OFFICE OF
INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

AUDIT REPORT

Opinion on the U.S. Postal Service's Fiscal Year 2017 Closing Package Financial Statements

November 16, 2017

Report Number FT-AR-18-002

November 16, 2017

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

FROM: TAMMY L. WHITCOMB
ACTING INSPECTOR GENERAL

SUBJECT: Audit Report – Opinion on the U.S. Postal Service's Fiscal Year 2017 Closing Package Financial Statements (Report Number FT-AR-18-002)

Report on the Closing Package Financial Statements

We have audited the accompanying Closing Package Financial Statements of the U.S. Postal Service which comprises the Government-wide Treasury Account Symbol Adjusted Trial Balance System (GTAS) Reconciliation Report – Reclassified Balance Sheet as of September 30, 2017, and the related GTAS Reconciliation Reports – Reclassified Statement of Net Cost and Reclassified Statement of Changes in Net Position, for the year then ended, and the related notes to the financial statements (hereinafter referred to as the "closing package financial statements") (Project Number 17BM008FT000).

The notes to the financial statements comprise the following:

- The GTAS Closing Package Lines Loaded Report,
- Financial Report (FR) Notes Report (except for the information in the FR Notes Report entitled "2016 – September, "Prior Year", "PY", "Previously Reported", "Line Item Changes", "Threshold", and the information as of and for the year-ended September 30, 2016, in the "Text Data" of the FR Notes Reports), and,
- The accompanying Note X (except for the information as of and for the year-ended September 30, 2016).

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 (GAAP); 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 audit. We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB); the standards applicable to financial audits contained in U.S. *Government Auditing Standards*, issued by the Comptroller General of the U.S.; and Office of Management and Budget (OMB) Bulletin Number 17-03, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin Number 17-03 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, 2017, and its net costs and changes in net position for the year then ended in accordance with U.S. GAAP.

Emphasis of Matter

Note X

We draw attention to Note X to 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 Treasury's (Treasury) *Treasury Financial Manual* (TFM) Volume I, Part 2, Chapter 4700 (TFM Chapter 4700) for the purpose of providing financial information to the 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 sheet of the Postal Service as of September 30, 2017, as required by the Postal Reorganization Act of 1970, as amended, and the related statements of operations, cash flows, and changes in net position (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. During fiscal year (FY) 2015, 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 $123,240,593 in FY 2017. 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.

- Workers' Compensation - 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 Postal Service historically recorded part of this fee as an expense covering July through September. It recorded the remainder as a prepaid expense covering October through June. The DOL historically recorded the entire amount as revenue. These treatments resulted in differences in intragovernmental activity when reported to Treasury. In FY 2017, the Postal Service recognized the entire administrative fee as an expense. It also recognized the FY 2016 prepaid amount as an expense. This recognition of the prepaid portion will result in an intragovernmental difference in the FY 2017 *Financial Report of the U.S. Government*. The Postal Service also included an accrual for the estimated administrative fee attributable to July through

September 2017 within their workers' compensation liability, which the DOL did not record. This will also result in an intragovernmental difference on the FY 2017 *Financial Report of the U.S. Government.*

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, auditing standards generally accepted in the U.S., 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, 2017 and 2016, and its report thereon, dated November 14, 2017, expressed an unqualified opinion on those financial statements.

Additionally, in its unqualified opinion on the FY 2017 general-purpose financial statements, dated November 14, 2017, the IPA firm emphasized liquidity matters discussed in the Postal Service's Form 10-K disclosures. That view should be read in conjunction with this report.

Required Supplementary Information and Required Supplementary Stewardship Information

U.S. GAAP requires that the information except for such information entitled "2016 – September", "Prior Year", "PY", "Previously Reported", "Line Item Changes", and "Threshold", and the information as of and for the year ended September 30, 2016, included in the "Text Data" of the FR Notes Reports and "Other Text Data" of the Other Data Report, included in Other data Report Numbers 1, 8, 9, 15 through 19, to be presented to supplement the basic closing package financial statements.

Such information, although not a part of the basic 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 basic 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 audit of the closing package financial statements. Although our opinion on the closing package financial statements is not affected, Other Data Report Number 9 contains material departures from the prescribed guidelines because the information included in these Other Data Reports presents the required information for the *Financial Report of the U.S. Government* and not the required information for the Postal Service's financial statements. 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. GAAP requires 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. Based on our review of the statute, we believe the Postal Service is not required to report such information.

Other Information

Our audit was conducted for the purpose of forming an opinion on the closing package financial statements as a whole. The information other than that described in the first paragraph and the paragraph labeled *Required Supplementary Information* and *Required Supplementary Stewardship Information* are presented for purposes of additional analysis in accordance with TFM Chapter 4700 and are 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 audit of the closing package financial statements as of and for the year ended September 30, 2017, and accordingly, we do not express an opinion or provide assurance 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, auditing standards generally accepted in the U.S., and *Government Auditing Standards*, the Postal Service's IPA firm issued a report[1] dated November 14, 2017, 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 PCAOB, *Government Auditing Standards,* and

[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*.

OMB Bulletin Number 17-03 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, 2017. However, in its FY 2017 report, the IPA firm included one significant deficiency from FY 2016, which was remediated in FY 2017, and two new significant deficiencies.

Ineffective IT General Controls within a Meter Service Organization's Information Technology (IT) Application – Remediated during FY 2017.

Under Postal Service regulations, third party providers of postage software and postage meters must provide the Postal Service a Service Organization Control (SOC) 1 report from their auditors, which summarizes the design and operating effectiveness of their company's internal controls. During Postal Service management's evaluation of the SOC 1 reports for FY 2016, it was determined that one postage meter company received a qualified opinion related to ineffective IT general controls, specifically related to the "logical access" and "change management" within a key IT application. As the Postal Service relies on the detailed meter reset transactional data within this IT application in order to determine the timing and amount of the Postal Service's meter deferred revenue (Postage in the Hands of the Public or PIHOP), Postal Service management performed additional analytical procedures to substantiate that the risks associated with the ineffective IT general controls were not so severe as to cause a material misstatement in the financial statements. Based upon the IPA firm's evaluation, the IPA firm concluded that there was a significant deficiency in internal control as of September 30, 2016. During FY 2017, the meter company's management developed a remediation plan and implemented enhanced control procedures, with close monitoring by the Postal Service. The Postal Service received the FY 2017 SOC 1 report, which was unqualified, and the IPA firm concluded that appropriate control objectives were addressed. Accordingly the IPA firm concluded the significant deficiency was remediated as of September 30, 2017.

Lack of Independent Board of Governors and Audit and Finance Committee under COSO 2013 Principle 2 – Not remediated during FY 2017.

A significant control deficiency developed during the first quarter of FY 2017 when on December 8, 2016, the term of the last remaining independent Governor on the Postal Service's Board of Governors expired, resulting in no independent Governors. The absence caused a departure from compliance with COSO 2013 principles, in particular Principle 2, which establishes that a Board of Directors (Governors) shall demonstrate independence from management and exercise oversight of the development and performance of internal controls. This represents a departure from a principle underlying the internal control framework (2013) established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and as such, represents a significant deficiency. With the continued absence of independent Governors, this significant deficiency remained un-remediated as of September 30, 2017.

Windows Privileged Access Management – Not remediated during FY 2017.

During FY 2017, the Postal Service identified two IT general control (ITGC) deficiencies in its Windows Operating System (OS) environment:

- Certain Windows privileged accounts either did not have the required approval documentation to support that they were appropriately provisioned and/or were inappropriately provisioned locally.
- Certain activities were not being appropriately logged, safeguarded and monitored during the course of the fiscal year as part of Postal Service's controls around Windows security logging and monitoring.

These deficiencies were determined to be operating in nature, as they related to inconsistent authorization documentation or operation of existing monitoring controls. Management identified a combination of mitigating factors and compensating controls, which addressed some of the risks presented by the un-remediated deficiencies. Those mitigating factors and compensating controls were tested by the Postal Service.

There is an unaddressed IT risk within the Windows OS, as the network does not adequately detect attempts by unauthorized users to leverage, elevate, or exploit access to information systems. This presents a risk that a privileged user might have access to privileges beyond those necessary to perform their assigned duties, which may lead to the direct and indirect manipulation or processing of financial data. Due to the pervasiveness of the identified issues within the Windows OS environment, management aggregated these deficiencies into one significant deficiency related to the operating effectiveness of controls.

Management completed a process to remove inappropriate access that was identified during the course of its testing. It is in the process of designing and implementing its remediation plan for the noted deficiencies. This significant deficiency remains un-remediated as of September 30, 2017.

Compliance and Other Matters

The IPA firm also noted one instance of non-compliance with laws and regulations. Specifically, the Postal Accountability and Enhancement Act of 2006, as amended,[2] required the Postal Service to make annual payments into the Postal Service Retiree Health Benefits Fund. The Postal Service failed to comply with the law when it failed to make $33.9 billion of payments between the years 2012 through 2016. The U.S. Office

[2] Public Law 109-425.

of Personnel Management (OPM) considers the $33.9 billion due and payable. The Postal Service continues to reflect this amount as a current liability on its balance sheet.

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, 2017, we also considered the Postal Service's internal control over 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 the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. 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 Number 17-03.

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 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 disclosed an instance of noncompliance that is required to be reported herein under *Government Auditing Standards* and OMB Bulletin Number 17-03. The TFM and OMB Circular A-136, *Federal Reporting Requirements,*[3] 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.[4] 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 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

[3] August 15, 2017.
[4] DOL, OPM, Federal Financing Bank, and Bureau of the Public Debt.

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, Volume 1, Part 2, Chapter 4700 to provide agencies with instructions to meet the requirements of GMRA. The TFM Chapter 4700 requires agencies to:

1. Submit a GTAS adjusted trial balance which will be used to populate a Reclassified Balance Sheet, Reclassified Statement of Net Cost, and Reclassified Statement of Changes in Net Position.

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 noted information required to meet FASAB standards.

5. Report the information in the FR Notes Report and Other Data Report entitled "2016 – September", "Prior Year", "PY", "Previously Reported", "Line Item Changes", and "Threshold", and the information as of and for the year-ended September 30, 2016 included in the "Text Data" of the FR Notes Reports and "Other Text Data" of the Other Data Reports and the information in Note X related to the prior year balances, are presented for purposes of additional analysis in accordance with TFM Chapter 4700 are not a required part of the closing package financial statements.