

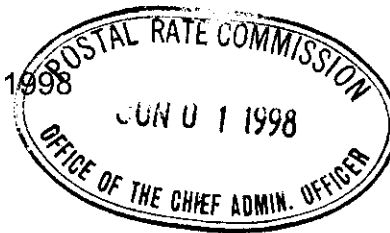


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CLERK

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

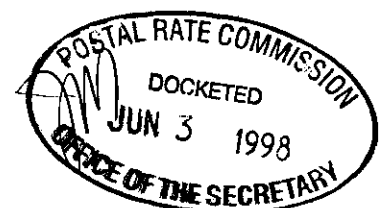
We will provide in a subsequent transmission the Cost Segments and Components Report and the pertinent workpapers and portions of LIOCATT.

Sincerely,

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking

Enclosures

cc: Ms. Brown

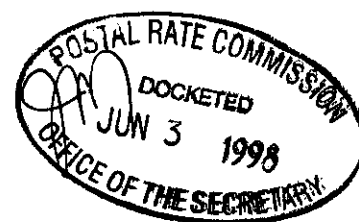


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Report of Independent Accountants

United States Postal Service Cost and Revenue Analysis

September 30, 1997



Report of Independent Accountants

Board of Governors
United States Postal Service

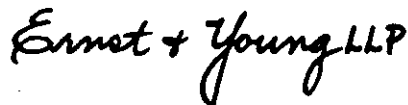
We have examined the following tables of financial information ("the Summary Tables") included in the Cost and Revenue Analysis of the United States Postal Service (Postal Service) for the year ended September 30, 1997:

- 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.



May 20, 1998



COST AND REVENUE ANALYSIS

FISCAL YEAR 1997

FINANCE

Fiscal Year 1997

See accompanying notes.

SUMMARY OF REVENUE AND COST FOR MAJOR SERVICE CATEGORIES

Fiscal Year 1997

Classes and Sub-Classes of Mail (note 1)	(In millions)			(per piece)			
	Revenue (note 6)	Incremental Cost (notes 2&12)	Volume Variable Cost (note 3)	Revenue D	Marginal Cost (note 4) E	Contribution Margin	
						Contribution Margin \$ (note 5) (D-E)	Cost Coverage (note 5) (D/E)
	A	B	C				
Free mail - blind, handicapped & servicemen.....	-	\$25.4	\$25.4	-	\$0.476	N/A	0.00%
International mail (note 8).....	\$1,614.8	1,341.6	1,265.1	\$1,604	1,256	\$0.347	127.64%
Total mail.....	56,266.4		31,020.2	0.295	0.163	0.132	181.39%
Special Services:							
Registry (note 14).....	94.9	113.5	77.5	5,836	4,765	1,071	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	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	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	145.32%
Ancillary services.....	0.0						
Total COD.....	21.8						
Special delivery.....	1.4	3.3	3.3	9,978	23,446	(13,468)	42.56%
Money orders (note 7).....	267.1	182.7	134.7	1,296	0.654	0.642	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.....	1,088,181	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	3,472,833	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	31,840	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.....	4,708	N/A	N/A	N/A	N/A
Special delivery.....	139	N/A	N/A	N/A	N/A
Money orders.....	208,108	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	<u>1,597</u>
Total revenue per the CRA Report (page 2)	<u>\$58,331</u>	Total costs per the CRA Report (page 2)	<u>\$57,068</u>

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	84.4
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.

