

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Modification of Analytic Principles in
Period Reporting (Proposal Twenty-One)

Docket No. RM2010-3

PUBLIC REPRESENTATIVE COMMENTS
IN RESPONSE TO ORDER NO. 321

(October 29, 2009)

On October 20, 2009, the Postal Service filed a petition requesting that it be allowed to file "Pro Forma" accounting data for periodic reporting of financial and operating results for FY 2009 and FY 2010.¹ Subsequently, the Postal Regulatory Commission (Commission) issued Order No. 321 summarizing the Postal Service's request, designating a public representative, and establishing November 2, 2009 as the deadline for comments.²

The Public Representative supports the Postal Service's request but suggests a change to the Service's proposed rule. There are also aspects of the proposal that the Postal Service did not address but should be considered by the Commission. Specifically, which of the Service's routinely filed financial statements are affected by this proposal? What is the estimated effect on attributable and institutional costs from the recognition of the \$4 billion reduction of retiree health benefits filed as part of the Postal Service's Annual Compliance Report for FY 2009? These comments address the accounting treatment of the adjustment, and the Public Representative's proposed revision to the Postal Service's rule.

¹ Petition of the United States Postal Service Requesting Authorization to Utilize Pro Forma Accounting Data in Periodic Reporting (Proposal Twenty-One), October 20, 2009 (Proposal).

² PRC Order No. 321, Notice of Proposed Rulemaking on Analytic Principles Used in Periodic Reporting (Proposal Twenty-One) October 22, 2009 (Order No. 321).

I. Background

The Postal Accountability and Enhancement Act (PAEA), requires the Postal Service to make regularly scheduled payments averaging \$5.5 billion per year into the newly established Postal Service Retiree Health Benefits Fund (PSRHBF) from FY 2007 through FY 2016.³ The Postal Service made payments of \$5.4 billion and \$5.6 billion for FY 2007 and FY 2008, respectively. The FY 2009 payment of \$5.4 billion was due on September 30, 2009. However, due to the unprecedented financial setbacks due to rapidly declining mail volumes and revenues, the Postal Service determined that it would not have sufficient cash resources available to make the scheduled FY 2009 payment into the fund.

In January of 2009 before the Senate and on March 25, 2009 before the House of Representatives, the Postmaster General urgently requested that Congress provide some relief from the PSRHBF payments⁴. In response the House of Representatives introduced H.R. 22 which would have provided three years of relief from the higher retiree health benefits payments. The Senate devised its own solution in the form of S. 1507, which changed the method of calculating the payment to the PSRHBF.

Both proposals were debated extensively, and the House of Representatives did pass H. R. 22.⁵ However, by the end of September it appeared that reconciliation between the two competing bills was not progressing fast enough to provide any relief from the scheduled \$5.4 billion payment due for FY 2009. Eventually, Congress

³ Pub. L. No. 109-435, 120 Stat. 3218 (2006).

⁴ See Statement of Postmaster General/CEO John E. Potter before the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security of the Committee on Homeland Security and Governmental Affairs, January 28, 2009. See also Statement of Postmaster General/CEO John E. Potter before the House Subcommittee on Federal Workforce, Postal Service, and the District of Columbia of the Committee on Oversight and Government Reform, March 25, 2009.

⁵ Defense Production Act Reauthorization of 2009, Pub. L. 111-67, September 30, 2009 (Pub. L. 111-068).

inserted a provision into the FY 2010 Continuing Resolution which provided a one time reduction of \$4 billion from the \$5.4 billion due.⁶ Pub. L. 111-068 was passed on September 30, 2009, the last day of FY 2009. However, the President did not sign the bill until October 1, 2009, the first day of FY 2010.

II. An Accounting Question

Because Pub. L. 111-068 was enacted after the closing of the books of account for FY 2009, the Postal Service had to decide on the accounting treatment of the retiree health benefit relief. First, the Service could have applied the reduction in the expense in FY 2009, reducing the expense for retiree health benefits and improving the net loss position of the Service. This approach is presumably what Congress intended when it made the change in the payment for retiree health benefits retroactive to the original passage of PAEA. Additionally, the Office of Personnel Management (OPM) and the Office of Management and Budget (OMB) plan to treat the change in the retiree health benefits payment as if it took place in FY 2009. Proposal at 7.

However, this approach generally would not be permitted by Generally Accepted Accounting Principles (GAAP) on which the USPS bases its entire financial accounting structure. If the Service were to take the reduction in FY 2009, it could lead the outside auditors, Ernst & Young, to render a qualified opinion on the financial statements⁷.

Alternatively, the Postal Service could have made an audit adjustment to account for the change in retiree health benefits. During the process of an audit there could be

⁶ See Pub. L. No. 111-068.

⁷ There are four types of audit opinions an auditor may issue in the examination of an entities financial statements, an unqualified opinion, an adverse opinion, a disclaimer, or a qualified opinion. A qualified opinion must be issued if the scope of the audit has been limited by management or if there is a failure to follow GAAP. The auditor can be satisfied that the overall financial statements are fairly presented and in conformance with GAAP *except for* a specific aspect of the statements. In this case, booking the reduction in retiree health benefits in FY 2009 rather than FY 2010. Auditing, An Integrated Approach, sixth edition, Arens and Loebbecke, 1994, pp38-39.

several different adjustments to the accounts for errors, omissions, data input errors, or additional changes to various accrual accounts, such as Repriced Annual Leave. In FY 2008, some of the audit adjustments that affected revenues and expenses can be found in the USPS ACR filing⁸.

However, it is apparent that the outside auditors did not approve of this solution either. For treatment of retiree health benefits to adhere to GAAP, an explanation of the effect on the financial statements for FY 2009 is in order. The Service noted that the expense for retiree health benefits fund would still be \$5.4 billion on the FY 2009 income statement. Proposal at 3. So, the net loss reported on the audited income statement will probably be at least \$7 billion. However, the Service did not specify the effect on the other financial statements, i.e., the balance sheet and the statement of cash flows.

The Public representative asserts that the balance sheet for FY 2009 should show a payable liability for retiree health benefits of \$5.4 billion. Additionally, net cash should probably show a significant increase from the beginning of the year. Net cash shows this increase because, while the expense of retiree health benefits would be charged against revenues for the year, no cash would be used to pay this liability until the end of the year. The Service did not write a check for \$5.4 billion on September 30, primarily because there wasn't sufficient cash to pay the bill.

In the first quarter of FY 2010, the Service should eliminate the retiree health benefits payable entry by crediting retained earnings by \$4 billion (amount of the relief) and cash for \$1.4 billion (amount of the payment). It should also debit the liability, retiree health benefits payable, by \$5.4 billion. These transactions would only appear on the balance sheet and would not affect the income statement for any of FY 2010.

The Postal Service noted that the FY 2010 income statement would reflect the \$4 billion adjustment to retiree health benefits. Proposal at 4. The Public Representative

⁸ Docket No. ACR2008, USPS Library Reference USPS-FY08-05, Cost Segments and Components Reconciliation to Financial Statements and Account Reallocations, RealTB08.XLS.

is not sure that this is correct, based on the analysis described above. The Commission should request that the Service explain how the adjustment would affect the FY 2010 financial statements, including the income statement. The Service should also endorse the Public Representative's explanation as described above or provide the Commission and other stakeholders with its reasoning for how the adjustment will affect FY 2010 financial statements.

III. Annual Compliance Report and the CRA

The Proposal petitions the Commission to change its reporting rules to allow for the use of the "Pro Forma" financial statements as the basis for financial type filings the Service must provide under the Commission's data reporting rules. These filings include the Cost and Revenue Analysis Report (CRA) and all of the underlying workpapers and reports supporting the CRA, including the Cost Segments and Components Report (CSC).

Under current methodology, the total costs of retiree health benefits appear in cost segment 18.3.6 titled "Annuitant Health Benefits and Earned CSRS Pensions". These costs, which consist of the annual premium costs for current retirees paid to OPM and the scheduled payment into the PSRHBF as mandated by PAEA, are treated similarly to workers compensation costs. The costs are split into "current year" and "prior year" costs. Current year costs represent the cost of pension and retiree health benefits earned by current employees during FY 2009 and consist of the normal cost for retiree health benefits and CSRS pensions, as determined by OPM. These costs are attributable to the same degree as total labor cost. The prior year costs comprise the remainder of the total costs of retiree health benefits and are considered institutional.⁹

⁹ A discussion of the treatment of retiree health benefits and CSRS pension costs are detailed in Docket No. ACR2007, Library Reference USPS-FY07-2, Supplement to USPS-FY07-2, "Treatment of Annuitant Health and CSRS Benefits Costs.

In FY 2008, the current year's costs for Annuitant Health Benefits and Earned CSRS Pensions totaled approximately \$4.8 billion and consisted of the normal cost for retiree health benefits of \$3.4 billion and the normal cost of CSRS pension benefits of \$1.4 billion. The total cost of the annual premium costs for current retirees and the scheduled payment to the PSRHBF was \$7.4 billion, so when the current costs are subtracted this leaves prior years costs of \$2.6 billion.

Under the Postal Service's proposal, the total costs for cost segment 18.3.6 would be \$1.4 billion (the new scheduled payment as per Pub. L. 111-068) plus the cost of health benefits premiums for current retirees, which have been estimated at \$2.0 billion, for a total of \$3.4 billion. Under the current attribution methodology, the current year's costs for FY 2009 would be the OPM estimated normal cost for retiree health benefits and the estimated normal cost for CSRS pensions. While those figures have not been released by OPM or the Postal Service, the normal cost for retiree health benefits was estimated by OPM for the Senate Committee on Homeland Security and Governmental Affairs in their draft of S. 1507.

In that bill, the Senate proposed to eliminate the current schedule of payments into the PSRHBF and replace it with payments consisting of the normal cost of retiree health benefits plus a payment schedule to pay down the unfunded liability.¹⁰ For FY 2009, OPM estimated that the normal cost for retiree health benefits would be \$3.3 billion.¹¹ The normal cost of the CSRS pension benefits changed little from FY 2007 to FY 2008, so assuming the same for FY 2009 results in an estimated normal cost of \$1.4 billion. The total, \$4.5 billion, is \$1.1 billion greater than the total cost of cost segment 18.3.6 under the Postal Service's Proposal. This result implies that the prior year's cost component is a negative \$1.1 billion. Since the prior year's cost is considered institutional, there should be a reduction of institutional costs of \$1.1 billion.

¹⁰ See S. 1507, Section 3.

¹¹ This is assuming a decline of 50,000 employees from the FY 2008 estimation, a 7% health trend rate, and a 6.25% discount rate.

There are several areas where this reduction in institutional costs could have an impact, but one important affect would be the required 5.5% institutional cost charge for competitive products. This issue was not addressed by the Postal Service but these are questions that the Commission must consider as it determines the appropriateness of the Postal Service's Proposal.

IV. **Change in USPS Draft Proposed Rule**

The Commission's rules for data reporting consist of three sections. The first section includes definitions, procedures for changes to formats of the reports, and procedures for changes to the underlying analytical principles of the reports. The second section is directed at the Service's 3652 report (Annual Compliance Report) including the format and content of the report and a listing of the type of documentation that has to be filed in support of the report. The third section consists of many of the financial and data reports that were incorporated from former rules 3001.102 and 103. These reports generally provide information, on an ongoing basis, on USPS volumes, revenues, expenses, financial position, and other operating data.

The Postal Service's proposed rule change proposes that **all periodic reports submitted under Part 3050** shall be filed as if the adjustment to retiree health benefits in Pub. L. 111-068 was booked in FY 2009, rather than FY 2010. Proposal at 8, Attachment Two.

The Public Representative agrees that all of the reports filed in support of the Service's section 3652 report for FY 2009 should reflect the Pro Forma data with the FY 2009 retiree health benefits adjustment. However, not all of the financial reports included in the rules of Part 3050 should rely solely on that Pro Forma data. The ongoing financial reports that are included in rules 3050.28, 3050.35, and 3050.40 should include both the actual GAAP compliant data and the pro forma data, in the

same manner as the Postal Service intends to issue the FY 2009 audited financial statements to the public.

These ongoing financial reports will report data from the GAAP-compliant accounting data included in the trial balance. The pro forma data consists of the same type of data, save for the one adjustment to the retiree health benefits expense account. Each of the reports should have both versions of FY 2009 compared to the results from the applicable period in FY 2010. This comparison is important in determining the ongoing financial health of the Postal Service and in monitoring the Service's cost reduction efforts.

V. Conclusion

The proposal of the Postal Service to use pro forma accounting data in the preparation of the FY 2009 Annual Compliance Report should be allowed, however, it is premature to determine if the same dispensation should be granted for the FY 2010 Annual Compliance Report.

The Public Representative also recommends that the use of pro forma data in reporting FY 2010 ongoing results for the month, quarter, or annual results should also be accompanied by the GAAP compliant accounting data.

Respectfully submitted,

R. Kevin Harle
Public Representative

901 New York Avenue NW Suite 200
Washington DC 20268-0001
202-789-6824
kevin.harle@prc.gov