

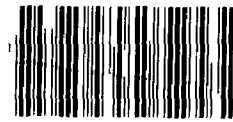
GAO

Report to the Congress

September 1986

FINANCIAL AUDIT

United States Postal Service's Financial Statements for 1985



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**Comptroller General
of the United States**
B-223663

September 24, 1986

To the President of the Senate and the
Speaker of the House of Representatives

This report presents the results of our review of the independent certified public accountant's audit of the United States Postal Service's financial statements for fiscal year 1985. The United States Postal Service provides domestic postal services to metropolitan cities, small towns and communities, and rural areas. The Postal Service endeavors to provide prompt, reliable, and efficient services in transporting its patrons' communications.

The Postal Service contracts with a CPA firm for an annual audit of its financial statements. Arthur Young and Company audited the Postal Service's 1985 and 1984 financial statements. Our review of the 1985 audit was made under provisions of the Postal Service Reorganization Act of 1970 (39 U.S.C. 2008), which authorizes the General Accounting Office to audit the accounts and operations of the Postal Service. In order to fulfill our audit responsibilities, to avoid unnecessary duplication and expense, and to make the most efficient use of our available resources, we reviewed the work and report of the independent certified public accountant.

In contracting for the audit, the Postal Service did not request the auditor to prepare reports on internal accounting controls and compliance with laws and regulations, as required by generally accepted government auditing standards. Otherwise, we found nothing to indicate the auditor's opinion on the fiscal year 1985 financial statements is inappropriate or cannot be relied upon. The auditor reported an unqualified opinion.

Our review was conducted in accordance with generally accepted government auditing standards. To determine the reasonableness of the auditor's work and the extent to which we could rely on it, we

- interviewed Postal Service officials to obtain information about the entity's operations, including its system of financial records and the preparation of its financial statements;
- interviewed the auditor to identify the audit approach and the methods used to control the quality of audit work;
- evaluated information about the qualifications and independence of the auditor;

-
- reviewed the financial statements and the auditor's reports to evaluate compliance with generally accepted accounting principles and generally accepted government auditing standards; and
 - reviewed the auditor's working papers to determine (1) the nature, timing, and extent of audit work performed, (2) the extent of audit quality control methods used by the auditor, (3) whether there was a study and evaluation of the entity's internal controls, (4) whether the auditor tested transactions for compliance with applicable laws and regulations, and (5) whether the evidence in the working papers supported the auditor's opinion on the financial statements.

Arthur Young's Report

In the opinion of Arthur Young & Company, the United States Postal Service's financial statements present fairly its financial position at September 30, 1985, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

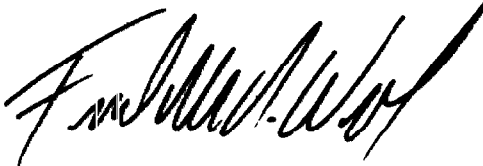
Arthur Young & Company's contract with the Postal Service stipulated that the audit be conducted in accordance with generally accepted auditing standards, rather than generally accepted government auditing standards. While both standards require a study and evaluation of internal accounting controls, the government standards also require a report on the review of internal accounting controls and a report on compliance with laws and regulations which can materially affect the financial statements. At our request, the Postal Service has agreed to contract for future audits of its financial statements in accordance with generally accepted government auditing standards, beginning with the fiscal year ending September 30, 1986.

Conclusion

Although the omission of reports on internal accounting controls and compliance with laws and regulations was not in accordance with generally accepted government auditing standards, we found nothing to indicate that Arthur Young & Company's opinion on the fiscal year 1985 financial statements of the Postal Service is inappropriate or cannot be relied on. We believe that the financial statements, together with Arthur Young & Company's opinion and our review of its work, constitute a dependable basis for the Congress' oversight of the Postal Service's financial position.

The comparative financial statements of the Postal Service and the auditor's opinion are presented in this report.

We are sending copies of this report to the Director of the Office of Management and Budget, to the Postal Service's Board of Governors, and to the Postmaster General.

for 
Charles A. Bowsher
Comptroller General
of the United States

Contents

Financial Statements

Balance Sheets	6
Statements of Operations and Changes in Equity	8
Statements of Changes in Financial Position	9
Notes to Financial Statements	10
Report of Independent Accountants	14

Financial Statements

Balance Sheets

	Sept. 30, 1985	Sept. 30, 1984
(dollars in thousands)		
Assets		
Current assets		
Cash	\$ 274,274	\$ 262,078
U.S. Government securities, at amortized cost which approximates market	2,369,701	2,290,478
Receivables		
U.S. Government—Notes 2 and 6	161,341	344,553
Foreign countries	197,332	214,861
Accrued interest	25,792	73,071
Other	<u>56,662</u>	<u>52,569</u>
	441,127	685,054
Less allowances	<u>20,769</u>	<u>18,843</u>
	420,358	666,211
Supplies, advances and prepayments	<u>170,408</u>	<u>113,869</u>
Total current assets	3,234,741	3,332,636
Other assets—Note 5	20,196	20,155
Property and equipment, at cost—Note 5		
Land	594,065	548,352
Buildings	4,223,712	3,969,337
Equipment	<u>3,004,289</u>	<u>2,795,619</u>
	7,822,066	7,313,308
Less allowances for depreciation	<u>2,757,425</u>	<u>2,500,644</u>
	5,064,641	4,812,664
Construction in progress	1,055,327	686,965
Leasehold improvements, net of amortization	<u>113,719</u>	<u>109,512</u>
	6,233,687	5,609,141
Deferred retirement costs—Note 4	<u>17,571,593</u>	<u>12,597,726</u>
	<u>\$27,060,217</u>	<u>\$21,559,658</u>

See notes to financial statements.

Financial Statements

	Sept. 30, 1985	Sept. 30, 1984
Liabilities and equity		
(dollars in thousands)		
Current liabilities		
Outstanding postal money orders	\$ 302,310	\$ 265,947
Compensation and employees' benefits	1,638,604	1,453,856
Amounts payable to other U.S. Government agencies	101,232	151,389
Other accounts payable and accrued expenses	659,132	749,701
Deferred revenue	564,815	493,003
Estimated prepaid postage	954,000	889,000
Current portion of long-term debt	<u>91,800</u>	<u>373,000</u>
Total current liabilities	4,311,893	4,375,896
Long-term debt, less current portion—Note 5	1,983,263	1,092,264
Other liabilities		
Amounts payable for retirement benefits—Note 4	17,134,576	12,363,202
Employees' accumulated leave—Note 6	776,121	734,557
Workers' Compensation claims—Note 2	2,776,000	2,663,000
Other	<u>20,000</u>	<u>20,000</u>
	20,706,697	15,780,759
Commitments and contingencies—Notes 4, 7 and 8		
Equity		
Capital contributions of the U.S. Government—Note 6	3,042,310	3,043,205
Deficit from operations since commencement on July 1, 1971	<u>(2,983,946)</u>	<u>(2,732,466)</u>
	58,364	310,739
	<u>\$27,060,217</u>	<u>\$21,559,658</u>

See notes to financial statements.

Financial Statements

Statements of Operations and Changes in Equity

	Year Ended Sept. 30, 1985	Year Ended Sept. 30, 1984
	(dollars in thousands)	
Operating revenue	\$27,736,071	\$25,313,554
Appropriations for revenue forgone for certain classes of mail—Note 3	<u>969,620</u>	<u>879,000</u>
	28,705,691	26,192,554
Operating expenses		
Compensation and employees' benefits	24,349,087	22,157,261
Other	<u>4,858,114</u>	<u>4,200,092</u>
	29,207,201	26,357,353
Loss from operations	(501,510)	(164,799)
Interest income	<u>309,870</u>	<u>364,427</u>
	(191,640)	199,628
Interest expense	<u>59,840</u>	<u>82,276</u>
Net (loss) income	(251,480)	117,352
Equity—beginning of year	310,739	111,770
Capital contributions by U.S. Government, including \$76,421,000 in 1984 for unfunded leave liability—Note 6	<u>(895)</u>	<u>81,617</u>
Equity—end of year	<u>\$ 58,364</u>	<u>\$ 310,739</u>

See notes to financial statements

Statements of Changes in Financial Position

	Year Ended Sept. 30, 1985	Year Ended Sept. 30, 1984
(dollars in thousands)		
Sources of working capital		
From operations		
Net (loss) income	(\$ 251,480)	\$ 117,352
Charges to operations not requiring current outlays of working capital		
Amortization of deferred retirement costs	714,805	318,239
Depreciation and amortization	372,167	307,060
Provision for noncurrent Workers' Compensation claims	113,000	60,000
Increase in employees' accumulated leave	<u>41,564</u>	<u>41,932</u>
Total sources from operations	990,056	844,583
Increase in noncurrent amounts payable for retirement benefits	4,771,374	70,723
Increase in long-term debt	890,999	—
Capital contributions by U.S. Government	<u>(895)</u>	<u>81,617</u>
Total sources	6,651,534	996,923
Uses of working capital		
Additions to deferred retirement costs	5,688,672	362,692
Additions to property and equipment, net	996,713	859,970
Increase (decrease) in other assets	41	(1,158)
Decrease in long-term debt	<u>—</u>	<u>298,591</u>
Total uses	<u>6,685,426</u>	<u>1,520,095</u>
Increase in working capital deficiency	<u>(\$ 33,892)</u>	<u>(\$ 523,172)</u>
Changes in components of working capital		
Increase (decrease) in current assets		
Cash and U.S. Government securities	\$ 91,419	\$ 32,978
Receivables	(245,853)	210,526
Supplies, advances and prepayments	<u>56,539</u>	<u>(143,903)</u>
	(97,895)	99,601
Increase (decrease) in current liabilities		
Outstanding postal money orders	36,363	41,211
Compensation and employees' benefits	184,748	171,827
Amounts payable to other U.S. Government agencies	(50,157)	(11,038)
Other accounts payable and accrued expenses	(90,569)	22,710
Deferred revenue	71,812	59,063
Estimated prepaid postage	65,000	39,000
Current portion of long-term debt	<u>(281,200)</u>	<u>300,000</u>
	<u>(64,003)</u>	<u>622,773</u>
Increase in working capital deficiency	<u>(\$ 33,892)</u>	<u>(\$ 523,172)</u>

See notes to financial statements.

Notes to Financial Statements

September 30, 1985 and 1984

**Note 1
Postal Reorganization
and Accounting Policies**

The United States Postal Service (Postal Service) commenced operations on July 1, 1971, in accordance with the provisions of the Postal Reorganization Act. Its initial capital consisted of the equity of the Government of the United States in the former Post Office Department, with assets carried at original cost less depreciation. All liabilities attributable to operations of the former Post Office Department remained liabilities of the U.S. Government, except that the unexpended balances of appropriations made to, held or used by, or available to the former Post Office Department and all liabilities chargeable thereto became assets and liabilities, respectively, of the Postal Service.

Buildings and equipment are depreciated over their estimated useful lives using the straight-line method. Leasehold improvements are amortized over the lesser of the lease period or their useful life. Repairs and maintenance costs which do not materially extend the life of assets are expensed as incurred.

Research and development costs, which relate primarily to new equipment design, are expensed as incurred. Such costs amounted to approximately

\$25,000,000 in Fiscal Year 1985 and \$26,000,000 in Fiscal Year 1984.

Workers' Compensation costs are recorded as an operating expense in the year of injury at the net discounted present value of the total estimated costs of claims. Estimates of the total costs of claims are based upon severity of injury, age, assumed mortality, experience trends and other factors.

Estimated prepaid postage represents the estimated amount of revenue collected prior to the end of the year for which services will be performed in the following year.

Amounts payable for retirement benefits reflect the Postal Service's legal obligation to the Civil Service Retirement and Disability Fund (the Fund) arising from increases in basic annual salary in an amount equal to the present value of the equal annual installments due to the Fund and payable over a 30-year time period. Amounts applicable to operations of future years are charged to deferred retirement costs and are subsequently amortized through operating expenses.

**Note 2
Workers' Compensation**

The Postal Service's Workers' Compensation Program is administered by the Department of Labor. Under the Postal Reorganization Act, all payments made by the Department of Labor for injuries experienced prior to July 1, 1971 remain liabilities of the U.S. Government to be funded by appropriations. As part of the Fiscal Year 1985 budget process, Congress approved appropriations to reimburse the Postal Service for amounts paid and expensed in Fiscal Years 1982, 1983 and 1984 for injuries experienced prior to July 1, 1971. Accordingly, the Postal Service established, at September 30, 1984, a receivable from the U.S. Government of approximately \$121,000,000 as a recovery of amounts previously expensed. These appropriations, as well as an additional appropriation of \$42,000,000 for Fiscal Year 1985, were received in Fiscal Year 1985.

**Note 3
Operating Appropriations**

The Postal Reorganization Act (the Act) appropriated to the Postal Service all revenue received by it and, additionally, authorized certain amounts to be appropriated "for public service costs incurred by it in providing a maximum degree of effective and regular postal service nationwide." This appropriation was to continue on a declining basis through Fiscal Year 1984. After Fiscal Year 1984, the Postal Service could reduce the amount authorized to be appropriated if it found the amounts so determined were no longer required to operate in accordance with the policies of the Act. The Postal Service did not request or receive any public service appropriation during Fiscal Years 1984 and 1985.

Further, the Act authorized to be appropriated to the Postal Service each year a sum determined by the Postal Service to be equal to revenue forgone by it in providing certain mail services free or at reduced rates. Operating appropriations for revenue forgone received during Fiscal Years 1985 and 1984 totaled \$969,620,000 and \$879,000,000, respectively, including appropriations of \$189,000,000 and \$169,000,000, respectively, to offset the effect of Congress extending the period of phasing rates of certain classes of mail.

**Note 4
Retirement Program**

The Postal Reorganization Act provides that officers and career employees of the Postal Service shall be covered by the Civil Service Retirement Program (the Program) and the Postal Service shall withhold from pay and shall pay to the Civil Service Retirement and Disability Fund (the Fund) the amounts specified by the Program. The Postal Service and its employees contribute seven percent each of basic annual salary to the Fund. However, employees hired since January 1, 1984, pay 1.3 percent of basic annual salary to the Fund and 7.05 percent of gross wages for Social Security pending final determination of their retirement status.

In addition, unlike most government agencies, the Postal Service is liable for that portion of any estimated increase in the unfunded liability of the Fund attributable to Postal Service employee-management agreements that authorize increases in basic annual salary on which benefits payable from the Fund are computed. The estimated increase in the unfunded liability as determined by the Office of Personnel Management (OPM) is paid by the Postal Service in 30 equal annual installments with interest computed at the rate used in the most recent valuation of the Civil Service Retirement System (currently five percent), with the first payment thereof due at the end of the fiscal year in which an increase in basic annual salary becomes effective. The total increase in the annual payment that resulted from increases in

basic annual salary was approximately \$318,998,000 and \$58,115,000 for Fiscal Years 1985 and 1984, respectively. The Fiscal Year 1984 increase includes amounts applicable to retroactive pay adjustments granted under the final 1984 employee-management agreement.

Under the July 1981 and 1984 employee-management agreements, cost-of-living increases (COLAs) accumulated under the prior agreements become part of basic annual salary in two phases. For those employees who so elected and who were eligible for optional retirement at the contract date or within the next six years, the accumulated COLAs become part of basic annual salary during the fiscal year following the contract date. For all other employees, the accumulated COLAs are included in basic annual salary under the 1981 and 1984 agreements in October 1984 and October 1987, respectively. Whether COLAs to be paid in Fiscal Years 1985, 1986 and 1987 under the provisions of the 1984 employee-management agreements will be included in basic annual salary will be determined in future contract negotiations.

In Fiscal Year 1984, OPM informed the Postal Service that, with respect to the COLAs scheduled for inclusion in basic

annual salary in October 1984 under the provisions of the 1981 employee-management agreements, it would consider employee and employer contributions applicable to these COLAs since November 1981, and related interest, in determining the unfunded liability beginning in Fiscal Year 1985. Postal Service management reviewed OPM's position and accepted it in Fiscal Year 1985 for purposes of determining the unfunded liability and annual payment thereon. Management expects OPM's position to apply also to accumulated COLAs scheduled to be included in basic annual salary in October 1987 under the terms of the 1984 employee-management agreements.

The increases in the unfunded liability and annual payment for retirement benefits in Fiscal Year 1985 include \$3,212,987,000 and \$199,056,000, respectively, due to the addition of accumulated COLAs to basic annual salary in October 1984 and \$1,011,798,000 and \$62,685,000, respectively, due to the addition of accumulated COLAs to basic annual salary in April 1985.

The estimated future minimum payments required to fund amounts payable for retirement benefits at September 30, 1985 are as follows:

Fiscal Year	Amount
1986	\$ 1,294,452,000
1987	1,294,452,000
1988	1,294,452,000
1989	1,294,452,000
1990	1,294,452,000
Thereafter	24,359,978,000
	30,832,238,000
Less amount representing interest and the portion classified as a current liability	13,697,662,000
	<u>\$17,134,576,000</u>

Aggregate retirement costs for Fiscal Years 1985 and 1984 were \$2,260,000,000 and \$1,847,000,000, respectively, including \$1,251,793,000 and \$949,836,000 attributable to amortization of deferred retirement costs and interest on the unfunded liability.

Note 5

Long-Term Debt and Interest Costs

The Postal Reorganization Act authorizes the Postal Service to issue and sell obligations not to exceed \$10,000,000,000 outstanding at any one time. The net increase outstanding in any one year shall not exceed \$1,500,000,000 for capital improvements and \$500,000,000 for operating expenses. Such obligations shall not be obligations of the U.S. Government unless the Secretary of the Treasury, upon request of the Postal Service, determines that it would be in the public interest to pledge the full faith and credit of the Government of the United States.

Long-term debt consists of the following:

On September 30, 1985, the Postal Service received a loan of \$970,000,000 from the Federal Financing Bank, the proceeds of which are to be used to fund capital investments and accelerate mechanization efforts. The Board of Governors authorized this loan, which requires periodic principal payments of \$38,800,000 for 25 years.

The 6% Postal Service Bonds, Series A, were issued under a Trust Indenture dated February 1, 1972, and are secured by a first lien on the revenue, income, fees, rents, appropriations and other receipts of the Postal Service, the proceeds of all obligations issued by the Postal Service, and all sinking and improvement funds established pursuant to the Indenture. On July 31 of each year, the

Postal Service is required to deposit in a sinking and improvement fund the sum of \$10,000,000 either in cash or reacquired Series A Bonds. The Trust Indenture further provides, however, that, at the option of the Postal Service, such sinking fund requirements may be applied to the payment of costs of capital additions or improvements to properties of the Postal Service. Since the commencement of the sinking fund in 1978, the Postal Service has applied \$66,700,000 to the construction of mail facilities. The balance in the sinking fund (\$13,300,000 in 1985 and \$10,000,000 in 1984) is classified with other assets in the accompanying balance sheets. The bonds are redeemable prior to maturity, at the option of the Postal Service, on or after February 1, 1982, at the principal amount plus accrued interest.

At September 30, 1985, the maturities of long-term debt, including sinking fund requirements, are as follows:

	Sept. 30, 1985	Sept. 30, 1984
6% Postal Service Bonds, Series A, due February 1, 1997	\$ 250,000,000	\$ 250,000,000
Notes payable to Federal Financing Bank		
8.20% payable \$20,000,000 each May 31, with balance due May 31, 1985	—	320,000,000
8.075% payable \$32,000,000 each year to May 31, 2000	480,000,000	512,000,000
7.80% payable \$15,000,000 each year to May 31, 2001	240,000,000	255,000,000
10.475% payable \$38,800,000 each year to May 31, 2010	970,000,000	—
Mortgage notes payable including interest of 4% to 15% maturing from Fiscal Years 1986 through 2009 secured by land, buildings and equipment with a carrying amount of \$194,000,000 (aggregate annual installments approximate \$6,000,000 with approximately \$86,000,000 due in Fiscal Year 1988)	<u>135,063,000</u>	<u>128,264,000</u>
	2,075,063,000	1,465,264,000
	<u>91,800,000</u>	<u>373,000,000</u>
Less current portion	<u>\$1,983,263,000</u>	<u>\$1,092,264,000</u>

Fiscal Year	Amount
1986	\$ 101,800,000
1987	101,800,000
1988	187,800,000
1989	101,800,000
1990	101,800,000
Thereafter	<u>1,480,063,000</u>
	<u>\$2,075,063,000</u>

Total interest costs incurred during Fiscal Years 1985 and 1984 were \$107,740,000 and \$115,581,000, respectively, of which \$47,900,000 and \$33,305,000, respectively, were capitalized as part of the cost of newly constructed property and equipment.

**Note 6
Accumulated Annual Leave**

Employees are permitted to accumulate certain unused annual leave which is payable when taken, upon severance of employment or upon retirement

The former Post Office Department (POD) accrued such accumulated annual leave, and at July 1, 1971 the liability was recorded by the Postal Service

For Fiscal Years 1972 through 1981, the Postal Service was appropriated transitional funds to cover one-twelfth of the annual leave liability carried forward at July 1, 1971. The Omnibus Budget Reconciliation Act of 1981 deferred until Fiscal Year 1985 the Fiscal Years 1982, 1983 and 1984 authorizations for transitional appropriations of annual leave. As part of the Fiscal Year 1985 budget process, Congress approved appropriations to the Postal Service of \$76,421,000 covering the remaining POD liability for accumulated annual leave. This amount was treated as a receivable by the Postal Service at September 30, 1984 and was received during Fiscal Year 1985.

Employees are permitted to accumulate unused sick leave but such amounts are not vested, therefore, sick leave is expensed when paid.

**Note 7
Commitments**

At September 30, 1985, the estimated cost to complete approved Postal Service

	1985	1984
Noncancellable real estate leases, including related taxes (1985—\$33,400,000, 1984—\$32,500,000)	\$337,500,000	\$311,800,000
Facilities leased from the General Services Administration subject to 30-day notice of cancellation	39,100,000	33,700,000
Equipment and other short-term rentals	<u>90,900,000</u>	<u>76,600,000</u>
	<u>\$467,500,000</u>	<u>\$422,100,000</u>

At September 30, 1985, the future minimum rentals for all noncancellable leases approximate the following

Fiscal Year	Amount
1986	\$ 285,000,000
1987	272,000,000
1988	234,000,000
1989	195,000,000
1990	157,000,000
Thereafter	<u>536,000,000</u>
	<u>\$1,679,000,000</u>

Most of these leases contain renewal options for periods ranging from three to twenty years. Certain noncancellable real estate leases have options to purchase the facilities at prices specified in the leases.

capital projects was approximately \$904,000,000

Total rental expense for the years ended September 30, 1985 and 1984 is summarized as follows

1985 1984

\$337,500,000	\$311,800,000
39,100,000	33,700,000
<u>90,900,000</u>	<u>76,600,000</u>
<u>\$467,500,000</u>	<u>\$422,100,000</u>

**Note 8
Contingencies**

Several equal employment opportunity, employee compensation and postal rate class action lawsuits are pending against the Postal Service. In addition, there are certain pending suits and claims resulting from traffic accidents involving postal vehicles and injuries on postal properties, suits involving personal claims, and suits and claims arising out of postal contracts.

In the opinion of management and General Counsel, adequate provision has been made for amounts which may become due under the suits, claims and proceedings discussed in the preceding paragraph, and the likelihood of the aggregate final settlements of the above suits, claims and proceedings having a material effect on the accompanying financial statements is remote.

Report of Independent Accountants

Board of Governors
United States Postal Service

We have examined the accompanying balance sheets of the United States Postal Service at September 30, 1985 and 1984, and the related statements of operations and changes in equity and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements mentioned above present fairly the financial position of the United States Postal Service at September 30, 1985 and 1984, and the results of operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

Arthur Young & Company

Arthur Young & Company
Washington, D.C.
November 15, 1985

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