Testimony of

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Introduction

Chairman Johnson, Ranking Member Peters, and members of the Committee on Homeland Security and Governmental Affairs, good morning. My name is Robert Taub. I am the Chairman of the Postal Regulatory Commission (Commission). I am pleased to testify before you today.

Background

The Commission is an independent federal agency that is responsible for ensuring transparency and accountability of the U.S. Postal Service's $71 billion operations and finances.

As a separate and independent federal regulatory agency, the Commission determines the legality of the Postal Service's prices and products, adjudicates complaints and fair competition issues, and oversees the Postal Service's delivery performance consistent with statutory requirements. Its mission is to ensure transparency and accountability of the Postal Service and foster a vital and efficient universal mail system. The Commission is composed of five Commissioners, each appointed by the President and confirmed by the Senate.

The Commission carries out this work with a very small budget and staff. Its current year appropriation is $15.2 million, roughly 1/50th of 1 percent of the Postal Service's expenses. Commission funding comes entirely from the off-budget, permanently appropriated, Postal Service Fund, which is wholly comprised of ratepayer--not taxpayer--funds.

Task Force

In April of 2018, President Trump issued an executive order establishing the Task Force on the United States Postal System. To quote from the President's order, "The USPS is on an unsustainable financial path and must be restructured to prevent a taxpayer-funded bailout…" The order goes on to list a series of facts that support that claim, and further states that, "It shall be the policy of [the Trump] Administration that the United States postal system operate under a sustainable business model to provide necessary mail services to citizens and businesses, and to compete fairly in commercial markets." I fully agree.

The Postal Service faces significant financial obstacles for the future. Since FY 2008, the volume of Market Dominant mail has annually decreased, declining from 210.6 billion pieces to 140.7 billion pieces – **a 33 percent drop**. Years of net losses have resulted in Postal Service total liabilities exceeding total assets by $63 billion. With its growing liability for retiree health benefits, the inability to finance needed capital investments, and the continued loss of high-revenue First-Class Mail volume, the important task of improving the financial condition of the Postal Service is daunting. The attached document entitled *Preliminary Overview of U.S. Postal Service Finances for FY 2018* provides much greater detail, and is based upon financial results the Postal Service files quarterly with the Commission.

The fundamental problem is that the Postal Service cannot currently generate sufficient funds to cover its mandated expenses and also invest in critically deferred capital needs.

The President's Task Force brought together agency heads from the Department of Treasury, the Office of Management and Budget, and the Office of Personnel Management. The executive order establishing the Task Force directed that I be consulted with as Chairman of the Commission.

My invitation to today's hearing noted that many of the Task Force report recommendations pertain directly to the work of the Commission, including a recommendation that the Commission's role as regulator be strengthened. I was asked to focus my comments on the report's findings and recommendations, particularly those related to the Commission's obligations and its mission to foster a vital and efficient universal mail system, as well as on how the Commission might implement these recommendations and the potential impact of these recommendations on the Postal Service and its customers.

As always, the Commission stands ready to assist with whatever Congress may ask or require of us. However, as I mentioned, the Commission operates on a very lean budget. Already, under current funding, the Commission faces challenges meeting its demands. Should Congress seek to expand the Commission's authority, additional resources will be required. This point is significant, as our current funding model left the Postal Service without a regulator during the recent government shutdown.

<u>Commission's Budget Process</u>

For 38 years since its creation in 1970, the Commission requested and received its funding directly from the Postal Service out of the Postal Service Fund. Funding requests were deemed approved by the Postal Service's President-appointed-Senate-confirmed Governors unless adjusted by their unanimous written decision.

Passage of the Postal Accountability and Enhancement Act of 2006 (PAEA) transferred the Commission into the annual appropriations process. Congressional intent was to ensure the financial independence of the newly modified agency from the Postal Service. Despite now being part of the appropriations process, the Commission's budget continues to come solely from the off-budget Postal Service Fund.

While the theory behind transferring the Commission into the appropriations process was reasonable, the government shutdowns in 2013 and 2019 shuttered the Commission while the Postal Service remained open. This is a serious problem, impeding the Commission's critical postal oversight on behalf of the American public and directly impacting sorely needed Postal Service revenues. I therefore ask that Congress consider reverting the Commission's budget process to the 1970 language. Given that the Task Force recommends an enhanced regulator, I wanted to take the opportunity to highlight the Commission's funding dilemma.

Task Force Recommendations

Having not served directly on the Task Force, my remarks reflect Commission staff's best interpretation of the recommendations, and what actions we believe to be within the Commission's authority. My fellow witnesses representing the Task Force members may be able to further elaborate on the intent of the recommendations. Moreover, of course, any action taken by the Commission would require a majority vote of the Commissioners in office.

With respect to the Task Force recommendations, there are many legitimate suggestions provided in the Task Force report, and working with the Treasury Department and the Postal Service, we intend to further explore them where administratively possible. However, one of them in particular stands out to me and is consistent with the Commission's recommendations made to Congress in the past. I believe that the single most important thing that can be done for the Postal Service and the United States is to clearly define the Postal Service's Universal Service Obligation, or USO. Only by defining the USO clearly can we begin to design a system that will fund the services required. It is our Nation's mission statement for the Postal Service.

Task Force Recommendations Related to the Universal Service Obligation

The Task Force made six administrative recommendations related to the USO. I will discuss three of them in my statement. One was the recommendation that the USO be clearly defined. To understand what changes may be necessary to the USO to pursue the policies expressed by this Administration and the Task Force's recommendations, it is important to first understand how the USO is currently defined.

The Commission has significant experience exploring the question of the USO. The PAEA directed the Commission to annually estimate the costs of universal service and to submit to the President and Congress a comprehensive report[1] on universal postal service and the postal monopoly in the United States.[2] In the resulting 2008 USO report, the Commission determined that the USO has seven attributes: geography,

[1] Postal Regulatory Commission. Report on the Universal Postal Obligation and the Postal Monopoly. December 19, 2008.
[2] The Postal Accountability and Enhancement Act of 2006, 120 Stat. 3198, sec. 702.

range of products, access to facilities, delivery frequency, prices/affordability, quality of service, and users' rights (or enforcement).

Other nations have imposed universal service requirements directly on their postal operator by statute, regulation, licensing, or contract. Countries like Australia, Canada, and Germany – just to name a few – have a detailed definition of universal postal service, with specific standards for delivery and retail access. Unlike other countries, the USO within the United States is largely undefined and instead is comprised of a broad set of policy statements with only a few legislative proscriptions. Aside from the annual appropriations mandate for the past 36 years to provide 6 days of delivery, Congress has rarely established rigid, numerical standards of minimally acceptable service for any of the attributes identified by the Commission. Absent a specifically defined USO, the Postal Service has been expected to determine and meet the needs and expectations of the Nation on its own, while balancing the delivery of service against budgetary constraints.

In the absence of a clear definition of the USO, particularly given the Postal Service's current financial challenges, each of us may have a different view of what services and operations the Postal Service must provide to fulfill the USO, and all of our views will have different price tags. The Commission recommended in its 2008 report "that Congress consider and balance all the features of universal service as part of any review of changes necessary to preserve a financially viable Postal Service".

The Commission is required in its *Annual Report to the President and Congress* (Annual Report) to estimate the costs incurred by the Postal Service for three types of public services or USO activities: postal services to areas of the Nation the Postal Service would not otherwise serve; free or reduced rates for postal services as required by Title 39; and other public services or activities the Postal Service would not otherwise provide but for legal requirements. In the *Annual Report* issued in January 2018, the Commission estimated that the total cost of providing services for these three categories is $4.53 billion.

As part of the financial pressure of generating sufficient funds to remain solvent, the Postal Service must consider how to fund this $4.53 billion cost in universal service obligations. These obligations increase the amount of money required to undertake capital investments, and pay other multibillion dollar obligations such as retiree health and other benefit related costs.

As part of the recommendation to clearly define the USO, the Task Force stated "*Provide a targeted definition of minimum, essential postal services, that due to specific social and economic needs have a basis for government protection*." The Commission has the existing administrative authority to review and approve specific product eliminations, transfers, and introductions requested by the Postal Service within the context of the USO. In considering such requests, the Commission would give due regard to the following statutory factors in its determination: the availability and nature of private sector enterprises engaged in delivery of the product involved; the views of those who use the product on the appropriateness of the proposed action; and the likely impact of the proposed action on small business concerns.

Additionally, the Commission would evaluate any proposed changes to postal product offerings for consistency with the other overarching policies of Title 39, including the foundational tenets of universal service set forth in 39 U.S.C. § 101 and prohibition on undue discrimination between mail users under 39 U.S.C. § 403. It is important to note that the Postal Service, any user of the mails, or the Commission on its own initiative may request (or, in the Commission's case, begin) a proceeding under section 3642 to modify the product lists. Such a proceeding would evaluate those criteria set forth in section 3642 as discussed above.

A related USO Task Force recommendation was to "*Establish a rule that specifies that access to the postal system must only be sufficient to implement defined USO standards for delivery."* The Task Force notes that the Postal Service should have flexibility to determine the number of access points (post offices, retail facilities, and collection boxes) as long as these meet the defined USO standard of delivery and are compatible with financial sustainability.

The Commission's 2008 USO Report sets forth that the access component of the USO is flexible to meet articulated policy goals, stating that the Postal Service "enjoys considerable discretion to determine the nature and location of postal facilities by which access will be provided." However, the report goes on to state that this discretion is curtailed by the statute in meaningful ways, such as the preclusion of closing a small post office solely because it operates at a deficit, the prohibition on unreasonable discrimination or undue preference, and preclusions in annual appropriations acts for closing specific facilities.

The Postal Service could administratively make significant changes to its retail and collection box network absent legislative change, and has done so in recent history (*See, e.g.,* Docket No. N009-1, Advisory Opinion Concerning the Process for Evaluating

Closings Stations and Branches, March 10, 2010; Docket No. N2011-1, Advisory Opinion on Retail Access Optimization Initiative, December 23, 2011; Docket No. N2012-1, Advisory Opinion on Mail Processing Network Rationalization Service Changes, September 28, 2012).

If the Postal Service were to begin a new initiative relating to its post office network on a nationwide basis, the Commission's administrative oversight role in such an initiative would be two-fold. If a proposal were to, at minimum, change postal services on a substantially nationwide scope, then prior to implementation the Postal Service would need to seek an advisory (non-binding) opinion from the Commission on whether the proposal was consistent with the policies of title 39 USC 3661. The Commission would issue its Opinion after the opportunity for a hearing on the record. After any proposed changes were implemented, the Commission also has jurisdiction to review appeals of post office closings or consolidations and may set aside the Postal Service determination to close or consolidate a post office if found to be arbitrary and capricious, made without observance of proper legal procedure, or unsupported by substantial evidence of the record. When the Postal Service begins the process of closing or consolidating a post office, it is required by statute to consider the effect on the community and on postal employees caused by the proposed closing or consolidation, as well as whether the action would be consistent with the policies of effective and regular postal services set forth in the PAEA.

Other Postal Service initiatives, such as the realignment of collection boxes, or mail processing facilities, if done in such a way as to constitute at minimum a substantially nationwide change in the nature of postal services, would also require an advisory opinion from the Commission. *See* 39 USC § 3661. In any of those instances, however, the Postal Service maintains broad discretion to adjust its network.

Another Task Force recommendation related to the USO was to "*Maintain current discretion to determine mode of delivery consistent with a financially sustainable business model."* The Postal Service currently has flexibility to determine which mode of delivery optimizes a financially sustainable business model. The Task Force emphasizes that it should make the procedures and requirements for delivery modes transparent and public. The Postal Service has the ability to promulgate rules and standards that could provide transparent criteria by which mode of delivery is determined.

The Commission's role in implementing this type of Postal Service request would again be two-fold. In the case of a migration from one delivery mode to another for existing postal customers on at least a substantially nationwide basis, the Commission would prospectively offer an advisory opinion pursuant to 39 USC 3661 on whether the proposed change comports with the policies of title 39.

Additionally, the Commission may also review the effect of such implementation retrospectively, through the Commission's complaint process, to ensure the Postal Service does not exercise its discretion in an unduly discriminatory manner, or inconsistent with other tenets of title 39.

Other Task Force Recommendations

The Task Force made several recommendations regarding mail and package markets. The majority of these recommendations would require new administrative action by the Postal Service and the Commission. However, the Commission has already done substantial work regarding the Task Force's recommendations to: "*Develop a new model that can be used to both set rates and control costs to achieve sustainability"* and *"Require price increases, reduce service costs, or exit the business for any mail products that are not deemed an essential service and do not cover their direct costs."*

With regards to those recommendations, the Commission recently issued its findings related to the system for regulating rates and classes first established in 2006 by the PAEA. The Commission determined that, 10 years after the passage of the PAEA, while some of the aspects of the prior system worked as planned, overall, the ratemaking system had not achieved the objectives of the PAEA.

As a result of these findings, the Commission is currently in the process of promulgating rules to modify existing regulations or adopt an alternative system that the Commission believes will achieve the objectives of 3622.

<u>Conclusion</u>

The Postal Service is the one government agency that touches every American on a daily basis; it is an organization that literally serves 159 million American households and businesses on a typical day. It facilitates trillions of dollars in commerce. It is a significant driver of the Nation's economic engine and an essential piece of its infrastructure.

Throughout its nearly 244-year history, the Postal Service has endured multiple economic recessions and a Great Depression. It has dealt with numerous disasters, which have interfered with mail delivery and strained the infrastructure. It has responded to these immense challenges by adapting, often despite predictions of failure or even its demise in the face of competition from new technologies.

With the inherent and underlying strength of the system, today's Postal Service can survive these challenges too. The fundamental problem is that the Postal Service cannot currently generate sufficient funds to cover its mandated expenses and also invest in critically deferred capital needs. Issuance of the Task Force report was an effort to address the financial dilemma problem, and help key stakeholders find a path forward.

I commend committee leadership for holding today's hearing. On behalf of the Commission and its hard working staff, thank you for the opportunity to testify today. I am happy to answer any questions.

Postal Regulatory Commission

Preliminary
Overview of U.S. Postal Service
Finances for FY 2018

March 12, 2019

Commission Focus on Postal Service Financing

Commission rules require the Postal Service to file several reports with the Commission regarding financial results on a monthly, quarterly, and annual basis. The Commission staff internally analyzes these reports. Prior to 2014, the Commission's *Annual Compliance Determination* (ACD) included a chapter on the overall financial health of the Postal Service. However, because the ACD is focused on rates and service performance, it did not include a detailed analysis of other financial data provided in the Postal Service's *Annual Compliance Report* as well as its Securities and Exchange Commission equivalent Form 10-K filing. In 2014, the Commission developed a separate *Financial Analysis* report to provide greater clarity and transparency of the Postal Service's financial data and trends.

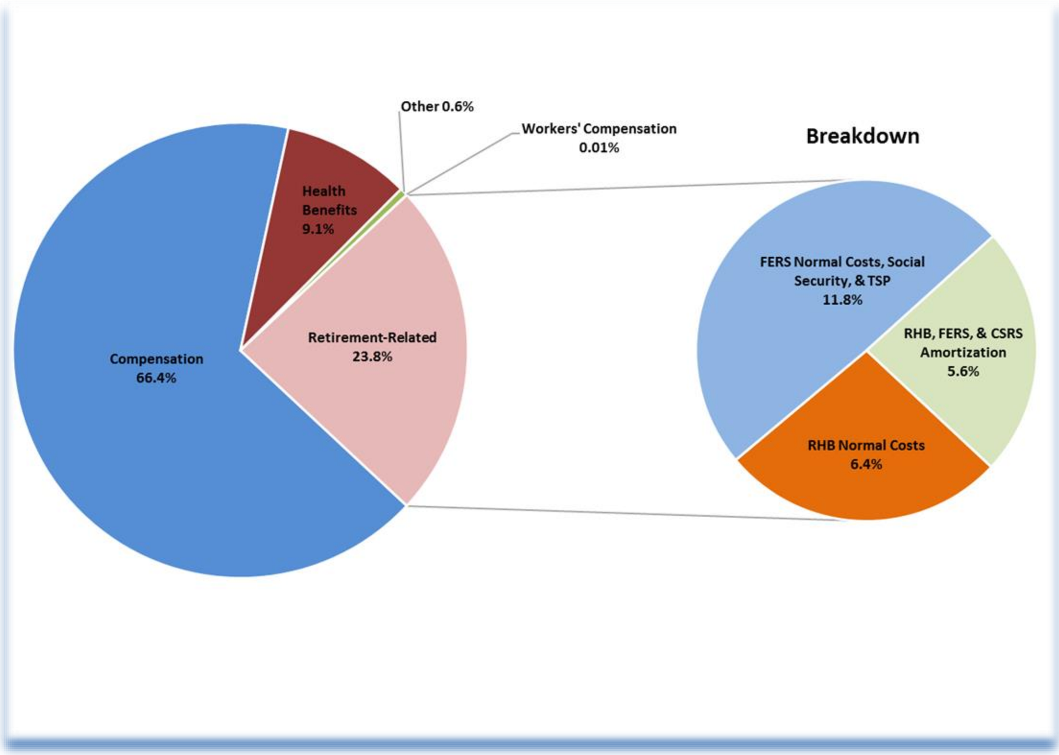
This year, the Commission will publish its sixth annual *Financial Analysis* report. The report not only reviews the overall financial position of the Postal Service, but also analyzes volumes, revenues, and costs of both Market Dominant and Competitive products. The Postal Service's financial position is analyzed in terms of profitability, solvency, activity, and stability using accounting ratios. Although the Commission is still preparing this year's report, I would like to highlight several preliminary observations and conclusions that may be drawn at this time. These preliminary observations and conclusions are subject to revision, with final observations and conclusions appearing in this year's *Financial Analysis* report expected to be issued in April.

Overview of USPS Finances: Liabilities Outstrip Assets Resulting in Low Liquidity

In FY 2018, the Postal Service had a total net loss of $3.9 billion, which is a $1.2 billion deterioration from FY 2017. This decade of consecutive net losses posted since FY 2007 has increased the net deficit to $62.6 billion. These continuing losses have significantly affected the financial position of the Postal Service by negatively affecting liquidity, requiring the Postal Service to use $13.2 billion of its $15 billion statutory borrowing capacity, and causing total net liabilities to far exceed total net assets.

In FY 2018, total revenue increased by $1.1 billion. Market Dominant revenue decreased by $1.3 billion while Competitive products revenue increased by $2.4 billion. Competitive product volumes continued to increase significantly in FY 2018, growing 11 percent over last year. This higher volume coupled with a Competitive product price increase (effective January 21, 2018) contributed to the increase in total revenue. Total Market Dominant revenue declined 2.6 percent from the prior year. CPI based price increases were not enough to offset declining volumes and higher operating expenses primarily driven by increases in compensation and benefits and transportation costs. Total expenses increased 3.1 percent or $2.2 billion in FY 2018. This increase is largely a result of higher overall compensation and benefits costs of $1.2 billion and an increase in transportation expense of $0.6 billion. Compensation and benefits costs as a percent of total expenses remained almost the same as in the prior year at 76.4 percent. Compensation accounts for the largest portion of personnel expenses, representing 66.4 percent of total personnel costs. Retirement benefits are the next largest component of total personnel expenses at 23.8 percent. Retirement benefits are comprised of amortization of unfunded retirement liabilities and employer contributions to the Federal Employee Retirement System (FERS), the Postal Service Retiree Health Benefits Fund (PSRHBF), Thrift Savings Plan (TSP) and Social Security. Employer contributions to the FERS employees current year service account for 11.8 percent of total retirement related expenses.

Percentage Breakdown of Total Personnel Expenses, FY 2018



An increase in contractual pay and workhours increased compensation expenses by $0.8 billion. Retirement expenses also increased consistent with increases in contractual pay. Other benefits costs such as the normal costs for retiree health benefits and workers' compensation costs also contributed to the increase in compensation and benefits. The significantly lower pharmaceutical compounding costs[3] and discount rates during FY 2017 were not repeated at the same level in FY 2018, resulting in an increase of $0.8 billion in workers' compensation expense. Transportation expenses increased by $0.6 billion in FY 2018. Further data on personnel related costs are detailed later in this testimony.

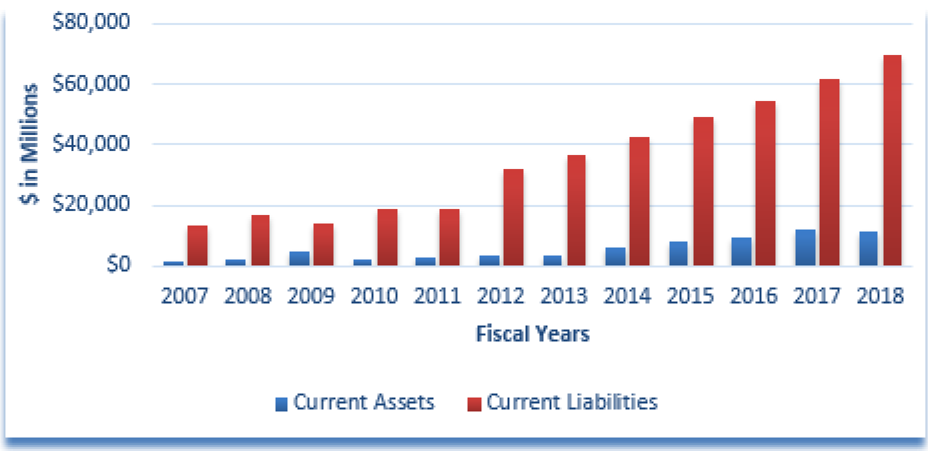
In the face of financial losses, since FY 2007, the Postal Service has reduced the size of its workforce by about 187,000 career employees, cut labor related costs, and increased its productivity. Today the Postal Service delivers roughly the same volume of

[3] In 2016, the Department of Labor (DOL) issued new rules for pharmaceutical compounding and for the year ended September 30, 2017, the Postal Service recorded a $549 million decrease from the prior year.

mail that it delivered in 1986, but with almost 160,000 fewer total employees. Yet even with these sizeable reductions, the Postal Service does not have the cash to pay down all of its debt or fully invest much needed capital in its operations.

The significant gap between the Postal Service's net current assets and net current liabilities is of particular concern. The Commission finds that despite an improvement in liquidity during FY 2018, current assets, consisting mostly of cash and cash equivalents, continue to be insufficient to meet the payment of current liabilities.

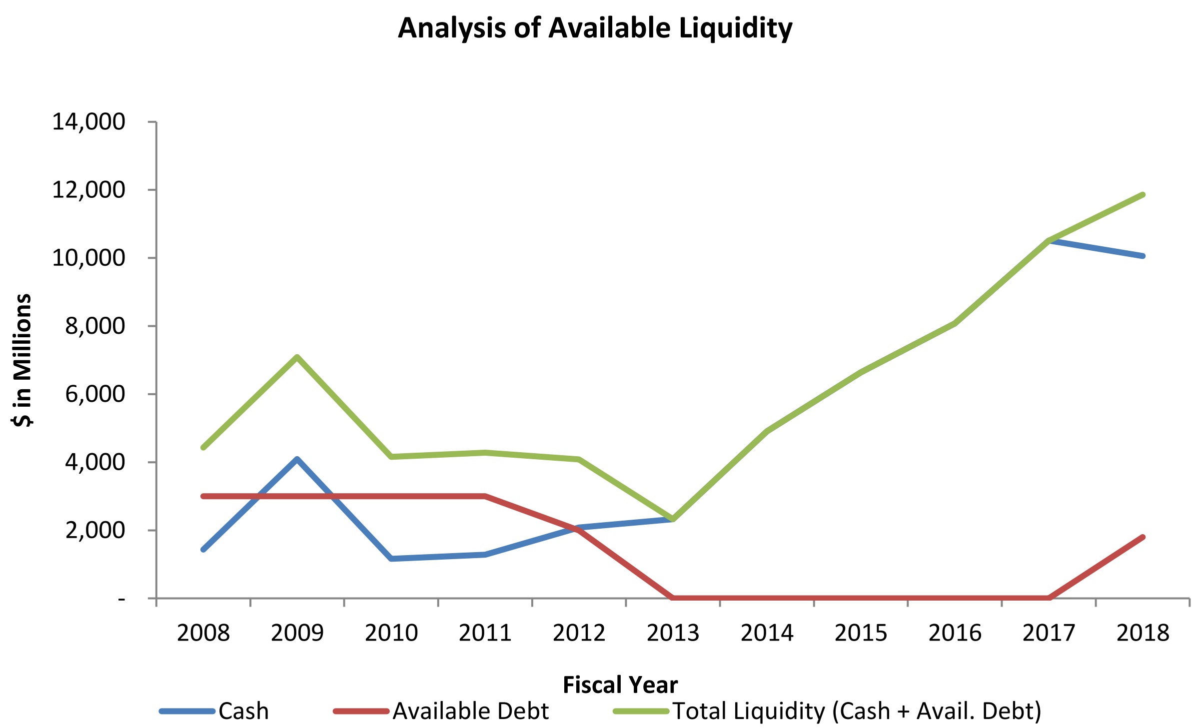
Postal Service Current Assets and Current Liabilities



In FY 2018, total current liquid assets decreased by $0.5 billion from FY 2017 and the amount of current liabilities rose by $7.6 billion, worsening the overall financial situation. Most of the increase in the current liabilities is due to the fact that the Postal Service did not make the normal costs for RHB and the amortization payments on the unfunded retirement obligations. The total net current assets were $11.6 billion at the end of FY 2018, of which $10.3 billion was cash and cash equivalents. Net current liabilities at the end of this fiscal year were $69.5 billion, which included $42.6 billion in unpaid RHB accruals for FY 2012 through FY 2018 when the Postal Service was unable to pay down the obligation along with the amortization payments on the RHB unfunded obligation. Also included in net current liabilities is $11 billion of the total $13.2 billion owed to the Federal Financing Bank. Further data on the PSRHBF and pensions are detailed later in this testimony in the additional information on personnel related costs.

These low liquidity levels in recent years have impeded the Postal Service’s ability to make capital investments in infrastructure and hindered the growth and productivity enhancements in key assets required for primary postal operations. As the Postal Service noted in the FY 2018 Form 10-K statement, it now operates an aging vehicle fleet, increasing the need, and consequently the cost, for maintenance and repair. Also unmet is the need to invest in sorting and handling equipment to fully capitalize on business opportunities in the growing package delivery markets.

According to the Postal Service’s FY 2018 Form 10-K statement, “If our operations do not generate the liquidity we require, we may be forced to reduce, delay or cancel investments in technology, facilities, and/or transportation equipment, as we have done in the recent past…. Additionally, our aging facilities, equipment and transportation fleet could inhibit our ability to be competitive in the marketplace, deliver a high quality service and meet the needs of the American public…. An aging or potentially obsolete infrastructure could result in loss of business and increased costs.”



On an *operational* basis the Postal Service’s net loss (i.e., before including the accruals for unfunded retirement health benefits, any non-cash adjustments to workers’ compensation liability, supplemental contribution to CSRS Annuity and FERS Annuity) is $2.1 billion. Most of this operational net loss can be attributed to higher operating expenses primarily driven by increases in compensation and benefits and transportation costs. Higher operating revenue of approximately $1.0 billion was not enough to offset the increase in overall expenses.

Compared to FY 2017, the Postal Service current assets decreased by $0.5 billion, primarily from a decrease in its cash position by $0.5 billion. Aging capital assets and the continued restriction in capital investment resulted in a decline in net property plant and equipment of $0.3 billion. Yet, as noted, this decrease is concerning when coupled with the continuing increase in current liabilities, primarily due to the inability of the Postal Service to make the statutorily required retiree health and pension payments into the PSRHBF and CSRDF. Overall, according to the Postal Service, it has approximately 54 days of cash available to pay basic operating expenses. The current level of Postal Service reported liquidity has improved since its low point in FY 2013, but the percentage increase from the prior year in total cash on hand plus available debt is almost the same as the percentage increase in current liabilities arising from unpaid bills for the same period.

If a downturn in the economy or other circumstance should further stress the Postal Service’s cash flow, it risks not being able to pay some of its bills and could, in a worst case scenario, run out of cash.

Analyzing Postal Service Financial Status: Profitability, Solvency, Activity, and Financial Stability

The Commission’s *Financial Analysis* report uses “ratio analysis” to measure the profitability, solvency, and financial stability of the Postal Service. As detailed in the Commission’s *Financial Analysis* reports, ratio analysis is used to conduct a quantitative analysis of information in a financial statement. Ratios are calculated from current fiscal year numbers and are then compared with previous years and historic averages to determine the Postal Service’s financial performance.

The ratios explain the Postal Service's financial health and provide valuable insight into its past performance. The financial data used in the ratio analysis is derived from accounting information not adjusted for inflation, changing demographics, industry dynamics, or government regulations. Financial analysis used in the private sector may not be directly relevant to government agencies because revenue streams, equity structures, and management incentives differ. It is also difficult to determine a single measurement that signifies financial health for a government agency. Financial performance, although not a primary indicator of success, influences the fulfillment of missions and objectives for government agencies with a service-related mission, such as the Postal Service.

The ratios calculated by the Commission for FY 2018 show a slight deterioration compared to the previous year with the majority deviating greatly from the average of the last 10 years. The Commission's *Financial Analysis* report calculates "liquidity-related ratios" as well as "key ratios" related to sustainability.

Liquidity-related ratios are one of the most widespread indicators of an agency's solvency. Calculated using the Postal Service's financial results for FY 2018, they show a decline over the prior year with values close to the historic 10-year average. The following table details the three liquidity-related ratios:

Ratio Analysis of Postal Service Financial Statements

Ratios	9/30/2018 Value	9/30/2017 Value	Change	Description of ratio	Postal Service Historic 10-Year Average Value
Current Ratio	0.17	0.20	(0.03)	This ratio is calculated by dividing current assets by current liabilities. It indicates an entity's ability to meet short term debt obligations.	0.16
Quick Ratio	0.16	0.19	(0.03)	This ratio is calculated by dividing liquid assets (cash, cash equivalents and short term investments, current receivables) by current liabilities. It is a measure of an entity's ability to meet its short term obligations using its most liquid assets (near cash or quick assets).	0.16
Cash Ratio	0.15	0.17	(0.03)	This ratio is calculated by dividing absolute liquid assets (cash, cash equivalents and short-term investments) by current liabilities.	0.12

Source - USPS FY 2015 Form 10-K Statement, USPS FY 2014 Form 10-K Statement

The FY 2018 cash ratio was 0.15—a deterioration from FY 2017. This is an improvement from the 10-year historic average—but as with the current ratio and quick ratio, the cash ratio indicates that the Postal Service does not have enough cash and/or cash equivalents (the most liquid assets) to meet all current liabilities. Current liabilities increased by 12.4 percent mostly due to the accrual of the current fiscal year's defaulted payment for amortization of unfunded retirement obligations and the RHB normal cost. At the same time, the Postal Service's current assets decreased by 4.0 percent, primarily due to the decrease in cash and cash equivalents. The Postal Service had no working capital at the end of FY 2018. The Postal Service's FY 2018 working capital was negative $57.9 billion. The net deterioration of $8.1 billion in working capital from the prior fiscal year was largely due to the growth in employee-related liabilities, including the accruals for payments for retirement obligations.

The Commission's *Financial Analysis* report assesses three key ratios for Postal Service sustainability as detailed in the following table. Ratios for the current fiscal year as seen in the debt ratio and the current liability ratio have deteriorated compared to the prior year and the historic average for the past 10 years.

Ratio Analysis of Postal Service Financial Statements

Ratios	9/30/2018 Value	9/30/2017 Value	Change	Description of ratio	Postal Service Historic 10-Year Average Value
Debt ratio (debt to assets ratio)	3.35	3.14	0.20	This ratio is calculated by dividing total liabilities (i.e. long-term and short-term liabilities) by total assets. It shows how much the company relies on debt to finance assets.	2.35
Fixed assets to Net worth ratio	(0.23)	(0.25)	0.02	This ratio indicates the extent to which the entity's cash is frozen in the form of fixed assets, such as property, plant, and equipment.	(2.29)
Current liability ratio	0.78	0.72	0.06	This ratio is calculated by dividing current liabilities by total (i.e. current and noncurrent) liabilities.	0.58

Source - USPS FY 2015 Form 10-K Statement, USPS FY 2014 Form 10-K Statement

The accruing nonpayment into the statutory unfunded retirement obligations and the current portion of debt have artificially skewed the Postal Service's current liabilities in relation to its assets. To reduce its debt ratio to historic averages, the Postal Service would have to significantly increase its current cash position or investments in capital assets and reduce its obligations.

The Postal Service's fixed assets to net worth ratio shows an insignificant improvement reflecting the slight increase in capital spending. However, the value remains at negative 0.23, a result of recurring net losses accumulated over the last decade. A negative fixed assets to net worth ratio indicates the erosion through depreciation of the entity's long term tangible business assets, a critical investment for a viable entity.

The current liability ratio reflects the Postal Service's share of short term liabilities to total liabilities at 78 percent, increasing six percentage points from the start of FY 2017. The accrual of the missed payments for retirement amortization, statutory RHBF prefunding, and RHB normal cost payments are included in current obligations, and account for the vast majority of current liabilities. An increasing current liability ratio indicates increasing obligations due to be paid within the current year. Understanding the Postal Service's liabilities is critical, especially as the cash flows generated from operations render the Postal Service unable to meet its current obligations.

Evaluating Financial Strength: Altman Z-Score

The Commission's *Financial Analysis* report also uses a financial analysis evaluating an agency's financial strength, defined as the Altman Z-Score, to calculate the possibility of bankruptcy. The users, stakeholders, and the business environment vary between the Federal Government and the private sector. Stakeholders of private sector entities use financial analysis to make investment and credit decisions, and success is often measured by the company's stock valuation. In contrast, Federal agencies are mission-oriented and measure success through the provision of service. Furthermore, unlike private sector firms, Federal agencies do not have direct shareholders whose income and wealth is affected by management decisions.

Financial analysis can be useful in both the Federal Government and the private sector. It can be used as a strategic management tool that provides the public with a concise and systematic way to organize the data in financial statements (e.g., balance sheets, income statements, and statements of cash flows) into meaningful information. The information derived from these indicators would provide the data needed to evaluate an agency's financial condition.

Financial viability is affected by a combination of environmental, economic, and organizational factors, including the decisions and actions of management and the governing board. For example, the decline in volume of First-Class Mail, which has a high-contribution margin (the decline being a negative environmental trend), can lead to the erosion of a healthy cost coverage base. However, Postal Service management's response to this decline and constraints on management flexibility also affect its financial condition.

As detailed in the Commission's *Financial Analysis* report, the Commission calculated the Altman Z-Score to predict the probability of the Postal Service running out of cash to pay its creditors. Financial analysis evaluates the financial strength of an agency through the use of a variety of metrics. In conjunction with financial ratios, these metrics are used to gauge an entity's long-term viability. However, sometimes the agency's ratios reflect conflicting views. To help eliminate confusion, New York University Professor Edward Altman developed the Z-Score in 1968 as a tool to explicitly address the likelihood that a company could go bankrupt.

A quantitative model designed to predict the financial distress of a business, the Altman Z-Score uses a blend of the traditional financial ratios and a statistical method known as multiple discriminant analysis. The formula has achieved general acceptance by management accountants and auditors.

The Commission calculates the Altman Z-Score in its *Financial Analysis* report to predict the probability of bankruptcy of an entity with the attributes of the Postal Service. The Commission uses a factor model for a private non-manufacturer to evaluate the Postal Service's financial stability as follows:

Altman Z-Score = T1+T2+T3+T4 as denoted in the tables below.

The four performance ratios in the calculations are combined into a single score by weighting. The coefficients are estimated from a set of entities that have previously declared bankruptcy. A matched sample of entities is collected and matched by industry and estimated assets.

The Commission calculates that the Postal Service's Altman Z-Score was negative 6.8 on September 30, 2018. That means that there is a high probability that the Postal Service will go into financial distress. More commonly, a lower Altman Z-Score reflects higher odds of bankruptcy. This 2018 Altman Z-Score of negative 6.8 for the Postal Service is a setback from the FY 2017 score of negative 5.9, and it is a significant deterioration from the positive score 10 years ago for FY 2006 of 0.2. Lower cash balances and unfunded retirement-related expenses decreased total assets, total liabilities and earnings compared to the prior year, resulting in deterioration from FY 2017 of three of the four ratios. Despite the results obtained, it should be mentioned that the Altman Z-Score as a predictor of the Entity's bankruptcy probability is only relative, the structure of the Postal Service's rations may be atypical, and interpreting the significance of the Z-Score would require deeper analysis by Postal Service management.

Altman Z-Score, FY 2006

Ratio	Calculation	Ratio Value on 9/30/2006	Weighting Factor	Product (col. 3 * col. 4)
1	2	3	4	5
T1	Working Capital/Total Assets	(0.3)	1.2	(0.4)
T2	Retained Earnings/Total Assets	0.2	1.4	0.3
T3	Earnings/Total Assets	0.0	3.3	0.1
T4	Capital/Total Liabilities	0.3	0.6	0.2
	Altman Z-Score			0.2

Source - Postal Service FY 2006 Form 10-K

Altman Z-Score, FY 2018

Ratio	Calculation	Ratio Value on 9/30/2018	Weighting Factor	Product (col. 3 * col. 4)
1	2	3	4	5
T1	Working Capital/Total Assets	(2.2)	1.2	(2.6)
T2	Retained Earnings/Total Assets	(2.3)	1.4	(3.3)
T3	Earnings/Total Assets	(0.1)	3.3	(0.5)
T4	Capital/Total Liabilities	(0.7)	0.6	(0.4)
	Altman Z-Score			(6.8)

Source - Postal Service FY 2018 Form 10-K

The deterioration in the Postal Service's viability relates to the erosion of retained earnings caused by consecutive net losses, the statutory obligation to prefund PSRHBF benefits, the unfunded retirement-related expenses and decreasing Retained Earnings/Total Asset ratio. A comparatively lower Working Capital/Total Assets ratio results from the continued lag in replacement of its almost fully depreciated existing assets. The significant drop in these two measures causes the negative fluctuation to the Postal Service Altman Z-Score when comparing FY 2018 with FY 2006.

Total Mail Volume: Continuing Decline

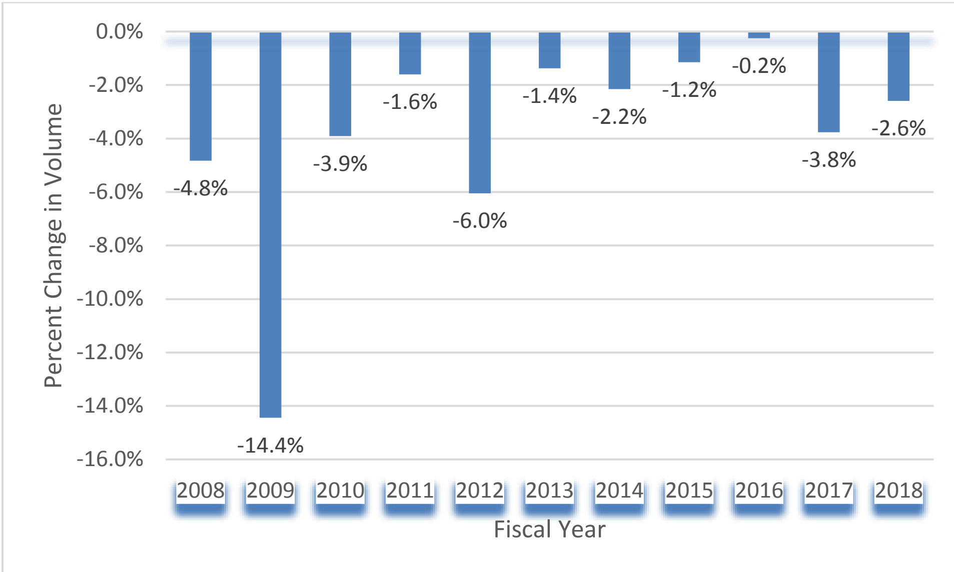
Total mail volume in 2018 dropped to levels not seen in more than 32 years, and the Postal Service anticipates further reductions in total volumes for 2019. The aggregate decline in mail volume is the result of the economic recession of 2007 along with the acceleration of a long-term trend of mail migrating to electronic media. According to the Postal Service, the volume lost to electronic alternatives is not expected to return because the movement constitutes a fundamental and permanent change in mail use by households and businesses.

Market Dominant Products: continuing decline, particularly in First-Class Mail

Over the last decade, Market Dominant products volume declined by approximately 56 billion pieces. Approximately 42 percent of the volume decline occurred in FY 2009 when Market Dominant volume declined 12 percent.

For specific products within the Market Dominant category, volume declines at different rates. In FY 2018, First-Class Mail volume declined by approximately 2.3 billion pieces, or 3.9 percent of total First-Class Mail, and Marketing Mail volume decreased by 1.1 billion pieces, or 1.4 percent of total Marketing Mail. These classes constitute the bulk of the volume of Market Dominant products overall. In FY 2018, First-Class Mail and Marketing Mail accounted for 89 percent of the total mail volume. The decline in First-Class Mail is the most troubling as First-Class Mail contributes the most to the overhead costs of the Postal Service.

Percent Change in Market Dominant Volume



Competitive Products: continuing increases but lower margin

Volumes and revenues for Competitive products, which are mainly parcels, increased 10.8 percent and 12.2 percent, respectively, in FY 2018. While Competitive products volume and revenue have grown consistently in recent years, its volume only makes up 3.9 percent of the total mail volume of the Postal Service. In addition, the margin (i.e., the overall cost coverage) on Competitive products is lower than the margin for First-Class Mail. In other words, the Postal Service earns more money from First-Class Mail than it does from Marketing Mail or Competitive product parcels.

The continuous decline in First-Class Mail volume and revenue seriously jeopardizes the Postal Service's ability to cover its fixed overhead costs.

Personnel Related Costs

In FY 2018, total personnel related expenses, including the accrual for retirement related expenses and the non-cash adjustments to the workers' compensation, increased by $1.7 billion or 3 percent from the prior year. The Postal Service continues to expense the amount payable for amortization costs of the unfunded RHB, FERS and

CSRS liabilities and the RHB normal costs, although it remains unable to make the actual payment into the funds.

Beginning in 1989, the law required the Postal Service to pay the government's share of the premium for its own annuitants. In 2006, the Office of Personnel Management (OPM) estimated that the Postal Service needed to generate $75 billion to cover benefits for all its current and future retirees. The 2006 Postal Accountability and Enhancement Act (PAEA) established the PSRHBF to collect these payments from the Postal Service. Until 2006, the Postal Service had $0 (i.e., zero, nothing) set aside to pay for its future retiree health benefits. In addition to the initial amount transferred from the Civil Service Retirement and Disability Fund of $17 billion into the PSRHBF upon enactment, the Postal Service paid $20.9 billion during the first 5 years after enactment of the 2006 law to meet this overly ambitious statutory requirement to prefund much of its future retiree health benefits. Presently, even though the Postal Service has not made any of the required payments for the past 8 years, the prefunding payments, the amortization payments to liquidate the unfunded RHB liability, or the normal costs, there is $47.5 billion in contributions and interest receivable in the PSRHBF and a current unfunded amount of $66.5 billion (this is the portion that remains unpaid by the Postal Service).

Under current law, in addition to the Postal Service paying the normal cost amounts for retiree health benefits each year, the unfunded amount of $66.5 billion less the missed payments for prior years was amortized over 40 years beginning in FY 2017. Also, in FY 2017, the PSRHBF started to pay the current year health benefits premiums.

The Postal Service funding requirements for CSRS also changed significantly in FY 2017. The Postal Accountability and Enhancement Act (PAEA) suspended the Postal Service's contributions to the Civil Service Retirement System (CSRS) until after FY 2016. OPM notified the Postal Service that the CSRS annuity and FERS annuity accounts were underfunded by $24.2 billion and $17.1 billion as of the end of FY 2017. Under current law, the unfunded liability is to be amortized over 26 years and 30 years, and the annual payment due in FY 2018 was estimated by OPM to be $1.4 billion and $958 million.

During FY 2018, the Postal Service filed two requests in accordance with the PAEA requiring the Commission to procure actuarial services to review various OPM assumptions used in calculating Postal Service retirement related liabilities. In the first request filed pursuant to Section 802(c) of the PAEA, the Postal Service asks the Commission to conduct a review of OPM's determination regarding the CSRS liability.[4] In particular, the Postal Service asks whether it is appropriate for OPM to calculate the CSRS supplemental liability on the basis of government-wide demographic and salary-growth assumptions, rather than those specific to Postal Service CSRS employees and annuitants. The Postal Service indicates that OPM has already changed its rules going forward to use new postal-specific demographic assumptions.[5] Thus, the Postal Service is further asking whether it would be appropriate to re-determine the CSRS supplemental liability payment due on September 30, 2017, using the new assumptions.

The Commission entered into a contract with Segal Consulting to provide an independent actuarial analysis of the assumptions used by OPM. The analysis concludes that the current government-wide assumptions produce valuation results that are within the range of reasonable outcomes based on generally accepted actuarial principles. However, it would be more appropriate to use postal-specific assumptions.[6] Postal-specific demographic assumptions are reflected in the amortization payment due in FY 2018 to liquidate CSRS and FERS unfunded liabilities.

In the second request filed pursuant to 5 U.S.C. § 8909a(d)(5)(A), the Postal Service asks the Commission to conduct a review of OPM's determination regarding the RHB liability.[7] In particular, the Postal Service asks whether it is appropriate and consistent with the law for OPM to calculate RHB liabilities on the basis of government-wide assumptions, rather than those specific to Postal Service employees and annuitants.

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[4] Docket No. SS2018-1, Request of the United States Postal Service for Review of the Office of Personnel Management's Determination Regarding Civil Service Retirement System Liability, November 13, 2017.
[5] *See,* 5 C.F.R. § 831.117(a).
[6] Docket No. SS2018-1, Transmittal of the Civil Service Retirement System Demographic and Salary Assumptions Report, June 11, 2018.
[7] Docket No. SS2018-2, Request of the United States Postal Service for the Commission to Conduct a Review of the Office of Personnel Management's Determination Regarding Retiree Health Benefits Liability, January 30, 2018.

The Commission entered into a contract with Segal Consulting to provide an independent actuarial analysis of the assumptions used by OPM. The analysis concludes that it was appropriate to calculate RHB liabilities on the basis of government-wide assumptions. It also concludes that it also would be appropriate to use postal-specific assumptions in that this would provide a more accurate estimate of RHB liability.[8]

In response to the RHBF Report, OPM states that it will not be revising its calculations determined as of September 30, 2016, which use government-wide assumptions. OPM states that the actuarial and economic assumptions used in these calculations were consistent with the assumptions used to determine CSRS and FERS liabilities.[9] However, OPM has issued new pension regulations that became effective October 27, 2017, which direct use of postal-specific demographic assumptions going forward.[10]

From an operations standpoint, personnel costs increased by $1.2 billion in FY 2018 – a majority of which comprises compensation and retirement benefits. Compensation increased by $769 million while retirement benefits increased by $116 million and normal costs of RHB increased by $361 million. Compensation expenses grew over the previous year mainly due to obligated salary increases and the growth in Shipping and Package volumes, where, because of the size and shape of pieces, handling requires more workhours. As noted previously, retirement benefits expenses grew consistent with general salary increases.

Summary: Significant Financial Obstacles for the Future

In summary, the Postal Service still faces significant financial obstacles for the future. With the growing liability of unfunded retirement related obligations, the inability to borrow for needed capital investments, and the continued loss of high margin First-Class Mail revenues, the important task of improving the financial condition of the Postal Service is daunting. Total liabilities exceed total assets by $63 billion.

[8] Docket No. SS2018-2, Transmittal of the Retiree Health Benefit Fund Liability Examination Report, August 8, 2018 (RHBF Report).
[9] *See*, SFFAS 5, par. 83.
[10] Docket No. SS2018-2, Letter from OPM, February 20, 2019.