December 30, 2010

VINCENT H. DEVITO, JR.
VICE PRESIDENT, CONTROLLER

SUBJECT: Audit Report – Fiscal Year 2010 Financial Statements Audit – Eagan Information Technology and Accounting Service Center (Report Number FT-AR-11-005)

This report presents the results of our audit of the selected financial activities and accounting records at the U.S. Postal Service Eagan, MN, Information Technology and Accounting Service Center (IT/ASC) for the fiscal year (FY) ended September 30, 2010 (Project Number 10BM001FT000). We conducted this audit in support of the independent public accounting (IPA) firm's overall audit opinions on the Postal Service's financial statements and internal controls over financial reporting.[1] This audit addressed financial risk. See Appendix A for additional information about this audit.

The Postal Reorganization Act of 1970, as amended, requires annual audits of the Postal Service's financial statements. Also, the U.S. Congress enacted Sarbanes-Oxley (SOX) legislation in calendar year (CY) 2002 to strengthen public confidence in the accuracy and reliability of financial reporting. Section 404 of SOX requires management to state its responsibility for establishing and maintaining an adequate internal control structure and make an assertion on the effectiveness of the internal control structure over financial reporting. The Postal Accountability and Enhancement Act of 2006 requires the Postal Service to comply with Section 404 of the SOX Act of 2002 beginning in FY 2010. The Board of Governors contracted with the IPA to express an opinion on the Postal Service's financial statements, and beginning in FY 2010, that responsibility was expanded to include an opinion on the Postal Service's internal control over financial reporting.

Conclusion

During our audit of the Eagan IT/ASC we noted:

- Financial accounting policies and procedures of the Postal Service provide for an adequate internal control structure[2] and comply with accounting principles generally accepted in the U.S.

[1] The IPA maintains overall responsibility for testing and reviewing significant Eagan IT/ASC accounts and processes. The U.S. Postal Service Office of Inspector General (OIG) coordinated audit work with the IPA to ensure adequate coverage.
[2] To ensure key controls are properly designed and operationally effective.

- Accounting transactions at the Eagan IT/ASC impacting the general ledger account balances for assets, liabilities, equity, income, and expenses of the Postal Service are fairly stated in accordance with accounting principles generally accepted in the U.S.

- General ledger account balances conform with the general classification of accounts of the Postal Service on a basis consistent with that of the previous year.

- The Postal Service is in compliance with laws and regulations that have a direct and material effect on the financial statements taken as a whole.

We did not propose any adjustments, but we did identify an issue regarding territorial cost-of-living that was communicated to management through an interim report.[3] This item was not material to the financial statements and did not affect the overall adequacy of internal controls. Also, throughout the year, we reviewed internal controls over financial reporting and identified control deficiencies[4] regarding payment certification and payroll. Because these controls are considered key,[5] any error could impact the IPA's opinion on internal controls over financial reporting. Therefore, we brought them to management's attention at the time of discovery to assist them with their responsibility for establishing and maintaining an adequate internal control structure over financial reporting. The IPA identified additional information system control deficiencies affecting the Eagan IT/ASC that were not in the scope of our audit and are not reported here, including monitoring controls, missing or incomplete documentation, no evidence of review, and access to systems not timely being removed. The IPA informed management of these issues on November 2, 2010.

Payment Certification

The Postal Service processed payments certified by an officer without a valid signature/designation card on file. Specifically, personnel inadvertently omitted an employee from the certifying officer list sent from St. Louis to the Eagan Disbursing Branch, and Eagan Disbursing Branch personnel correctly revoked the person's authority. However, disbursing personnel continued to process payments with the employee's certification. This occurred because disbursing branch personnel did not always verify the certifying officer was on the authorized certifying officer list[6] before releasing payments. Postal Service policy[7] requires disbursing officers to examine Postal Service (PS) Forms 1865, Voucher and Schedule of Payments, for proper

[3] *Territorial Cost-of-Living Allowance* (Report Number FT-AR-10-012, dated August 16, 2010).
[4] A control deficiency 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.
[5] A key control is a control that, if it fails, there is at least a reasonable likelihood that a material error in the financial statement would not be prevented or detected on a timely basis.
[6] The *Certifying Officer List* is generated by various ASC managers identifying employees who have the authority to certify disbursement of funds for the Postal Service.
[7] Handbook F-19, *Accountability of Disbursing Officers*, Section 223, dated September 1991.

completion, correct certification, and accurate computation. From June 17 through July 20, 2010, personnel received PS Forms 1865 from the St. Louis ASC totaling $148.9 million. Although the total amount and number of checks released were accurate in this case, when employees do not validate certifying officials, there is a risk of improper payment.

We notified management of the error and they immediately updated the certifying officer list. In addition, they implemented additional controls to prevent future improper certification of payments. We previously reported this issue and management stated they would confirm deletions prior to revoking signature/designation cards and compare certifying official signatures on payment vouchers to those on signature/designation cards[8] for verification. We will continue to monitor this issue as part of our ongoing financial statement audit work. See Appendix B for calculation of other impact.

Management's Comments

Management agreed with the finding and the other impact amount but disagreed with the categorization of the other impact as "Disbursements at Risk." They stated it may lead readers to misinterpret the risk relative to the payments involved. Furthermore, although management agreed with the importance of the certifying officer validation, they emphasized that there are several other compensating controls in place that greatly reduce the risk of improper payments. Management immediately updated the certifying officer list and implemented additional controls on July 21, 2010. See Appendix C for management's comments in their entirety.

Evaluation of Management's Comments

Although the report does not contain any recommendations, we consider management's comments responsive to the finding. Regarding the categorization of other impact, OIG policy is to consider disbursements made without following proper controls and processes as Disbursements at Risk. Although we acknowledge other compensating controls are in place, this control is considered key for financial reporting purposes and any error could impact the IPA's opinion on internal controls over financial reporting. Therefore, we continue to believe the categorization is accurate.

Payroll

The *Time and Attendance System Close Out Report* was not accurate for Postal Service pay periods 15 through 17 for calendar year 2010. This occurred because there was an error in the formula used to determine the percentage of time records closed and processed. Management uses this report to review all non-rural employee time records to ensure that 99.9 percent of payroll expenses and liabilities are properly stated. Without an accurate threshold calculation, management may inaccurately conclude that a sufficient number of employee time records have been processed. We

[8] *Internal Controls over Receipt and Disbursing Activities* (Report Number FT-AR-07-006, dated December 21, 2006).

notified management of the error and they corrected the formula. We will continue to monitor this issue as part of our ongoing financial statement audit work.

Management's Comments

For payroll, management agreed in part with the finding. They agreed that the Time and Attendance System Close Out report did have an error and that it was corrected in pay period 17, calendar year 2010. However, they disagreed that the error would have caused an inaccurate conclusion since the close out report also contains other totals that would identify the number of failed records. In addition, management stated the finding failed to acknowledge that the processed records and the reviewed and approved reports for pay periods 15 through 17, calendar year 2010, exceeded the established threshold. Management implemented the error correction prior to pay period 18 of calendar year 2010.

Evaluation of Management's Comments

Although the report does not contain any recommendations, we consider management's comments responsive to the finding. We acknowledge there are other totals that would identify the number of failed records and that the processed records and the reviewed and approved reports exceeded established thresholds for the stated pay periods. However, this control is considered key for financial reporting purposes and any error could impact the IPA's opinion on internal controls over financial reporting. Therefore, we continue to believe the accuracy of this report is critical to ensuring the correct percentage of time records closed and processed.

Progress on Prior Years' Recommendations

In FY 2005, we reported[9] that the Postal Service did not always follow Internal Revenue Service (IRS) employment tax regulations for reporting salary overpayments. We recommended that management revise policy to comply with IRS regulations, establish accounts receivable for gross amounts due, and inform employees of tax implications. In January 2010, management generated account receivable invoices for gross amounts due for prior year salary overpayments and notified employees of the IRS tax regulations. By December 31, 2010, management will implement a revised process for current year salary overpayments. Specifically, they will generate an account receivable invoice for the net amount due and, if the receivable is not repaid by December 31 of the current calendar year, management will consider the outstanding amount taxable income and establish an additional receivable for the applicable taxes due. If management processes these changes as planned, it will satisfy our recommendations.[10] We will continue to monitor this area as part of our annual financial statement audit work.

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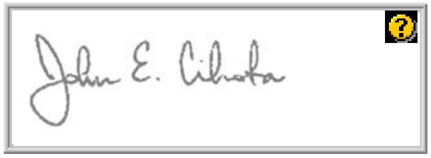
[9] *Reporting Salary Overpayments to the Internal Revenue Service* (Report Number FT-MA-05-002, dated September 28, 2005).

[10] We did not classify the recommendations as significant in our audit report.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Lorie Nelson, director, Financial Reporting, or me at 703-248-2100.



John E. Cihota
Deputy Assistant Inspector General
for Financial Accountability

Attachments

cc: Joseph Corbett
Stephen J. Nickerson
Jean D. Parris
Dean R. Rodman
Steven R. Phelps
Julie S. Moore

APPENDIX A: ADDITIONAL INFORMATION

BACKGROUND

The Eagan IT/ASC is one of three ASCs Postal Service-wide.[11] The Eagan IT/ASC functions as a large, centralized accounting and disbursement center and its employees are responsible for processing payroll, maintaining the general ledger, reconciling financial data, and maintaining cash and receivable accounts.

We will issue separate financial statement audit reports for headquarters and the St. Louis and San Mateo IT/ASCs. Further, in addition to the overall opinions on the Postal Service's financial statements and internal control over financial reporting, the Board of Governors' IPA issued a separate report on its consideration of the Postal Service's internal controls and its test of compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report was to describe the scope of testing of internal control over financial reporting and compliance and the results of that testing, not to provide an opinion on internal control over financial reporting or on compliance.[12] The OIG will also issue a separate report for the audit of the FY 2010 information system controls at the Eagan, San Mateo, and St. Louis IT/ASCs; and the Raleigh Information Technology Service Center.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of the audit were to determine whether:[13]

- Financial accounting policies and procedures of the Postal Service provide for an adequate internal control structure[14] and comply with accounting principles generally accepted in the U.S.

- Accounting transactions at the Eagan IT/ASC that impact the general ledger account balances for assets, liabilities, equity, income, and expenses of the Postal Service are fairly stated in accordance with accounting principles generally accepted in the U.S.

- General ledger account balances conform to the general classification of accounts of the Postal Service on a basis consistent with that of the previous year.

- The Postal Service complies with laws and regulations that have a direct and material effect on the financial statements taken as a whole.

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[11] Other IT/ASCs are located in St. Louis, MO and San Mateo, CA.
[12] In addition to the IPA's work, these reports encompass work the OIG performed at headquarters, the three IT/ASCs, field sites, and the Raleigh, NC Information Technology Service Center.
[13] The IPA maintains overall responsibility for testing and reviewing significant Eagan IT/ASC accounts and processes. The OIG coordinated audit work with the IPA to ensure adequate coverage.
[14] To ensure key controls are properly designed and operationally effective.

As part of our audit, we assessed internal controls, tested transactions, and verified account balances. We conducted this audit from November 2009 through January 2011 in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB) and the standards applicable to financial audits contained in the *Government Auditing Standards* issued by the comptroller general of the U.S. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to limit audit risk to a low level that is, in our professional judgment, appropriate for supporting the overall audit opinion on financial statements. Those standards also require considering the results of previous engagements and following up on known significant findings and recommendations that directly relate to the objectives of the audit. An audit also requires a sufficient understanding of internal controls to plan the audit and determine the nature, timing, and extent of audit procedures to be performed. We believe the evidence obtained provides a reasonable basis for our conclusion based on our audit objectives.

We supported the IPA in obtaining reasonable assurance about whether the financial statements were free of material misstatements (whether caused by error or fraud). Absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. Therefore, an audit conducted in accordance with PCAOB and *Government Auditing Standards* may not detect a material misstatement. However, external auditors and the OIG are responsible for ensuring that appropriate Postal Service officials are aware of any significant deficiencies that come to our attention. We discussed our conclusions with management officials on November 28, 2010, and included their comments where appropriate.

We relied on computer-generated data from a number of Postal Service financial systems, including the following.

- Accounting Enterprise Data Warehouse Reporting
- National Accounting Oracle Financial Application
- Time and Attendance Systems
- Accounts Receivable-Oracle
- Standard Accounting For Retail T-Recs (Chesapeake Reconciliation)
- Returned and Check Management System
- Commercial Check Tracking System
- Payroll Systems
- SAP Human Capital Management
- Employee Personnel Action History
- PostalEASE
- Eagan Accounts Payable System
- National Meter Accounting Tracking System
- Payment Switch

To assess the reliability of these systems' data, we performed specific internal control and transactions tests, including tracing selected financial information to supporting source records. For example, we traced payroll system reports to original *Notification of Personnel Action* documentation. We determined that the data were sufficiently reliable for the purposes of this report.

PRIOR AUDIT COVERAGE

We issued the following reports addressing selected financial activities and accounting records at the Eagan IT/ASC.

Report Title	Report Number	Final Report Date	Report Results
Fiscal Year 2009 Postal Service Financial Statements Audit – Eagan Information Technology and Accounting Service Center	FT-AR-10-004	11/20/2009	We did not report any adjustments or significant issues and did not make any recommendations. Management took corrective action during our audit to document evidence when evaluating payroll processing.
Fiscal Year 2008 Postal Service Financial Statements Audit – Eagan Information Technology and Accounting Service Center	FT-AR-09-002	11/20/2008	We did not report any adjustments or significant issues and did not make any recommendations. Management took corrective action during our audit regarding Federal Employees' Retirement System Contribution Rates.
Internal Controls over Receipt and Disbursing Activities	FT-AR-07-006	12/21/2006	Personnel processed payments certified by an officer without a valid signature/designation card on file and employees commingled funds with personal accounts. Management agreed with our recommendations and enhanced controls over disbursing activities and, during our audit, discontinued depositing cash into employee personal accounts to convert to checks.
Management Advisory – Reporting Salary Overpayments to the Internal Revenue Service	FT-MA-05-002	9/28/2005	See the "Progress on Prior Years' Recommendations" section of this report.

APPENDIX B: OTHER IMPACT

We calculated total disbursements during the time where an employee did not have a valid signature/designation card on file but continued to certify payments as follows:

Disbursements at Risk[15]

Date of PS Form 1865	Disbursement Amount
June 17, 2010	$2,289,048
June 18, 2010	9,416,945
June 21, 2010	56,074,161
June 23, 2010	5,223,534
June 24, 2010	3,249,066
June 25, 2010	2,578,648
June 28, 2010	5,823,640
June 29, 2010	6,041,130
June 30, 2010	3,345,616
July 1, 2010	5,161,784
July 2, 2010	2,373,990
July 6, 2010	6,944,368
July 7, 2010	3,566,689
July 8, 2010	4,346,645
July 9, 2010	3,294,649
July 12, 2010	3,082,954
July 14, 2010	6,922,868
July 15, 2010	3,259,409
July 16, 2010	11,166,020
July 19, 2010	1,946,564
July 20, 2010	2,832,692
Total Impact	**$148,940,420**

[15] Disbursements made without following proper Postal Service internal controls and processes.

APPENDIX C: MANAGEMENT'S COMMENTS

VINCENT DEVITO
VICE PRESIDENT, CONTROLLER

UNITED STATES
POSTAL SERVICE

December 17, 2010

LUCINE WILLIS
DIRECTOR, AUDIT OPERATIONS

Subject: Fiscal Year 2010 Financial Statements Audit—Eagan Information Technology and Accounting Service Center (Report Number FT-AR-11-DRAFT)

Thank you for the opportunity to review and comment on the findings of the draft audit report. Since the audit concluded that the Postal Service was in compliance with laws and regulations that have a direct and material effect on the financial statements, the following comments focus on two of the findings addressed in the report:

Finding: Payroll
Management agrees in part with the finding. As stated, Time and Attendance System Close Out Report did have an error in the calculation of the percentage of closed time records. Also, the error was corrected subsequent to pay period 17. Management disagrees that the error would have caused an inaccurate conclusion that a sufficient number of employee time records had been processed. We disagree with this statement because the report also contains the raw number of total and failed records. The raw number of total and failed records is an equally valid indicator that can be used to ensure that payroll expenses and liabilities are properly stated. The finding also fails to acknowledge that the processed records and the reviewed and approved reports for each pay period (15-17) did in fact exceed the established threshold.

The correction to the formula was implemented prior to pay period 18 of calendar year 2010, and the responsible postal official was Larry Cruse, Manager, Payroll.

Finding: Payment Certification
Management agrees with the finding and "Other Impact" amount of $148.9 million, but wishes to note that the categorization of the payments as 'disbursements at risk' has strong connotations and may lead readers of the report to misinterpret the level of risk relative to the payments involved. Simply labeling them 'disbursements' would seem to provide sufficient information. Though we understand the importance of the certifying official validation, we also want to emphasize that there are several other internal and compensating controls in place such as segregation of duties, support documentation requirements, and controlled access to payment systems that greatly reduce the chances of improper payments, irrespective of the certifying official validation.

Postal management immediately updated the certifying officer list and implemented additional controls on July 21, 2010, and the responsible official was Dean Rodman, Manager, Accounting Services.

This report and management's response do not contain information that may be exempt from disclosure under the FOIA.

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