USPS-FY13-39

FY 2013 Competitive Products Fund Reporting Materials

I. PREFACE

A. Purpose and Content

USPS-FY13-39, Competitive Products Fund Reporting Materials, includes a copy of the Postal Service's annual report to the Secretary of the Treasury regarding the Competitive Products Fund, required by section 2011(i), and other Competitive Products Fund materials provided in accordance with Commission Rules 3060.20 through 3060.23. Specifically, this year that other material includes PRC Forms CP-01, CP-02, CP-03, and CP-04.

B. Predecessor Document

USPS-FY12-39

C. Methodology

These materials draw upon cost and revenue data reported throughout the Postal Service's FY 2013 ACR, and therefore are implicitly based on the methodologies upon which the ACR is based. For purposes of specifically developing the PRC Forms, the procedures employed track those previously endorsed by the Commission.

D. Input/Output

For PRC Forms CP-01 and CP-02, inputs are from the FY13 CRA and last year's PRC Forms CP-01 and CP-02. Inputs for PRC Forms CP-03 and CP-04 come from accounting records.

II. ORGANIZATION

USPS-FY13-39 consists of one PDF file, which includes this Preface, and four Excel files.

The Postal Service's Annual Report to the

Secretary of the Treasury

Regarding the Competitive Products Fund

For Fiscal Year 2013,

Required by 39 U.S.C. § 2011(i)

CONTROLLER
FINANCE

UNITED STATES
POSTAL SERVICE

December 27, 2013

Mr. Richard L. Gregg
Department of the Treasury
1500 Pennsylvania Avenue, NW
Room 2112 MT
Washington, DC 20220-2112

Dear Mr. Gregg:

Pursuant to 39 U.S.C. 2011(i)(1), the United States Postal Service hereby submits the enclosed *Competitive Products Fund Report* (CPFR) for the fiscal year ending September 30, 2013.

Additional information regarding the Postal Service is available elsewhere. The *2013 United States Postal Service Annual Report* on form 10 – K is available on http://about.usps.com/who-we-are/financials/. In addition, we file an *Annual Compliance Report* with the Postal Regulatory Commission within 90 days of the end of each fiscal year.

Sincerely,

Timothy O'Reilly
VP, Controller

Enclosures

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Competitive Products Fund Report
For Fiscal Year Ending
September 30, 2013

BACKGROUND

On December 18, 2008, the Postal Regulatory Commission (PRC) issued Order No. 151, Docket No. RM2008-5 Order Establishing Accounting Practices and Tax Rules for Competitive Products. With respect to the Competitive Products Fund (CPF), a fund established in the United States Treasury, the PRC rules are based on a theoretical, on-paper-only enterprise. Necessarily, the PRC's rules are distinct from generally accepted accounting principles (GAAP).

In Fiscal Year 2013, the Competitive Products Fund generated pretax earnings of $2,083.3 million, which produced a tax obligation of $1,354.1 million. As required by law, this amount will be transferred to the Postal Service Fund by January 15, 2014.

As discussed in our *2013 United States Postal Service Annual Report on Form 10-K ("Annual Report"),* the law divides our services into two broad categories: Market-Dominant and Competitive. Market-Dominant services include, but are not limited to, First-Class Mail, Standard Mail, Periodicals, and certain parcel services. Price increases for these services are subject to a price cap by class of mail based on the Consumer Price Index–All Urban Consumers (CPI-U). Competitive services, such as Priority Mail, Priority Mail Express, Parcel Select and Parcel Return Service, Bulk Standard Post, and some types of International Mail have greater pricing flexibility and are commonly referred to as "Shipping and Package Services".

On September 25, 2013, the Postal Service proposed two separate price increases for Market Dominant (Mailing Services) products, an average 1.6% increase based on changes in the Consumer Price Index (CPI) and a 4.3% average increase, on top of the 1.6% increase due to extraordinary and exceptional circumstances that have resulted in unacceptably low levels of liquidity. The 4.3% "exigent" price increase was deemed necessary by the Board of Governors to enable the Postal Service to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States, in view of the uncertain path towards postal reform legislation. The proposed pricing changes would increase the price of a First-Class Mail single-piece letter from $0.46 to $0.49. Similar increases would be applied to Standard Mail, Package Services, Periodicals, and Extra Services. The proposed changes, which, if approved by the PRC, would go into effect in January 2014, are expected to generate $2 billion of additional annualized revenue for the Postal Service.

Prices for Competitive services, by law, must cover costs attributable to each product, as well as an appropriate share of the institutional costs of the Postal Service. The required share of institutional costs to be covered by Competitive market services as determined by the PRC is 5.5% of total institutional costs. By law, changes in prices for our Competitive market services must be announced at least 30 days prior to the implementation date. Prices for these Competitive market services – including Express Mail, Global Express Guaranteed, Express Mail International, Priority Mail, Priority Mail International, Parcel Select, and Parcel Return Service – increased an average of 9% in January 2013. New pricing for Competitive market services will go into effect on January 26, 2014 at an average increase of 2.4%.

We offer contract prices, rebates, online price reductions, and other incentives to encourage customers to increase their volumes and in turn increase Postal revenue.

Reclassification of Certain Postal Services

Periodic reclassifications and expansions of services from Market-Dominant to Competitive, which require approval from the PRC, are necessary to rationalize service offerings. The additional flexibility provided in Competitive services allows us to better offer services that meet customer needs, to increase business for the Postal Service, and to allow us to price our products and services competitively within the markets in which we operate. The Postal Service's Competitive services generally include most of our shipping, package, and expedited delivery services.

In Quarter I, 2012, with the approval of the PRC, we reclassified certain lightweight commercial parcels previously included in the Market-Dominant category as First-Class Mail Parcels. These parcels were classified as First-Class Package Services and included in Competitive services. In addition, certain Post Office Box services were reclassified from Market-Dominant to Competitive. In Quarter II, 2012, Standard Mail parcels used for the fulfillment of customer orders were reclassified as part of Parcel Select which is a Competitive service. There were no new reclassifications in Quarter III or IV, 2012. On July 20, 2012, the PRC conditionally approved the transfer of Standard Post (formerly Parcel Post) from Market-Dominant to Competitive, effective January 27, 2013. On September 10, 2012, the PRC approved the transfer of First-Class Package International Service from Market-Dominant to Competitive, also effective January 27, 2013.

While there are distinct legal and regulatory classifications of postal services known as either Market-Dominant or Competitive which are required to be reported in the attachments to this document, Postal Service management utilizes the following broad service categories to evaluate performance and manage the business: First-Class Mail, Standard Mail, Shipping and Packages, International, Periodicals, and Other. Throughout our *Annual Report* document, operational measurements and financial data, such as revenue and volume, will be reported utilizing these categories.

Risk Factors

The risk factors identified in this section are discussed in our *Annual Report,* and they are particularly relevant to our Shipping Services.

Adverse changes in the economy directly impact our business, negatively affecting our results of operations.

Even with some regulatory and legislative changes, our ability to generate sufficient cash flows from current and future management actions to increase efficiency, reduce costs, and generate revenue may not be sufficient to meet all of our financial obligations.

We are subject to Congressional oversight and regulation by the Postal Regulatory Commission and other government agencies. We have a wide variety of stakeholders whose interests and needs are sometimes in conflict.

Adverse events may call into question our reputation for quality and reliability or our ability to deliver the mail, and could diminish the value of the Postal Service brand. This could potentially adversely affect our revenues and results of operations.

Our need to restructure our operations in response to declining mail volumes may result in significant costs. It is possible that the measures being considered would be insufficient to reduce our workforce and physical infrastructure to a level commensurate with lower and declining mail volumes.

Our business and results of operations are significantly affected by competition from both competitors in the market place as well as substitute products and channels provided by electronic communication services. If we do not compete effectively, operate efficiently,

grow marketing mail and package services, and increase revenue and profit margins from other sources, this adverse impact will become more substantial over time.

Existing laws and regulations limit our ability to introduce new services or products, enter new markets, generate new revenue streams, or manage our cost structure. These laws and regulations also may prevent us from increasing prices sufficiently, or generating sufficient efficiency improvements, to offset increased costs. This would adversely affect our results of operations.

An unduly burdensome union contract arrived at either through negotiation or arbitration could have a significant adverse impact on our future results of operations by impacting our control over wages and benefits and/or by limiting our ability to manage our workforce effectively.

We rely on the terms and conditions of our contracts with vendors and customers to deliver our services. These contracts are renegotiated on a routine and periodic basis. Significant changes in the costs, pricing, or terms associated with these contracts could adversely affect our business.

Fuel expenses are a material part of operating costs. A significant increase in fuel prices could adversely affect costs and results of operations.

We rely extensively on computer systems and technology to manage the delivery of mail, process transactions, summarize results, and manage our business. Disruptions in both our primary and secondary (back-up) systems could harm our ability to run our business and potentially result in significant losses of revenue or additional operating costs. In addition, such disruptions could impair our reputation for reliable service, which would also adversely affect results of operations.

Due to our current cash constraints, our operational performance in the future could be at risk as a result of inadequate capital investment in transportation equipment, mail processing equipment, facilities, or information technology, which are either essential to operations or necessary to improve the quality of our services.

We have a substantial amount of indebtedness.

Health and pension benefit costs represent a significant expense to us.

Workers' compensation insurance and claims expenses could have a material adverse effect on our business, financial condition, and results of operations.

The potential liability associated with existing and future litigation against us could have a material adverse effect on our business, results of operations, financial condition, and cash flows.

A failure to protect the privacy of information we obtain from customers could damage our reputation and result in a loss of business.

International conflicts or terrorist activities and the effects of these events may have adverse impacts on business operations or our financial results. In addition, we are subject to the risk of biohazards and other threats placed in the mail.

We may be adversely impacted by the legal or regulatory responses to actual or perceived global climate change.

We are also subject to risks and uncertainties that affect many other businesses, including:

- Market acceptance of new product and service initiatives;
- Adverse weather conditions or natural disasters, such as hurricanes, which can damage property and disrupt operations;
- Widespread outbreak of an illness or any other communicable disease, or any other public health crisis; and
- Changes in interest rates.

These risks and others could clearly affect the liquidity of the Competitive Products Fund that is held within the U.S. Treasury.

RESULTS OF OPERATIONS

Using PRC methodology, Competitive Mail and Services revenue totaled $13.7 billion in 2013 and volume totaled 3.1 billion pieces. In 2013, Competitive Mail and Services accounted for 2.0% of total Postal Service mail volume and 20.3% of total revenue.

Before further discussion, it may be useful to define several terms that are part of our regulatory lexicon. Coverage is defined as the ratio of revenue to attributable costs, using PRC-determined methodology. Institutional costs are those costs that are not attributable. When a product's revenue exceeds its attributable costs, the difference represents contribution toward covering institutional costs.

In FY2013 the Postal Service transferred $1,057.1 million from the Competitive Products Fund to the Postal Service Fund. This transfer represented a prepayment of current and future year's institutional costs.

In addition to covering attributable costs, Competitive Mail and Services are required, by the PRC, to bear 5.5% of postal-wide institutional costs. Total costs for Competitive Mail and Services are by definition equal to their attributable costs plus 5.5% of postal-wide institutional costs. In 2013, the contribution from Competitive Mail and Services equaled 11.76% of the institutional costs of the Postal Service. The difference between this 11.76% and the required 5.5% threshold is the "net income" for Competitive Mail and Services, and it is used to calculate the required tax transfer from the Competitive Products Fund in the U.S. Treasury to the Postal Service Fund, also within the Treasury. For 2013, this regulatory defined net income totaled $2,083.3 million. Tax due will be transferred from the Competitive Products Fund to the Postal Service Fund by January 15, 2014.

PRC Forms CP-01, CP-02, CP-03, and CP-04

For Fiscal Year 2013

Table 1
Proposed Competitive Products Income Statement
($ in 000s)

PRC Form CP-01

	FY 2013	FY 2012	$ Change from SPLY	% Change from SPLY
Revenue				
(1) Mail and Services Revenues (a)	13,668,579	11,425,730	2,242,849	19.6%
(2) Investment Income	36	516	(480)	-93.0%
(3) Total Competitive Products Revenue	13,668,615	11,426,246	2,242,369	19.6%
Expenses				
(4) Volume Variable Costs	9,636,800	8,283,600	1,353,200	16.3%
(5) Product Specific Costs	125,300	99,700	25,600	25.7%
(6) Total Competitive Products Attributable Cost	9,762,100	8,383,300	1,378,800	16.4%
(7) Net Income Before Institutional Cost Contribution	3,906,515	3,042,946	863,569	
(8) Required Institutional Cost Contribution	1,823,217	2,234,386	(411,169)	-18.4%
(9) Net Income (Loss) Before Tax	2,083,298	808,560	1,274,738	
(10) Assumed Federal Income Tax *	729,154	282,996	446,158	157.7%
(11) Net Income (Loss) After Tax	1,354,144	525,564	828,580	

Line (1): Total revenues from Competitive Products volumes and Ancillary Services
Line (2): Income provided from investment of surplus Competitive Products revenues
Line (3): Sum total of revenues from Competitive Products volumes, services, and investments
Line (4): Total Competitive Products volume variable costs as shown in the Cost and Revenue Analysis (CRA) report
Line (5): Total Competitive Products product specific costs as shown in the CRA report
Line (6): Sum total of Competitive Products costs (sum of lines 4-5)
Line (7): Difference between Competitive Products total revenues and attributable costs (line 3 less line 6)
Line (8): Minimum amount of Institutional Cost contribution required under 39 CFR 3015.7 of this chapter.
Line (9): Line 7 less line 8
Line (10): Total assumed Federal income tax as calculated under 39 CFR 3060.40
Line (11): Line 9 less line 10

(a) Note: Mail and Services revenues have been adjusted to include gains from the sales and impairments of property and equipment. The gain for FY 13 was $53M with the amount allocated to Competitive Products (Building and Equipment allocation) of $7.779M. The gain for FY12 was $5M with the amount allocated to Competitive Products (Building & Equipment allocation) of $630K.

* Note: 2013 Assumed Federal Income Tax is estimated based on the 2013 and 2012 Federal corporate tax rates respectively.

Table 2
Annual Summary of Competitive Products Financials (FY 2013)
($ in 000s)
PRC Form CP-02

		Beginning Value	Change from Prior Year	Ending Value
(1)	Cumulative Net Income (Loss) After Assumed Federal Income Tax *	$1,630,733	$1,354,144	$2,984,877
(2)	Total Financial Obligations (List of Financial Obligations)	$0	$0	$0
(3)	Total Financial Investments (List of Financial Investments)	$1,057,050	($1,057,050)	$0
Line 1:	Beginning Value: Sum total of Net Income (Loss) as of October 1 of Reportable Fiscal Year			
	Change from Prior Year: Amount of Net Income (Loss) of Reportable Fiscal Year			
	Ending Value: Sum of Beginning Value and the Change from Prior Year			
Line 2:	Beginning Value: Sum total of Financial Obligations as of October 1 of Reportable Fiscal Year			
	Change from Prior Year: Amount of Net Financial Obligations of Reportable Fiscal Year			
	Ending Value: Sum of Beginning Value and the Change from Prior Year			
Line 3:	Beginning Value: Sum total of Financial Investments as of October 1 of Reportable Fiscal Year			
	Change from Prior Year: Amount of Net Financial Investments of Reportable Fiscal Year			
	Ending Value: Sum of Beginning Value and the Change from Prior Year			

* Note: 2013 Assumed Federal Income Tax is estimated based on the 2013 Federal corporate tax rate.

Table 3
Competitive Products Property and Equipment Assets (FY 2013)
(Actual $)

PRC Form CP-03

Finance Number	Finance Location	Asset Identifier	Asset Description	Cost	Accumulated Depreciation	Net Book Value
ClickNShip	475 L'Enfant Plaza, Wash, DC 20260	1916084	Shredder	$3,673.92	$1,010.32	$2,663.60
ClickNShip	475 L'Enfant Plaza, Wash, DC 20260	1057123	Micro Computer System	$4,812.00	$4,812.00	$0.00
ClickNShip	475 L'Enfant Plaza, Wash, DC 20260	1147567	Micro Computer System	$23,138.00	$23,138.00	$0.00
ClickNShip	475 L'Enfant Plaza, Wash, DC 20260	1147568	Micro Computer System	$23,138.00	$23,138.00	$0.00
ClickNShip	475 L'Enfant Plaza, Wash, DC 20260	1147569	Micro Computer System	$23,138.00	$23,138.00	$0.00
Total			Total	$77,899.92	$75,236.32	$2,663.60

Table 4
Statement of Allocated Assets and Liabilities for Competitive Products
($ in thousands)

	FY2013		FY 2012	PRC Form CP-04
Total Net Assets	**USPS Annual Report**	**Corp. Fin. Reporting - Competitive Products**	**Corp. Fin. Reporting - Competitive Products**	**Distributed on Basis of:**
Cash and Cash Equivalents	2,638,000	535,514	406,057	Revenue
Net Accounts Receivable	984,000	199,752	160,742	Revenue
Supplies, Advances, and Prepayments	122,000	24,766	22,063	Revenue
Total Current Assets	3,744,000	760,032	588,861	
Property and Equipment				
Buildings	24,452,000	4,232,641	3,618,896	Depreciation cost for Buildings
Leasehold Improvements	1,290,000	223,299	178,663	Depreciation cost for Leasehold Improvements
Equipment	19,629,000	1,960,937	1,824,956	Depreciation cost for Equipment
Land	2,895,000	501,125	432,012	Depreciation cost for Buildings
Accumulated Depreciation	31,156,000	4,735,718	3,941,594	Depreciation cost for Bld/Eq/Leasehold/Vehicle
Construction in Progress	402,000	69,597	48,529	Depreciation cost for Buildings & Leaseholds
Total Property and Equipment, Net	17,512,000	2,251,881	2,161,463	
Appropriations and Receivables - Revenue Forgone	385,000	0	0	Non Competitive
Total Assets	21,641,000	3,011,913	2,750,324	
Total Assets Determined from Section 2011(e)(5)		4,393,123	3,959,186	
Total Net Liabilities	**USPS Annual Report**	**Competitive Products**	**Competitive Products**	**Distributed on Basis of:**
Liabilities:				
Current Liabilities				
Compensation and Benefits	1,529,000	244,793	248,704	Labor
Retire Health Benefits	16,766,000	2,684,237	1,501,470	Labor
Workers' Compensation	1,322,000	211,917	179,425	Workers' Comp Expense
Payables and Accrued Expenses	1,913,000	388,339	321,309	Revenue
Customer Deposit Accounts	1,229,000	249,487	211,871	Revenue
Deferred Revenue-Prepaid Postage	2,993,000	607,579	702,851	Revenue
Outstanding Postal Money Orders	671,000	5,744	852	Actual International Money Orders Outstanding
Prepaid Box Rent and Other Deferred Revenue	460,000	188,457	202,357	Actual Competitive Deferred Box Rents
Debt	9,800,000	1,491,560	1,245,450	Volume Variable Interest Expense
Non-Current Liabilities				
Workers' Compensation	15,918,000	2,551,655	2,178,066	Workers' Comp Expense
Employee Accumulated Leave	1,982,000	317,715	248,941	Repriced Annual Leave
Deferred Appropriation and Other Revenue	159,000	0	0	Non Competitive
Long-Term Portion of Capital Lease Obligation	354,000	61,277	60,639	Leasehold Depreciation
Deferred Gains on Sales of Property	308,000	45,206	39,448	Depreciation cost for Buildings & Equipment
Contingent Liabilities and Other	860,000	137,686	113,364	Labor
Long-Term Portion Notes Payables	5,200,000	0	0	Non Competitive
Total Liabilities	61,464,000	9,185,652	7,254,748	