OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

July 25, 2012

MEMORANDUM FOR: PATRICK R. DONAHOE
POSTMASTER GENERAL

E-Signed by Tammy Whitcomb
VERIFY authenticity with e-Sign

FROM: **for** David C. Williams
Inspector General

SUBJECT: Review of Fiscal Years 2012 and 2013 Liquidity
(Report Number FI-WP-12-001)

This memorandum provides the U.S. Postal Service Office of Inspector General's (OIG) review of U.S. Postal Service liquidity projections as of June 2012 (Project Number 12BD016FI000). Without legislation to eliminate or defer prefunding payments into the Retiree Health Benefits Fund, the U.S. Postal Service will likely default on the $11.1 billion in payments due in fiscal year (FY) 2012[1] and the $5.6 billion payment due in FY 2013. In addition to these defaults, the Postal Service projects an estimated $100 million cash shortfall on October 15, 2012, with a slow increase in liquidity from October through December 2012. Liquidity risks and shortfalls are projected to return in spring 2013 through October 2013, with the Postal Service projecting an estimated $1.2 billion cash shortfall in mid-October 2013.

These liquidity concerns exist even with the expected Postal Service default on the Retiree Health Benefits prefunding payments. To preserve its liquidity, the Postal Service presented the following additional measures for consideration: withhold employer contributions to the overfunded Federal Employees Retirement System (FERS) pension fund, and consider three different options for reimbursement of the U.S. Department of Labor (DOL) workers' compensation claims and administration costs.

As a result of our review, we believe the projected cash flow and liquidity figures, based on projected revenues and expenses, appear reasonable. Based on that

[1] The Postal Service is required to make prefunding payments of $5.5 billion in August 2012 and $5.6 billion in September 2012.

analysis, we concur with the Postal Service's projections that it might not have sufficient cash to fund its operations in October 2012 and at other times during FY 2013. However, it should be noted that the key components of projected cash flows, revenues, and expenses can be significantly impacted by the external economic environment, such as unanticipated changes in the Consumer Price Index, the cost of fuel, and consumer demand. Additionally, revenues and expenses can also be impacted by the global political and financial environments. All these factors could significantly change the future actual results for the projections presented.

For example, the cash flow projections include an estimated increase in revenue of $300 million for the 2012 presidential election. This increased revenue is expected near October 15, 2012—the projected low point of cash. If the revenue amount is not realized, there could be an increase in the projected cash shortfall.

In addition, we noted the following regarding areas the Postal Service is considering for preserving cash in order to continue delivering mail:

- The Postal Service is unable to make required payments to the Retiree Health Benefits Fund and is considering suspending payments to the FERS pension fund. Although the FERS pension fund payments are legally required, the U.S. Department of Justice has determined that suspending the FERS payments would have no impact on Postal Service employees. The Postal Service has overfunded FERS by $11.4 billion, and it has funded its health benefit fund at a level much greater than the private sector and federal government.

- The Postal Service described three potential options for reimbursing the DOL for workers' compensation expenses. The Postal Service is legally required to make an annual lump sum payment due in mid-October 2012 (and 2013). Not paying the amount due or paying installments for several months would assist the Postal Service in retaining cash for operational needs; however, this method could potentially put the DOL in a position in which it could not fulfill its operational needs. We suggest the Postal Service work closely with the DOL to identify a mutual solution.

To support our conclusions in this statement, we reviewed the liquidity documentation provided to us on June 11, 2012, and considered the following:

- Prior period audited annual financial statements and reviewed quarterly reports issued by the Postal Service.

- Discussions held with Postal Service management to describe the forecasting process and to identify key areas of risk for the development of the forecast data.

- Support for various critical economic assumptions from third party consulting firms by published government sources.

- Monetary impact of all audit reports issued. Similar information has been presented to Postal Service executives.

We also conducted various procedures to verify the reasonableness of the reported information. Those procedures included, but were not limited to, documentation of the overall process, interviews with key personnel responsible for developing the documentation and included data, verification of selected critical components[2] of the forecasting model,[3] and review of the legal impact of the various liquidity preservation methods identified in the documentation. We did not apply any specific test procedures to the applications used to generate the data in the documentation and did not test the overall reliability of the systems used to generate the data. We reviewed the documentation as it relates to the baseline forecasting of liquidity through October 15, 2013, the potential cost savings of the liquidity preservation measures presented, and the potential legal impact of some of the measures presented.

Further, we reviewed prior OIG audit reports to identify additional areas where the Postal Service could preserve cash. The Postal Service should consider these cost-reduction initiatives, as they might provide additional liquidity between now and October 15, 2013. These ideas do not require legislative action to implement but might require some initial investment. See Appendix A for a list of those reports.

Management's Comments

Although we made no recommendations in our report, management agreed with our conclusion that its cash flow and liquidity projections were reasonable. Management noted that the potential negative liquidity does not include pending defaults on $16.7 billion of retiree health benefits prepayments in late FY 2012 and FY 2013 that are required under the Postal Accountability and Enhancement Act. In addition, management agreed that their actual financial results may vary from the forecast and said they will closely monitor the liquidity and overall financial position while preserving cash and mitigating the risk of a cash shortfall. Management also noted the Postal Service Board of Governors has not decided whether to take any extraordinary cash preservation methods, but they are monitoring the situation. As a result, no decisions have been made at this time to withhold employer contributions to the FERS or modify workers' compensation payments to the DOL.

[2] Evaluated selected components based on subjectivity and risk.
[3] The forecasting model is used to estimate future period revenues and expenses used to generate estimated future cash flows.

Management noted that Appendix A makes reference to a number of prior OIG reports identifying cost savings and reemphasized that many of the recommendations in the reports would require significant up-front costs to implement, have the potential for stakeholder resistance, or carry significant implementation challenges. Management added it is actively pursuing the cost-saving measures outlined in its *Five-Year Plan*.

See Appendix B for management's comments, in their entirety.

Evaluation of Management's Comments

The OIG considers management's comments responsive to the statements and conclusion in the report. We acknowledge management concerns related to the audit projects noted in Appendix A and addressed them in the appendix.

Thank you for the opportunity to provide this information. If you have any questions or need additional information, please contact Mark Duda, assistant inspector general for audit, or me at (703) 248-2100.

cc: Joseph Corbett
Stephen J. Masse
Corporate Audit and Response Management

Appendix A: Prior OIG Reports

Following is a list of recent OIG reports that identified potential cost savings. Immediate implementation of some or all of the recommendations in the reports could provide additional liquidity between now and October 15, 2013. None of these recommendations require congressional action to implement.

No.	OIG Audit Topic	Audit Report	Report Date	Potential Annualized Savings for Fiscal Year 2013 (in millions)[4]
1	Modes of Delivery[5]	DR-AR-11-006	7/7/2011	$5,000
2	Benchmarking Mail Distribution to Carriers	EN-MA-11-001	3/25/2011	$518
3	Retail, Network, and Administrative Optimization	MS-AR-10-004 FF-AR-10-224(R) NO-AR-11-004 EN-AR-11-004 FF-AR-11-009 NL-AR-12-006	7/28/2010 9/20/2010 12/14/2010 3/31/2011 6/14/2011 5/29/2012	$771
4	Processing and Distribution Center and Delivery Efficiency Reviews	DR-AR-11-001 DR-AR-11-003 DR-AR-12-001 NO-AR-12-005 DR-AR-12-002	11/22/2010 1/20/2011 6/5/2012 6/5/2012 6/19/2012	$154
5	Postal Vehicle Service Audits	NL-AR-11-001 NL-AR-11-002 NL-AR-11-004 NL-AR-12-001 NL-AR-12-005	1/13/2011 3/18/2011 7/25/2011 2/2/2012 4/25/2012	$73
6	Density of First Class Mail on Air Transportation	NL-AR-12-003	3/12/2012	$2

[4] Some of these savings would require some period of time to implement before the savings could be realized and could involve some initial investment cost. Management did not concur with all recommendations and associated monetary impacts of the listed reports.
[5] Savings are associated with converting existing door-to-door to more economical and efficient delivery modes, such as curbside delivery.

Appendix B: Management's Comments

FINANCE

UNITED STATES POSTAL SERVICE

July 16, 2012

LUCINE M. WILLIS
DIRECTOR, AUDIT OPERATIONS

SUBJECT: Review of Fiscal Year 2012 and 2013 Liquidity (Report Number FI-WP-12-DRAFT)

Thank you for the opportunity to review and comment on the Office of Inspector General's (OIG) Review of Fiscal Year 2012 and 2013 Liquidity. We are pleased to note that your review concluded that our cash flow and liquidity projections are reasonable and that you concurred with our conclusion that the United States Postal Service may become insolvent in October 2012 and at other times later in FY2013. These potential insolvency positions are irrespective of our pending defaults on $16.7 billion of retiree health benefits prepayments in late-2012 and 2013 that are required under the Postal Accountability and Enhancement Act.

As your report notes, our actual financial results may vary from those in our forecast. Accordingly, we continue to closely monitor our liquidity and overall financial position, and management continues its work to preserve cash and mitigate the risk of a cash shortfall. Our Governors have not yet made a decision on whether to take any extraordinary cash preservation measures, but rather will monitor the situation with management and decide, as needed, in the future. Therefore, no decisions to withhold employer contributions to the Federal Employees Retirement System or modify workers' compensation payments to the Department of Labor have yet been made.

Appendix A to your report makes reference to a number of prior OIG reports identifying potential cost savings. As we note in our responses to the individual audits, many of the recommendations in these reports would require significant up-front costs to implement, would likely meet with significant stakeholder resistance, or carry significant implementation challenges. The Postal Service is continuing to actively pursue the cost-savings measures outlined in our *Five-Year Plan*, which will yield significant savings when fully implemented.

Nothing in this report is exempt from disclosure under the Freedom of Information Act.

Stephen J. Masse
Chief Financial Officer & Executive Vice President (A)

cc: Mr. Donahoe
audittracking@uspsoig.gov
CARMManager@usps.gov

475 L'ENFANT PLAZA SW
WASHINGTON DC 20260-5000