



September 30, 2010

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CHIEF FINANCIAL OFFICER AND EXECUTIVE VICE PRESIDENT

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SUBJECT: Management Advisory – Summary of Substantial Overfunding in Postal
Service Pension and Retiree Health Care Funds
(Report Number FT-MA-10-002)

This report summarizes the results of four U.S. Postal Service Office of Inspector General (OIG) reports identifying overfunding issues in employees' and retirees' benefit funds (Project Number 10BS002FT000). This self-initiated report addresses financial risk. See [Appendix A](#) for additional information about this topic.

The U.S. Postal Service has reached a critical point in its history. It faces tremendous challenges to overcome in order to remain financially sound and meet its mission. Because the Postal Service is such a large employer with substantial retirement benefits, prefunding requirements of its pension and retiree health care liabilities pose significant challenges. Our office has researched prefunding Postal Service pension and retiree health care funds to determine whether such requirements are reasonable and whether overfunding issues could exist.

Congress recognizes the Postal Service's financial challenges and the issues associated with prefunding certain liabilities. Two Congressional reports, the Senate Committee on Appropriations' *Report to Accompany S. 1436 Financial Services and General Government Appropriations Bill 2010* (Senate Report 111-43) and the U.S. House's *Conference Report to Accompany H.R. 3288 Departments of Transportation and Housing and Urban Development, and Related Agencies Appropriations Act, 2010*, (House Report. 111-366) make suggestions to the agency in this regard. The reports urge the Postal Service to coordinate with the Office of Personnel Management (OPM) and Office of Management and Budget (OMB) to develop a fiscally responsible legislative proposal granting a limited measure of relief from the Postal Accountability and Enhancement Act (Postal Act of 2006) requirements to prefund retiree health benefits.

This report discusses OIG reports the Postal Service can use when working with those agencies. It summarizes our work identifying overfunding in the pension and retiree health care funds and provides sizing information on the amounts of the overfunding.

Conclusion

We have planned or issued four OIG reports¹ presenting overfunding issues associated with pension and retiree health care funds. If our proposals to recover the overfunded amounts were placed in effect, the Postal Service could potentially recover \$142.4 billion. In addition, the Postal Service:

- Would no longer be required to prefund the Postal Service Retiree Health Benefits Fund (retiree health fund) an average of \$5.6 billion per year.
- Could prefund pensions and retirees' health benefits at benchmarked levels.
- Could pay existing retirees' health insurance premiums from the retiree health fund.
- Could extinguish its debt to the U.S. Department of the Treasury (Treasury).

The proposals could also provide significant levels of cash for operations, subject to any legislative restrictions placed on those funds. Finally, providing these funds would allow the Postal Service to continue optimizing its infrastructure at a more reasonable pace and minimize the impact on current employees. While these proposals might be more than the "limited measure of relief" envisioned by the Senate and House conference reports, they are critical to addressing the Postal Service's financial needs. Also, implementing these proposals could end the unjust practice of using Postal Service funds provided by postage ratepayers to fund benefits for non-postal government employees. These proposals include:

1. Recover the \$75 billion overfunding to the Civil Service Retirement System (CSRS) and use the funds to extinguish the Postal Service's \$10 billion debt to the Treasury² and finance retiree health care. Certain Postal Service employees and retirees were employed by the former Post Office Department and we determined the OPM's current method of funding CSRS pensions allocates a disproportionately higher share of costs to the Postal Service.³ If the Postal Service partially uses the funds to extinguish the debt, the Postal Service could avoid future annual interest expense of about \$157 million. See [Appendix C](#) for our calculation of monetary impact. Further, if the agency used the funds to

¹ We will issue the fourth report addressing prefunding pensions and retiree health care at 80 and 30 percent levels, respectively, in the near future.

² As of September 30, 2009.

³ *The Postal Service's Share of CSRS Pension Responsibility* (Report Number RARC-WP-10-001, dated January 20, 2010) and *Civil Service Retirement System Overpayment by the Postal Service* (Report Number CI-MA-10-001, dated June 18, 2010).

finance retiree health care, the Postal Service would be relieved of Postal Act of 2006's funding requirements.

2. Reduce prefunding levels to benchmarked standards of 80 percent for pensions and 30 percent for retiree health care. We benchmarked and found Standard and Poor's 500 companies' (S&P 500) prefunded levels for pensions to be 80 percent and Fortune 1000 companies retiree health care prefunded levels to be 30 percent.⁴

If the Postal Service prefunded its pension responsibilities at the benchmarked levels rather than the current 100 percent level, it could potentially recover \$45.9 billion.⁵ If the prefunding of the retiree health care liabilities were lowered to 30 percent, the Postal Service could recover \$9.2 billion. Combining the two amounts yields \$55.1 billion. We plan to issue our report on this matter in the near future.

3. Recover overfunding of FERS pension contributions of \$5.5 billion. Based on information from the OPM, the Postal Service's Federal Employee Retirement System (FERS) pension plan was overfunded at the end of fiscal year (FY) 2008 and projected to be overfunded at the end of FY 2009.⁶ Allowing some flexibility to address recent legislative changes in the fund and possible changes to actuarial assumptions, we determined the Postal Service could potentially recover \$5.5 billion due to overfunding. See [Appendix C](#) for our calculation of monetary impact.
4. Reduce the projected health care inflation rate to the industry standard of 5 percent. In our prior work in this area,⁷ we determined the OPM had assumed a 7 percent inflation rate, versus the benchmarked standard of 5 percent. Changes have been made to the OPM assumptions,⁸ but even with the revised inflation rates, there is overfunding. We estimated the Postal Service could potentially recover \$6.8 billion. See [Appendix C](#) for our calculation of monetary impact.

The table on the next page summarizes these initiatives and their impact, if enacted, in FY 2011. See [Appendix B](#) for further discussion and detailed analyses of these opportunities.

⁴ The federal government currently prefunds its pension responsibilities at 41 percent and its retiree health care liabilities at 0 percent. See the Postal Service inspector general's written statement *Continuing to Deliver: An Examination of the Postal Service's Current Financial Crisis and its Future Viability*, dated April 15, 2010, to the Committee on Oversight and Government Reform and the Subcommittee on the Federal Workforce, Postal Service, and the District of Columbia, U.S. House of Representatives.

⁵ \$31.8 billion from CSRS funding and \$14.1 billion from FERS funding.

⁶ The OPM has not yet determined the final FY 2009 funding status.

⁷ *Estimates of Postal Service Liability for Retiree Health Care Benefits* (Report Number ESS-MA-09-001(R), dated July 22, 2009).

⁸ Since we issued the report, the OPM has revised the projected inflation rate using a downward slope, commencing at 8 percent and ending at 5.5 percent.

Summary of Pension and Retiree Health Care Overfunding Issues

Opportunity	Potential Recovery	Additional Details
Recover CSRS overfunding.	\$75 billion ⁹	\$75 billion available for \$10 billion debt payment and operations (might be partially restricted for future retiree liabilities).
Reduce funding percentages for retiree pension and health care plans to benchmarked standard: <ul style="list-style-type: none"> ▪ CSRS/FERS at 80 percent. ▪ Retiree health care at 30 percent. 	\$55.1 billion ¹⁰ (\$31.8 billion CSRS, \$14.1 billion FERS, and \$9.2 billion retiree health care ¹¹).	\$55.1 billion available for operations (might be partially restricted for future retiree liabilities), payments for current retirees' health care insurance premiums paid from the retiree health fund, and payments to maintain fund levels calculated on an actuarial basis each year.
Recover FERS overfunding.	\$5.5 billion.	\$5.5 billion available for operations (might be partially restricted for future retiree liabilities).
Reduce excessive inflation assumptions on retiree health care from OPM sloping scale to 5 percent benchmarked standard.	\$6.8 billion, if done at the same time as reduced funding of retiree health care to 30 percent.	\$6.8 billion available for operations.
Total Potential Recovery	\$142.4 billion	

Source: Planned or issued OIG reports.

The Postal Service has opportunities to appropriately fund its pension and retiree health care obligations, reduce debt, eliminate burdensome Postal Act of 2006-required annual payments, and dramatically improve cash flow. The total potential is \$142.4 billion available for operations and other needs, in addition to other benefits, such as earning interest and eliminating interest payments.

These opportunities should be included in deliberations with the OPM and the OMB when addressing the Postal Service's financial condition. Furthermore, they should be included in discussions with Congress, the Postal Regulatory Commission, and other stakeholders, as appropriate. Addressing these issues would significantly improve the

⁹ The Segal Company, in its report to the Postal Regulatory Commission on this matter (*Report to the Postal Regulatory Commission on Civil Service Retirement System Cost and Benefit Allocation Principles*, dated June 29, 2010), estimated the overpayment as between \$50 billion and \$55 billion.

¹⁰ Based on September 30, 2009, balances.

¹¹ This amount represents a recovery based on reducing funding of retiree health care to 30 percent of the liability. The \$6.8 billion listed above represents reducing the liability based on lower expected inflation rate for future health care.

Postal Service's financial condition and allow it to operate in a business-like manner, effecting a transformation envisioned by the Postal Act of 2006.

We previously made recommendations addressing the \$75 billion CSRS overfunding for the OPM's improper allocation methodology, the \$5.5 billion FERS overfunding, and the \$6.8 billion for the OPM's use of excessive inflation assumptions. We will soon be making recommendations addressing a \$55.1 billion overfunding based on prefunding pensions at 80 percent and retirees health care at 30 percent of actuarial liabilities.

We recommend the chief financial officer and executive vice president, in coordination with the vice president, Government Relations and Public Policy:

1. Develop a comprehensive legislative strategy to recover overfunded amounts.
2. Aggressively pursue and carefully review all available data related to Civil Service Retirement System, Federal Employee Retirement System, and retiree health benefit calculations, including those associated with determining any overfunding situations, to ensure that calculations are reasonable and accurate.

Management's Comments

Management neither agreed nor disagreed with the recommendations or the monetary impact. However, management is currently working with Congress to address the findings of the four reviews summarized in this report. For example, they are actively pursuing a legislative solution to the CSRS overfunding, and are considering requesting legislation that would provide a mechanism to recover and resolve any future FERS overfunding.

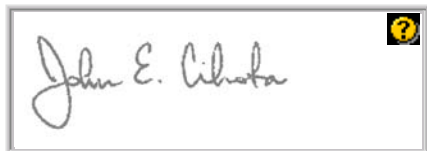
Further, management currently reviews the annual valuations provided by the OPM and plans to continue this effort. Prior to the Postal Act of 2006, management performed independent annual valuations of the retiree health fund and will consider reinstating this practice. While management has not performed regular independent valuations of the CSRS or FERS programs, they will consider reinstating this practice. See [Appendix D](#) for management's comments, in their entirety.

Evaluation of Management's Comments

The OIG considers management's comments responsive to the recommendations, and management's corrective actions should resolve the issues identified in the report. Although management did not provide specific target completion dates for corrective actions, the OIG understands management cannot predict when or if Congressional actions will be taken or completed. We will continue to monitor the actions taken by the Postal Service to address these recommendations.

The OIG considers both recommendations significant, and therefore requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective actions are completed. These recommendations should not be closed in the Postal Service's follow-up tracking system until the OIG provides written confirmation that the recommendations can be closed.

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.

A rectangular box containing a handwritten signature in cursive that reads "John E. Cihota". In the top right corner of the box, there is a small yellow square icon with a question mark.

John E. Cihota
Deputy Assistant Inspector General
for Financial Accountability

Attachments

cc: Stephen J. Masse
Kimberly A. Weaver
Corporate Audit and Response Management

APPENDIX A: ADDITIONAL INFORMATION

BACKGROUND

In recent years, the Postal Service has experienced an unprecedented reduction in mail volume. This decline resulted from a major recession the nation recently confronted and from diversion of letter mail to electronic alternatives. The effect of these two conditions has been a substantial drop in revenue, placing the Postal Service in dire financial circumstances.

Adding to the challenges, the Postal Service faces requirements by the Postal Act of 2006 to fund its future retirees' health care obligations through FY 2016 at an average of \$5.6 billion annually. In addition, it must pay its share of existing retirees' health care premiums of about \$2.2 billion annually. These burdensome requirements, when added to the decline in revenues, rendered the Postal Service capable of only making \$1.4 billion of the Postal Act of 2006-required retiree health care payment of \$5.4 billion as of September 30, 2009. Congress thus amended the required payment for FY 2009 to the amount the Postal Service paid.

The OIG has issued reports and a white paper detailing overfunding in pension and retiree health care funds that, if rectified, could enable the Postal Service to readily address the challenges. These opportunities would enable the Postal Service to fully meet its obligations, extinguish debt, and provide substantial positive cash flow.

Because Congress amended the Postal Act of 2006 for FY 2009 only, there remains a critical need for immediate action. The Postal Service is uncertain whether it will have sufficient cash on September 30, 2010, to fund the required \$5.5 billion payment to the retiree health care fund. Also, in July 2009, the Government Accountability Office (GAO) listed the Postal Service as one of its "high-risk" government agencies.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of this advisory is to summarize various OIG reports in identifying substantial cost-recovery opportunities related to employees' and retirees' benefits. We accumulated information from inspector general testimonies to Congress, prior audit and management advisory reports, the Postal Service's 2009 annual report, and other sources in preparing this report. We did not rely on computer-generated data to support the opinions and conclusions presented in this report.

We conducted this review from May through September 2010 in accordance with the *Quality Standards for Inspections*.¹² We discussed our observations and conclusions with management officials on September 10, 2010, and included their comments where appropriate.

PRIOR AUDIT COVERAGE

We issued the following reports addressing opportunities for recovering overfunded amounts related to employees' and retirees' benefits. Management generally agreed with our recommendations that included seeking financial relief.

Report Title	Report Number	Final Report Date	Report Results
<i>Federal Employees Retirement System Overfunding</i>	FT-MA-10-001	8/16/2010	This report identifies that the Postal Service overfunded its FERS contributions by \$5.5 billion. Also, there is no present legislation to resolve surpluses. Further, it recommends that the Postal Service's pension responsibilities be clearly delineated and separated from those of the rest of the federal government.
<i>Civil Service Retirement System Overpayment by the Postal Service</i>	CI-MA-10-001	6/18/2010	The report discusses the \$75 billion CSRS overfunding by the Postal Service, assesses the related facts, and identifies solutions.
<i>The Postal Service's Share of CSRS Pension Responsibility</i>	RARC-WP-10-001	1/20/2010	This report discusses the inequities of the current system of funding of the Postal Service's CSRS pension responsibility and explains that it has resulted in the Postal Service overfunding \$75 billion to the pension fund.
<i>Estimates of Postal Service Liability for Retiree Health Care Benefits</i>	ESS-MA-09-001(R)	7/22/2009	This report questions the OPM's assumption that the annual health care cost inflation rate will average 7 percent annually for all future years.

¹² These standards were last promulgated by the President's Council on Integrity and Efficiency (PCIE) and the Executive Council on Integrity and Efficiency (ECIE) in January 2005. Since then, The Inspector General Act of 1978 as amended by the IG Reform Act of 2008, created the Council of the Inspectors General on Integrity and Efficiency (CIGIE), which combined the PCIE and ECIE. To date, the *Quality Standards for Inspections* have not been amended to reflect adoption by the CIGIE and, as a result, still reference the PCIE and ECIE.

APPENDIX B: DETAILED ANALYSIS

CSRS Overfunding

The Postal Service overpaid its CSRS obligation by \$75 billion because the OPM calculates the federal government's portion of retirees' pensions using their salaries as of June 30, 1971.¹³ This "freeze frame" methodology results in a significantly higher liability for the Postal Service. Also, Public Law 108-18, passed in April 2003, requires the Postal Service to fund CSRS pension benefits on a "dynamic actuarial model." This model anticipates the effect of inflation, which includes both increases in salary and cost of living adjustments to pensions.

The "freeze frame" methodology resulted in the Postal Service overfunding its CSRS obligation by \$75 billion, which should be refunded. The \$75 billion refund would allow the Postal Service to pay off its \$10 billion of debt to Treasury. By doing this, the Postal Service could avoid annual future interest expense of about \$157 million. In addition, all required prefunding of pensions and retirees' health care could be met. Further, the Postal Service's payments for health benefit premiums of current retirees could be paid from the fund, eliminating an additional \$2.2 billion in payments per year.

On April 15 and 22, 2010, the postmaster general and chief executive officer discussed the issue in his testimony before a U.S. House of Representatives committee and U.S. Senate subcommittee, respectively. In addition, management, in response to the OIG advisory report concerning the \$75 billion overfunding, acknowledged the overfunding and stated that it is pursuing various options the OIG provided to obtain a more equitable CSRS valuation and access to any resulting funds.

In addition, the Segal Company (Segal), in its report to the Postal Regulatory Commission on this matter,¹⁴ recognized the economic impact of the OPM's actuarial calculations on the Postal Service. However, Segal estimated the overpayment being between \$50 billion and \$55 billion. Its lower estimate resulted from using a different methodology for calculation which found that the federal government should benefit from the graduated rates of earning pension benefits. Segal agreed with the OIG that the "freeze frame" approach should not be used and stated its belief that the Postal Service should be entitled to review, at its own expense, the OPM's actuarial assumptions, methods, and calculations in identifying the overfunded amount.

¹³ On that date, the U.S. Post Office Department ceased operations, and the U.S. Postal Service was established. Employees of the Post Office Department who were participants in the CSRS remained covered for retirement benefits when they became employees of the Postal Service.

¹⁴ *Report to the Postal Regulatory Commission on Civil Service Retirement System Cost and Benefit Allocation Principles*, dated June 29, 2010.

Prefund Pensions at 80 Percent and Retiree Health Care at 30 Percent

Our benchmarking results showed the Postal Service could fund pensions and the retiree health care fund at less than 100 percent of actuarial liabilities. The S&P 500 companies' median prefunding level for pensions in 2009 was 79 percent of their pension liabilities.¹⁵ The aggregate prefunding for states' pensions in 2008 was also 79 percent. In addition, the GAO has reported that many experts consider at least 80 percent prefunding to be sound for government pensions.¹⁶ Further, the Pension Protection Act of 2006 considers pensions that are prefunded at less than 70 percent as being "at risk" and attempts to protect such plans by commencing restrictions when prefunding is below 80 percent. By contrast, the federal government currently prefunds its pension responsibilities at 41 percent and the military at 24 percent. If the Postal Service's funding percentage was reduced to 80 percent, it would have overpaid its CSRS liability an additional \$31.8 billion and its FERS liability by \$14.1 billion, a total overfunding of \$45.9 billion.

Moreover, we determined the average level by Fortune 1000 companies that prefund retiree health care (many do not prefund) is 28 percent, and the military prefunds retiree health care at 29 percent. Also, we determined that state governments that prefund their retirees' health care averaged 30 percent. By contrast, the federal government does not prefund its retiree health care at all, even though its liabilities result from using the same plans as the Postal Service.

Rounding to 30 percent, the Postal Service could prefund its retiree health care plan liability at \$26.2 billion. With assets of about \$35.5 billion, the Postal Service has overfunded its obligation by \$9.2 billion. This overfunding combined with the \$45.9 billion overfunding from pensions would yield a \$55.1 billion potential recovery.

Using this approach, payments for pensions and retiree health care liability would need to be made each year on an actuarial basis to maintain funding levels at 80 percent and 30 percent. This approach provides the Postal Service with a means of maintaining fiscal responsibility during the current financial crisis. During financially lucrative periods, management could choose to prefund at higher levels. Consequently, there would no longer be a need for Postal Act of 2006 funding requirements averaging \$5.6 billion, as they would be superseded by this new obligation to maintain annual funding at a 30 percent level. Further, current retiree health care costs presently at about \$2.2 billion could be paid from the fund. We plan to issue a report on this matter in the near future.

¹⁵ From 2001 through 2009, S&P 500 companies' median pension prefunding ranged from 73 to 112 percent.

¹⁶ The GAO's *State and Local Government Retiree Benefits Current Funded Status of Pension and Health Benefits*, dated January 2008.

FERS Overfunding

Postal Service career employees hired after December 31, 1983, generally participate in FERS, which provides the same retirement benefits to other federal government employees. In FY 2009, the Postal Service contributed \$3 billion to FERS based on a contribution rate of 11.2 percent of employees' pay. The OPM establishes FERS contribution rates using actuarial assumptions for future rates of inflation, cost of living adjustments, annual salary increases, and an assumed rate of return. Funding is accomplished through employee payroll deductions, in addition to agency contributions. The funding status for the Postal Service, as well as the federal government, is calculated by subtracting the pension assets from the actuarial accrued liability.

At the end of FY 2008, the Postal Service's portion of FERS had a \$6.5 billion surplus based on information from the OPM. The FERS surplus was projected to be \$6.8 billion at the end of FY 2009.¹⁷

Recently legislation passed providing a retirement credit for sick leave for employees participating in FERS. This 30-year anticipated liability could reduce the current plan surplus by up to \$680 million. Additionally, we expect that changes in actuarial assumptions could reduce the surplus by another \$620 million. Even with these adjustments, there is a surplus of \$5.5 billion.

Controlling excessive surpluses in FERS pension obligations would substantially reduce the annual expenses incurred by the Postal Service and increase the cash flow from its operations. This action promotes the Postal Service's ability to operate on a self-supporting, break-even basis and cover its expenses through its revenue rather than taxpayer dollars.

The OPM's Assumed Health Care Inflation Rate

The Postal Service is required by the Postal Act of 2006 to prefund retirees' health care. Prefunding is accomplished via deposits into the retiree health fund. The OPM provides calculations of the fund's assets and values the related liabilities.

An employer's accumulated post-retirement benefit obligation, including retirees' health care, is the actuarial present value of all future benefits attributed to an employee's service rendered to that date. The obligation assumes the plan continues in effect and that all assumptions about future events are fulfilled. In developing an employer's assumed or future health care costs, estimates of health care inflation are considered.

We ascertained that the OPM's assumption that annual health care cost inflation will average 7 percent annually for future years is unreasonably high. Using this

¹⁷ The OPM has not yet determined the final FY 2009 funding status.

assumption, at the end of FY 2016, the estimated retiree health care liability is expected to be \$129.4 billion. Assets in the retiree health benefit plan are expected to be \$103.7 billion. The resulting unfunded liability would be \$25.7 billion, making the plan about 80 percent prefunded.

We determined industry, publicly owned utilities, and the private sector generally used a projected health care inflation rate of about 5 percent. Using this lower rate, at the end of FY 2016, the Postal Service will have a retiree health care liability of \$90.5 billion and asset funding of \$103.7 billion. Given the more reasonable health care inflation rate assumption, the Postal Service will have overfunded its retiree health care liability by \$13.2 billion, making the plan about 115 percent prefunded.

The OPM has since revised its trend rate for health care inflation from a flat 7 percent average to a sloped trend rate that starts at 8 percent and gradually decreases to 5.5 percent. Using this new trend rate, the OPM projected the Postal Service's retiree health liabilities to be \$87 billion as of the end of FY 2009.¹⁸ If the current sloped rate were reduced to the 5 percent level used in the private sector and were paired with the reduction in retiree health care prefunding levels to benchmarked standards (30 percent), the Postal Service could potentially recover another \$6.8 billion.

¹⁸ We have not seen any FY 2016 liabilities projected by the OPM since it commenced using sloped inflation rates.

APPENDIX C: MONETARY IMPACT

In prior reports, the OIG identified a monetary impact associated with the CSRS pension overpayment and retiree health benefits. Specifically, in the report *Civil Service Retirement System Overpayment by the Postal Service*,¹⁹ the OIG noted the Postal Service overpaid the CSRS fund about \$75 billion since 1971. The OIG calculated \$49.808 billion in monetary impact based on recovery of that amount; however, it did not include interest expense avoided as a result of extinguishing the Treasury debt. In addition, in the report *Estimates of Postal Service Liability for Retiree Health Care Benefits*,²⁰ the OIG questioned the OPM's assumption that the annual health care cost inflation rate will average 7 percent annually for all future years. The OIG calculated \$5.95 billion in monetary impact based on suspension of the Postal Act of 2006-required payments; however, it did not include savings related to altering the liability amount for retiree health benefits. The following summarizes the additional monetary impact identified.

Funds Put to Better Use²¹

Finding	Amount
Interest Expense Avoided	\$1,334,328,299
FERS Overfunding	3,297,375,216
Reduction in the Projected Health Care Inflation Rate	4,076,754,812
TOTAL	\$8,708,458,327²²

Interest Expense Avoided

The \$75 billion refund would allow the Postal Service to pay off its \$10 billion debt to Treasury. By doing this, the Postal Service could avoid future interest expense. We have calculated the related monetary impact as \$1,334 million, based on the length of and interest rates on the notes to Treasury as of September 30, 2009.

¹⁹ Report Number CI-MA-10-001, dated June 18, 2010.

²⁰ Report Number ESS-MA-09-001(R), dated July 22, 2009.

²¹ Funds that could be used more efficiently by implementing recommended actions.

²² The total potential recovery is \$142.5 billion. This appendix recognizes monetary impact for the three areas listed using present value computations. The OIG has claimed in prior reports monetary impact related to CSRS overfunding and savings related to suspending its Postal Act of 2006-required annual payments. The OIG also intends to claim additional monetary impact related to reducing prefunding levels to benchmarked standards when we issue that report in the near future.

Interest Avoided on Elimination of Treasury Debt	Amount (in millions)
Annual Average Amount of Debt Carried	\$7,397 ²³
Annual Payment Reduction in Interest Expense	(\$157)
Present Value of Interest Expense Avoided for a 10-Year Period ²⁴	\$1,334

FERS Overfunding

Current OPM funding rules state that underfunded amounts are amortized over 30 years and the annual payment represents a supplemental amount in addition to the normal cost. No provision for correcting a surplus situation currently exists; therefore, the current rules are described as “asymmetric.”²⁵

We assume the current \$5.5 billion surplus amount could be corrected in a manner analogous to the OPM’s funding rules for an underfunded situation whereby that amount is amortized over 30 years and the resulting annual payment is deducted from the annual Postal Service FERS normal cost contribution to the fund. Effectively, the Postal Service would be providing the OPM with a 30-year loan at a 5.75 percent annual interest rate.

²³ We estimated the average principal on the revolving line of credit by averaging the ending balance sheet amounts for Q4, FY 2009; Q1, FY 2010; Q2, FY 2010; and Q3, FY 2010.

²⁴ Using the Postal Service’s current cost of capital rate of 3.875 percent, OIG policy allows monetary impact to be calculated for a 10-year period.

²⁵ Not identical on both sides of a central line.

FERS Pension Surplus	Amount (in millions)
Projected Overfunded Amount as of September 30, 2009	\$6,800
Less: Impact of 30-Year Anticipated Liability for Sick Leave Credit	(680)
Less: Impact of Potential Changes to Actuarial Assumptions	(620)
Adjusted Surplus	<u>\$5,500</u>
Annual FERS Payment Reduction Amount Resulting from Amortizing \$5.5 Billion Adjusted Surplus Over 30 Years ²⁶	<u>(\$389)</u>
Present Value of Cumulative Annual Reduction Amounts for a 10-Year Period ²⁷	<u>\$3,297</u>

Reduction in the Projected Health Care Inflation Rate

Similar to the FERS overfunding above, we assume the current \$4.1 billion surplus amount could be corrected in a manner analogous to the OPM's funding rules for an underfunded situation.

Retiree Health Care Surplus	Amount (in millions)
Projected Overfunded Amount as of September 30, 2009	<u>\$6,800</u>
Annual Payment Reduction Amount Resulting from Amortizing \$6.8 Billion Adjusted Surplus Over 30 years ²⁸	<u>(\$481)</u>
Present Value of Cumulative Annual Reduction Amounts for a 10-Year Period ²⁹	<u>\$4,077</u>

²⁶ Using the OPM's current discount rate of 5.75 percent.

²⁷ Using the Postal Service's current cost of capital rate of 3.875 percent. OIG policy allows monetary impact to be calculated for a 10-year period.

²⁸ Using the OPM's current discount rate of 5.75 percent.

²⁹ Using the Postal Service's current cost of capital rate of 3.875 percent. OIG policy allows monetary impact to be calculated for a 10-year period.

APPENDIX D: MANAGEMENT'S COMMENTS



September 30, 2010

MS. LUCINE WILLIS

SUBJECT: Management's Response to the "Transmittal of Draft Management Advisory – Summary of Substantial Overfunding in Postal Service Pension and Retiree Health Care Funds" (Report Number FT-MA-10-DRAFT)

The above-referenced report summarizes the results of four reviews by the United States Postal Service Office of the Inspector General (OIG). Final reports have been issued on three of the reviews, and we have considered a draft report for the fourth piece of work. All four reviews have focused on the funded status of the Postal Service's employee and retiree benefit funds.

Management has responded separately to each of the three issued reports. Management agreed that the Postal Service has overfunded the current pension obligations of the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS). Management also agreed that the assumptions used by the Office of Personnel Management (OPM) to value the obligations of the Postal Service Retiree Health Benefits Fund (PSRHBF) are conservative, resulting in higher-estimated obligations.

In the fourth review, with the report still in a draft stage, the OIG examined the funding policies for our retirement programs, as represented by CSRS, FERS, and the PSRHBF. The OIG compared our statutorily mandated funding levels, which require 100% funding, with retirement plan funding levels achieved by commercial and other governmental entities. The OIG's draft recommendation is for funding levels of 80% for the two pension funds and 30% for the retiree health benefits fund. We believe those recommended funding levels are a matter of public policy to be ultimately decided by the Congress and the Administration.

Management is, however, currently working with Congress to address the findings of the four reviews summarized in this report. In response to the OIG's specific recommendations, we offer the following:

Recommendation 1:

Develop a comprehensive legislative strategy to recover overfunded amounts.

Response:

Regarding CSRS, management has pursued the processes available in the Postal Accountability and Enhancement Act (PAEA) by obtaining an independent review of the CSRS valuation by the Postal Regulatory Commission (PRC). The PRC findings supported the contention in the OIG report that the CSRS is overfunded. In their response to the PRC's report, OPM concluded that OPM does not have the authority to make a reallocation in the manner suggested in the PRC's report. They state that the current approach for determining the CSRS liabilities is appropriate and supportable, and as a matter of law, cannot be modified by OPM without new legislation. Management has been actively pursuing a legislative solution to the CSRS overfunding, and currently, there are two bills pending in Congress that address this issue.

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Management initiated contact with OPM to address the FERS overfunding issue. We were advised by OPM that again, as a matter of law, there is no current mechanism to resolve the surplus funding issue. We plan to file an appeal to OPM's proposed increase in FERS contribution rates that are effective October 1, 2010, as one means to potentially minimize possible overfunding. Management is also considering requesting legislation that would provide a mechanism to recover and resolve any future FERS overfunding.

Recommendation 2:

Aggressively pursue and carefully review all available data related to CSRS, FERS, and retiree health benefit calculations, including those associated with determining any overfunding situations, to ensure that calculations are reasonable and accurate.


Response:

The Postal Service currently reviews the annual valuations provided by OPM for financial reporting purposes and plans to continue this effort. Prior to the PAEA of 2006, the Postal Service performed independent annual valuations of the PSRHBf for financial disclosure purposes and will consider reinstating this practice. While we have not in the past performed regular independent valuation of the CSRS or FERS programs, management will consider instituting this practice.

This report and management's response does not contain information that may be exempt from disclosure under the Freedom of Information Act.



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