UNITED STATES
POSTAL SERVICE

POSTAL RATE COMMISSION
JUN 01 1998
OFFICE OF THE CHIEF ADMIN. OFFICER

June 2, 1998

Hon. Margaret P. Crenshaw, Secretary
Postal Rate Commission
1333 H Street, NW, Suite 300
Washington, D.C. 20268-0001

Dear Ms. Crenshaw:

In connection with the Commission's rules pertaining to periodic reports, 39 C.F.R. § 3001.102 (1997), I have enclosed copies of the following:

Cost and Revenue Analysis (CRA), Fiscal Year 1997

We will provide in a subsequent transmission the Cost Segments and Components Report and the pertinent workpapers and portions of LIOCATT.

Sincerely,

Daniel J. Foucheaux, Jr.

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking

Enclosures

cc: Ms. Brown

POSTAL RATE COMMISSION
DOCKETED
JUN 3 1998
OFFICE OF THE SECRETARY

475 L'Enfant Plaza SW
Washington DC 20260

Report of Independent Accountants

United States Postal Service Cost and Revenue Analysis

September 30, 1997

ERNST & YOUNG LLP

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Washington, D.C. 20036

Phone: 202 327 6000

Report of Independent Accountants

Board of Governors
United States Postal Service

We have examined the following tables of financial information ("the Summary Tables") included in the Cost and Revenue Analysis of the United States Postal Service (Postal Service) for the year ended September 30, 1997:

- Summary of Revenue and Cost for Major Service Categories and
- Summary of Revenue and Cost for Major Service Categories - Volume Statistics.

The Summary Tables are based on information in the postal system of accounts used in preparing the financial statements, as well as various postal operational and statistical information sources. Our examination of the Summary Tables was made in accordance with standards established by the American Institute of Certified Public Accountants and was, therefore, designed primarily for the purpose of expressing an opinion on the Summary Tables taken as a whole. Accordingly, our examination included such procedures as we considered necessary under the circumstances. We believe our examination provides a reasonable basis for our opinion.

In our opinion, the Summary Tables mentioned above present fairly, in all material respects, the allocations of the United States Postal Service revenue and costs among the indicated categories of mail and services provided by the Postal Service during the year ended September 30, 1997, on the basis described in the Notes to the Summary Tables.

As discussed in Notes 1, 2, and 12 to the Summary Tables, in 1997 the United States Postal Service revised its methodology to determine the distribution of Postal Service costs by categories of mail or service. One component of the revised methodology includes the use of Management Operating Data System (MODS) work hours and Total Piece Handlings data to develop and distribute the Postal Service's mail processing costs by categories of mail.

Ernst + Young LLP

May 20, 1998

UNITED STATES
POSTAL SERVICE

COST AND REVENUE ANALYSIS

FISCAL YEAR 1997

FINANCE

SUMMARY OF REVENUE AND COST FOR MAJOR SERVICE CATEGORIES
Fiscal Year 1997

Classes and Sub-Classes of Mail (note 1)	Revenue (note 6) (in millions)	Incremental Cost (notes 2&12) (in millions)	Volume Variable Cost (note 3) (in millions)	Revenue (per piece)	Marginal Cost (note 4) (per piece)	Contribution Margin $ (note 5) (per piece)	Contribution Margin % (note 5) (per piece)	Cost Coverage (note 5) (per piece)
	A	B	C	D	E	(D-E)	(D-E)/D	(D/E)
First-Class Mail:								
Letters and sealed parcels	$32,238.2	$16,994.0	$15,743.4	$0.342	$0.167	$0.175	51.17%	204.77%
Cards (note 13)	994.4	625.5	609.2	0.186	0.114	0.072	38.73%	163.22%
Fees	164.9	-	-					
Total First Class	33,397.6	17,709.6	16,352.7	0.335	0.164	0.171	51.04%	204.23%
Priority Mail	3,856.9	2,201.0	1,881.1	3.611	1.761	1.850	51.23%	205.03%
Express Mail	824.7	611.9	362.4	12.960	5.696	7.265	56.05%	227.54%
Mailgram	2.0	1.4	1.4	0.372	0.259	0.112	30.27%	143.41%
Periodicals:								
In-county	80.9	82.4	80.9	0.085	0.085	0.000	0.00%	100.00%
Outside the county:								
Regular publications	1,638.3	1,547.7	1,525.6	0.226	0.210	0.016	6.88%	107.39%
Nonprofit publications	316.1	342.9	337.0	0.147	0.157	(0.010)	-6.61%	93.80%
Classroom publications	10.2	10.9	10.8	0.162	0.172	(0.010)	-6.03%	94.32%
Fees	22.0	-	-					
Total Periodicals	2,067.5	1,989.4	1,954.3	0.199	0.188	0.011	5.48%	105.79%
Standard Mail (A)								
Single piece rate	137.3	226.6	226.3	0.802	1.322	(0.520)	-64.83%	60.67%
Enhanced carrier route	4,552.3	1,978.0	1,883.0	0.144	0.060	0.085	58.64%	241.75%
Regular	6,776.8	4,520.7	4,405.7	0.208	0.135	0.073	34.99%	153.82%
Nonprofit enhanced carrier route	219.9	155.2	156.4	0.077	0.054	0.022	28.89%	140.62%
Nonprofit	1,112.3	1,084.0	1,069.7	0.109	0.105	0.004	3.83%	103.98%
Fees	77.2	-	-					
Total Standard Mail (A)	12,875.8	8,199.1	7,741.1	0.167	0.100	0.066	39.88%	166.33%
Standard Mail (B):								
Parcels zone rate (note 10)	771.2	849.6	835.4	3.255	3.526	(0.271)	-8.33%	92.31%
Bound printed matter	451.9	333.1	330.5	0.866	0.633	0.233	26.86%	136.73%
Special standard	356.7	223.9	222.7	1.760	1.098	0.661	37.57%	160.18%
Library mail	45.2	48.3	48.2	1.675	1.783	(0.109)	-6.48%	93.91%
Fees	2.0	-	-					
Total Standard Mail (B)	1,627.0	1,477.7	1,436.8	1.646	1.454	0.192	11.69%	113.24%

See accompanying notes.

SUMMARY OF REVENUE AND COST FOR MAJOR SERVICE CATEGORIES
Fiscal Year 1997

	(In millions)			(per piece)				
Classes and Sub-Classes of Mail (note 1)	Revenue (note 6)	Incremental Cost (notes 2&12)	Volume Variable Cost (note 3)	Revenue	Marginal Cost (note 4)	Contribution Margin $ (note 5)	Contribution Margin % (note 5)	Cost Coverage (note 5)
	A	B	C	D	E	(D-E)	(D-E)/D	(D/E)
Free mail - blind, handicapped & servicemen	-	$25.4	$25.4	-	$0.476	N/A	N/A	0.00%
International mail (note 8)	$1,614.8	1,341.6	1,265.1	$1.604	1.256	$0.347	21.66%	127.64%
Total mail	56,266.4		31,020.2	0.295	0.163	0.132	44.87%	181.39%
Special Services:								
Registry (note 14)	94.9	113.5	77.5	5.836	4.765	1.071	18.35%	122.48%
Ancillary services	4.2							
Total Registry	99.1							
Certified (note 14)	333.1	294.9	329.4	1.157	1.144	0.013	1.13%	101.15%
Ancillary services	293.6							
Total Certified	626.7							
Insurance (note 14)	61.0	45.5	46.9	1.806	1.389	0.417	23.09%	130.03%
Ancillary services	1.7							
Total Insurance	62.7							
COD (note 14)	21.8	14.7	15.0	4.627	3.184	1.443	31.19%	145.32%
Ancillary services	0.0							
Total COD	21.8							
Special delivery	1.4	3.3	3.3	9.978	23.446	(13.468)	-134.97%	42.56%
Money orders (note 7)	267.1	182.7	134.7	1.296	0.654	0.642	49.56%	198.26%
Stamped envelopes	17.1	11.8	11.8					
Special handling	0.7	1.3	1.3					
Post office box	577.6	471.7	471.7					
Other	-		120.0					
Total Special Services	1,674.1		1,211.4					
Miscellaneous items (note 9)	247.2		-					
Total mail and services (note 8)	58,187.7		32,231.6					
Appropriations: Revenue forgone	83.4		-					
Total operating revenue	58,271.1		-					
Investment income	59.7		-					
Total (note 7)	58,330.8		32,231.6					
All other costs	-		24,834.7					
Total costs (note 7)	-		57,066.4					

See accompanying notes.

SUMMARY OF REVENUE AND COST FOR MAJOR SERVICE CATEGORIES
Fiscal Year 1997
VOLUME STATISTICS

Classes and Sub-Classes of Mail (note 1)	Pieces (thousands)	Weight in Pounds (thousands)	Weight per Piece (ounces)	Cubic Feet (thousands)	Weight per Cubic Foot (pounds)
First-Class Mail:					
Single-Piece letters	54,240,238	2,504,814	0.7	179,608	13.9
Presort letters	40,062,616	1,572,462	0.6	112,754	13.9
Total Letters	94,302,854	4,077,276	0.7	292,362	13.9
Single-Piece cards	3,003,755	18,784	0.1	1,351	13.9
Presort cards	2,353,333	19,023	0.1	1,368	13.9
Total cards	5,357,088	37,807	0.1	2,719	13.9
Total First Class	99,659,942	4,115,083	0.7	295,081	13.9
Priority Mail	1,068,181	1,860,608	27.9	147,177	12.6
Express Mail	63,633	76,348	19.2	10,784	7.1
Mailgram	5,326	0	0.0	0	0.0
Periodicals:					
In-county	947,047	252,500	4.3	13,721	18.4
Outside the county:					
Regular publications	7,254,321	3,472,633	7.7	194,895	17.8
Nonprofit publications	2,147,170	580,832	4.3	35,484	16.4
Classroom publications	62,866	32,360	8.2	1,889	17.1
Total Periodicals	10,411,404	4,338,325	6.7	245,989	17.6
Standard Mail (A)					
Single piece rate	171,188	30,727	2.9	2,548	12.1
Commercial:Standard (A)					
Enhanced carrier route	31,504,820	4,516,459	2.3	255,557	17.7
Regular	32,527,736	4,280,469	2.1	242,204	17.7
Total Commercial	64,032,556	8,796,928	2.2	497,761	17.7
Nonprofit:Standard (A)					
Nonprofit enhanced carrier route	2,871,973	193,734	1.1	11,835	16.4
Nonprofit non carrier route	10,177,913	672,489	1.1	41,083	16.4
Total Nonprofit	13,049,886	866,223	1.1	52,918	16.4
Total Standard Mail (A)	77,253,630	9,693,878	2.0	553,227	17.5

See accompanying notes.

SUMMARY OF REVENUE AND COST FOR MAJOR SERVICE CATEGORIES
Fiscal Year 1997
VOLUME STATISTICS

Classes and Sub-Classes of Mail (note 1)	Pieces (thousands)	Weight in Pounds (thousands)	Weight per Piece (ounces)	Cubic Feet (thousands)	Weight per Cubic Foot (pounds)
Standard Mail (B):					
Parcels zone rate	236,928	1,264,004	85.4	180,160	7.0
Bound printed matter	521,726	1,237,431	37.9	83,077	14.9
Special standard	202,732	334,971	26.4	31,640	10.6
Library mail	27,018	53,503	31.7	3,970	13.5
Total Standard Mail (B)	988,404	2,889,909	46.8	298,847	9.7
US Postal Service	377,330	88,385	3.7	6,275	14.1
Free mail - blind, handicapped & servicemen	53,301	30,627	9.2	2,983	10.3
International mail	1,006,909	259,223	4.1	39,715	6.5
Total mail	190,888,060	23,352,386	2.0	1,600,085	14.6
Special Services:					
Registry	16,254	N/A	N/A	N/A	N/A
Certified	288,018	N/A	N/A	N/A	N/A
Insurance	33,771	N/A	N/A	N/A	N/A
COD	4,706	N/A	N/A	N/A	N/A
Special delivery	139	N/A	N/A	N/A	N/A
Money orders	206,108	N/A	N/A	N/A	N/A
Stamped envelopes	N/A	N/A	N/A	N/A	N/A
Special handling	N/A	N/A	N/A	N/A	N/A
Post office box	N/A	N/A	N/A	N/A	N/A
Other	N/A	N/A	N/A	N/A	N/A
Total Special Services	548,996	N/A	N/A	N/A	N/A

See accompanying notes.

UNITED STATES POSTAL SERVICE
NOTES TO COST AND REVENUE ANALYSIS
Fiscal Year 1997

1. COST AND REVENUE ANALYSIS

The Cost and Revenue Analysis (CRA) is prepared annually by the United States Postal Service (Postal Service) each year commencing October 1 and ending September 30 as an aid in determining that the Postal Service is meeting the statutory requirements under Title 39, U.S. Code, that "each class of mail or type of mail service bear the direct and indirect costs attributable to that class or service...." The CRA presents estimates of the total and unit revenue of the categories of mail and services provided by the Postal Service during the year, as well as their estimated incremental and marginal costs. Such estimates are considered as one element of the Postal rate making process.

CRA data are based on information from the postal system of accounts. The postal system of accounts, however, generally does not accumulate financial data by class and subclass of mail. Apportionment factors are, therefore, required for development of the data for CRA purposes. These apportionment factors are derived from various postal operational and statistical information sources. Some of these, such as the In-Office Cost System and the Revenue, Pieces and Weight System, are dedicated to this purpose and involve extensive statistical sampling of postal activity during the year. New sampling procedures were partially implemented during Fiscal Years 1995 and 1996 for the Revenue, Pieces and Weights System to accommodate the effects of automation implementation. Coincident with implementation of these new sampling procedures, the difference between actual revenue as derived from the Postal Service financial systems and extrapolated revenue derived from the Revenue, Pieces and Weights System (before the routine adjustment for such differences) has increased. Management is continuing to refine and implement the new sampling procedures and explore further refinements and enhancements to sampling and expansion algorithms inherent in the Revenue, Pieces and Weights System. While extrapolated sample revenue should approximate actual Postal Service revenue, the system has been designed to accommodate and adjust for such differences, and the accuracy of apportionment factors used to develop per piece information does not necessarily depend on how close sample revenue are to actual revenues.

In 1997, the Postal Service changed its methodology used in estimating costs related to classes and subclasses of mail, and introduced estimates of incremental, volume variable and marginal costs. Development of such estimates included as one component the use of operational data included in the Management Operating Data System. The Postal Service also developed variability factors intended to estimate the relationship between increases and decreases in mail volume with associated changes in costs. Supporting information essential to the development of the CRA data is generally obtained from special studies. The methods employed to determine variability factors, incremental volume variable, and marginal costs are documented in the Summary Description and in testimony filed by the Postal Service before the Postal Rate Commission. The various criteria and methodologies utilized to develop the information presented in the CRA Report are available from Cost Attribution in Finance.

2. INCREMENTAL COSTS

The incremental cost of a subclass of mail or service is an estimate derived from Postal Service cost models of the cost the Postal Service incurs as a result of providing the entire annual quantity of that subclass or service. Conversely, it is the estimate of the cost avoided by eliminating a product, assuming that all other products continue to be provided at their current volumes. The purpose of this cost category is to provide an indication of whether the customers of one subclass of mail (or group of subclasses) may be subsidizing customers of another subclass (or group of subclasses). Note, the incremental cost of a class of mail is greater than the sum of the incremental costs of its constituent subclasses. Class incremental cost includes common costs that are not caused by any one subclass alone but rather by the entire class.

3. VOLUME VARIABLE COSTS

The estimated volume variable cost (sometimes called total marginal cost) of a subclass is the product of its volume and its marginal cost. The sum of the volume variable cost across all subclasses (total volume variable cost) is the revenue that the Postal Service would earn, at current volumes, if it priced each subclass at its marginal cost. Therefore, the difference between the Postal Service's total cost and its total volume variable cost represents the sum of dollars the Postal Service must earn by setting the price levels of its subclasses above their marginal costs, if the Postal Service is going to break even in a given year. For the year ended September 30, 1997 volume variable costs comprised 56.48% of all costs incurred by the Postal Service.

4. MARGINAL COST

The Postal Service estimates of the marginal cost of subclass or mail category is the change in cost that results from a small change in its volume alone, with the volumes of other subclasses or mail categories remaining constant.

5. CONTRIBUTION MARGIN AND COST COVERAGE

The relation of unit revenue to marginal cost provides a measure of the contribution earned by a subclass or mail category at the margin of production. The measure indicates the rate at which a given subclass offsets all other costs of the Postal Service. The contribution margin percent column gives the same information as a proportion of revenue per piece. The cost coverage column expresses unit revenue as a percentage of marginal cost.

6. FEES

Fees associated with a specific class or subclass of mail are included in the reported revenue for that class or subclass.

7. MISCELLANEOUS ADJUSTMENTS

The following differences exist between the revenues shown in the Fiscal Year 1997 Annual Report of the Postal Service (AR) and the Fiscal Year 1997 CRA:

a) The money order float of $54.8 million included with interest income in the AR is included with special services revenue in the CRA.
b) Mortgage income of $0.8 million included with interest income in the AR is reported as miscellaneous revenue in the CRA.
c) Reconciliation with the Annual Report of the Postmaster General (page 45):

(dollars in millions)

Per the Annual Report		Per the Annual Report:	
Operating revenue	$58,216	Operating expenses	$54,873
Interest income	115	Interest expense on borrowings	307
		Imputed interest on retroactive assessment of employee benefits	32
		POD Worker's compensation expense	258
		Interest Expenses on unfunded retirement liabilities	1,597
Total revenue per the CRA Report (page 2)	$58,331	Total costs per the CRA Report (page 2)	$57,066

8. INTERNATIONAL MAIL

International mail costs include costs of both U.S. origin and foreign origin mail. Volume statistics, however, do not include foreign origin mail.

9. MISCELLANEOUS ITEMS

Miscellaneous items include philatelic sales, fees, fines, unclaimed money from dead letters, sales of services performed for government agencies and private contractors.

10. ALASKA AIR TRANSPORTATION

The Postal Service spent $112.9 million on air transportation within the state of Alaska. $93.5 million of this total was provided for parcel post mailers. Alaska Bypass mail cost $53.9 million. The Postal Service realized $9.9 million in revenue from Alaska bypass service.

11. **OTHER**

All figures in the CRA are rounded; detail may not add to totals. Percents are rounded to the nearest decimal.
- Denotes zero values.
( ) Denotes negative values.

12. **PRODUCT SPECIFIC COST**

Of the incremental cost of certain subclasses, a portion consists of product specific cost. Those amounts are as shown below (in millions):

First Class Cards	$11.3
Priority Mail	308.3
Express Mail	234.8
International Mail	64.4
Money Orders	45.9

13. **CARDS**

Volume variable cost includes $3.9 million for stamped cards' printing cost.

14. **SPECIAL SERVICES**

Excludes ancillary service revenue.