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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268–0001

RATE ADJUSTMENT DUE TO EXTRAORDINARY OR EXCEPTIONAL CIRCUMSTANCES	Docket No. R2013-11

RESPONSE OF THE UNITED STATES POSTAL SERVICE TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 16
(December 12, 2014)

The United States Postal Service hereby provides its responses to Presiding Officer's Information Request No. 16, issued December 4, 2014. The question is stated verbatim and followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorney:

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December 12, 2014

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1. MPA – the Association of Magazine Media and Alliance of Nonprofit Mailers suggests that a Postage in the Hands of the Public (PIHOP) adjustment could be calculated using the formula: Adjustment = ($0.02 / $0.49) x Forever Stamp Sales – ($0.02 / $0.49) x Revenue From Forever Stamps Used.[1]

a. Please provide the data required to calculate the adjustment as described above.
b. Please provide the source of the data provided in part a.
c. Please discuss the merits of MPA's proposed adjustment.

RESPONSE:

a. As will be discussed more thoroughly in response to subpart c. below, as the Postal Service understands the intent of the MPA adjustment (i.e., the adjustment specified in the NOI response of those parties and reproduced in this question), the data required to calculate the MPA adjustment properly do not exist. Nevertheless, for discussion purposes, attached to this response electronically is an Excel spreadsheet (POIR.16.Resp.xls) consisting of three columns. The first two columns include monthly data for Forever Stamp Sales and Forever Stamp Usage. With respect to the third column, the MPA/ANM NOI Response (November 19, 2014) correctly noted (page 3, footnote 1) that "[i]f revenue for Forever Stamps used is recognized based upon the price of the stamp when purchased (as opposed to its value when used), the weighted average price of the stamps when purchased should be substituted for $0.49 in the latter part of this equation." Therefore, the spreadsheet includes monthly figures for the applicable estimated weighted average price of the stamps when purchased as well.

[1] Comments of MPA—The Association of Magazine Media and Alliance of Nonprofit Mailers on Notice of Inquiry Issued November 5, 2014, November 19, 2014.

b. Stamp Sales come directly through the general ledger. There are separate General Ledger/Trial Balance accounts to identify Forever stamp sales.

Usage of Forever stamps and Forever embossed envelope and cards is measured through a statistical estimation process. First, using the ODIS-RPW probability statistical sampling system, national estimates of the number of Forever stamps, envelopes and cards are constructed by 'layer' or year of issue.[2] Second, using current period and cumulative sales and usage by layer, a maximum likelihood estimate is constructed that 'values' the stamp from the combined price points at which it may have been bought.[3] Third, the Forever valuation is then applied to the estimated counts by layer and summed across layers to arrive at the estimated total revenue usage.

Regarding the statistical estimation of Forever stamp counts, the ODIS-RPW system is a national probability sampling system whereby mail pieces are randomly sampled as they exit the Postal Service delivery units (station, branches, associate offices and plants). The statistical design is a complex multi-stage sampling plan that stratifies a sampling frame of mail exit points (MEPs), draws random samples of MEPs, and spreads the sampling MEPs over the days of the sampling period (MEP-days). On randomly selected MEP-days, ODIS-RPW data collectors randomly sample mail as it arrives at the delivery units. Direct expansion estimators are constructed by applying

[2] 'Layer' is identified by the year printed on the Forever stamp, or the year of issue. The year can be found in one of four corners of each Forever stamp. Forever embossed cards and envelopes are a separate layer.

[3] Forever stamps may be bought at various prices. For example, the 'A Flag for all Seasons' series were first issued at 46 cents, and then after the January 26, 2014 price increase, they have been sold at 49 cents. Therefore, the 'valuation' of these stamps would be at something less than 49 cents; between the 46 and 49 cents.

data collector counts of Forever stamps and cards and envelopes to the inverse of the probabilities of selection, and summing to national totals. Regarding the valuation of the layers, data are collected on sales and usage for both the current period and cumulative to date.[4] Using these data, the number of stamps retained by layer is calculated by price point as well as the total retained for the layer. Estimated usage probabilities or maximum likelihood estimates are obtained for each layer by dividing the estimated number retained at each price point by the total retained. These probabilities are applied to current period usage counts to estimate the usage counts by price point, which is then multiplied by the price point to calculate the total realized revenue in the period. Revenue per piece is calculated by dividing the estimated realized revenue by the total usage count for the period. The calculated revenue per piece typically is less than the current rate, unless of course the layer (year of issue) was sold only at the current price point.

c. The problem being addressed arises from the convergence of accrual accounting, Forever stamps, and the need under Order No. 1926 to estimate a running tab of surcharge revenue. Because the Postal Service's systems (including RPW and billing determinants reporting) are based on accrual accounting, a surcharge revenue calculation methodology which merely multiples 2 cents by the billing determinant volume for stamped letters for the period starting with implementation of the surcharge would be flawed. As noted by the Postal Service when first introducing its own proposed adjustment, the flaw occurs because many of the Forever stamps used (and

[4] Sales data indicate the purchase at the various price points. Usage data are collected monthly with no information about the price point. The valuation process estimates the price point.

hence accrued) after implementation of the surcharge were purchased at 46 cents or less, not at 49 cents. The Postal Service's proposal to alleviate this flaw was to continue to use accrual accounting to estimate surcharge revenue, but to add an adjustment which deducted from the surcharge revenue the amount of 2 cents times the estimated number of Forever stamps that were held by the public at the time of surcharge implementation, and thus are available to be used to avoid the higher-priced stamps sold after the surcharge was imposed.

The NOI methodology (i.e., that methodology presented by the Commission in its Notice of Inquiry) instead moves entirely away from accrual accounting (for just one type of mail -- stamped letters) and focuses instead directly on cash accounting. The theory is that , by taking the number of Forever stamps sold each month at 49 cents, we can get a direct measure of the total surcharge revenue associated with those stamps (at 2 cents per stamp). The obvious merit of this methodology is its simplicity -- it is a one-step direct estimate of surcharge revenue for this category. It should be readily transparent to all that when a Forever stamp is purchased at 49 cents, the Postal Service has received the benefit of the 2-cent surcharge. But as has also been discussed, while simple, this approach is imperfect due to the limitations of the available information. The problem in this instance is not with the amount of revenue to *include* with the surcharge revenue aggregation (which is unambiguously 2 cents times the number of Forever stamps sold), but rather with the amount of revenue to *exclude* from what would otherwise be the surcharge revenue aggregation generated from the billing determinants.

Both the Commission in the NOI and MPA in its Response agree in theory what the objective of the exercise should be:

> A straightforward solution would be to calculate the surcharge collected from Forever stamps by quarter by multiplying the quarterly volume of Forever stamps sold while the surcharge was in effect (calculated by total quarterly Forever stamp revenue divided by 49 cents) by 2 cents and subtracting the quarterly volume of Forever stamps from the quarterly billing determinants volumes used to calculate the amount of surcharge collected. This solution avoids double counting the surcharge collected from mail pieces that were sent with Forever stamps.

Notice of Inquiry (November 5, 2014) at 3; quoted in MPA/ANM Response (November 19, 2014) at 2-3.. The difficulty comes in identifying "the quarterly volume of Forever stamps [within] the quarterly billing determinants volumes used to calculate the amount of surcharge collected." MPA's erroneous assumption appears to be that the estimate of Forever stamp volume derived from a sample-based revenue estimate of Forever stamp Usage to be employed in MPAs proposed calculation is necessarily equivalent to the actual (albeit implicit) Forever stamp volume that emerges as an *output* of the billing determinant process. Unfortunately, this assumption fails because there are other subsequent steps applied to the Usage that are made before it goes into the billing determinant process, such as the BRAF (Book Revenue Adjustment Factor) and similar procedures, utilizing a host of other inputs beyond the sample-based estimates. The procedures which lead to these circumstances were described in great detail in a previous rulemaking proceeding. Please see the description of Proposal Three, Docket No. RM2011-11 (May 18, 2011). This precludes equivalency between the sample-based Usage estimates and the implicit volume that is reflected in the actual billing determinants used for surcharge revenue calculation. Ultimately, this creates an apples-to-oranges anomaly within the MPA proposal.

As explained in the NOI itself, the NOI adjustment has two features which potentially affect the accuracy of the adjustment. NOI (Nov. 5, 2014) at 3-4. Those features, however, act in offsetting directions. Given the inherent imprecision in this aspect of surcharge revenue estimation, the NOI proposal provides a more pragmatic basis for adjustment. The proposed MPA adjustment may offer the appearance of greater accuracy, but that appearance is illusory. The available information does not support a direct estimation of how much of the Single Piece billing determinant surcharge revenue relates to actual Forever stamp usage in the manner contemplated by MPA.

MPA's proposed adjustment is complicated. It continues to begin the exercise with an accrual-based initial surcharge revenue estimate, but would then implement the adjustment set forth in the formula in this POIR question. If we examine the two terms of the adjustment formula, however, we see that the first element (Forever stamps sold) relates to cash accounting, and the second element (Forever stamp usage) relates to accrual accounting. Thus, after starting with an accrual initial estimate, there is an adjustment which is the difference between a cash estimate and an accrual estimate. The inherent complexity of this approach is obvious.[5] Consequently, between the NOI methodology and the MPA proposal, the Postal Service submits that the simplicity and transparency of the NOI methodology trumps any concern that

[5] Compounding the complexity is the apples-to-oranges incongruity discussed above between the initial accrual estimate (based on the billing determinants) and the accrual component of the adjustment (the Usage figure).

the positive and negative offsets specified in the NOI may not balance perfectly. By using cash accounting to hone in on the number of Forever stamps sold during each month of the surcharge period, the NOI methodology provides the most direct solution to the problem presented.