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United States General Accounting Office
Washington, DC 20548

September 12, 2002

Mr. John E. Potter
Postmaster General

Subject: *U.S. Postal Service: Accounting for Postretirement Benefits*

Dear Mr. Potter:

As you know, in 1992 GAO issued a report that, among other things, considered the United States Postal Service's (USPS) accounting for postretirement health benefit costs.[1] That report concluded that USPS's use of the pay-as-you-go basis of accounting for the postretirement health benefit costs of employers that participate in multiemployer plans was in accordance with existing private sector generally accepted accounting principles (GAAP). However, GAO recommended disclosure of the full amount of the accrued benefits earned by USPS employees and retirees in notes to its financial statements to provide more complete information for making informed judgments about USPS in dealing with oversight matters, assessing rate change requests, and evaluating USPS's overall financial position and performance. While USPS's current disclosures may meet the minimum requirements under GAAP, the enhanced disclosures GAO recommended, which are not precluded under GAAP, would, in our view, provide additional transparency in USPS's financial statements. USPS disagreed with this recommendation and therefore has not implemented it.

We recently reviewed and reassessed our 1992 report and have concluded that it did not adequately consider the potential accounting ramifications of the unique statutory obligations that USPS has, which are not applicable to other multiemployer plans – both pension and other postretirement benefit plans. In addition, it is clear that existing GAAP does not directly address the unique characteristics of government plans similar to those that USPS participates in. Given this, combined with the economic and competitive environment USPS now faces, ongoing efforts to transform USPS to address its financial and operational challenges, and both the Congress' and the public's call for more information and transparency regarding financial reporting matters, we believe that it is an appropriate time for USPS to reassess how best to account for and disclose this very significant financial obligation.[2]

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[1] United States General Accounting Office, *Financial Reporting: Accounting for the Postal Service's Postretirement Health Care Costs*, GAO/AFMD-92-32 (Washington, D.C.: May 20, 1992).
[2] *See, e.g.*, United States General Accounting Office, *U.S. Postal Service: Deteriorating Financial Outlook Increases Need for Transformation*, GAO-02-355 (Washington, D.C.: Feb 22, 2002).

In 1992, when considering how to account for its postretirement health obligations, USPS considered Statement of Financial Accounting Standards No. 106, *Employer's Accounting for Postretirement Benefits Other Than Pensions* (SFAS No. 106). SFAS No. 106 provides for two methods of accounting for these obligations – as a multiemployer plan, which results in pay-as-you-go accounting, or as a single- (or multiple) employer plan, which results in accrual accounting. At that time, USPS's management decided and its outside auditors concurred that the characteristics of USPS and its plan were most like those of a multiemployer plan; therefore, pay-as-you-go accounting was adopted. We were subsequently asked to comment on the accounting treatment, which led to issuance of our 1992 report.

We now believe that our previous analysis of the application of SFAS No. 106 to USPS and its plan in our 1992 report did not adequately consider certain significant facts and circumstances. First, the basic premise behind the SFAS No. 106 exemption from accrual accounting for multiemployer plans was that the liability for an individual employer would be difficult and expensive to determine and would be of limited value. This does not appear to be the current situation for USPS. In addition, USPS is a unique entity unlike any addressed in SFAS No. 106. Although USPS is a governmental entity that has, in large part, voluntarily decided to participate in the federal health plan administered by the Office of Personnel Management (OPM), it is an independent establishment in the executive branch of the U.S. government and, unlike most federal government entities, has been charged with being a self-supporting entity and given greater flexibility in determining the rates of pay for its employees.

We also believe that our previous analysis of multiemployer characteristics did not give adequate attention to at least two additional significant areas where USPS's plan is different from a typical multiemployer plan. First, an attempt by the USPS to terminate its participation in the Federal Employees Health Benefits Plan (FEHBP) would be subject to statutory constraints. Unlike private sector employers, USPS is statutorily prohibited from making a variation, addition, or substitution with respect to fringe benefits if it would result in a program of fringe benefits that on the whole is less favorable to its officers and employees than fringe benefits in effect on July 1, 1971.[3] Further, as to unionized officers and employees, no changes can be made except by collective bargaining agreement. This statutory provision may not technically require USPS to provide its officers and employees with a substitute defined benefit health "plan" comparable to FEHBP. However, because of the significance of health insurance coverage to any "program of fringe benefits" and the dominance of unionized employees within USPS with whom USPS would have to obtain concurrence, it seems highly unlikely that USPS would be able to terminate participation in FEHBP without providing a comparable defined benefit health plan. Multiemployer plans are not typically subject to comparable statutory constraints. In any event, if termination were to occur, USPS would be required to continue to make contributions to OPM towards the health costs of its current retirees.

[3] 39 U.S.C. 1005(f) (2000).

Second, like most multiple employer (single-employer) plans, USPS is required by law to make contributions towards the health costs of only its own retirees and employees and no others. In a typical multiemployer plan, an employer may have to make additional contributions in the event that other employers that participate in the plan are unable to make their required contributions.

Because of the above and other unique characteristics, we believe that USPS should consider whether the accrual basis of accounting is both the acceptable and appropriate method for USPS's postretirement health benefits, especially considering the importance of giving full consideration to economic realities as USPS attempts to transform itself in order to respond to major operational and financial challenges. USPS management and the Board of Governors, the Postal Rate Commission, the Congress, and other stakeholders need to have a clear understanding of USPS's true financial condition as difficult transformation decisions are being considered.

We believe decisionmakers' ability to fully consider the impact of these obligations is hindered by the current lack of recognition and disclosure of them in USPS's financial statements. In our view, the aim of accounting and financial reporting should be to reflect economic reality and provide all stakeholders with the soundest and most transparent basis for decision making. Thus, we are suggesting that USPS reconsider whether it would be the appropriate method to account for its long-term legal responsibility to pay these costs for its retired employees on an accrual basis. For these same reasons, we believe USPS should also reconsider the unconventional accounting treatment of its pension obligation, which is currently reflected as a liability on the balance sheet with an offsetting deferred asset. This treatment is not consistent with either multiemployer or single-employer accounting under SFAS No. 87, *Employers' Accounting for Pensions.* We will be assessing the impact of this accounting treatment further as part of our ongoing work on USPS.

Regardless of whether USPS changes its accounting treatment for its pension and postretirement health obligations, our recommendation regarding enhanced disclosure, which is even more critical in today's environment, still stands. In addition, in our view, while the current transformation plan does reference USPS's pension obligations, it does not adequately address the challenges associated with USPS's retiree health obligations. Further, even if the accounting treatment is not changed, we believe USPS should consider building accrual-based costs for these obligations into its future rate requests so as to avoid the sharp escalation in rates that will otherwise be necessary in later years to fund these costs on a pay-as-you-go basis. If this were done, there would be several options for use of the additional revenues, including reducing USPS's considerable and growing debt load.

Based on discussions with you and other Board of Governors members, it is clear that the Board and management are giving serious attention to this matter. In recent correspondence, the Chairman of the Board stated that USPS will follow an appropriate process for reviewing potential changes in accounting policy for postretirement benefits. In commenting on a draft of this letter, the Chief Financial Officer indicated that USPS does plan to address the issues raised by GAO on both the pension and the postretirement health obligations in the management discussion and analysis (MD&A) section of this year's annual report.

We were encouraged to hear that USPS does intend to provide some discussion of the pension and postretirement health obligations in the MD&A included in this year's annual report. However, we want to emphasize that such a discussion will be of limited use to the readers of USPS's annual report if an estimate (or a range of estimates) of the postretirement health obligations is not included. Based on our recent discussions with OPM, we believe that USPS's postretirement health obligations are reasonably estimable at this time and, therefore, could be included in this year's report. We also want to reemphasize how important we believe it is for USPS to carefully reassess its overall accounting treatment for both pension and postretirement health obligations given the various factors that we noted earlier in this letter. In the absence of a decision by USPS to adopt accrual accounting, we believe it is particularly important to include discussion and estimates of USPS's postretirement health obligations in the footnotes to the financial statements because these statements and the related notes need to stand alone as a full and complete story of the financial condition, obligations, and results of operations of USPS.

We conducted our assessment of these matters from June 2002 through September 2002 in accordance with generally accepted government auditing standards. We appreciate the comments you provided us on a draft of this letter and have considered them, as appropriate. We will send copies of this letter to the chairmen and ranking minority members of the Senate Committee on Governmental Affairs, House Committee on Government Reform, House and Senate Committees on Appropriations, the chairman of the Postal Rate Commission, and other interested parties. We will also make copies available to others on request.

We would be happy to meet with you, at your convenience, to discuss these issues further.

Sincerely yours,

David M. Walker
Comptroller General
of the United States

cc: Mr. Robert Rider, Chairman
Board of Governors of the United States Postal Service

Ms. Ernesta Ballard, Chair
Audit and Finance Committee of the Board of Governors

Mr. Richard Strasser, Jr., Chief Financial Officer
United States Postal Service

Ms. Karla Corcoran, Inspector General
United States Postal Service

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