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ORDER NO. 479

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

Before Commissioners: Ruth Y. Goldway, Chairman;
Tony L. Hammond, Vice Chairman;
Mark Acton;
Dan G. Blair; and
Nanci E. Langley

Accounting Practices and Tax Rules for Competitive Products — Docket No. RM2009-9

ORDER ESTABLISHING METHODOLOGY FOR THE ALLOCATION OF ASSETS AND LIABILITIES OF THE COMPETITIVE PRODUCTS ENTERPRISE

(Issued June 25, 2010)

I. INTRODUCTION

This Order establishes a methodology for allocating assets and liabilities to the theoretical competitive products enterprise (CPE). In general, it adopts the methodology proposed by the Postal Service, except regarding the allocation of Deferred Gains on Sales of Property.

In Order No. 151, which established financial accounting practices for competitive products, the Commission directed the Postal Service to develop the assets and liabilities of the theoretical CPE by identifying all asset and liability accounts within its Chart of Accounts used solely for the provision of (a) competitive products, or (b) market dominant products, and for those not identified with either, to submit for

Commission approval a proposed methodology detailing how each asset and liability account identified in the Chart of Accounts should be allocated to the theoretical CPE.[1] The Commission suggested allocating assets and liabilities based on appropriate cost drivers or, in their absence, on the ratio of competitive products revenue to total revenue. 39 CFR 3060.12(c).

II. THE POSTAL SERVICE FILING

In response to Order No. 151, the Postal Service filed a proposed methodology for the allocation of assets and liabilities to the theoretical CPE.[2] It indicates that, with five exceptions, the proposed methodology tracks the methodology suggested by the Commission in PRC-LR-1 in Docket No. RM2008-5. *Id*. at 1-2. The Postal Service assigns distribution keys to three categories for which the Commission made no allocation. A revenue distribution key is proposed for the allocation of *Supplies, Advances and Prepayments* (Balance Sheet Assets), and for *Payables and Accrued Expenses* (Balance Sheet Liabilities). It proposes to allocate *Outstanding Postal Money Orders* (Balance Sheet Liabilities) based on Actual International Money Orders Outstanding. *Id.* at 2. It proposes a larger distribution based on revenue for allocating *Customer Deposit Accounts* (Balance Sheet Liabilities). *Id*. at 3. Lastly, unless specifically identified as competitive products assets, the Postal Service proposes no allocation for the distribution of *Deferred Gains on Sales of Property* (Balance Sheet Liabilities), as the gains not deferred are not immediately recognized in the income for competitive products. *Id*.

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[1] *See* Docket No. RM2008-5, Order Establishing Tax Rules and Accounting Practices for Competitive Products, December 18, 2008, at 17-18 (Order No. 151). *See also* 39 CFR 3060.12 and 3060.13.

[2] Notice of the United States Postal Service Regarding Proposed Methodology for the Allocation of Assets and Liabilities to Competitive Products, July 23, 2009 (Notice).

In summary, the five accounts where the Postal Service's methodology differs from that proposed in Order No. 151 are as follows:

- Asset: Supplies, Advances, and Prepayments—the Postal Service allocation is based on total revenues; the Commission did not propose an allocation.

- Liability: Payables and Accrued Expenses—the Postal Service allocation is based on total revenues; the Commission did not propose an allocation.

- Liability: Customer Deposit Accounts—the Postal Service allocation is based on total revenues; the Commission allocation is limited to a specific account, Expedited Mail Advance Deposit.

- Liability: Outstanding Postal Money Orders—the Postal Service allocation is based on actual Outstanding International Money Orders; the Commission did not propose an allocation.

- Liability: Deferred Gains on Sales of Property—the Postal Service did not propose an allocation; the Commission allocation is based on Building Depreciation Expenses.

The Commission used public data available from the FY 2007 Annual Compliance Determination (ACD) to construct its methodology for allocation, while the Postal Service used the nonpublic FY 2008 ACD and Annual Compliance Report data with redactions for information pertaining to competitive products. Revisions to the Commission's proposed allocation methodology, PRC-LR-1, were attached to the Postal Service's filing as Table 4, with the nonpublic version filed as an Excel worksheet, USPS-RM2009-9/NP1.

III. COMMENTS

In Order No. 287, the Commission noticed the Postal Service's filing and provided an opportunity for interested persons to submit comments.[3] The Public Representative is the only party who filed initial comments in response to Order No. 287.[4] The Public Representative agrees with the Postal Service's revisions to the Commission's suggested methodology with one exception. She takes issue with the Postal Service's (and the Commission's) suggested treatment of deferred gains from sales of property, advocating an allocation based on the ratio of competitive product revenue. *Id.* at 12-13, and Attachment A at 1-3. Additionally, the Public Representative expresses concern on the expansive redaction of the proposed Statement of Allocated Assets and Liabilities as filed by the Postal Service. *Id*. at 14.[5] The Postal Service submitted reply comments in response to these two issues.[6]

A. Deferred Gains on Sales of Property

In Order No. 151, the Commission suggested that the Deferred Gains on Sales of Property be distributed on the same ratio (Building Depreciation as the key) used to distribute the underlying Property and Equipment. The Postal Service contends that "there is no basis to allocate any of this item to Competitive Products," a contention it believes is supported "by the fact that no *un*deferred gains from the sale of property are

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[3] Notice of Proposed Rulemaking Concerning Allocation of Assets and Liabilities to Competitive Products Enterprise, August 24, 2009 (Order No. 287).

[4] Public Representative's Comments in Response to Order No. 287, October 23, 2009 (PR Comments).

[5] The Public Representative also offers several minor clarifying revisions to the proposed methodology.

[6] Reply Comments of the United States Postal Service Regarding Proposed Methodology for the Allocation of Assets and Liabilities to Competitive Products, November 24, 2009, at 3-4 (Reply Comments). Concurrently, the Postal Service filed a motion for late acceptance of its Reply Comments, Motion of the United States Postal Service for Late Acceptance of Reply Comments, November 24, 2009. The motion is granted.

allocated to Competitive Products as revenue." Notice at 3 (emphasis in original). Thus, it proposes no allocation, except for any property devoted exclusively to competitive products, in which case, it would be appropriate to recognize any gains (or losses) in the competitive products Income Statement. *Id.; see also* Reply Comments at 3-4.

The Public Representative counters that a deferred gain or loss from the sale of property, plant, and equipment that were previously allocated to competitive products should be recognized in the competitive products Income Statement, or in the Statement of Allocated Assets and Liabilities, when the corresponding assets are sold. PR Comments at 13, and Attachment A. She asserts that the gain or loss should be allocated to the competitive products Income Statement using a ratio based on revenue. *Id.* If the gain or loss is deferred and recognized on the Balance Sheet of the combined competitive products and market dominant products, the deferred gain or loss should also be allocated to the competitive products Statement of Allocated Assets and Liabilities. *Id.*, Attachment A at 3.

In reply, the Postal Service disagrees with the Public Representative and reiterates its position that neither gains nor losses on the sale of property should be allocated to the CPE's Income Statement or balance sheet (Statement of Allocated Assets and Liabilities for Competitive Products), unless the property is used exclusively for competitive products. Reply Comments at 3-4. The Postal Service states that the primary revenue for the competitive products enterprise is through the sale of competitive products and not the sale of property. The Postal Service contends that reflecting in the Income Statement annual gains (or losses) from the sale of property that is not used solely for competitive products would misrepresent "the true value to the organization arising from competitive product offerings in those years." *Id.* at 3.

B. Disclosure of Content of Statement of Allocated Assets and Liabilities

The Public Representative expresses concern that the public version of the Statement of Allocated Assets and Liabilities filed by the Postal Service in support of its methodology may have been redacted too extensively. She believes that the Postal Service's intentions with respect to future filings should be explored well in advance of the inaugural filing of the Statement of Allocated Assets and Liabilities. PR Comments at 14.

In reply, the Postal Service indicates that with the new confidentiality rules in place, it "no longer anticipates seeking protection for the broad range of data shielded in its July filing." Reply Comments at 4.

IV. COMMISSION ANALYSIS

The Postal Service proposes five changes to the Commission's proposed allocation methodology. The Commission did not propose an allocation method for Supplies, Advances, and Prepayments, an asset category, or for Payables and Accrued Expenses, a liability category, stating that they should be assigned using cost drivers derived from the related expense accounts. The Postal Service proposes using Total Revenue as the basis of the allocation. The underlying expense accounts for these assets are distributed based on several different distribution keys. The Commission reviewed the various accounts comprising the Supplies, Advances, Prepayments and Accounts Payables and found several instances where certain accounts could be directly tied to a particular expense or tied to expenses that have been attributed based on distribution keys. However, no one overall relationship to expenses was apparent that could be tied to these balance sheet items.

Commission review found that the amounts allocated using an account-by-account analysis would be similar to the allocation using total revenues. One of the goals of Order No. 151 was to avoid having the Postal Service do an account-by-account analysis of the balance sheet. The time required and potential cost of such an analysis outweigh any potential benefit gained in developing the competitive products balance sheet. Therefore, the Commission accepts the Postal Service's proposed allocation based on total revenues.

For the liability Outstanding Postal Money Orders, the Postal Service proposes that it be distributed based on Actual International Money Orders Outstanding. The Commission finds this acceptable because the remaining money orders outstanding are domestic and therefore market dominant.

For Customer Deposit Accounts, a liability category, the Commission proposed a distribution based on the Expedited Mail Advance Deposit account. The Postal Service proposes using Revenue instead, an approach which will result in a broader distribution and increase the share of the total accrued amount of this item allocated to Competitive Products. The Commission accepts the Postal Service's proposed distribution.

The Commission proposed to allocate Deferred Gains on Sales of Property, a liability category, based on building depreciation. The Postal Service proposed that this liability not be allocated to competitive products, unless the property was used exclusively for competitive products. The Postal Service argues that the inclusion of immediate gains on the Income Statement for competitive products would provide an inaccurate snapshot of the value of the CPE. Reply Comments at 3. The Public Representative takes issue with both the Commission's and the Postal Service's approach, suggesting an alternative allocation method based on revenue with both gains and losses allocated to the CPE.

The Postal Service's ability to provide competitive products is enabled by its property, plant and equipment which are reflected on the Competitive Products Income Statement as depreciation expense. Consequently, the gain or loss from the sale of any such property, plant or equipment, even though not directly assigned to individual products, should be included in the income statement of the enterprise. There is no dispute between the commenters that gain or loss from the sale of property used exclusively for competitive products (as reflected on the Competitive Products Property and Equipment Assets report) should be included on the CPE's income statement. Nor is there any dispute that any deferred gain (or loss) on such property should be included on the Statement of Allocated Assets and Liabilities.

Gains or losses on sales of property not devoted exclusively to either market dominant or competitive products should not be exempt from distribution to the CPE simply because of joint usage. To distribute the gains (or losses) to the theoretical CPE, a predetermined ratio is required which reasonably allocates the gains (or losses) between market dominant and competitive products.

General allocation methodologies suggest that the best method for distribution is direct correlation and if not available then by a variable most closely related to the amount being distributed.[7] As noted, the Commission proposed a methodology using depreciation, while the Public Representative suggests that revenue is a superior approach.

A variety of ratios could be developed. An allocation ratio based on historical usage of the asset by product category may reflect the most directly related variable. However, it would require a time consuming and detailed analysis of plant and equipment to develop estimated usage percentages. The costs of such an effort would outweigh any potential benefits that might be achieved.

As suggested by the Public Representative, revenue could be used to distribute gains (or losses) and could be developed relatively easily from available data which includes "gains and revenue from sales of major assets." While this approach would, to some degree, take into account wear and tear of the asset used to support the products being sold, it is influenced by various factors unrelated to usage such as the economy,

[7] Charles T. Horngren, Srikant M. Datar, George Foster, Madhav Rajan & Christopher Ittner, Cost Accounting: A Managerial Emphasis 547 (13th ed. 2009).

competition, and pricing. Stated otherwise, it could be argued that the asset enables the ultimate sale of the products.[8]

The methodology proposed by the Commission, based on depreciation, has several advantages which the Commission finds persuasive. First, it is easily developed from information readily available in Cost and Revenue Analysis reports. Second, it takes wear and tear of the asset into account and is directly related to the property sold. Third, the results may properly be included in the computation of net gain or loss on sale of the property. In sum, it is directly related and enables a quick and efficient computation using readily available data.

Finally, the Commission supports the detailed disclosure of the Statement of Assets and Liabilities by the Postal Service and agrees with the Postal Service that the Commission's new confidentiality rules will allow the Postal Service to file an unredacted version of the proposed competitive products Statement of Allocated Assets and Liabilities.

[8] By its very nature, allocation of a gain or loss from a deferred sale based on current revenue would not include revenue being deferred as the recognition of the gain or loss delayed.

It is ordered:

The Notice of the United States Postal Service Regarding Proposed Methodology for the Allocation of Assets and Liabilities to Competitive Products, filed July 23, 2009, is accepted with the following exceptions:

1. The net realized gain (or loss) on sales of property used jointly by competitive and market dominant products shall be allocated to the Income Statement of the competitive products enterprise based on competitive products attributable depreciation costs.

2. The deferred gains or (losses) on sales of property used jointly by competitive and market dominant products shall be allocated to the Statement of Allocated Assets and Liabilities of the competitive products enterprise based on competitive products attributable depreciation costs.

By the Commission.

Shoshana M. Grove
Secretary