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Comptroller General
of the United States

United States General Accounting Office
Washington, DC 20548

January 31, 2003

Congressional Requesters

Subject: *Review of the Office of Personnel Management's Analysis of the United States Postal Service's Funding of Civil Service Retirement System Costs*

In our December 2001 report, *United States Postal Service: Information on Retirement Plans* (GAO-02-170), we raised the question of whether the United States Postal Service (USPS) was paying more or less than appropriate to cover benefit payments for the Civil Service Retirement System (CSRS) for which it is responsible. In May 2002, we asked the Office of Personnel Management (OPM) to calculate a hypothetical "Postal Fund" balance and projected funding status by estimating the

- present value (PV) of the future benefits USPS is required to fund for CSRS retirees and survivors under current law and
- extent to which prior and projected future contributions required by current law would fund these benefits.

OPM released its analysis in November 2002, indicating that, based on current contributions, USPS's CSRS obligations would be significantly overfunded in the future.¹ The Administration has proposed legislation that addresses this overfunding. Given the significance of this issue, you asked us to (1) review OPM's analysis for reasonableness and (2) analyze the legislative proposal to identify any issues needing further consideration. This report provides a summary of our briefing on January 30, 2003, and the attached slides highlight the results of our work and the information we provided.

Results in Brief

Review of OPM's Analysis. To perform its analysis, OPM determined the net assets (USPS agency and employee contributions plus earnings benefits and administrative expenses) available in the hypothetical "Postal Fund" as of September 30, 2002. OPM then calculated the PV of future benefits payable and future contributions to determine the extent to which "Postal Fund" net assets and required future contributions would fund the projected remaining benefits to be paid. Its analysis concluded that as of September 30, 2002

¹ OPM's projections are made through 2071, the estimated date at which the last remaining USPS CSRS annuitant would receive a benefit payment.

- \$20.5 billion in CSRS benefits for USPS employees and annuitants remained to be funded and
- contribution rates set in current law would ultimately result in an overfunding of the amount needed to cover CSRS benefit obligations attributable to USPS annuitants by \$71.0 billion.

OPM included the cost of military service for USPS employees first hired into civilian service after June 30, 1971, and a portion of the costs for employees hired before July 1, 1971—the effective date of the Postal Reorganization Act—in its reconstruction of the “Postal Fund” and calculations of the PV of future benefits—even though under current law the Department of the Treasury is responsible for funding these costs. Applying current law regarding military service funding to OPM’s analysis, and making other adjustments discussed below, results in

- a current overfunding of \$4.1 billion versus the \$20.5 billion yet to be funded according to OPM’s initial analysis and
- a projected overfunding of \$103.1 billion versus the \$71.0 billion amount OPM initially projected.

We found a similar issue regarding OPM’s treatment of certain spousal benefit payments and payments for CSRS offset benefits. OPM assumed in its analysis that USPS was responsible for these costs even though under current law Treasury funds them. OPM has not analyzed the feasibility of determining the effect of these issues on its calculations, but believes the amounts would be insignificant.

We also found that in its analysis OPM gave credit to the “Postal Fund” for a \$285 million special payment USPS made with appropriations provided to it in fiscal year 1975 to fund increases in pension liabilities that resulted from pay increases in 1972 and 1973. The effect of this was to increase the “Postal Fund” balance by about \$2.9 billion, as of September 30, 2002, including compound interest.

In reviewing OPM’s calculation, we also identified several adjustments that would improve its accuracy and collectively resulted in an increase of about \$5 billion to the “Postal Fund” net assets. These include

- changing the basis of accounting for employee withholdings and USPS contributions from cash to accrual,
- reflecting certain employee voluntary and civilian service deposits and redeposits in the analysis that were not in OPM’s initial analysis,
- using actual data on 30-year and 15-year payments by USPS rather than the estimated payments used in OPM’s initial analysis, and
- making other miscellaneous adjustments.

Analysis of Proposed Legislation. As a result of OPM’s analysis, the Administration has proposed legislation that reduces the payments USPS would be required to make for CSRS benefits from approximately \$4.7 billion annually to an estimated \$1.8 billion in fiscal year 2003, a savings of \$2.9 billion. Several issues, some of which were discussed above, could affect the amount of annual payments

USPS would be required to make under the proposed legislation. These issues are as follows:

- **Treatment of military service costs**—The legislative proposal would make USPS responsible for military service costs, which decreases the projected overfunding by almost \$28 billion. The Congress needs to decide whether USPS should be responsible for any or all of these costs. In this regard, one possible alternative approach would be to require USPS to fund only the military service of employees hired after June 30, 1971. This would result in \$16.6 billion yet to be funded by USPS and its employees (versus \$23.7 billion under the legislative proposal, as adjusted) and a projected overfunding of \$0.8 billion (versus an underfunding of \$6.3 billion under the legislative proposal, as adjusted).
- **Treatment of payments made with appropriated funds**—OPM’s analysis credited the “Postal Fund” with a \$285 million special payment USPS made in fiscal year 1975 with appropriated funds. The effect of this credit was to increase the “Postal Fund” balance by \$2.9 billion, as of September 30, 2002, including compound interest. The legislative proposal does not address the treatment of these appropriated funds.
- **Treatment of underfunded or overfunded amounts and future refinements**—The legislative proposal generally calls for a 40-year amortization period for any unfunded liability. This approach is consistent with the Administration’s proposal for CSRS liabilities for non-USPS employees. However, a shorter amortization period that more reasonably reflects the average remaining working lives of CSRS employees may be more appropriate. Additionally, the proposed legislation does not specify how to treat an overfunded situation, or how future refinements in the calculation and variances from projected versus actual experience that affect the over- or underfunded position would be addressed.
- **Choice of demographic assumptions**—Using CSRS-wide versus USPS-specific demographics affects the funding status. For example, using CSRS demographics instead of USPS-specific demographic assumptions under the legislative proposal would decrease the overfunded amount by approximately \$1.5 billion.

OPM’s projections will need to be adjusted based on the decisions made regarding these issues. In addition, USPS still faces substantial obligations related to postretirement health benefits (estimated at \$40 billion to \$50 billion) as well as significant outstanding debt to the federal government (\$11.1 billion as of September 30, 2002) that should be considered in determining the treatment of the projected overfunding of CSRS obligations. The Congress needs to decide (1) whether some or all of the difference in current versus proposed future contributions should be used to reduce outstanding debt to the federal government or address USPS’s unfunded postretirement health obligations, and (2) what, if any, other restrictions should be placed on the use of these funds.

Scope and Methodology

To achieve our objectives, we performed various procedures to assess OPM's analysis and the legislative proposal. These procedures are described in detail in appendix III of the attached slides. The procedures we performed do not constitute a financial audit or actuarial review of OPM's projections, and we are not expressing an opinion on the material accuracy of the calculations contained herein. Rather, our procedures focused on determining the reasonableness of OPM's methods, assumptions, and data. Thus, while we found significant issues pertaining to OPM's projections, there may be other issues that did not come to our attention. We performed our work from November 2002 through January 2003, in accordance with generally accepted government auditing standards.

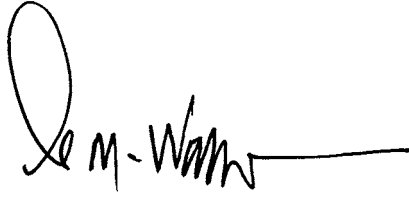
Agency Comments

We discussed the findings of these briefing slides with OPM officials, including the Director, Office of Actuaries, who generally agreed with the facts presented. Based on their consideration of these slides during our meeting, they provided the following observations:

- The primary difference between the \$103.1 billion potential overfunding and the 71.0 billion originally reported by OPM is due to the treatment of military service.
- Although under current law governing funding of CSRS the USPS does not pay for the cost of benefits attributable to military service, the Administration's proposed legislation is intended to replace the current funding methodology with a new approach modeled after the funding of FERS.
- Under the Administration's proposal, the USPS would be responsible for the cost of military service. The Administration believes that charging the USPS is appropriate because under its proposal the "Postal Fund" would be created with a proportional share of the excess investment returns earned by the CSRDF over the past 30 years.

We are sending copies of this report to the Director of OPM, the Postmaster General, the Director of OMB, the Secretary of the Treasury, and other interested parties. The report is also available at no charge on GAO's home page at <http://www.gao.gov>. If you have questions about this report, please contact Linda Calbom, Director, Financial Management and Assurance, at (202) 512-8341, or Robert Martin, Assistant Director, at (202) 512-6131. You may also reach them by E-mail at calboml@gao.gov

or martin@gao.gov. Other key contributors to this assignment were Kent Bowden, Margaret Cigno, Fred Evans, Darren Goode, and Scott McNulty.

A handwritten signature in black ink, appearing to read "D. M. Walker", with a long horizontal line extending to the right.

David M. Walker
Comptroller General
of the United States

Enclosure

List of Requesters

The Honorable Susan M. Collins
Chairman
Senate Committee on Governmental Affairs

The Honorable Thomas R. Carper
United States Senate

The Honorable Tom Davis
Chairman
House Committee on Government Reform

The Honorable Ernest J. Istook
Chairman
Subcommittee on Treasury, Postal Service and General Government
House Committee on Appropriations

The Honorable Dan Burton
The Honorable Steny Hoyer
The Honorable John M. McHugh
The Honorable Dave Weldon
House of Representatives



United States Postal Service

Review of the Office of Personnel Management's Analysis of the United States Postal Service's Funding of Civil Service Retirement System Costs

Briefing for Congressional Requesters
January 30, 2003



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- Appendix II - Data Limitations and Use of Estimation Methods
- Appendix III - Detailed Scope and Methodology



Introduction

- In our December 2001 report, *United States Postal Service: Information on Retirement Plans (GAO-02-170)*, we raised the question of whether the United States Postal Service (USPS) is paying more or less than needed to cover future Civil Service Retirement System (CSRS) benefit payments.
- In May 2002, we asked the Office of Personnel Management (OPM) to, in effect, calculate a hypothetical “Postal Fund” balance and projected funding status by estimating the
 - present value (PV) of the future benefits to CSRS retirees and survivors that USPS is required to fund, and
 - extent to which prior and projected future contributions required by current law are estimated to fund these benefits.



Objectives

Our objectives were to

- review OPM's analysis released in November 2002 for reasonableness, and
- analyze the legislative proposal and identify any issues needing further consideration.



Results in Brief

- In November 2002, OPM reported that, based on the current level of contributions, USPS would significantly overfund the amount needed in the future to cover CSRS benefit obligations attributable to its annuitants. We found that the amount of overfunding is considerably greater than OPM initially calculated and reported, due primarily to OPM's treatment of military service costs in its analysis that differs from how military service is funded under current law.
- While the Administration's legislative proposal submitted by OPM addresses the projected overfunding by reducing the annual payments USPS makes to fund CSRS benefits, a number of issues, including treatment of military service costs and USPS past payments made with appropriated funds, could affect the projected and current CSRS funding status.



- OPM's published projections will need to be adjusted based on decisions regarding these issues, as well as refinements resulting from improved data and methodologies. In addition, USPS still faces substantial obligations related to postretirement health benefits for its present and past employees, as well as significant outstanding debt, that should be considered in determining the treatment of the projected overfunding of CSRS obligations.



Scope and Methodology

- To achieve our objectives, we performed various procedures to assess OPM's analysis and the legislative proposal. These procedures are described in detail in appendix III.
- These procedures do not constitute a financial audit or actuarial review of OPM's projections, and we are not expressing an opinion on the material accuracy of the calculations contained herein. Instead, we focused on the reasonableness of OPM's methods, assumptions, and data.



- Thus, while we found several significant issues pertaining to OPM’s reconstruction of the “Postal Fund” and projections and proposed various adjustments, there may be other issues that would significantly impact OPM’s projections that did not come to our attention in the course of this review. See appendix II for a description of known data limitations and OPM’s estimation methods.
- We performed our work from November 2002 through January 2003, in accordance with generally accepted government auditing standards.



Background

- USPS commenced operations on July 1, 1971 in accordance with the provisions of the Postal Reorganization Act of 1970 (P.L. 91-375).
- USPS is an independent establishment of the executive branch with a goal to operate on a break-even basis over time and cover its expenses almost entirely through postal revenues.
- At inception, USPS did not have any unpaid liabilities to OPM for retirement benefits. The federal government remained responsible for all the liabilities attributable to the operations of the former Post Office Department, including any unfunded retirement benefits.



- USPS currently makes the following contributions to the Civil Service Retirement and Disability Fund (CSRDF):
 - agency matching contributions, which for most employees is 7.0 percent of basic pay,
 - payments to fund the increase in the present value of future retirement benefits resulting from general pay increases (in 30 equal annual installments with interest at 5 percent), and
 - payments to fund the increase in the present value of future retirement benefits resulting from the granting of annuitant cost-of-living adjustments - COLAs (in 15 equal annual installments with interest at 5 percent).



- The laws enacted over time creating the current approach to funding USPS's CSRS costs do not require the calculation of a USPS-specific liability and do not create a "Postal Fund" within the CSRDF.
 - Therefore, current law does not require a calculation of the funding status of USPS's benefit obligations. OPM performed these calculations for the purpose of analyzing the extent to which USPS has funded the CSRS benefits of its employees and annuitants.
 - Thus, investment and actuarial risk – and any resulting gains or losses that could reduce or increase actual retirement costs – are currently borne by the the federal government.
 - See appendix I for a list of the key laws and a short description of each.



Assessment of OPM's Analysis

- In performing its analysis, OPM
 - determined the “net assets” (USPS agency and employee contributions plus net earnings on the fund balance less benefits and administrative expenses) available in the “Postal Fund” as of September 30, 2002,
 - calculated the present value (PV) as of September 30, 2002 of
 - future benefits payable to current employees and annuitants, and
 - all required future contributions, and
 - determined the extent to which “Postal Fund” net assets and required projected future contributions would fund projected future benefits to be paid.



- OPM's analysis concluded that
 - \$20.5 billion in future CSRS benefits for USPS employees and annuitants remained to be funded as of September 30, 2002, and
 - USPS contribution rates set in current law would ultimately result in an overfunding of the amount needed to cover CSRS benefit obligations attributable to USPS annuitants by \$71.0 billion as of September 30, 2002.*

* OPM's analysis was projected through 2071, the estimated date at which the last remaining USPS CSRS annuitant would receive a benefit payment.



- OPM included the cost of military service for USPS employees first hired into civilian service after June 30, 1971 and a portion of the costs for those employees hired before July 1, 1971 in its reconstruction of the “Postal Fund” and calculations of the actuarial present value of future benefits - - even though under current law Treasury is responsible for funding these costs.
- Applying current law regarding military service funding, and making other adjustments (discussed in subsequent slides), to OPM’s analysis of future benefits to be funded results in
 - a current overfunding of \$4.1 billion (versus \$20.5 billion yet to be paid per OPM’s initial analysis), and
 - a projected ultimate overfunding of \$103.1 billion (versus \$71.0 billion per OPM’s initial analysis).



- We also found that, similar to the military service issue, OPM's initial analysis assumed that USPS had been responsible for the cost of certain spousal benefit payments and CSRS offset benefits that, under current law, Treasury is responsible for funding.
- OPM has not analyzed the feasibility of determining the impact of these issues on its calculations, but believes the amounts would be insignificant.



- In addition, we found that in its analysis OPM credited the “Postal Fund” for a special payment USPS made with \$285 million in appropriations it received in fiscal year 1975.
 - Congress provided these appropriations to fund increases in pension liabilities resulting from general pay increases that USPS negotiated for in 1972 and 1973.
 - This special contribution, including compound interest, increases OPM’s calculation of the “Postal Fund” balance by \$2.9 billion as of September 30, 2002.



- In reviewing OPM's calculation, we also identified several adjustments that would improve its accuracy and would collectively result in an increase to the "Postal Fund" net assets of about \$5.0 billion. Those adjustments, including interest, relate to
 - changing the basis of accounting for employee withholdings and USPS contributions from cash to accrual and other corrections (\$2.2 billion),
 - certain employee voluntary and civilian service deposits and redeposits that were not reflected in OPM's initial analysis (\$1.8 billion),
 - using actual data on 30-year and 15-year payments by USPS rather than estimated payments in OPM's initial analysis (\$0.5 billion), and
 - other miscellaneous adjustments, net (\$0.5 billion).



- A comparison of OPM's calculation and a recalculation applying current law regarding military service funding, eliminating the credit for the special appropriation, and making other adjustments is shown in table 1.
- The special appropriation impact is shown separately in the table, whereas the following are factored into the existing line items:
 - adjustments for the military service issue,
 - addition of future employee military service deposits that were not included in OPM's initial analysis (\$0.7 billion),
 - the adjustments described above, and
 - changes in certain economic assumptions and benefit estimation and allocation methods that were made to improve accuracy and consistency of the calculations.



Assessment of OPM's Analysis

Table 1: USPS's Funding of CSRS Benefits as of September 30, 2002 as initially reported by OPM and recalculated to reflect current law regarding military service funding,* the impact of payments made with appropriated funds, and various other adjustments.*

(Dollars in Billions)

	OPM initial calculation	Recalculation	Difference
"Postal Fund" net assets	\$ 152.1	\$ 185.0	\$ 32.9
PV of future benefits	(172.6)	(178.0)	(5.4)
Benefits (yet to be funded)/overfunded	(20.5)	7.0	27.5
Impact of payments made with appropriated funds	0.0	(2.9)	(2.9)
Revised benefits (yet to be funded) / overfunded	(20.5)	4.1	24.6
PV of all future contributions	91.5	99.0	7.5
Projected overfunding	\$ 71.0 =====	\$ 103.1 =====	\$ 32.1 =====

Source: Developed by GAO based on OPM's data and actuarial calculations.

*Changes related to these items are factored in throughout the calculation.



Assessment of the Legislative Proposal

- The legislative proposal would reduce the amount of CSRS payments by USPS from approximately \$4.7 billion annually under current law to an estimated \$1.8 billion annually (in fiscal year 2003) -- an annual savings of \$2.9 billion in 2003 based on OPM's initial calculation. The amount of savings in future years will change
 - once the adjustments we identified are factored into the over/underfunding to be amortized, and
 - depending on decisions that are made regarding issues discussed in the following slides.



- Several issues could affect the amount of annual payments required to be made by USPS under the legislative proposal, as follows
 - treatment of military service costs,
 - treatment of payments made with appropriated funds,
 - amortization period for any overfunded or underfunded amounts, including those arising from data refinements and variances between projected and actual experience,
 - use of the most appropriate investment rate of return, and
 - choice of demographic and economic assumptions.



Treatment of Military Service

- The legislative proposal would make USPS responsible for military service costs as assumed in OPM's initial calculation, which decreases the "Postal Fund" net assets by \$27.9 billion.
- One possible alternative approach, among others, would be to require USPS to fund the military service of employees hired after June 30, 1971.



- Table 2 shows the financial effect of treating military costs under the following three possible alternatives (as adjusted for the items previously discussed):
 - USPS funds a portion of the military service costs for employees hired before 1972 and all military costs for employers hired after 1971 as per the legislative proposal (Pro-rata funding by USPS),
 - the alternative described on the previous slide (Partial funding by USPS), and
 - the approach embodied in current law, whereby Treasury funds the military costs (No funding by USPS).
- For purposes of these alternatives, we assume that regular contributions would equal the full dynamic normal cost, which is currently 24.4% of employee pay. Dynamic normal cost reflects CSRS economic and demographic assumptions, and the full cost of all military service.



Assessment of the Legislative Proposal

Table 2: The effect of possible approaches to allocating the cost of military service on USPS's Funding of CSRS benefits as of September 30, 2002, using USPS-specific demographic assumptions.

(Dollars in Billions)

	Pro-rata funding by USPS	Partial funding by USPS	No funding by USPS
"Postal Fund" net assets	\$ 168.4	\$ 174.2	\$ 185.0
PV of future benefits	<u>(189.2)</u>	<u>(187.9)</u>	<u>(178.0)</u>
Benefits (yet to be funded) / overfunded	(20.8)	(13.7)	7.0
Impact of payments made with appropriated funds	<u>(2.9)</u>	<u>(2.9)</u>	<u>(2.9)</u>
Revised benefits (yet to be funded) / overfunded	(23.7)	(16.6)	4.1
PV of normal cost contributions (24.4%) ^a	16.7 ^b	16.7 ^b	16.7 ^b
PV of future employee military service deposits	0.7	0.7	0.0
PV of 30-year payments	0.0	0.0	0.0
PV of 15-year payments	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>
PV of all future income	<u>17.4</u>	<u>17.4</u>	<u>16.7</u>
Projected (underfunding) / overfunding	\$(6.3) =====	\$ 0.8 =====	\$ 20.8 ^c =====

^a OPM did not calculate a USPS-specific dynamic normal cost percentage that reflects the differing methods of allocating military service and USPS-specific demographic assumptions.

^b These figures were calculated by applying the CSRS dynamic normal cost percentage to projections of future USPS payroll derived using USPS-specific demographic assumptions.

^c The legislative proposal does not specify the treatment of projected overfunding when future benefits are currently overfunded. One alternative would be to permit USPS to reduce its portion of normal cost contributions.

Source: Developed by GAO based on OPM data and actuarial calculations.



Treatment of Payment Made with Appropriated Funds

- As discussed previously, OPM's analysis credited the "Postal Fund" with a \$285 million special payment made with funds appropriated in fiscal year 1975 for that specific purpose.
 - The impact was to increase the "Postal Fund" balance as of September 30, 2002 by \$2.9 billion (including compound interest).
 - The legislative proposal does not address the treatment of these appropriated funds.



Treatment of Underfunded or Overfunded Amounts and Refinements

- The legislative proposal generally specifies a 40-year amortization period for any unfunded liability.
 - This is consistent with the Administration's proposal for CSRS liabilities related to nonpostal employees.
 - A shorter amortization period that more reasonably reflects the likely remaining working lives of CSRS employees may be more appropriate.
- The legislative proposal does not specify how an overfunded situation would be treated or how future refinements in the calculation that impact the over/underfunded position would be addressed.



- In addition to the spousal benefit and CSRS offset issues previously noted, OPM's future calculations for USPS CSRS costs are subject to change resulting from such items as data refinements, changes in estimation methods, and actuarial gains and losses. For example
 - OPM used estimated benefit payment data when some actual data are available. Using actual data could result in more accurate projections. OPM has not analyzed the feasibility of extracting the actual data.
 - OPM and/or others may ultimately determine that better data or estimation methods exist to project the status of the "Postal Fund."
 - OPM needs to determine and address future variances between projected and actual experience in connection with key assumptions (e.g., retirement rates, rates of return on investment, etc.).



Use of the Most Appropriate Investment Rate of Return

- OPM allocated total CSRS investment returns to the “Postal Fund” based on the ratio of average yearly “Postal Fund” net assets to all CSRS plan net assets.
 - This approach would be consistent with the view that, although USPS was a new legal entity, USPS employees who previously worked for the Post Office Department were not new participants in the CSRS plan.
- An alternative approach would be to use the average rate of return for new plan investments each year beginning with the creation of USPS.
 - This approach would be consistent with the view that USPS was a new employer joining a multiple employer pension plan.



- We were unable to determine the monetary impact this alternative approach would have on the “Postal Fund’s” net assets as of September 30, 2002 because we were unable to obtain the necessary data regarding annual investment returns on new CSRDF investments for the past 30 years.



Choice of Demographic and Economic Assumptions

- Using CSRS-wide versus USPS-specific demographics impacts the funding status. For example, using CSRS demographics instead of the USPS-specific demographic assumptions OPM used in its initial analysis and reflected in the legislative proposal would decrease the overfunded amount by approximately \$1.5 billion.
- The funding status is also impacted by the choice of economic assumptions. For example, OPM utilized CSRS's long-term economic assumptions (e.g., 3.75% rate of inflation) in its revised projections. On the other hand, the Office of Management and Budget's (OMB) economic assumptions reflect short-term expectations (e.g., 1.8% rate of inflation). The use of CSRS's long-term assumptions increases both the present value of future benefits and the present value of future contributions in OPM's analyses.



- Currently, the law gives OPM's Board of Actuaries the authority to establish the demographic and economic assumptions to be used in all valuations of the CSRS.



Other USPS Financial Obligations

- Another significant issue that should be considered in conjunction with the treatment of the CSRS overfunding is that USPS faces substantial obligations related to
 - postretirement health care benefits estimated to be between \$40 - \$50 billion that are yet to be funded, and
 - outstanding debt to the federal government of \$11.1 billion as of September 30, 2002.



Conclusions

- While we agree with OPM's initial conclusion that current law would result in a significant overfunding of USPS's CSRS benefit costs, the amount of the overfunding is considerably greater than initially calculated and reported by OPM.
- The legislative proposal would address this overfunding issue by reducing the amount of annual payments required to be made by USPS to fund CSRS benefits.



- However, there are a number of issues that need to be considered that could significantly impact both the projected and current CSRS funding status of USPS under the legislative proposal.
 - OPM’s projections will need to be adjusted based on the decisions made regarding these issues.
- In addition, USPS still faces substantial obligations related to postretirement health benefits for its present and past employees, as well as significant outstanding debt, that should be considered in determining the treatment of the projected overfunding of CSRS obligations.



- The Congress needs to decide
 - whether some or all of the difference in current versus proposed future contributions should be used to reduce outstanding debt to the federal government or address USPS's unfunded postretirement health obligations, and
 - what, if any, other restrictions should be placed on the use of these funds.



- We discussed a draft of these briefing slides with OPM officials on January 29, 2003, who generally agreed with the facts presented. OPM provided the following observations based on their brief consideration of these slides:
 - The primary difference between the \$103.1 billion potential over-funding and the \$71.0 billion originally reported by OPM is due to the treatment of military service.
 - Although under the current law governing funding of CSRS the USPS does not pay for the cost of benefits attributable to military service, the Administration's proposed legislation is intended to replace the current funding methodology with a new approach modeled after the funding of FERS.



- Under the Administration’s proposal, the USPS would be responsible for the cost of military service. The Administration believes that charging the USPS is appropriate because under its proposal the “Postal Fund” would be credited with a proportional share of the excess investment returns earned by the CSRDF over the past 30 years.



- P.L. 91-93, Civil Service Retirement Amendments of 1969
Increased the statutory contributions made by employees and agency employers and required Treasury to fund the future increases in pension liabilities due to changes in benefits and increases in pay, the annual interest on existing unfunded liabilities, and the portion of benefit payments attributable to creditable military service.
- P.L. 93-349, Postal Service Payments to Retirement Fund
Required USPS to fund increases in pension liabilities resulting from USPS employee general pay increases in 30 equal payments with interest beginning at the end of the fiscal year in which the pay increase becomes effective.



- P.L. 93-554, Supplemental Appropriations Act
Provided USPS with a \$281 million appropriation to pay for the first three installments due on increases in its pension liabilities that resulted from the 1972 pay increase and the first two installments for the 1973 pay increases, plus interest. According to House Report No. 93-1378, another \$4 million was made available to USPS for this purpose as part of the Postal Service Appropriations Act of 1975 (P.L. 93-381).
- P.L. 100-203, Omnibus Budget Reconciliation Act of 1987
Required that USPS deposit \$350 million into the CSRDF. According to House Report No. 101-964, this payment was used to fund a portion of the cost of USPS annuitant COLAs.



- P.L. 101-239, Omnibus Budget Reconciliation Act of 1989
Required USPS to fund increases in pension liabilities resulting from COLAs granted to USPS employees who first became annuitants on or after October 1, 1986 or to the survivors of employees or employee annuitants who die on or after October 1, 1986. The law provided payment schedules for COLAs granted in 1987–1989. Increases in pension liabilities resulting from COLAs granted in 1990 and thereafter were to be paid in 15 equal payments with interest beginning at the end of the fiscal year in which the pay increase becomes effective. This law further stipulated that USPS would be liable only for the portion of the increase that is attributable to civilian service rendered after June 30, 1971. In fiscal year 1990, USPS paid approximately \$74 million under the provisions of this law before it was amended by P.L. 101-508.



- P.L. 101-508, Omnibus Budget Reconciliation Act of 1990
Changed the date from which USPS was responsible for funding the cost of annuitant COLAs from October 1, 1986 to July 1, 1971. Furthermore, P.L. 101-508 amended the 1987–1989 annual payments for COLAs set forth in P.L. 101-239 and established annual payments for pre-1987 and 1990 COLAs. However, the law did not require any payments for COLAs that were outside the 15-fiscal-year-period that began with the first fiscal year that the COLA took effect. This law required USPS to pay a total of \$1,685 million during fiscal years 1991- 1995 for pre-fiscal year 1987 COLAs.
- P.L. 103-66, Omnibus Budget Reconciliation Act of 1993
Required that USPS deposit \$693 million into the CSRDF no later than September 30, 1998, to pay more towards the cost of previous annuitant COLAs.



- OPM experienced obvious challenges in reconstructing 30 years of income and expense to create a “Postal Fund” within the CSRS plan. In some cases data were no longer available, such as regular employee and agency contribution data from 1972 through 1982. In other cases, such as employee salaries on July 1, 1971, it would have been too costly and time-consuming to obtain data from the individual hardcopy personnel and benefit files for hundreds of thousands of USPS employees and annuitants.
- One key overarching limitation of these data is OPM’s reliance on unaudited financial data for 25 of the 30 year span of its analysis. OPM received an unqualified opinion for the first time on its fiscal year 1997 financial statements of the CSRDF.



- Following is a list of some of the most significant estimation methods used to overcome the lack of readily available data
 - Regular employee and agency contributions for 1972–1982 were not available and, thus, OPM initially estimated these to be equal to the average amount of regular contributions made by USPS and its employees from 1983 – 2001 as a percent of total CSRS regular contributions.
 - After successfully reconciling USPS’s accrual-based agency contributions to OPM’s cash-based figures for 1983 - 2001, OPM accepted our suggestion to revise its estimates for 1972 – 1982 using USPS’s accrual-based figures for those years.



- Employee voluntary and civilian service deposits and redeposits were estimated to be equal to the ratio of total CSRS voluntary and service deposits to total CSRS employee withholdings multiplied by USPS employee withholdings.
- Annual CSRS investment returns were allocated to the “Postal Fund” based on the ratio of average yearly “Postal Fund” net assets to all CSRS plan net assets.
- Asset transfers to the Federal Employees’ Retirement System (FERS) from CSRS for USPS employees who were automatically transferred to FERS on January 1, 1987 were estimated based on fiscal year-end investment balances of the FERS “Postal Fund” for fiscal years 1983 – 1987. These transfers are reflected as reductions in the regular employee and agency employer contributions for these four fiscal years.



- There was insufficient documentation to support how the \$170 million transferred to FERS for USPS employees who elected coverage during the open season that ended on December 31, 1987 was calculated. Furthermore, although this transfer is reflected in OPM’s revised analysis as occurring on September 30, 1988, OPM could not provide evidence that this transfer or a similar transfer of \$1,124 million for non-USPS CSRS employees ever occurred.
- There remains a question as to whether OPM should have reflected a transfer of assets in its analysis of the “Postal Fund” for those USPS employees who elected to transfer from CSRS to FERS during the 1998 open season.



- Benefit payments for each fiscal year were estimated by indexing each annuitant's most recent monthly benefit payment amount by the amount of each annual COLA back to the annuity start date. OPM's approach to estimating benefit payments does not take into account any postretirement elections or adjustments that may have changed an annuitant's monthly payment.
- Estimated benefit payments were adjusted to reflect a factor for dropped records (e.g., child survivor annuitants), refunds of contributions to separated employees, death claim payments, administrative expenses, and an amount for the imprecision of benefit payment estimation methods. OPM calculated a separate adjustment factor for each fiscal year that was equal to the ratio of total CSRS benefits using the methods noted above to total actual CSRS expenses per published financial and actuarial reports.



- Estimated benefit payments to USPS nondisability annuitants were allocated between “postal” and “federal” shares to reflect
 - all civilian service rendered after June 30, 1971 and before July 1, 1971, respectively,
 - estimated salary on July 1, 1971, and
 - benefit accrual rates on service rendered after June 30, 1971 and before July 1, 1971, respectively.



- Disability retirement benefit payments were allocated based only on service adjusted for applicable benefit accrual rates. Survivor benefits are allocated using similar factors based on employee annuitant data.
- OPM’s annuity system maintains total years and months of creditable military and civilian service, but not actual dates when military service was performed and dates of hire into a civilian position. Consequently, OPM estimated employee date of hire by subtracting total civilian service from the annuity commencing date. This approach assumes that there were no significant breaks in federal civilian service. Also, military service is assumed to have occurred immediately prior to the assumed civilian date of hire.



- OPM’s annuity system maintains data on average high-three years salary and final salary at retirement, but not an employee’s salary at every point in time. To estimate salaries on July 1, 1971, OPM developed assumptions regarding general and merit pay increases based on historical data on USPS’s active population.
- Despite the use of estimation methods, there still remain limitations for which OPM has not separately adjusted and for which it may not be cost beneficial to develop estimation methods. These include the two following matters.



- OPM maintains data within its annuity system on the last agency an employee worked at before retirement, but not the amount of creditable service an employee accumulated while employed at each agency during his/her entire federal career. Consequently, benefit payments and regular contributions are not prorated based on service rendered at USPS and other federal agencies.
- The “Postal Fund” was credited with all contributions processed and deposited into the CSRDF by USPS, such as military service deposits, made only by employees during the time when they were employed by USPS and salary offsets for annuitants who were reemployed by USPS, regardless of the agency the employee retired from.



- To achieve our objectives, we
 - discussed with OPM’s actuarial staff their process for developing the annual income and expense components of the “Postal Fund,” projections of future benefits and contributions, and the underlying assumptions, estimation methods, and data,
 - reviewed the legislative history of laws that have affected USPS’s funding of CSRS costs,
 - compared OPM data on the amount and timing of employee and agency contributions to USPS data and evaluated OPM’s methods for estimating contributions when data were unavailable,



- compared OPM’s method for allocating investment returns to the methods OPM employs when allocating total investment returns between the CSRS and FERS plans and the “federal” and “USPS” FERS funds,
- obtained documentation from OPM on the amount of funds transferred from CSRS to FERS for USPS employees who were automatically transferred to FERS on January 1, 1987, as well as those USPS employees who elected FERS coverage during the 1987 open season,
- evaluated the reasonableness of OPM’s methods for estimating annual benefit payments and allocating a pro-rata share of refunds and administrative expenses,



- evaluated the reasonableness of OPM’s methodologies for allocating estimated benefit payments and other expenses between service rendered before and after July 1, 1971 – the effective date of the Postal Reorganization Act,
- reconciled the financial data used to develop the various income and expense components of the “Postal Fund” with data from OPM’s published financial and actuarial reports,
- tested the arithmetic accuracy of various computations and summarizations, including reperforming OPM’s estimate of annual benefit payments and related allocations for a nonrepresentative selection of nine annuitants,



- discussed with OPM’s actuaries
 - their choice of economic and demographic assumptions and actuarial models used to project future USPS-specific benefits and contributions,
 - the extent to which these actuarial assumptions and models are similar to those used to prepare projections of the entire CSRS for financial statement purposes,
 - the effect of using USPS-specific demographics versus CSRS-wide demographics on the funded position as of September 30, 2002, and
- reviewed the legislative proposal and identified matters that may need adjustment, clarification, or further consideration.



- We did not perform a financial audit of the “Postal Fund” as of September 30, 2002 or any of the annual income and expense components. Further, we did not perform an actuarial review of OPM’s projections of future benefits and contributions, and are not expressing an opinion on the material accuracy of these projections. Instead, we focused on the reasonableness of OPM’s methods, assumptions, and data.
- While we found several significant issues pertaining to OPM’s reconstruction of the “Postal Fund” and projections and proposed various adjustments, there may be other issues that would significantly impact OPM’s projections that did not come to our attention in the course of this review.
- We performed our work in Washington, DC from November 2002 through January 2003, in accordance with generally accepted government auditing standards.