



OFFICE OF
INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

AUDIT REPORT

Opinion on the U.S. Postal Service's Fiscal Year 2015 Closing Package Financial Statements

November 17, 2015

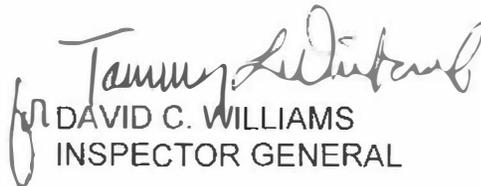
Report Number FT-AR-16-001



November 17, 2015

MEMORANDUM FOR: JOSEPH CORBETT
CHIEF FINANCIAL OFFICER AND EXECUTIVE
VICE PRESIDENT

FROM:


for DAVID C. WILLIAMS
INSPECTOR GENERAL

SUBJECT: Audit Report – Opinion on the U.S. Postal Service’s Fiscal
Year 2015 Closing Package Financial Statements
(Report Number FT-AR-16-001)

Report on the Closing Package Financial Statements

We have audited the U.S. Postal Service’s closing package financial statements, the Balance Sheet as of September 30, 2015, and September 30, 2014; the Statement of Net Cost and Statement of Changes in Net Position, and the accompanying note reports (except for the information in the FR Notes Report entitled "Threshold") for the years then ended (hereinafter referred to as the closing package financial statements) (Project Number 15BD006FT000). The objective of the audit was to express an opinion as to whether the closing package financial statements present fairly, in all material respects, the financial position and results of the Postal Service as of and for the fiscal years (FYs) ending September 30, 2015, and September 30, 2014, and its net costs and changes in in net position for the years then ended, in accordance with U.S. generally accepted accounting principles.

Management's Responsibility for the Closing Package Financial Statements

Management is responsible for the preparation and fair presentation of these closing package financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the closing package financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these closing package financial statements based on our audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB); the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the U.S.; and Office of Management and Budget (OMB) Bulletin Number 15-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin Number 15-02 require that we plan and perform the audit to obtain reasonable assurance about whether the closing package financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the closing package financial statements. The procedures selected depend on the auditor's judgment, including assessments of risk of material misstatement of the closing package financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the agency's preparation and fair presentation of the closing package financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the agency's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant estimates made by management, as well as evaluating the overall presentation of the closing package financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinion

In our opinion, the closing package financial statements referred to above present fairly, in all material respects, the financial position of the Postal Service as of September 30, 2015, and September 30, 2014, and its net costs and changes in net position for the years then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

Note X

We draw attention to Note X of the closing package financial statements which describes that the accompanying closing package financial statements were prepared to comply with the requirements of the U.S. Department of the Treasury's (Treasury) *Treasury Financial Manual* (TFM) Volume I, Part 2, Chapter 4700 for the purpose of providing financial information to Treasury and the U.S. Government Accountability Office (GAO) to use in preparing and auditing the *Financial Report of the U.S. Government*, and are not intended to be a complete presentation of the balance sheets of the Postal Service as of and for the years ended September 30, 2015, and 2014, as required by the Postal Reorganization Act of 1970, as amended, and the statements of

operations, cash flows, and changes in net deficiency, (hereinafter referred to as general-purpose financial statements). Our opinion is not modified with respect to this matter.

Recurring Intragovernmental Transactions

- Transactions with the U.S. Department of Defense (DOD) - The DOD reimburses the Postal Service for payments to air carriers for transporting mail to DOD's overseas locations. The Postal Service elected to record the reimbursements as an offset to expense because it invoices the DOD only to cover expenses. The Postal Service stated it does not make a profit on these transactions. The DOD records payments to the Postal Service as an expense.

These treatments resulted in differences in intragovernmental activity when reported to the Treasury. In a dispute resolution ruling, Treasury determined the Postal Service should record this activity as revenue. However, the Postal Service did not change its accounting treatment for the reimbursements totaling \$171 million in FY 2015. Based on its research, the Postal Service concluded payments received from DOD for international mail delivery could be recorded as an offset to an expense in the financial statements.

- Administrative Fee for Processing Workers' Compensation Claims - The U.S. Department of Labor (DOL) administers workers' compensation claims filed by Postal Service employees. In addition to reimbursing the DOL for the cost of claims, the Postal Service pays an annual administrative fee. The fee billed in August 2015 was \$71,544,096.

The Postal Service recorded part of this fee as an expense covering July through September of FY 2015. It recorded the remainder as a prepaid expense covering October through June of FY 2016. The DOL historically recorded the entire amount as revenue. These treatments resulted in differences in intragovernmental activity when reported to Treasury. To date, there has been no resolution on the different accounting treatments.

Other Matters

Opinion on the General-Purpose Financial Statements

The Postal Service's independent public accounting (IPA) firm has audited, in accordance with the standards of the PCAOB and the standards applicable to financial audits contained in U.S. *Government Auditing Standards* issued by the Comptroller General of the U.S., the general-purpose financial statements of the Postal Service as of and for the years ended September 30, 2015, and 2014, and its report thereon, dated November 13, 2015, expressed an unqualified opinion on those financial statements.

Additionally, in its unqualified opinion on the FY 2015 general-purpose financial statements, dated November 13, 2015, the IPA firm included an emphasis of matter referring to liquidity concerns discussed in the Postal Service's Form 10-K disclosures and the expectation this trend will continue into FY 2016. That view should be read in conjunction with this report.

Required Supplementary Information and Required Supplementary Stewardship Information

U.S. generally accepted accounting principles require that the information in the Other Data Report Numbers 1, 8, 9, and 14 through 18, be presented to supplement the closing package financial statements. Such information, although not a part of the closing package financial statements, is required by the Federal Accounting Standards Advisory Board (FASAB) who considers it to be an essential part of financial reporting for placing the closing package financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the U.S., which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the closing package financial statements, and other knowledge we obtained during our audits of the closing package financial statements in order to report omissions or material departures from prescribed guidelines, if any, identified by these limited procedures. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Management has omitted data related to deferred maintenance and repairs in the GF007 Other Data Report, Note 9, that U.S. generally accepted accounting principles require to be presented to supplement the closing package financial statements. Such missing information, although not a part of the closing package financial statements, is required by the FASAB who considers it to be an essential part of financial reporting for placing the closing package financial statements in an appropriate operational, economic, or historical context. Our opinion on the closing package financial statements is not affected by this missing information. Also, 39 U.S.C. § 410 generally exempts the Postal Service from federal laws dealing with budgets or funds.

Other Information

Our audit was conducted for the purpose of forming an opinion on the closing package financial statements as a whole. The information in the sections included in the Other Data Report Numbers 1, 8, 9, and 14 through 18; the information included in the Other Data Info Section C – Tax Gap of Other Data Report Number 1; the information included in the Other Text Data of Other Data Report Number 1; the information in the sections entitled "Threshold" in FR Notes Report Numbers. 6, 8, 15, and 19; the information in the Closing Package Line Reclassification Summary Report – Balance Sheet and the information in the Closing Package Line Reclassification Summary

Reports – Statement of Net Cost are presented for the purposes of additional analysis in accordance with TFM Chapter 4700 and is not a required part of the closing package financial statements. We read the other information included with the closing package financial statements to identify material inconsistencies, if any, with the audited closing package financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the closing package financial statements and, accordingly, we do not express an opinion or provide assurances on it.

Restriction on Use of the Report on the Closing Package Financial Statements

This report is intended solely for the information and use of the management of the Postal Service, Treasury, OMB, and GAO in connection with the preparation and audit of the *Financial Report of the U.S. Government* and is not intended to be and should not be used by anyone other than these specified parties.

Other Reporting Required by Government Auditing Standards

In accordance with the standards of the PCAOB and *Government Auditing Standards*, the Postal Service's IPA firm issued a report¹ dated November 13, 2015, on its consideration of the Postal Service's internal control over financial reporting and the results of its tests of the Postal Service's compliance with certain provisions of laws, regulations, and contracts that are required to be reported under *Government Auditing Standards*. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin Number 15-02 in considering the Postal Service's internal control and compliance, and should be read in conjunction with this report in considering the results of our audit of the closing package financial statements.

In the IPA firm's report on its consideration of the Postal Service's internal control over financial reporting, the auditor did not identify any deficiencies in internal control over financial reporting considered to be material weaknesses as of September 30, 2015. However, in its FY 2015 report, the IPA firm identified two significant deficiencies.

Deferred Revenue – Prepaid Postage (Drop Shipment Mail in Transit)

A significant deficiency arose during the fourth quarter of FY 2014 within the Deferred Revenue – Prepaid Postage process specific to Drop Shipment Mail in Transit. The significant deficiency was due to the failure by management to detect an error in the completeness and accuracy of data used in the calculation of deferred revenue for drop shipment mailings as of September 30, 2014. During FY 2015, management implemented a remediation plan that included performing assessments on the design of the review of completeness and accuracy of data used in the Mail in Transit calculation. Based upon the results of management's testing, management concluded that the significant deficiency in Deferred Revenue – Prepaid Postage was remediated during

¹ Report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards*, dated November 13, 2015.

the fiscal year and no longer exists as of September 30, 2015. The IPA firm concurred with management's conclusions.

Cyber Intrusion Incident

A significant deficiency arose during the fourth quarter of FY 2014 within the information technology control environment. The significant deficiency was due to an intrusion by an external party that gained unauthorized access to certain information technology servers and privileged accounts. Management developed a multiple phase remediation plan, much of which has been executed in FY 2015, with remaining activities to occur in FY 2016. Accordingly, as of September 30, 2015, management has not yet fully remediated and tested the significant deficiency.

The IPA firm also noted one instance of non-compliance with laws and regulations. The Postal Service defaulted on the required prefunding payments to the Postal Service Retiree Health Benefit Fund of \$5.7 billion during FY 2015 and on required payments covering prior fiscal years totaling \$22.4 billion. The Postal Service defaulted on its payments due to insufficient cash resources and is expecting legislation that would significantly reduce or eliminate the required payments.

Internal Control over Financial Reporting Specific to the Closing Package Financial Statements

In planning and performing our audit of the closing package financial statements as of and for the year ended September 30, 2015, we also considered the Postal Service's internal control over the financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the closing package financial statements, but not for the purpose of expressing an opinion of the effectiveness of Postal Service's internal control. Accordingly, we do not express an opinion on the effectiveness of Postal Service's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as previously discussed, the IPA firm identified deficiencies in internal control that they consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees in their normal course of performing their assigned functions, to prevent, or detect and correct, misstatements, timely. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less

severe than a material weakness yet important enough to merit the attention by those charged with governance.

Apart from the significant deficiencies previously mentioned, we found no material weaknesses or significant deficiencies in internal control over the financial reporting process that are required to be reported under *Government Auditing Standards* and OMB Bulletin 15-02.

Compliance and Other Matters Specific to the Closing Package Financial Statements

As part of obtaining reasonable assurance about whether the Postal Service's closing package financial statements are free from material misstatement, we also performed tests of its compliance with certain provisions of TFM Chapter 4700, noncompliance with which could have a material effect on the closing package financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit of the closing package financial statements, and accordingly, we do not express such an opinion.

The results of our tests of compliance with TFM Chapter 4700 disclosed an instance of noncompliance that is required to be reported herein under *Government Auditing Standards* and OMB Bulletin Number 15-02. The TFM and OMB Circular A-136, *Federal Reporting Requirements*,² requires federal agencies to report financial data quarterly and reconcile with other agencies differences in reported amounts. Quarterly, the Postal Service reported to Treasury amounts involving financial transactions with selected agencies. However, the Postal Service reported amounts only for the four authoritative agencies.³ It did not reconcile intragovernmental activities and balances or identify reasons for differences with its trading partners unless contacted by other agencies.

The Postal Service relied on 39 U.S.C. § 410, which generally exempts the Postal Service from federal laws dealing with budgets or funds. It informed Treasury that, in addition to quarterly reporting with selected agencies, it would only submit financial data at fiscal year end.

Purpose of the Other Reporting Required by Government Auditing Standards

The purpose of the communication provided in the Other Reporting Required by *Government Auditing Standards* section is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Postal Service's internal control or on compliance. This communication is an integral part of an audit performed in accordance with U.S. generally accepted government auditing standards in considering internal control and compliance with provisions of laws, regulations, and contracts that have a material

² August 4, 2015.

³ The DOL, U.S. Office of Personnel Management, Federal Financing Bank, and Bureau of the Public Debt.

effect on the closing package financial statements. Accordingly, this communication is not suitable for any other purpose.

Attachment

cc: Julie S. Moore
Corporate Audit and Response Management

Note to the Closing Package Financial Statements

Note X - Closing Package Financial Statement Requirements

The Budget and Accounting Procedures Act of 1950 allows the Secretary of the Treasury to stipulate the format and requirements of executive agencies to furnish financial and operational information to the President and the Congress to comply with the Government Management Reform Act of 1994 (GMRA) (Pub. L. Number 103-356), which requires the Secretary of the Treasury to prepare and submit annual audited financial statements of the executive branch. The Secretary of the Treasury developed guidance in TFM Chapter 4700 to provide agencies with instructions to meet the requirements of GMRA. The TFM Chapter 4700 requires agencies to:

1. Reclassify all line items and amounts on the comparative audited consolidated, department-level balance sheets, statement of net cost/income statement, and statement of changes in net position to the closing package financial statements.
2. List closing package financial statement line item amounts identified as Federal by trading partner and amount.
3. Report notes information that is based on the Reclassified Balance Sheet line items and other notes information required to meet FASAB standards.
4. Report other data information that is not based on the Reclassified Balance Sheet line items and other data required to meet FASAB standards.