RHB liability. The PSRA adjustment of $57.0 billion is fundamentally different because it is the benefit resulting from the cancellation of the total accrued, unpaid RHB expenses. Additionally, the calculation of the change in the workers' compensation liability, included in accrued expenses, includes the full present value of current and future payments for employee workplace injury claims. A similar treatment of RHB liabilities would require the accrual of the entire RHB liability in the year it was incurred, and annual accruals for the changes to the full present value of current and future payments for RHB rather than just an amortization of this RHB liability.

3. 39 C.F.R. § 3050.11(a) Review of Proposal Seven

Alternative One and Alternative Two would each reallocate the $57.0 billion from its current record as an institutional cost.

Alternative One would not include the $57.0 billion in the CRA. With the application of Alternative One, the total expenses in the General Ledger would not match the total costs in the CRA for FY 2022. Thus, the data in the supporting reports

(CRA, Cost Segment and Component Reports (CSC)) for FY 2022 would be unreconciled with the general ledger and not accurate and complete in comparison with the Postal Service's FY 2022 Form 10-K.

Alternative Two is a more accurate alternative because it includes the $57.0 billion in the CRA and the reconciliation of the supporting reports (CRA, CSC) with the Postal Service's FY 2022 Form 10-K. Alternative Two improves the accuracy and transparency of the reporting of the $57.0 billion in the supporting documents in contrast with Alternative One. However, Alternative Two could be further improved with modifications that comport with the Commission's intent in its original Commission Letter.

D. Modified Alternative Two

The recording of the PSRA adjustment in the CRA should be consistent with the recording of a one-time non-operational gain/income. Modified Alternative Two would reallocate the $57.0 billion from where it is currently recorded as negative institutional costs in the "All Other" row in the "Attributable Cost" column of the CRA, and instead report it as a positive amount in the row titled "Miscellaneous Items" in the Revenue Column of the CRA.

1. Differences Between Modified Alternative Two and Postal Service Alternative Two

Postal Service Alternative Two would reallocate the $57.0 billion currently included on the CRA to the reporting category of "Miscellaneous Items" on the CRA. "Miscellaneous items" on the CRA are treated as independent from product or class levels and recorded as a separate line item when calculating total income.

It would reallocate the amount to the row "Miscellaneous Items" using an undefined additional cost segment "Miscellaneous Costs." As a result, the row "Miscellaneous Items" in the CRA "would now include entries in both the revenue and the cost columns." Petition, Proposal Seven at 9.

Both alternatives would reallocate the $57.0 billion in Component 203 to the row “Miscellaneous Items.” However, Modified Alternative Two would reallocate the $57.0 billion to the row “Miscellaneous Items” under the column titled “Revenue,” bypassing its inclusion in a cost segment. This is the main distinction from Postal Service Alternative Two, which would reallocate the $57.0 billion to the row “Miscellaneous Items” via an additional cost segment.

2. Differences Between Modified Alternative Two and Current Accounting Treatment

The Postal Service’s CRA report includes the $57.0 billion as a negative institutional cost in the row for “All Other” costs.

Application of Modified Alternative Two would reallocate the $57.0 billion to the CRA reporting category of “Miscellaneous Items” under the column “Revenue” as a noncash, nonexchange gain.

3. Analysis of Impact of Modified Alternative Two

As detailed below, the Commission determines that the forgiven defaulted accruals for PSRA RHB are not an expense or revenue, but a one-time non-operational adjustment treated as a gain akin to debt forgiveness. The Commission previously noted “[t]he extinguishment of a liability results in derecognition of the liability from the Balance Sheet. See FASB ASC 405-20 and further guidance in IFRS 9.3.3.1.” Commission Letter at 2 (emphasis omitted). Extinguishment of the liability to pay the defaulted RHB assessments did not alter the expenses that were incurred by the Postal Service. Nor did it relate to operations, financing, or other Postal Service activities.

Therefore, the most accurate characterization for the PSRA adjustment under FASB accounting principles is as a noncash, nonexchange gain. Its inclusion in the CRA in “Miscellaneous Items” reflects this character, allowing for reconciliation with the Postal Service FY 2022 Form 10-K. As noted in the Commission Letter, the extinguishment of a liability results in derecognition of the liability from the Balance

Sheet.[23] Based on the guidance in FASB ASC 405-20-40-1, a liability is derecognized when either (1) the loan is, in part or wholly, forgiven and the debtor is legally released; or (2) the debtor pays off the loan to the creditor. To derecognize a liability, an entity would reduce the liability by the amount forgiven and record a gain on extinguishment.[24]

Further support for this accounting treatment is found in the FASAB's new interpretation clarifying that debt cancellation is a nonexchange activity.[25] Paragraph 313 of the Statement of Federal Financial Accounting Standards (SFFAS) 7 provides that:

> the debt that an entity owes Treasury (or other agency) may be canceled by Act of Congress. The amount of debt that is canceled (including the amount of capitalized interest that is canceled, if any) is a gain to the entity whose debt is canceled and a loss to Treasury (or other agency). The purpose of borrowing authority is generally to provide an entity with capital rather than to finance its operations. Therefore, the cancellation of debt is not earned by the entity's operations and is not directly related to the entity's costs of providing goods and services. As a result, the cancellation is a nonexchange gain to the entity that owed the debt and a nonexchange loss to the lender.

SFFAS 7 Interpretation at 4.

Paragraph 133 of SFFAS 7 states that "[g]ains and losses are recognized rather than revenues and expenses in order to differentiate unusual or nonrecurring transactions for evaluating an entity's performance or setting its prices." *Id.* at 10.

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[23] Commission Letter at 2. *See* Federal Accounting Standards Advisory Board (FASB) Accounting Standards Codification (ASC) 405-20 and further guidance in International Financial Reporting Standards (IFRS) 9.3.3.1.

[24] *See* Association of International Certified Profession Accountants, Q&A Section 3200, Long-Term Debt, available at *https://us.aicpa.org/content/dam/aicpa/interestareas/frc/downloadabledocuments/tqa-sections/tqa-section-3200-18.pdf*.

[25] Interpretation 11, Interpretation of Federal Financial Accounting Standards 11, Debt Cancellation: An Interpretation of SFFAS 7, Paragraph 313, November 29, 2021 (SFFAS 7 Interpretation), available at *https://files.fasab.gov/pdffiles/handbook_interp_11.pdf*.

Based on the above guidance, reporting the gain in “Miscellaneous Items” in the CRA ensures accurate characterization of both the nonrecurring noncash, nonexchange gain and the Postal Service’s financial situation. The Postal Service’s net income would include the noncash, nonexchange gain from the PSRA adjustment, and the Balance sheet would reflect reduced total liabilities, ensuring that ratios and other analyses reflect these circumstances.

Additionally, this treatment avoids the distortive effects of treating the gain as negative expense, which if not causally attributed to a product would result in a negative institutional cost. The Mailer Associations and GCA propose to treat the forgiveness of the RHB liability as a negative expense, which would eliminate institutional costs for FY 2022, as opposed to a gain, which is not an expense (negative or otherwise) and does not have an effect on institutional costs.

The Mailer Associations claim that negative institutional costs are not nonsensical in this instance, but are the appropriate result of Congressional action that removes a massive amount of costs from the Postal Service’s balance sheet. Mailer Associations Comments at 3. While negative institutional costs may not be nonsensical in some circumstances, the Commission concludes that they would be non-sensical in this instance and lead to a report that is inaccurate and incomplete. Congress entirely removed the RHB debt in the PSRA, and instead replaced it with a pay-as-you-go retirement funding system. *See* PSRA § 102. Where this debt forgiveness did not affect the Postal Services expenses or costs, it would be distortive to treat it as a “negative expense” and thereby offset its institutional costs and nullify its density-rate authority for FY 2022. In the ten-year review, the Commission found that two types of costs were major drivers of Postal Service’s lack of financial stability: retirement costs and per-unit cost increases caused by declines in mail density.[26] The Commission modified the rate cap to provide additional rate authority for each of these costs. *Id.* Decreases in density increase per-unit costs because the Postal Service must deliver a

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[26] Order No. 5763, Docket No. RM2017-3 (Nov. 30, 2020) at 72-74, 100-101.

decreasing number of mailpieces to an increasing number of addresses. *Id.* at 72, 75. This results in costs significantly above inflation. *Id.* at 89-90. Elimination of RHB liability helps with the retirement cost issue—and is taken into account in the retirement rate authority—but it does not in any way address the increase in costs that results from spreading mail delivery costs among fewer pieces of mail. Crediting $57.0 billion to institutional costs would mask the increases in per piece delivery costs caused by decreasing density.

Additionally, the Mailer Associations and GCA note that the Postal Service's financial condition has been improved by the elimination of the RHB liability, and if ignored, would present a financial picture with a "greatly inflated total deficit" impacting future ratemaking authority. Mailer Associations Comments at 7; GCA Comments at 4. The Commission concurs with the Mailer Associations and GCA and notes that the Postal Service's accumulated net deficit is not affected by the treatment adopted in this Order. The Commission is not ignoring the elimination of the RHB liability; it is instead accounting for it in a manner that appropriately reflects its noncash, nonexchange character, and avoids the distortive effect of having the forgiveness of the entire accrued unpaid RHB liability reflected as a FY 2022 operational adjustment affecting institutional costs.

The non-cash income that results from the cancellation of the unpaid RHB expenses reduces the accumulated net deficit and the reduced balance in the Accumulated Deficit Since Reorganization. *See* Postal Service FY 2022 Form 10-K at 47, column September 30, 2022. The implementation of the Commission's alternative requiring the PSRA adjustment to be reported on the CRA as "Miscellaneous Items" results in the same net addition to the accumulated net deficit as reported on the Postal Service FY 2022 Form 10-K.

Furthermore, regardless of CRA treatment, the Balance Sheet will continue to reflect the Postal Service's gain as an improvement. Additionally, this method is better than Alternative One because it enhances transparency by ensuring the tracing and reconciling of Net Income reported on the CRA to Net Income on the Postal Service FY 2022 Form 10-K.

VI. CONCLUSION

Proposed changes to analytical principles are evaluated to ensure that they "improve the quality, accuracy, or completeness of the data or analysis of data" contained in the Postal Service's periodic reports, pursuant to 39 C.F.R. § 3050.11(a).

The Commission finds that Modified Alternative Two, as discussed above, improves the quality, accuracy, and completeness associated with the treatment of the forgiveness of the accrued RHB liability. The removal of the RHB liability is most accurately characterized as a nonrecurring, noncash, nonexchange gain, which has no effect upon institutional costs, as opposed to an expense or expense adjustment. Therefore, including the removal of the RHB liability in "Miscellaneous Items" in the "Revenue" column of the CRA will improve the quality and accuracy of the CRA, avoid the distortive effect of treating it as a negative cost, and preserve the consistency of the Net Income reported in the CRA with Net Income reported in the Postal Service FY 2022 Form 10-K.

The Commission notes that the PSRA's removal of the RHB liability is a one-time event that occurred in FY 2022 and therefore the analytical principle adopted for its reporting is only applicable to FY 2022.

VII. ORDERING PARAGRAPHS

It is ordered:

1. For purposes of periodic reporting to the Commission, the changes in analytical principles proposed by the Postal Service in Proposal Seven to Alternative Two are approved with the modifications as described above.

2. The Commission directs the Postal Service in Docket No. ACR2022 to file updated workpapers, if necessary, consistent with the body of this Order.

By the Commission.

Erica A. Barker
Secretary