AUDIT REPORT

Opinion on the U.S. Postal Service's Fiscal Year 2020 Reclassified Financial Statements

November 16, 2020

Report Number 20-269-R21

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MEMORANDUM FOR: JOSEPH CORBETT
CHIEF FINANCIAL OFFICER AND EXECUTIVE
VICE PRESIDENT

FROM: TAMMY L. WHITCOMB
INSPECTOR GENERAL

SUBJECT: Audit Report – Opinion on the U.S. Postal Service's Fiscal Year 2020 Reclassified Financial Statements
(Report Number 20-269-R21)

Report on the Reclassified Financial Statements

We have audited the accompanying Reclassified Financial Statements of the U.S. Postal Service which comprises the Government-wide Treasury Account Symbol Adjusted Trial Balance System (GTAS) Reconciliation Report – Reclassified Balance Sheet as of September 30, 2020, and the related GTAS Reconciliation Reports – Reclassified Statement of Net Cost and Reclassified Statement of Changes in Net Position, for the year then ended (hereinafter referred to as reclassified financial statements) and accompanying Note 44 (Project Number 20-269).

Management's Responsibility for the Reclassified Financial Statements

Management is responsible for the preparation and fair presentation of these reclassified financial statements in accordance with U.S. generally accepted accounting principles (GAAP); this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the reclassified financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these reclassified financial statements based on our audit. We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB); the standards applicable to financial audits contained in U.S. *Government Auditing Standards*, issued by the Comptroller General of the U.S.; and Office of Management and Budget (OMB) Bulletin Number 19-03, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the reclassified financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the reclassified financial statements. The procedures selected depend on the auditor's judgment, including assessments of risk of material misstatement of the reclassified financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the agency's preparation and fair presentation of the reclassified financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the agency's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant estimates made by management, as well as evaluating the overall presentation of the reclassified financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinion

In our opinion, the reclassified financial statements referred to above present fairly, in all material respects, the financial position of the Postal Service as of September 30, 2020, and its net costs and changes in net position for the yearthen ended in accordance with U.S. GAAP.

Emphasis of Matter

The Budget and Accounting Procedures Act of 1950 allows the Secretary of the Treasury to stipulate the format and requirements of executive agencies to furnish financial and operational information to the President and the Congress to comply with the Government Management Reform Act of 1994 (GMRA) (Pub. L. Number 103-356), which requires the Secretary of the Treasury to prepare and submit annual audited financial statements of the executive branch. The Secretary of the Treasury developed guidance in U.S. Department of the Treasury's TFM Chapter, Volume 1, Part 2, Chapter 4700 (TFM 2-4700) to provide agencies with instructions to meet the requirements of GMRA. The TFM 2-4700 requires agencies to submit a GTAS adjusted trial balance which Treasury uses to populate a Reclassified Balance Sheet, Reclassified Statement of Net Cost, and Reclassified Statement of Changes in Net Position.

The reclassified financial statements were prepared in accordance with the requirements of the TFM 2-4700 for the purpose of providing financial information to the Treasury and the U.S. Government Accountability Office (GAO) to use in preparing and auditing the *Financial Report of the U.S. Government,* and are not intended to be a complete presentation of the balance sheet of the Postal Service as of September 30, 2020, as required by the Postal Reorganization Act of 1970, as amended, and the related statements of operations, cash flows, and changes in net position (hereinafter referred to as general-purpose financial statements[1]).

As allowed by the Statements of Federal Financial Accounting Standards (SFFAS) Number 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, the Postal Service prepares and reports its fiscal year (FY) 2020 reclassified financial statements in accordance with accounting and reporting standards issued by the Financial Accounting Standards Board (FASB). Whereas, other federal agencies prepare and report their financial statements in accordance with accounting and reporting standards issued by the Federal Accounting Standards Advisory Board (FASAB).

The Postal Service changed its method of accounting for leases effective FY 2020, due to the adoption of Accounting Standards Update (ASU) Number 2016-02, Leases (Topic 842). The FASAB new standard[2] on leases will be effective beginning with reporting periods after September 30, 2023.The FASB standard for leases requires the Postal Service to record most leases on its balance sheets; and, as the lessee, to recognize a lease liability for the obligation to make lease payments and a right-of-use asset for the right to use the underlying asset for the lease term. The FASAB current standard requires other federal agencies to classify leases between capital and operating leases, in which, under operating leases, the lessee does not assume the risk of ownership of the asset and the lease expense is treated as an operating expense and does not affect the balance sheet. Due to the differing lease standards, the Postal Service's FY 2020 reclassified balance sheet lines, *Other Liabilities* (non-federal) and *General property, plant, and equipment, net* may not be comparable to other federal agencies.

Intragovernmental Transactions Differences

U.S. Department of Defense (DoD)

The DoD is responsible for transporting mail from overseas military facilities to Postal Service facilities and between overseas military Postal Service facilities. Operationally, the Postal Service transports the mail on behalf of DoD, and the DoD reimburses the

[1] The Postal Service general-purpose financial statements are published on the Security and Exchange Commission Form 10-K, as prescribed by the Postal Accountability and Enforcement Act of 2006 (PAEA) (PL-109-435).
[2] SFFAS Number 54, *Leases*.

Postal Service for fees paid for transporting this mail. The Postal Service records these amounts as net revenue, recognizing a contra-expense for the reimbursable amounts because it invoices the DoD only to cover expenses.

During FY 2015, in a dispute resolution ruling, Treasury determined the Postal Service should record this activity as revenue. The Postal Service maintains that the accounting treatment of the reimbursable military expenses as an offset to expense is appropriate and in accordance with GAAP promulgated by the FASB. For the year ended September 30, 2020, the Postal Service reported approximately $109 million, $43 million and $38 million in contra-expense with the Department of the Army, Department of the Air Force, and the Department of the Navy, respectively. Reciprocating activity was not reported by the Department of the Army or the Department of the Air Force, resulting in a difference of approximately $152 million.

Office of Personnel Management (OPM) Imputed Cost

OPM, on behalf of federal entities, manages the governmentwide employee benefit programs that provide retirement, health benefits, and life insurance to federal employees. FASAB standards require federal entities to recognize an imputed cost from OPM, because the cost to the federal government to provide a future retirement benefit to most employees is higher than the combined employer and employee contributions.[3] Imputed costs reflect the amount by which the cost to the federal government of an employee benefit exceeds the amount contributed by employees and their employers. This requirement is applicable to all retirement, health and life insurance benefit programs.

The Postal Service prepares its financial reports in accordance with GAAP promulgated by the FASB. GAAP requires the Postal Service to account for retirement, health, and life insurance benefit programs under multi-employer accounting rules, and expense is recognized for each period's legally required contribution.

Prior to FY 2019, the Postal Service converted its financial statements from FASB GAAP to FASAB GAAP and reported an imputed cost or benefit in its adjusted trial balance provided to the Bureau of Fiscal Service (Fiscal Service). Effective FY 2019, Treasury[4] eliminated the need for conversion. Therefore, for FY 2020, the Postal Service will not report this imputed cost in its adjusted trial balance. The Postal Service calculated an imputed cost of approximately $117 million for FY 2020.

Cash Held Outside of Treasury

The Postal Service is a Non-Treasury Disbursing Officer of the U.S. government, authorized to issue payments itself, rather than through the Treasury. However, the Postal Service is still required under 39 U.S.C. § 2003 to deposit all collections into the U.S. Treasury, except as provided by another law.

[3] SFFAS Number 5, *Accounting for Liabilities of The Federal Government*.
[4] TFM 4705.25, Special Basis of Accounting.

As an agency that has authority to issue Treasury checks, the Postal Service prepares and submits a monthly report that provides the balance of funds that the Postal Service considers in-transit to the Treasury.

The Fiscal Service considers this balance as cash held outside of Treasury and reports the amount as an asset of the General Fund. To reciprocate, the Fiscal Service has requested that the Postal Service report the balance as a liability to the General Fund.

The Postal Service maintains that reporting this balance as a liability will misrepresent its financial position. Unlike other federal entities, Postal Service collections are not receipts of the U.S. government, and are not a liability of the Postal Service. While funds are in-transit to the General Fund, and will ultimately be reported within the *Fund Balance With Treasury*, the amounts are not due to the General Fund. The Postal Service and the Fiscal Service agree that this balance as of September 30, 2020, is $453 million.

<u>Office of Personnel Management (OPM) Loss Allowance on Intragovernmental Receivables</u>

The U.S. Postal Service participates in three retirement plans: the Civil Service Retirement System (CSRS), the Federal Employees Retirement System (FERS), and the Postal Service Retiree Health Benefits (RHB). The first two are pension plans and the third is set up to fund the Postal Service's share of RHB premiums. The OPM administers these programs, including measurement of liabilities.

The Postal Service is required to contribute to FERS at rates specified by OPM and to make amortization payments for the unfunded liability.[5] It is also required to make amortization payments to pay down the unfunded liability of CSRS when OPM determines that such payments are necessary. The Postal Service has not made the required payments to amortize the unfunded liabilities of FERS and CSRS.[6]

PAEA established the Postal Service Retiree Health Benefit Fund (PSRHBF) and required the Postal Service to prefund retiree health benefits from FY 2007 through FY 2016. Beginning in FY 2012, the Postal Service defaulted on the statutorily-mandated prefunding payments. In FY 2017, the PSRHBF began funding the Postal Service share of retirement benefit premiums and the Postal Service was required to begin paying normal costs[7] and amortize the unfunded liability; the Postal Service did not make any required retiree health benefits payments from FY 2017 through FY 2020.

[5] An unfunded liability is defined as the difference between the estimated liability or commitment to current and future retirees and the assets set aside to fund benefits.
[6] For CSRS, amortization payments from FY 2017 through FY 2020 are due. For FERS, amortization payments from FY 2014 through FY 2020 are due.
[7] The amount established by OPM as the employer portion of retirement benefits attributable to active employees' current year of service.

As of September 30, 2020, the Postal Service has defaulted on the required payments of $63.2 billion for the pension and health benefits programs. OPM stated in their FY 2020 invoices for CSRS, FERS and PSRHBF that, "starting FY 2020, OPM will report and recognize the uncollected $63.2 billion contributions receivable from the Postal Service as a $0 realizable value as clarified in the new FASAB Technical Bulletin (TB) 2020-1 (*Loss Allowance on Intragovernmental Receivables*)."

The Postal Service has stated that, since it still has a legal obligation to make these payments, it has not made changes to its accounting policy and continues to report $63.2 billion as current liabilities.

Other Matters

Opinion on the General-Purpose Financial Statements

The Postal Service's independent public accounting (IPA) firm has audited, in accordance with the standards of the PCAOB, auditing standards generally accepted in the U.S., and the standards applicable to financial audits contained in U.S. *Government Auditing Standards* issued by the Comptroller General of the U.S., the general-purpose financial statements of the Postal Service as of and for the years ended September 30, 2020 and 2019, and its report thereon, dated November 13, 2020, expressed an unqualified opinion on those financial statements.

Additionally, in its unqualified opinion on the FY 2020 general-purpose financial statements, dated November 13, 2020, the IPA firm emphasized liquidity matters discussed in the Postal Service's general-purpose financial statement disclosures. That view should be read in conjunction with this report.

Restriction on Use of the Report on the Reclassified Financial Statements

This report is intended solely for the information and use of the management of the Postal Service, Treasury, OMB, and GAO in connection with the preparation and audit of the *Financial Report of the U.S. Government* and is not intended to be and should not be used by anyone other than these specified parties.

Other Reporting Required by Government Auditing Standards

In accordance with the standards of the PCAOB, auditing standards generally accepted in the U.S., and *Government Auditing Standards*, the Postal Service's IPA firm issued a report[8] dated November 13, 2020, on its consideration of the Postal Service's internal control over financial reporting and the results of its tests of the Postal Service's compliance with certain provisions of laws, regulations, and contracts that are required to be reported under *Government Auditing Standards*. This report is an integral part of an audit performed in accordance with PCAOB, *Government Auditing Standards,* and

[8] *Report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with Government Auditing Standards*, dated November 13, 2020.

OMB Bulletin Number 19-03 in considering the Postal Service's internal control and compliance, and should be read in conjunction with this report in considering the results of our audit of the reclassified financial statements.

In the IPA firm's report on its consideration of the Postal Service's internal control over financial reporting, the auditor did not identify any deficiencies in internal control over financial reporting considered to be significant deficiencies or material weaknesses as of September 30, 2020. Two significant deficiencies included in the IPA firm's 2019 report were remediated in 2020.

Lack of Comprehensive Policies and Procedures Designed to Revoke the Access of Former Employees to Postal Service Systems on a Timely Basis

In FY 2019, the Postal Service determined that due to a lack of comprehensive policies and procedures over system access for former employees, former employees' access to Postal Service financially-relevant systems was not being revoked on a timely basis.

During FY 2020, Postal Service management remediated this matter through system changes, additional communications and training, and other similar activities. Management also implemented an additional monitoring control to verify that no inappropriate activities resulted from the untimely removal of access. The IPA firm, based on their evaluation and testing, concluded the significant deficiency related to the lack of comprehensive policies and procedures over system access for former employees was remediated as of September 30, 2020.

Lack of Precision in the Review of a Portfolio of Transportation Contracts for the Implementation of ASC 842, Leases

The Postal Service implemented Accounting Standards Update 2016-02, Leases, codified in Accounting Standards Code (ASC) 842, on October 1, 2019. As part of its implementation efforts, Postal Service management identified a portfolio of transportation contracts that should be accounted for as leases under ASC 842. An error was made in determining the estimated lease liability and corresponding right-of-use asset for this portfolio of transportation contracts. For the financial statements for the year ended September 30, 2019, this error (which was corrected when identified and prior to the filing of the 2019 financial statements) affects the note disclosures of the estimated impact of adoption of ASC 842. While a review control was in place that should have identified this error, it was not operating at a sufficient level of precision to detect the error. Furthermore, no compensating controls were in place to detect the error.

During FY 2020, Postal Service management remediated this matter by implementing an additional review control related to the interpretation of contract portfolios and the determination of the estimated lease liability and corresponding right-of-use asset. The IPA firm, based on their evaluation and testing, concluded the significant deficiency related to the lack of precision in the review of a portfolio of transportation contracts was remediated as of September 30, 2020.

Compliance and Other Matters

The IPA firm also noted instances of non-compliance with laws and regulations. The Postal Service failed to comply with various laws when it defaulted on retirement and retiree health benefit obligations from FY 2012 through FY 2020. Table 1 provides RHB payments due by fiscal year-end as required by PAEA.

Table 1. Retiree Health Benefit Fund Payments Required by PAEA[9]

Fiscal Year-End Due Date	Payment Type	Amount (in Millions)
2012 through 2016	Retiree Health Benefit Prefunding	$33,900
2017	Normal Cost	3,300
	Unfunded Liability Amortization	955
2018	Normal Cost	3,700
	Unfunded Liability Amortization	815
2019	Normal Cost	3,800
	Unfunded Liability Amortization	789
2020	Normal Cost	3,900
	Unfunded Liability Amortization	810

Source: U.S. Postal Service Non-Compliance Letter, dated November 5, 2020.

[9] Title 5, U.S.C. §8909a(d)(3)(A) requires prefunding through FY 2016. Title 5, U.S.C. §8909a(d)(3)(B) requires calculation and payment of normal costs and unfunded liability amortization beginning in FY 2017.

Table 2 provides CSRS and FERS payments due by fiscal year-end.

Table 2. CSRS and FERS Required Payments

Type of Payment	Fiscal Year-End Due Date	Amount (in Millions)
CSRS Supplemental Liability[10]	2017	$1,700
	2018	1,400
	2019	1,600
	2020	1,800
FERS Supplemental Liability[11]	2014 through 2016	495
	2017	917
	2018	958
	2019	1,100
	2020	1,300

Source: U.S. Postal Service Non-Compliance Letter, dated November 5, 2020.

Postal Service management concurred with the reported instances of noncompliance related to the non-payments. As of November 13, 2020, the Postal Service has suffered no penalties or damages because of its inability to make these payments.

Internal Control over Financial Reporting Specific to the Reclassified Financial Statements

In planning and performing our audit of the reclassified financial statements as of, and for the year ended September 30, 2020, we also considered the Postal Service's internal control over the financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the reclassified financial statements, but not for the purpose of expressing an opinion of the effectiveness of Postal Service's internal control. Accordingly, we do not express an opinion on the effectiveness of Postal Service's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as previously discussed, the IPA firm identified deficiencies in internal control that they considered to be significant deficiencies. These significant deficiencies were remediated as of September 30, 2020.

[10] Title 5 of the U.S. Code §8348(h)
[11] Title 5 of the U.S. Code §8423(b)

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit the attention by those charged with governance. Apart from the significant deficiencies previously mentioned, we found no material weaknesses or significant deficiencies in internal control over the financial reporting process that are required to be reported under *Government Auditing Standards* and OMB Bulletin Number 19-03.

Compliance and Other Matters Specific to the Reclassified Financial Statements

As part of obtaining reasonable assurance about whether the Postal Service's reclassified financial statements are free from material misstatement, we also performed tests of its compliance with certain provisions of TFM 2-4700, noncompliance with which could have a material effect on the reclassified financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit of the reclassified financial statements and, accordingly, we do not express such an opinion. The results of our tests did not disclose any instances of noncompliance that would be required to be reported herein under *Government Auditing Standards* and OMB Bulletin Number 19-03.

Management's Comments

We provided a draft of this report to Postal Service management for their review and comment. Management stated they did not have any substantive comments. They also stated they will continue to improve and enhance their financial reporting, processes, and internal controls.

Purpose of the Other Reporting Required by Government Auditing Standards

The purpose of the communication provided in the Other Reporting Required by *Government Auditing Standards* section is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Postal Service's internal control or on compliance.

This communication is an integral part of an audit performed in accordance with U.S. generally accepted government auditing standards in considering internal control and compliance with provisions of laws, regulations, and contracts which could have a material effect on the reclassified financial statements. Accordingly, this communication is not suitable for any other purpose.

cc: Secretary of the Board of Governors
Corporate Audit and Response Management