United States General Accounting Office

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Report to Congressional Requesters

December 2001

UNITED STATES POSTAL SERVICE

Information on Retirement Plans

GAO-02-170

Contents

Abbreviations

CSRDF	Civil Service Retirement and Disability Fund
CSRS	Civil Service Retirement System
CPI-W	Consumer Price Index for Urban Wage Earners and Clerical Workers
COLA	cost-of-living adjustments
FEHBP	Federal Employees Health Benefit Program
FERS	Federal Employees Retirement System
OPM	Office of Personnel Management
TSP	Thrift Savings Plan
USPS	United States Postal Service

United States General Accounting Office
Washington, D.C. 20548

December 31, 2001

The Honorable Joseph I. Lieberman
Chairman
The Honorable Fred Thompson
Ranking Minority Member
Committee on Governmental Affairs
United States Senate

The Honorable Daniel K. Akaka
Chairman
The Honorable Thad Cochran
Ranking Minority Member
Subcommittee on International Security, Proliferation,
and Federal Services
Committee on Governmental Affairs
United States Senate

Your March 21, 2001, letter expressed concern about a number of issues pertaining to the United States Postal Service's (USPS) financial condition. This report addresses one of the issues raised in your letter, namely, identifying longer-term structural or operational issues that may affect the Service's ability to provide affordable universal postal service on a break-even basis. One key operational issue involves the Service's retirement costs and future liabilities. The Service's financial outlook has deteriorated significantly over the past few years. The Service finished fiscal year 2000 with a $199 million net loss and recently announced a $1.7 billion net loss for fiscal year 2001. The Service also projects a net loss of $1.35 billion for fiscal year 2002.[1] However, it is unknown what the impact of the events of September 11, 2001 and the subsequent delivery of anthrax spores through the U.S. mail will have on the volume and cost of future mail service. Consequently, estimated losses, and other projections in this report, which we and the Service's independent auditors have not verified, may be changed by USPS at a later date.

These current and projected losses are putting pressure on the Service's cash flows from operations and its debt situation. One major expense the Service incurs each year is for retirement benefits, and the Service

[1]For fiscal year 2001 USPS reported total revenue of $65.8 billion, and projects $68.8 billion in total revenue for fiscal year 2002.

anticipates significant increases in its retirement benefit expenses in future years. As agreed with your offices, we are providing information about the cost and funding requirements of the Service for federal retirement plans and other retirement benefits, which were 14.7 percent of total operating expenses in fiscal year 2000.

Results in Brief

According to USPS officials, its annual retirement plan costs are projected to increase significantly in the next 10 years from a cost of $8.5 billion in fiscal year 2000 to approximately $14 billion in fiscal year 2010. This significant increase presents a serious financial challenge to USPS management. The projected future cost of retirement benefits could have a material impact on the Service's ability to operate on a break-even basis without significant increases to the rates charged for universal postal service.

Contributing to the Service's increasing annual retirement costs is a mounting debt related to pay increases to employees resulting from new labor contracts and annual cost-of-living adjustments (COLA) for retirees, which were prescribed by law. USPS is responsible for paying both of these additional retirement costs[2] as part of its goal to operate on a self-supporting, break-even basis and cover its expenses almost entirely through postal revenues, not taxpayer dollars. The Service pays for these costs on an installment basis with related interest charges, as prescribed by law. Consequently, the Service reported to the Office of Personnel Management (OPM) an outstanding liability for future retirement benefits associated with this obligation of $32.2 billion as of September 30, 2000, and anticipates paying an additional $16.5 billion in future interest charges on this retirement liability over a 30-year period. The Service's cumulative retirement liability for this obligation has been growing each year even though the Service has been making significant, annual installment payments.

Although not part of a retirement plan, the Post-Retirement Health Benefit Program is an additional benefit available to USPS retirees. The cost of this benefit was $744 million in fiscal year 2000. When this benefit cost is added

[2]According to OPM, the U.S. Treasury makes a special annual contribution to OPM on behalf of all other federal agencies to cover increases in accumulated retirement benefits resulting from new or liberalized benefits, increases in pay, or extension of coverage to new employee groups.

to the retirement plan cost of $8.5 billion in fiscal year 2000, the total retirement-related cost for fiscal year 2000 is $9.3 billion. The Service projects the cost of this additional post-retirement health benefit to be $2 billion in fiscal year 2010. When this is added to the $14 billion of retirement plan expenses, the Service may be faced with a total retirement-related cost of $16 billion in fiscal year 2010.

USPS and OPM substantially agreed with our report. Matters of emphasis and points of clarity accompanying USPS' oral comments have been reflected in this report, as appropriate. OPM's written response is reprinted in appendix IV, along with our comments.

Background

The United States Postal Service commenced operations on July 1, 1971, in accordance with the provisions of the Postal Reorganization Act of 1970 (P.L. 91-375). The Service is an independent establishment of the executive branch with a goal to operate on a break-even basis and cover its expenses almost entirely through postal revenues. The equity the U.S. government held in the former Post Office Department became the initial capital of USPS (approximately $3 billion), and the U.S. government remained responsible for all the liabilities attributable to operations of the former Post Office Department. At inception, the Postal Service did not have any unpaid liabilities to OPM for retirement benefits. At that time, USPS employees participated in the federal Civil Service Retirement System (CSRS), which provided them the same benefits as other federal employees, that is, their future retirement benefits would be paid by OPM based on payroll deductions and USPS contributions under provisions of law governing CSRS.

With over 900,000 employees at the end of fiscal year 2000, USPS has the largest number of federal civilian employees, and *Fortune* magazine ranks it as the second largest employer in the United States. Similar to other federal career employees, USPS career employees participate in one of three federal retirement systems primarily administered by OPM:

- the Civil Service Retirement System,
- the Federal Employees Retirement System (FERS), and
- the CSRS Offset Plan.

At the end of fiscal year 2000, nearly 786,000 USPS career employees, or 87 percent of the Service's employees, were participating in one of the three federal retirement programs. The remaining 13 percent were casual labor and transitional employees who do not participate in the federal retirement plans. Of the total career employees, 263,383 employees (33.5 percent) participated in CSRS; 510,509 employees (65 percent) participated in FERS; and 12,021 employees (1.5 percent) participated in the CSRS Offset Plan.

Plan 1 – Civil Service Retirement System

CSRS is administered by OPM, which maintains a Civil Service Retirement and Disability Fund (CSRDF) for federal employees. CSRS is a defined benefit retirement plan,[3] which provides a basic annuity[4] to participants. Benefit payments to federal retirees and their survivors participating in any of the three retirement plans are made from CSRDF. CSRS covers employees hired prior to January 1, 1984. Employees hired after December 31, 1983, are not eligible for coverage in CSRS, but participate in either FERS or the CSRS Offset Plan. Contributions to the CSRS plan are collected from the Service and its employees and deposited into OPM's CSRDF, according to the proportionate sharing arrangement established in law.[5] Participating USPS employees contribute in the same proportion and percentage amounts as most other civilian federal employees. USPS and its employees also contribute to Medicare at the rate prescribed by law.

[3]A *defined benefit plan* specifies the benefit to be received at retirement by the employee participant. The plan calculates the benefit based on an established formula that incorporates the average or final salary and years of service.

[4]An *annuity* is a stream of equal periodic amounts either paid to or received from parties according to an agreement specifying the terms of the payment or receipt.

[5]OPM reported in its fiscal year 2000 Actuarial Valuation of the Civil Service Retirement and Disability Fund that it had an unfunded actuarial liability of $512.9 billion because the methods used to compute the standard annual contributions differ from what is needed to fully fund the retirement plans over the balance of federal employees' working careers. This unfunded liability relates to the CSRS plan as a whole, not FERS or the CSRS Offset Plan, and is not specific to the Service. It is currently unknown whether OPM's unfunded pension liabilities for CSRS could have a future impact on USPS.

Table 1: USPS and Employee CSRS Contribution Rates, as a Percentage of Basic Pay

Calendar year	USPS	Employee
1984 through 1998	7.00%	7.00%
1999	7.00%	7.25%
2000	7.00%	7.40%

In addition to the contributions to CSRS discussed above, the Service is responsible for making additional contributions to CSRDF to fund the future retirement costs of increases to pay that the Service granted to employees under terms in new labor contracts and the annual COLAs to retirees, which were prescribed by law. The provisions for the Service to make these additional contributions to OPM were included in amendments to the law governing CSRS and make the funding of USPS retirement plans different from other federal agencies making annual contributions to the federal CSRS retirement plan.[6] USPS makes these payments without any additional contributions from employee pay.

Plan 2 - Federal Employees Retirement System

In the Social Security Amendments of 1983 (P.L. 98-21), Congress mandated participation in Social Security by all civilian federal employees initially hired after December 31, 1983. Because Social Security provides both retirement and disability benefits, and because enrolling federal workers in both CSRS and Social Security would have resulted in employee contributions of more than 13 percent of each worker's salary, Congress directed the development of a new federal employee retirement system with Social Security as the cornerstone. The result of these efforts was FERS, created by P.L. 99-335, enacted on June 6, 1986.

[6] See 5 U.S.C. § 8348 (h) and (m). See also 39 U.S.C. § 1005 (d).

All permanent federal employees, including USPS employees, whose initial federal employment began after December 31, 1983, are covered by FERS, as are employees who voluntarily switched from CSRS to FERS during specified "open seasons." FERS consists of three elements: Social Security, a FERS annuity (a defined benefit plan), and a Thrift Savings Plan (TSP) (a defined contribution retirement savings and investment plan[7]).

Table 2: USPS and Employee FERS Contribution Rates, as a Percentage of Basic Pay

Calendar year	USPS	Employee
1987	13.50%	1.30%
1988 through 1989	12.86%	0.94%
1990	13.00%	0.80%
1991 through 1994	12.90%	0.80%
1995 through 1997	11.40%	0.80%
1998	10.70%	0.80%
1999	10.70%	1.05%
2000	10.70%	1.20%

The Service and its employees also contribute to Social Security and Medicare at the rates prescribed by law.

In addition, USPS is required to contribute to TSP a minimum of 1 percent per year of basic pay for employees covered by FERS. The Service also matches voluntary employee contributions up to 3 percent of an employee's basic pay, and 50 percent of a contribution from 3 to 5 percent of basic pay.

Plan 3 – CSRS Offset Plan

In the legislation that created FERS, Congress also created the CSRS Offset Plan. Typically, CSRS Offset retirement applies to employees who had breaks in service that exceeded 1 year and ended after 1983 and had 5 years

[7]A *defined contribution plan* specifies the amount of the periodic contribution to be paid by the employer rather than the benefits to be received by the employee participant, as in a defined benefit plan. A participant's benefits are usually based on the amount credited to the individual's account. Sponsor contributions are determined by applying a specified rate against a variable, such as labor hours worked or wages earned.

of creditable civilian service as of January 1, 1987. CSRS Offset retirement coverage also applies to employees hired before January 1, 1984, who acquired CSRS coverage for the first time after that date and had at least 5 years of creditable service by January 1, 1987. Under this plan, each employee and employer contribute an equal amount into Social Security, as prescribed by law. In retirement, these employees' CSRS benefits are reduced (offset) by a portion of their Social Security benefits.

Under the provisions of the CSRS Offset Plan, both USPS and the employee contribute a percentage of the employee's basic pay to the CSRS fund, Social Security, and Medicare at the statutorily prescribed rates.

Table 3: USPS and Employee CSRS Offset Plan Contribution Rates, as a Percentage of Basic Pay

Calendar year	USPS	Employee
1984 through 1998	7.00%	0.80%
1999	7.00%	1.05%
2000	7.00%	1.20%

Scope and Methodology

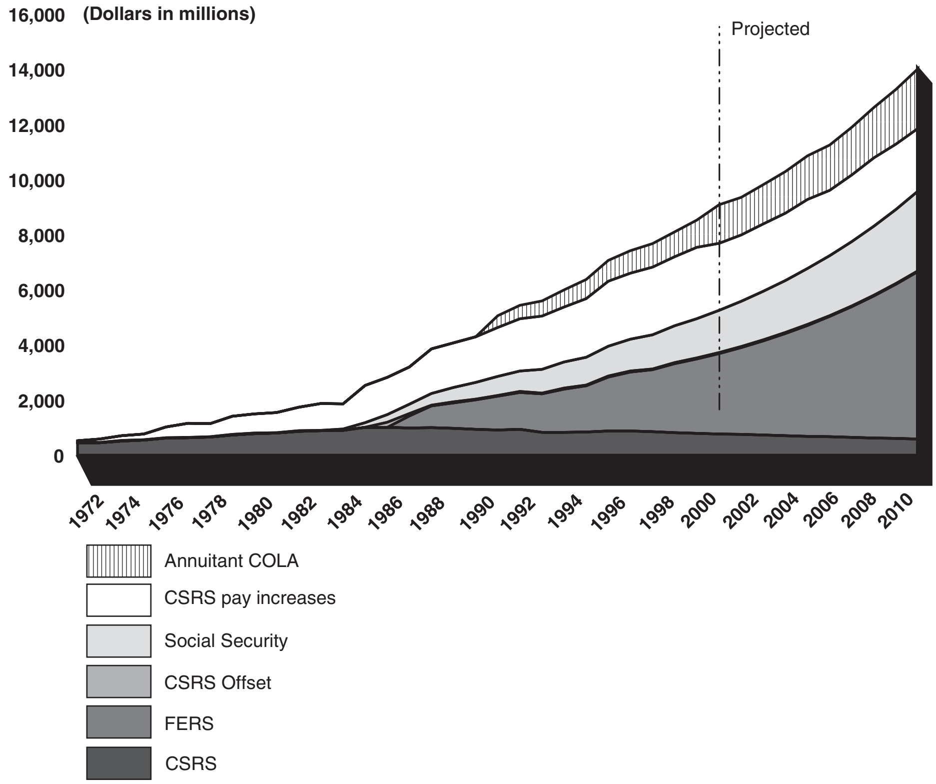
To better understand the full nature and components of the Service's retirement plans, we (1) interviewed officials at the Service and OPM, (2) reviewed and analyzed documents, including legislation, funding plans, budget documents, financial statements, USPS projections, and fiscal impact statements, and (3) analyzed the future projected costs of these plans. Our scope did not include identifying ways for the Service to respond to the current legal framework for funding its retirement liabilities to OPM for annual increases to CSRS basic pay and retiree COLAs. We conducted our work from May 2001 through October 2001 in accordance with generally accepted government auditing standards. We did not independently verify underlying data. We obtained oral comments from USPS and written comments from OPM on a draft of this report. OPM's written comments are reprinted in appendix IV.

Estimated Future Annual Costs for the Three Plans

The Service projects that the total annual retirement costs for the three plans, including installment payments for its additional liability for increases in pay and retiree COLAs under CSRS, will increase over the next 10 years from $8.5 billion in fiscal year 2000 to an estimated $14 billion in fiscal year 2010. The FERS portion of that total, including Social Security, is estimated to more than double from $4.1 billion in fiscal year 2000 to $9 billion in fiscal year 2010. See figure 1 for the total of all the retirement plans' historical and projected annual costs, including the installment payments made by USPS for its additional obligation to OPM for increases in pay and retiree COLAs under CSRS. See appendix I for the dollar amounts of each plan's cost, including payments for increases to CSRS employees' basic pay and retirees' COLAs. [8]

[8]We did not review the Postal Service's underlying assumptions that would support the projected amounts for fiscal years 2001 through 2010. Therefore, no comparison could be made to OPM assumptions normally used for such projections. Such a comparison would reveal any discrepancies in the method and amounts that may affect the financial outcome and the reliability of the projections.

Figure 1: Total Historical and Projected Annual Retirement Costs



Source: USPS data (not independently verified by GAO).

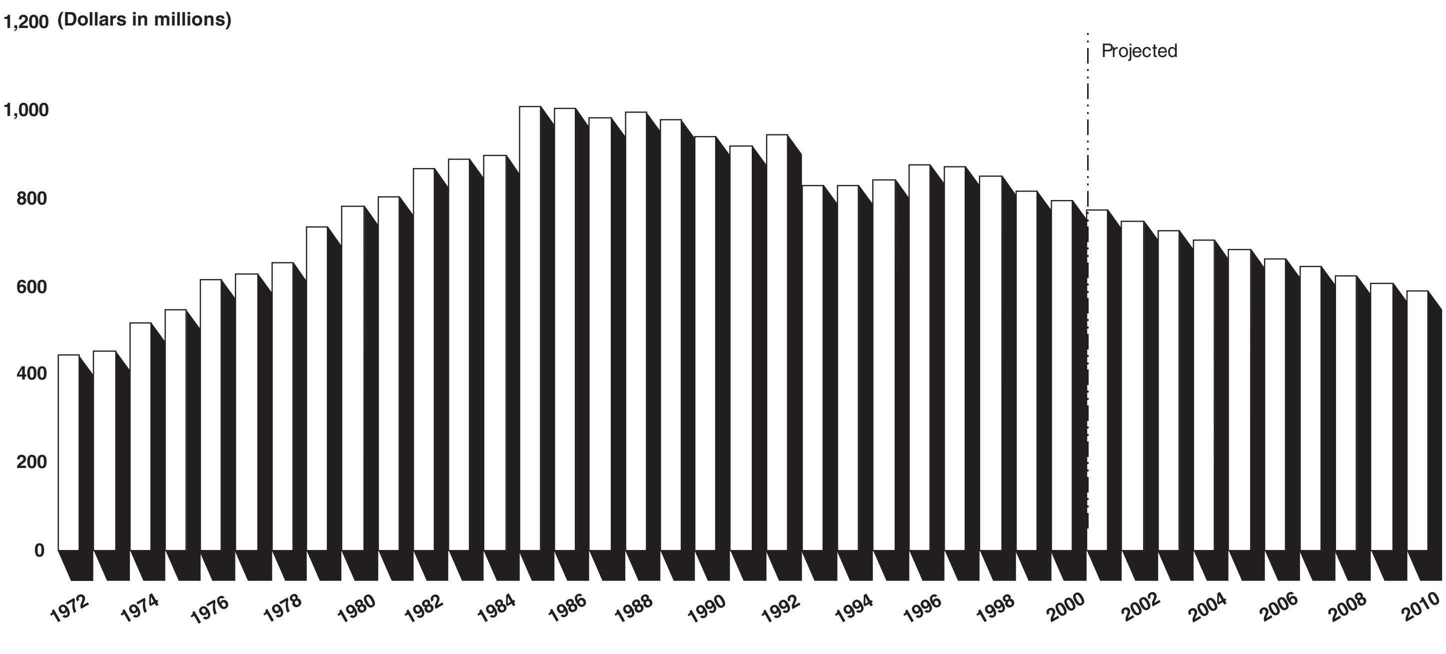
A discussion of the costs for each of the three individual plans follows.

Costs and Payments of the Three Individual Plans

CSRS

The cost of the CSRS retirement plan for fiscal year 2000 was $800 million, excluding the payments made toward the Service's additional obligation to OPM. Although total pension costs for all three retirement plans are expected to increase significantly, USPS estimates that the cost for the standard, annual CSRS contributions[9] will decrease in the future as current employees participating in the plan begin to retire. (See figure 2.)

Figure 2: Historical and Projected Standard Annual Cost of CSRS



Source: USPS data (not independently verified by GAO).

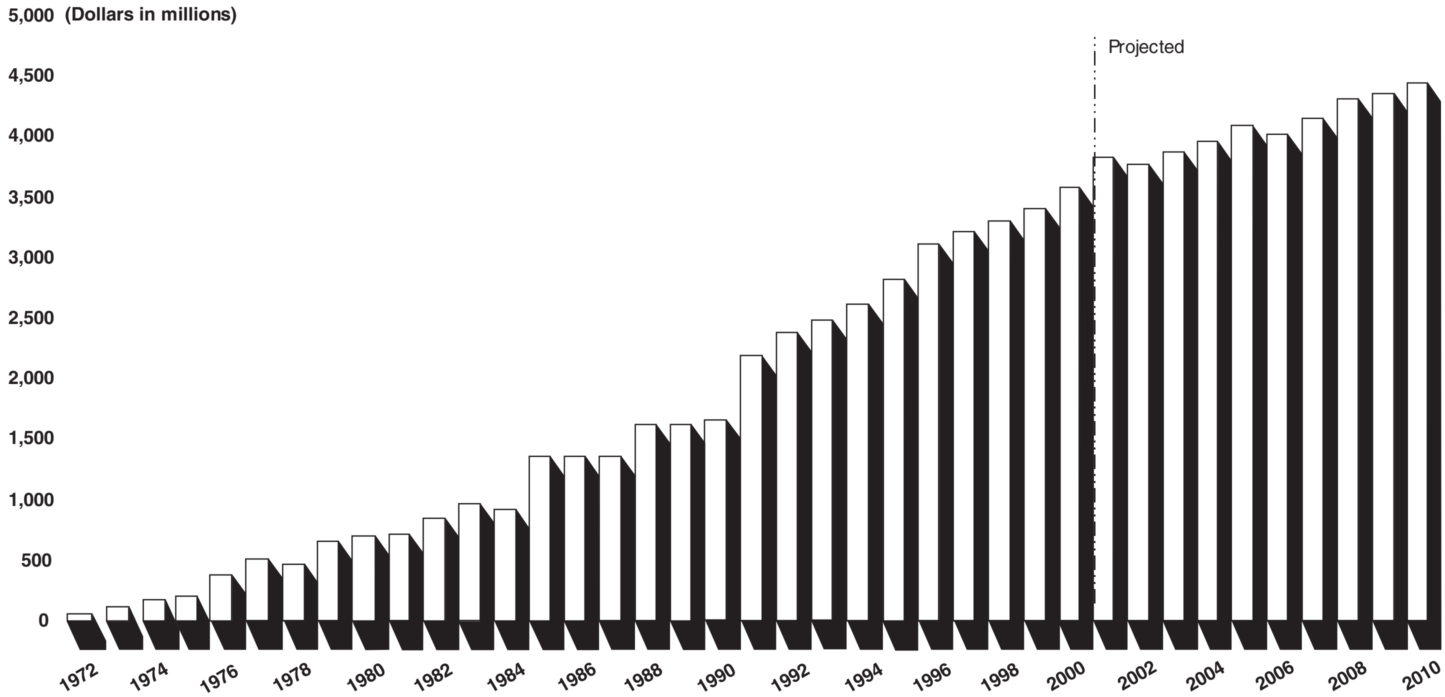
[9]For purposes of this report, the standard annual contributions to a retirement plan administered by OPM refer to the employers' contributions, based on employee pay, as set forth by law.

In addition to the standard, annual contributions to CSRS discussed above, the Service is responsible for paying additional amounts to CSRDF to fund the future costs of pay increases that USPS granted to its employees under terms in new labor contracts and the annual COLAs to retirees, which were prescribed by law.

The provisions for USPS to make these additional contributions to OPM make the funding of the Service's retirement plans for both pay increases and COLAs different from other federal agencies making annual contributions to the federal CSRS retirement plan.

As described in more detail in a later section of this report, USPS makes annual installment payments to OPM toward its additional liability for CSRS employees' pay increases and retirees' COLAs. The total installment payment for these liabilities in fiscal year 2000 was $3.6 billion, which included $1.6 billion in interest charges and $2 billion in principal payments. The Service estimates that its annual payments for these liabilities will continue to be significant, increasing steadily through fiscal year 2010, then decreasing at some later point as the number of employees, retirees, and survivors under CSRS decreases. (See figure 3.)

Figure 3: Historical and Projected Total Costs for Pay Increases, COLAs, and Interest Payments

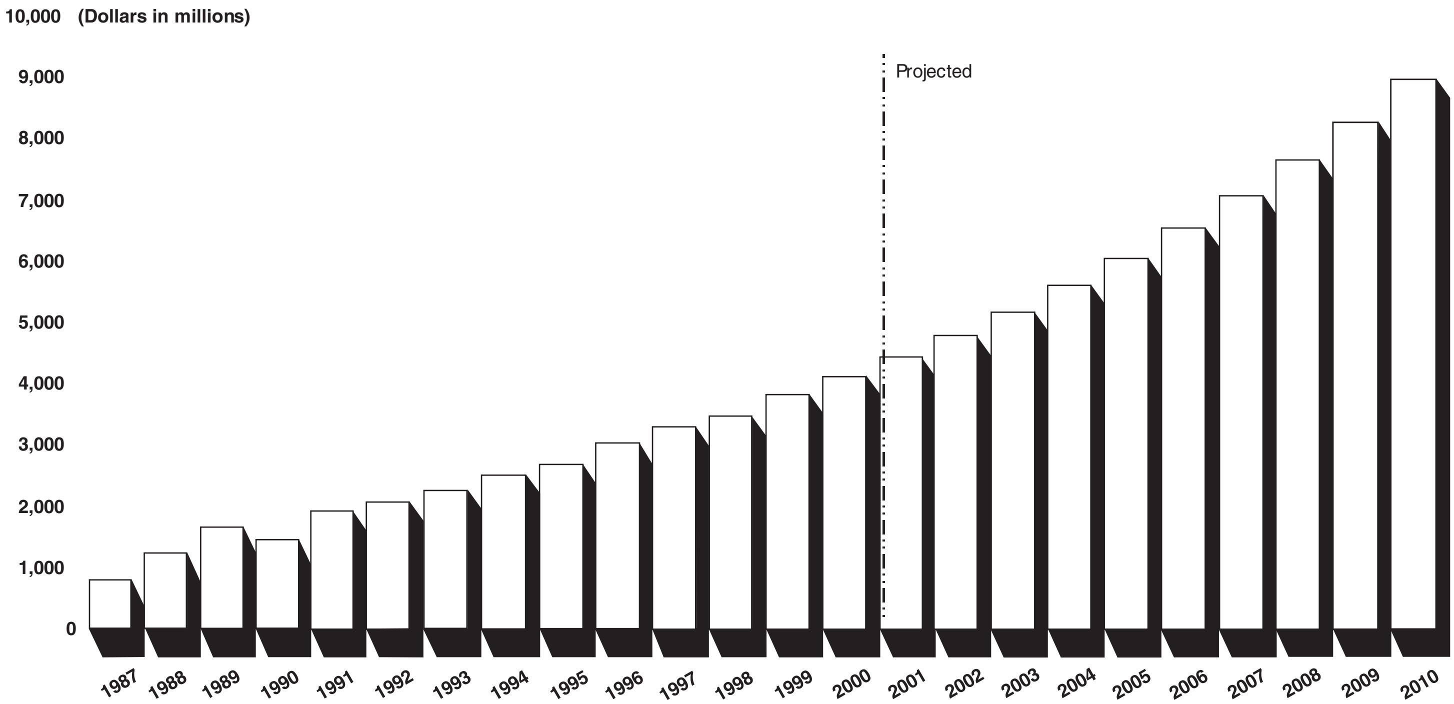


Source: USPS data (not independently verified by GAO).

FERS

The cost of FERS for fiscal year 2000 was $4.1 billion. The Service estimates that the annual cost of FERS will more than double to approximately $9 billion by fiscal year 2010. The large increase in FERS costs is expected because new employees (those hired after January 1, 1984) are mostly only eligible to participate in FERS. (See figure 4.) As employees in CSRS retire, they will be replaced by employees participating in FERS. The employers' standard, annual contributions toward FERS are higher than CSRS because FERS contributions are calculated by OPM on a stronger actuarial basis than CSRS contributions. FERS contributions are on a "dynamic" basis, which includes assumptions for future rates of inflation, future salary increases, and a provision for an assumed percentage rate of return on plan investments. Together, USPS contributions and employee withholdings are intended to fully fund the annual pension cost for employees covered under FERS over the employees' working careers with the Service.

Figure 4: Historical and Projected Cost of FERS

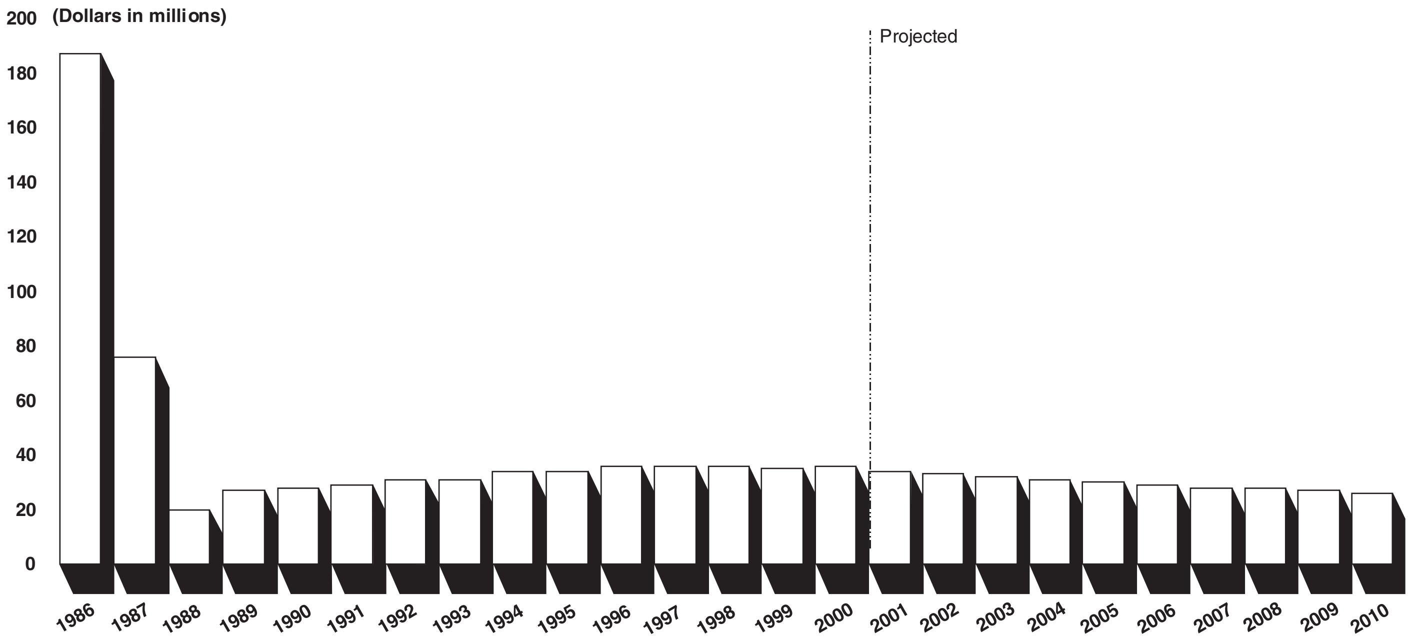


Source: USPS data (not independently verified by GAO).

CSRS Offset Plan

The cost of this plan for fiscal year 2000 was $35 million. Although total pension costs for USPS are expected to increase significantly, it estimates that the standard, annual contributions to the CSRS Offset Plan will decrease in the future as current employees participating in the plan begin to retire. (See figure 5.) The plan became effective during fiscal year 1986, but it covered certain employees hired after 1983; consequently, amounts paid in fiscal years 1986 and 1987 by the Service represent the retroactive effect of those costs.

Figure 5: Historical and Projected Annual Cost of the CSRS Offset Plan



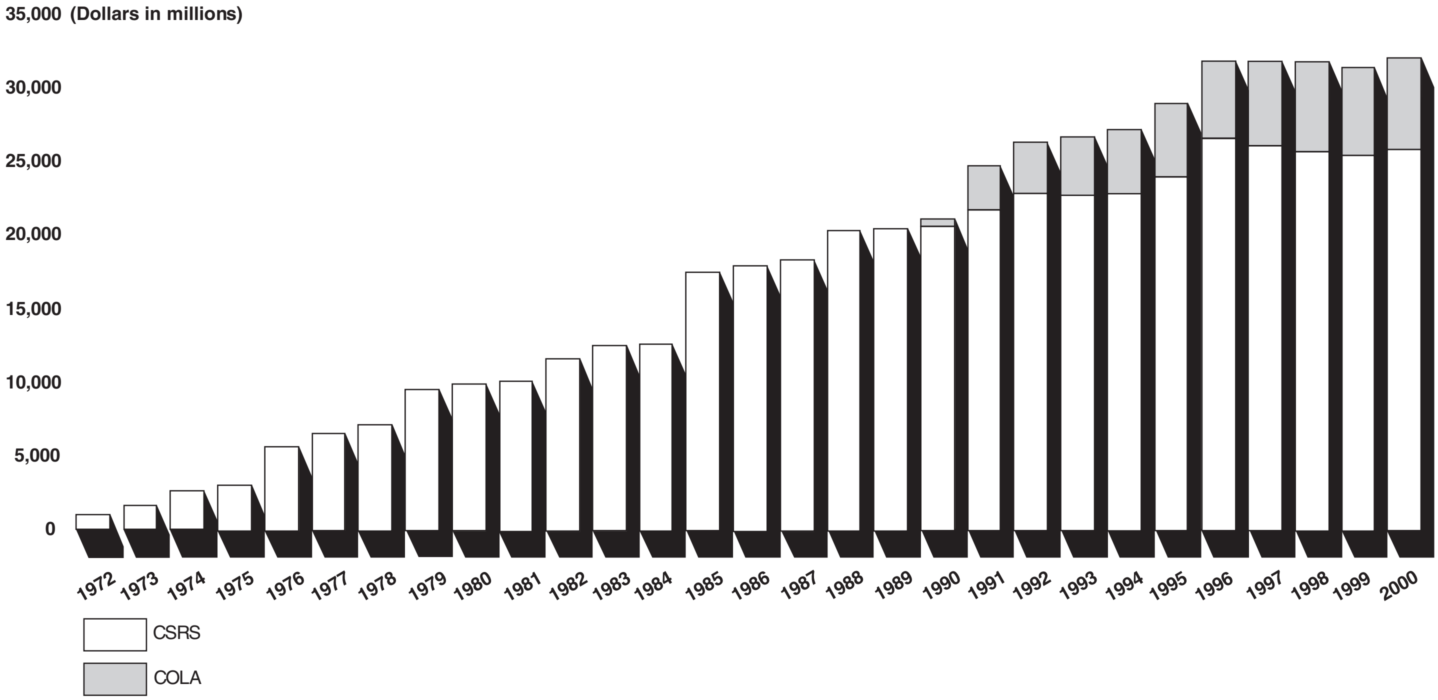
Source: USPS data (not independently verified by GAO).

Funding Status of the Three Plans

The Service pays in full its standard, annual retirement payments to OPM under provisions of the laws governing all federal employees participating in CSRS, FERS, and the CSRS Offset Plan. In addition, the Service reported in its fiscal year 2000 audited financial statements an outstanding liability for future retirement benefits of $32.2 billion (excluding $16.5 billion of future related interest charges over 30 years) due to obligations that made the Service liable for pay increases that employees received under terms of new labor contracts and for COLAs to retirees, who retired on or after July 1, 1971, and their survivors, under the CSRS retirement plan. COLAs are based on the rate of inflation as measured by the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). As prescribed by law, all CSRS retirees and survivors receive yearly COLAs equal to the annual percentage change in the CPI-W.

The Service's total liability balance has generally been increasing each year, even though it has been making annual installment payments toward this retirement liability. (See figure 6.)

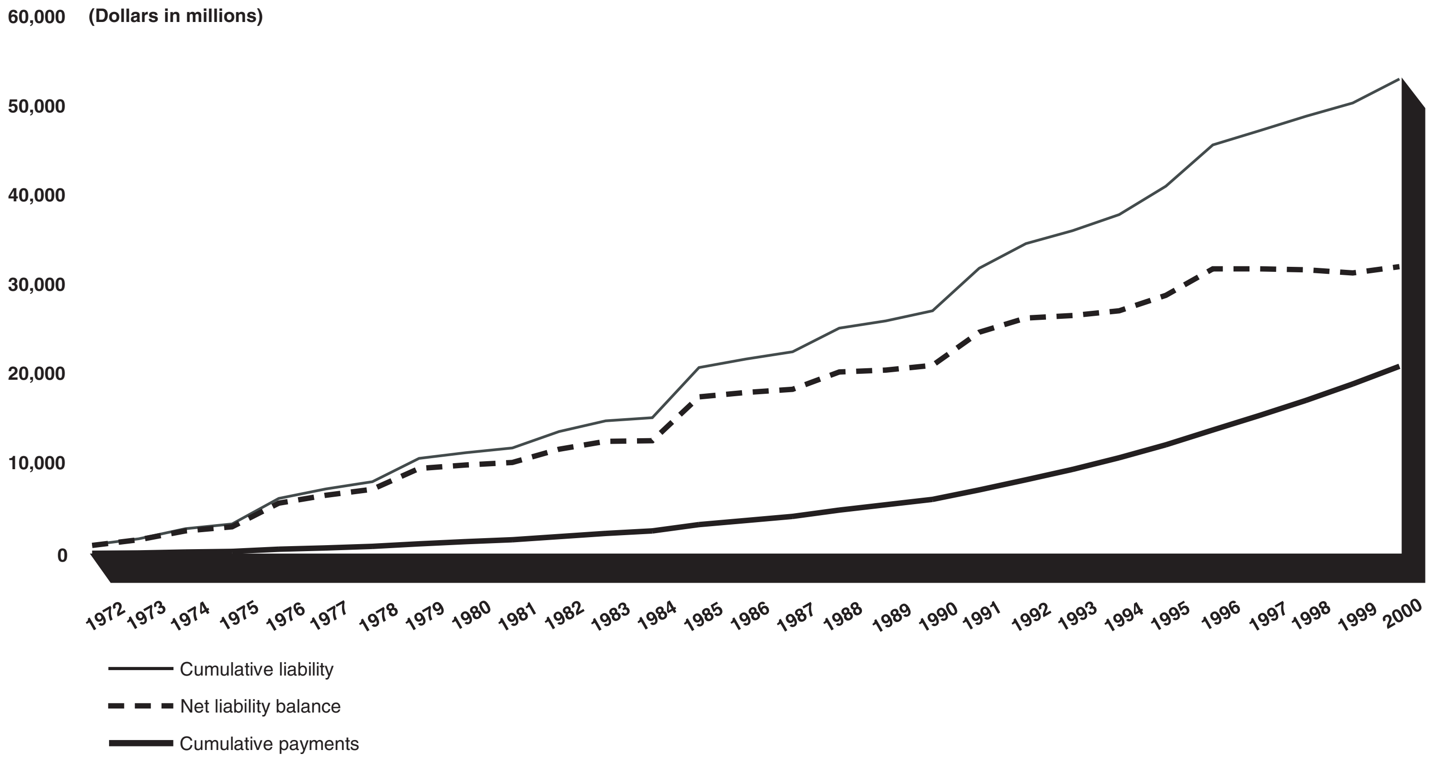
Figure 6: Changes in Employee Pay Increases and COLA Liability Ending Balance



Source: USPS data (not independently verified by GAO).

The increase is occurring because the annual additions to the Service's liability have generally been greater than the annual principal payments made under the installment payment provisions set forth by law. For instance, the Service's fiscal year 2000 additional liability was $2.7 billion, while its required principal installment payment was $2 billion, plus interest of $1.6 billion. Figure 7 displays how the annual increases in the liability have cumulatively increased more rapidly than the annual accumulated principal payments.

Figure 7: Comparison of Cumulative Annual Pay Increases and COLA Liability to Cumulative Payments



Source: USPS data (not independently verified by GAO).

Portion of Liability Due to Increases in Employee Pay

By law, whenever USPS increases a CSRS employee's pay as a result of new labor union contracts, it is liable to OPM for the present value of additional future retirement benefits to be paid to the employee upon retirement as a result of the pay increase.[10] When an increase in pay is authorized, OPM determines the Service's present value of the retirement liability for the future retirement benefits that will result from the pay increase. The Service is required to pay for this incremental liability in 30 equal annual installments, with interest computed at the rate used in the most recent valuation of CSRS, with the first payment due at the end of the fiscal year in which an increase in pay becomes effective. The interest rate for calculating the present value of the incremental liability and for determining the amortization payments has been 5 percent for 29 years.

According to OPM's Office of the Actuary, the law prescribes that the calculation of the additional annual cost of retirement benefits due to increases in basic pay be made on the "static" basis, which assumes no future inflation and no future general schedule salary increases. OPM's Board of Actuaries has recommended a 5-percent discount rate for the purpose of the static valuation. OPM does not make the calculations on a "dynamic" basis, which would include an assumed annual rate of inflation, future salary increases, and a provision for an assumed percentage rate of return on plan investments.

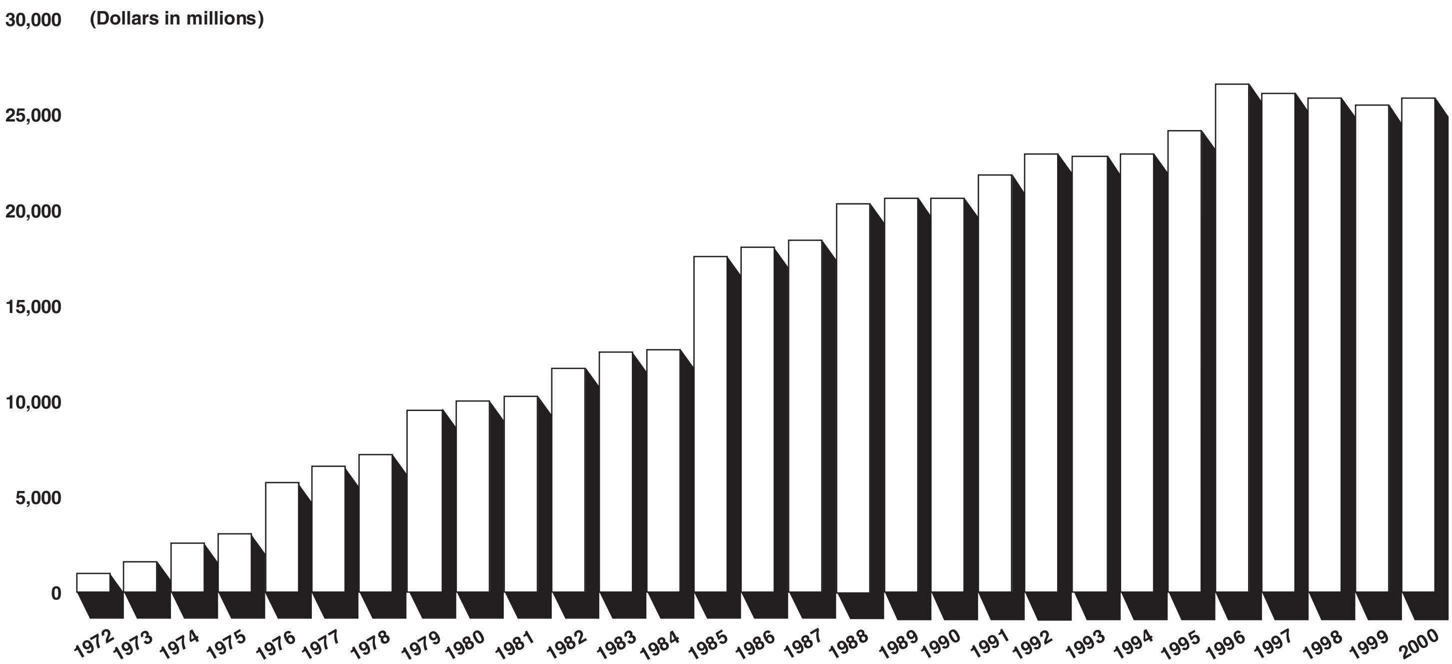
For fiscal year 1972, the Service's first fiscal year of operations, OPM determined that the additional liability for basic pay increases was approximately $1 billion. Under the 30-year installment arrangement, the Service paid $63 million toward that additional cost for fiscal year 1972, leaving an unpaid liability balance of $954 million to be paid for future years. In each subsequent year, additional liabilities were accrued as a result of pay increases in each of those years. Because the liabilities being added each year are also being paid off in 30-year installments, the overall liability for unpaid pension costs has grown dramatically, even though the Service has been making annual payments on the accumulating balance.

Figure 8 shows the growth in the liability balance attributable to increases in CSRS employee pay. For fiscal year 1972 through fiscal year 1981, the liability balance grew from approximately $1 billion to $10.3 billion. During the next 10 fiscal years (1982 through 1991), the balance grew to

[10]See 5 U.S.C. § 8348 (h).

$21.8 billion (a 112-percent increase), and in the latest 9 fiscal years (1992 through 2000), it grew to $25.9 billion (a 19-percent increase). As more of the current CSRS employees eligible for basic pay increases retire, future increases in the liability balance should level off and, eventually, the balance due for pay increases should start to decrease. However, this decrease will likely be accompanied by an increase in the growth of retiree COLA liabilities until the CSRS retiree group begins to diminish.

Figure 8: Retirement Liability Attributable to Increases in Employee Pay



Source: USPS data (not independently verified by GAO).

In the 29 years from fiscal years 1972 through 2000, the OPM assessments for pay increases totaled $42.1 billion. During that same period, the Service paid $16.2 billion in principal payments toward that liability, plus interest of $21.6 billion, for total payments to OPM of $37.8 billion. As of September 30, 2000, the Service owed $25.9 billion in principal, and its annual principal payments have generally been less than the additional liabilities assessed each year. Because the Service is making principal payments in amounts less than the new liability added each year, the unpaid balance is growing, as is the interest charged annually on the unpaid balance. See appendix II for the annual liabilities added by OPM to the

Service's balance for CSRS pay increases and the annual installment payments made by the Service to OPM to reduce the liability balance.

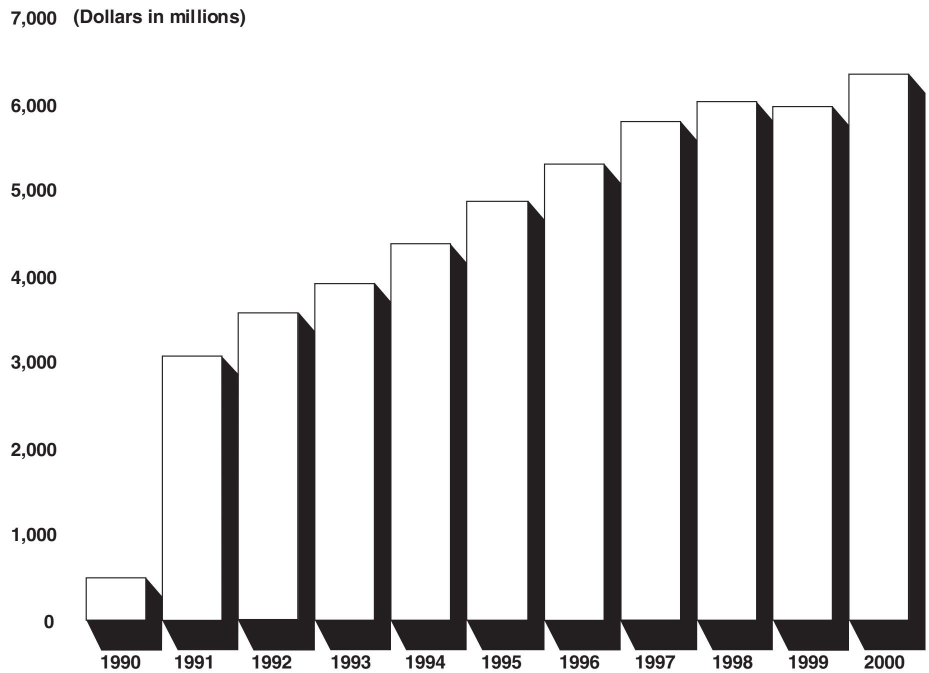
Portion of Liability Attributable to Increases in Retiree COLAs

By law, the Service is also liable for its share of the COLAs granted to retirees who retired after July 1, 1971, and their survivors. As prescribed by law, CSRS retirees and survivors receive yearly COLAs. Each year, OPM determines the estimated increase in the Service's liability for the COLA increase and establishes the amount of the installment payments to be made over a 15-year period, plus interest at 5 percent per year.

Since fiscal year 1990, the Service has recorded a total liability of $11.1 billion for retiree COLA increases. Of that liability amount, the Service has paid OPM $4.8 billion, plus interest of $2.3 billion for a total of $7.1 billion. Because the Service is only required to pays a portion of the annual increase of this liability, its payments have generally been less than the additional liabilities added each year, and the balance, as well as the interest on the unpaid balance, continues to grow. Even with projections of low inflation, the Service expects the new annual liability amounts to be larger than its annual payments on the liability because the retiree/survivor population will increase. Thus, the total liability for retiree COLAs is expected to continue to grow over time until most of the CSRS annuitants are deceased.

Figure 9 depicts the change in the liability amount. Also, see appendix III for the annual liabilities added by OPM to the Service's liability balance for COLA increases and the annual installment payments made by the Service to OPM toward reducing the balance.

Figure 9: Changes to Retirement Liability Due to Increases in Retiree COLAs



Source: USPS data (not independently verified by GAO).

An Additional Retirement Benefit: The Post-Retirement Health Benefit Program

Although not part of a retirement plan, the Post-Retirement Health Benefit Program is an additional benefit available to USPS retirees. The post-retirement health benefit represents a significant cost, which is also expected to increase in future years. USPS estimates that the annual cost of this benefit will increase from $744 million in fiscal year 2000 to about $2 billion in fiscal year 2010. In the Service's Integrated Financial Plan for Fiscal Year 2002, health care costs are projected to increase by 10 percent; however, subsequent to that projection it was reported that the average premiums for employees will rise an average 13 percent in fiscal year 2002. These large, unexpected increases in health care costs make projections of future costs very uncertain.

USPS is required to pay the employer's share of health insurance premiums incurred through participation in the Federal Employees Health Benefit Program (FEHBP) for all employees who retired on or after July 1, 1971, and their survivors.[11] The annual cost for this program is included in the Service's Total Compensation and Benefits expense reported in its annual financial statements and disclosed separately in the footnotes to those statements.

When the cost of the post-retirement health benefits of $744 million for fiscal year 2000 is added to the Service's total retirement costs of $8.5 billion for fiscal year 2000, the total for retirement-related costs becomes $9.3 billion in fiscal year 2000. USPS projects that in fiscal year 2010, these total retirement-related costs will increase to $2 billion and $14 billion, respectively, for a total of $16 billion. The Service also projected that these costs, in fiscal years 2001 and 2002, would increase to $9.9 billion and $10.3 billion, an increase of $600 million and $400 million over the preceding year for each of those years, respectively. These increases exert upward pressure on postal rates and constrict cash flows needed for operating purposes.

Service Faces Major Challenges

Many stakeholders are calling for a structural transformation of the Service because of the major financial, operational, human capital, and market competition challenges confronting it. Accordingly, in April 4, 2001, testimony[12] before the House Committee on Government Reform, the Comptroller General announced that we had placed the Service's transformational efforts and long-term outlook on our high-risk list. This focused needed attention on the challenges facing the Service. The Service responded by establishing a Transformation Plan Task Force on July 25, 2001. The task force will identify options to transform the Service so that it will be able to resolve the many challenges it faces in the future.

[11]See Budget Reconciliation Act of 1990 (P.L. 101-508).

[12]See *Transformation Challenges Present Significant Risks* (GAO-01-598T, April 4, 2001).

Questions for Further Consideration and Analysis

As the Transformation Plan Task Force examines the impact of these retirement costs and liabilities on the Service's overall financial condition and future operations, there are key questions that need to be addressed. Once the task force has analyzed these questions in detail, it can weigh various options and their long-term implications for the Service. Some of the specific questions that we see as being important include the following.

- What is the significance of USPS' growing retirement-related obligations on various options that will be considered as part of its transformation? How would issues relating to retirement-related obligations be addressed if a specific option were to be chosen, such as transforming USPS into a government corporation or a publicly owned company?
- What is the impact of USPS retirement-related obligations, including retiree health care costs, on its overall financial condition, equity position, cash flows from operations, and ability to fund capital outlays that depend on positive cash flows? Also, what is the impact of the Service's retirement-related obligations on the scope and quality of postal services that depend on the use of funds for continued modernization and maintenance of capital assets?
- What is the potential impact of growing retirement-related expenses on postal rates? Could this impact affect USPS' ability to be successful in a marketplace with increasing competition from electronic alternatives, private delivery companies, and foreign postal administrations?
- Under current law, is USPS fully covering OPM's future retirement costs for USPS employees, or is USPS paying more than is needed to cover OPM's future payments to USPS retirees? Has OPM estimated the amount of future obligations to USPS retirees, and has OPM determined that USPS has contributed a sufficient amount, or, possibly, more than enough, toward plan assets that will pay USPS retirees?

Agency Comments

USPS provided oral comments that substantially agreed with our report. Matters of emphasis and points of clarity recommended by USPS have been reflected in this report, as appropriate. OPM provided written comments that are reprinted in appendix IV, along with our comments.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the House and Senate Committees on Appropriations, the Postmaster General, the Chairman of the Postal Board of Governors, the Chairman of the Postal Rate Commission, the Chief Financial Officer of the

U.S. Postal Service, the Director of the Office of Personnel Management, and interested congressional committees. We will also provide copies to others on request.

If you have any questions on this report, please contact me at (202) 512-2600 or Jeanette M. Franzel, Acting Director, at (202) 512-9471. We can also be reached by e-mail at steinhoffj@gao.gov or franzelj@gao.gov, respectively. Joseph Applebaum, Senior Actuary, Michael Fischetti, Meg Mills, John Sawyer, and Fred Evans were key contributors to this report.

Jeffrey C. Steinhoff
Managing Director
Financial Management and Assurance

USPS Total Annual Retirement Plan Costs

Dollars in millions

Fiscal Year	CSRS	FERS (including TSP)	CSRS Offset	Social Security	CSRS pay increases	Annuitant COLA	Total
1972	$446	-	-	$ 13	$ 63	-	**$ 522**
1973	452	-	-	12	115	-	**579**
1974	517	-	-	14	176	-	**707**
1975	545	-	-	14	207	-	**766**
1976	617	-	-	17	385	-	**1,019**
1977	627	-	-	16	507	-	**1,150**
1978	655	-	-	15	470	-	**1,140**
1979	736	-	-	16	658	-	**1,410**
1980	782	-	-	16	697	-	**1,495**
1981	801	-	-	17	722	-	**1,540**
1982	868	-	-	16	850	-	**1,734**
1983	887	-	-	18	967	-	**1,872**
1984	897	-	-	46	917	-	**1,860**
1985	1,008	-	-	168	1,355	-	**2,531**
1986	1,005	-	$187	277	1,353	-	**2,822**
1987	982	$ 447	76	343	1,353	-	**3,201**
1988	996	792	20	426	1,618	-	**3,852**
1989	977	927	27	523	1,618	-	**4,072**
1990	940	1,064	28	607	1,659	-	**4,298**
1991	917	1,222	29	695	1,775	$420	**5,058**
1992	942	1,337	31	742	1,896	490	**5,438**
1993	828	1,397	31	854	1,938	551	**5,599**
1994	830	1,570	34	950	1,996	620	**6,000**
1995	843	1,670	34	1,008	2,132	689	**6,376**
1996	877	1,962	36	1,082	2,361	750	**7,068**
1997	870	2,142	36	1,162	2,396	817	**7,423**
1998	849	2,248	36	1,241	2,448	859	**7,681**
1999	816	2,505	35	1,337	2,505	903	**8,101**
2000	795	2,694	36	1,427	2,597	980	**8,529**
2001	771	2,918	34	1,531	2,433	1,398	**9,085**
2002	749	3,160	33	1,643	2,407	1,366	**9,358**
2003	727	3,425	32	1,762	2,447	1,425	**9,818**
2004	705	3,713	31	1,892	2,449	1,509	**10,299**

(Continued From Previous Page)

Dollars in millions

Fiscal Year	CSRS	FERS (including TSP)	CSRS Offset	Social Security	CSRS pay increases	Annuitant COLA	Total
2005	684	4,027	30	2,031	2,515	1,577	**10,864**
2006	664	4,369	29	2,179	2,372	1,647	**11,260**
2007	644	4,743	28	2,338	2,424	1,722	**11,899**
2008	625	5,150	28	2,509	2,476	1,833	**12,621**
2009	607	5,595	27	2,693	2,370	1,982	**13,274**
2010	589	6,080	26	2,889	2,282	2,164	**14,030**

Source: USPS data (not independently verified by GAO).

USPS Retirement Liability for Employees' Pay Increases

Dollars in thousands

Year	Additional liability	Payments: Principal	Payments: Interest	Payments: Total	Ending balance
1972	$ 1,016,736	$ 62,991		**$ 62,991**	**$ 953,745**
1973	677,824	57,298	$57,293	**114,591**	**1,574,271**
1974	1,117,000	95,471	80,814	**176,285**	**2,595,800**
1975	536,784	77,651	129,790	**207,441**	**3,054,933**
1976	2,880,330	232,294	152,747	**385,041**	**5,702,969**
1977	1,038,661	159,544	347,684	**507,228**	**6,582,086**
1978	809,164	148,088	322,319	**470,407**	**7,243,162**
1979	2,637,358	308,707	349,086	**657,793**	**9,571,813**
1980	632,661	234,367	462,712	**697,079**	**9,970,107**
1981	522,697	228,686	493,527	**722,213**	**10,264,118**
1982	1,825,052	341,930	508,269	**850,199**	**11,747,240**
1983	1,207,506	346,436	620,539	**966,975**	**12,608,310**
1984	362,692	291,969	625,438	**917,407**	**12,679,033**
1985	5,624,794	697,660	657,741	**1,355,401**	**17,606,167**
1986	945,930	472,748	880,308	**1,353,056**	**18,079,349**
1987	803,332	449,089	903,967	**1,353,056**	**18,433,592**
1988	2,653,868	697,467	920,508	**1,617,975**	**20,389,993**
1989	811,411	598,012	1,019,500	**1,617,512**	**20,603,392**
1990	661,998	628,355	1,030,170	**1,658,525**	**20,637,035**
1991	1,882,813	743,320	1,031,852	**1,775,172**	**21,776,528**
1992	1,900,849	804,504	1,091,282	**1,895,786**	**22,872,873**
1993	731,492	794,612	1,143,644	**1,938,256**	**22,809,753**
1994	930,608	855,421	1,140,489	**1,995,910**	**22,884,940**
1995	2,198,945	986,887	1,145,346	**2,132,233**	**24,096,998**
1996	3,696,728	1,156,628	1,204,853	**2,361,481**	**26,637,098**
1997	559,636	1,064,074	1,331,855	**2,395,929**	**26,132,660**
1998	835,936	1,141,085	1,306,634	**2,447,719**	**25,827,511**
1999	931,623	1,214,016	1,291,374	**2,505,390**	**25,545,118**
2000	1,639,396	1,327,314	1,270,150	**2,597,464**	**26,139,593**

Source: USPS data (not independently verified by GAO).

USPS Retirement Liability for Cost of Living Adjustments

Dollars in thousands

		Payments			
Year	**Additional liability**	**Principal**	**Interest**	**Total**	**Ending balance**
1990	$486,470	-	-	-	**$486,470**
1991	2,885,841	$306,225	$114,740	**$420,965**	**3,066,086**
1992	831,703	337,473	152,872	**490,345**	**3,560,316**
1993	729,650	372,711	178,017	**550,728**	**3,917,255**
1994	868,695	424,171	195,864	**620,035**	**4,361,779**
1995	971,513	470,585	218,093	**688,678**	**4,862,707**
1996	951,246	506,725	243,138	**749,863**	**5,307,228**
1997	1,041,176	551,926	265,364	**817,290**	**5,796,478**
1998	789,604	569,316	289,824	**859,140**	**6,016,766**
1999	537,246	601,895	300,839	**902,734**	**5,952,117**
2000	1,056,225	682,632	297,593	**980,225**	**6,325,710**

Source: USPS data (not independently verified by GAO).

Comments From the Office of Personnel Management

United States
Office of
Personnel Management Washington, DC 20415-0001

In Reply Refer To: Your Reference:

NOV 23 2001

Mr. Jeffery C. Steinhoff
Managing Director
Financial Management and Assurance
U. S. General Accounting Office
Washington, DC 20548

Dear Mr. Steinhoff:

Thank you for the opportunity to review the GAO report on the retirement costs and liabilities of the U.S. Postal Service. The report accurately summarizes Postal Service contributions to the Civil Service and Federal Employees retirement plans. These payments have been made in accordance with various laws enacted over the years, starting with the Postal Service reorganization. The payments were established to finance the additional cost of salary increases and retiree COLA's following creation of the Postal Service, and to distinguish that added cost from the rest of the Government.

See comment 1.

We would also note that, in addition to these funding requirements, Congress has required additional payments from the Postal Service that might be characterized as "fine tuning" of the Postal Service's retirement liability. For example, under the Omnibus Budget Reconciliation Act of 1990, which provided for funding of retiree COLA's, the Postal Service was required to contribute an additional $1.685 billion to cover liabilities for past COLA's, in addition to the 15-year amortization payments that were established. Also, under the Omnibus Budget Reconciliation Act of 1993, the Postal Service was required to contribute $693 million for additional liabilities under the Civil Service Retirement System.

As was mentioned in your report, the liabilities of the Civil Service Retirement System are funded under the static financing method prescribed by law. This methodology incorporates certain assumptions regarding the portion of the liabilities attributable to the Postal Service. The methodology used in allocating these liabilities differs somewhat between determining the cost of salary increases and the cost of COLA's. As you point out, these and other assumptions affect the calculation of the liabilities of the Postal Service and have been the subject of a number of studies and analyses since the Service's reorganization. We believe that the adequacy of Postal Service funding of the retirement system liabilities has been fully addressed by Congress. In addition, the Postal Service is fully complying with these provisions, and we have no study underway to explore them further.

CON 114-24-3
May 1993

See comment 2.

See comment 3.

Mr. Jeffery C. Steinhoff 2

We also note that on page 15 and 16 of the report, the report states that, "According to an OPM actuary, the law prescribes that the calculation of the additional annual cost of retirement benefits due to increases in basic pay be made on a 'static' basis, which assumes no future inflation, no future general schedule salary increases, and a 5 percent discount rate." The law does not prescribe the actual level of the discount rate. The actual level of the rate is determined based on a recommendation of the Board of Actuaries of the Civil Service Retirement System. In addition, the paragraph goes on to state that, "...the amortized cost of basic pay increases would be higher if the dynamic basis were used instead of the static basis." Actually, under the dynamic basis of funding, the cost of salary increases would not be separately identified, but would be included in the overall cost of the system. Comparisons between the static and dynamic funding methods are difficult to make because the methodologies are so different from each other.

I hope that these comments are helpful.

Sincerely,

for William E. Flynn, III
Associate Director
for Retirement and Insurance

The following are GAO's comments on the Office of Personnel Management's letter dated November 23, 2001.

GAO Comments

1. The "fine tuning" items were not included in the report because the amounts were paid to OPM by fiscal year 1998 and are no longer outstanding liabilities of the Postal Service.

2. Our report has been revised to reflect that the Board of Actuaries of CSRS determined the 5-percent discount rate used in the amortization tables to calculate payments to be made to OPM.

3. Our Senior Actuary agreed with the OPM comment; therefore, we have deleted the sentence from our report.

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