December 12, 2003

SUZANNE F. MEDVIDOVICH
SENIOR VICE PRESIDENT, HUMAN RESOURCES

SUBJECT: Audit Report – Comparison of Retirement Benefits to Workers' Compensation Benefits for Employees on the Periodic Roll (Report Number HM-AR-04-001)

This report presents the results of our audit comparing retirement benefits to workers' compensation benefits for totally disabled Postal Service employees on the periodic roll (Project Number 03YN009HK000). Our objective was to perform a comparative cost analysis of retirement benefits to workers' compensation benefits. This audit was initiated as a result of our review of Retirement Eligible Postal Service Employees on the Workers' Compensation Periodic Roll (Report Number HK-MA-03-001 dated March 21, 2003).

Our audit found the Postal Service could save $19 million over the next 10 years if 255 totally disabled employees on the periodic roll were required to retire under their applicable federal retirement system. Also, their survivors would receive benefits that may not be available under the Federal Employees' Compensation Act. Given the Postal Service's current $6.5 billion unfunded liability for workers' compensation and increasing annual chargeback costs, there is a need to reform the act to require eligible totally disabled employees to retire on disability or voluntary retirement under their applicable system. Legislative reform would help reduce the current number of employees on the periodic roll and assist the Postal Service in reducing future workers' compensation costs while providing adequate coverage to employees. Management agreed with our findings indicating the report makes a compelling case for changes to the Federal Employees' Compensation Act. Management further stated the findings and data depicted in the report would add support to the Department of Labor's efforts to reform the Federal Employees' Compensation Act. Management's comments and our evaluation of these comments are included in the report.

We appreciate the cooperation and courtesies provided by your staff during the audit. If you have any questions or need additional information, please contact Erica Blackman, director, Health Care Audit, at (703) 248-2100 or me at (703) 248-2300.

Mary W. Demory
Deputy Assistant Inspector General
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Attachment

cc: DeWitt O. Harris
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INTRODUCTION

Background

The Federal Employees' Compensation Act, enacted in 1916, is a comprehensive workers' compensation law designed to provide medical and death benefits, income replacement, and other services to employees with work-related injuries. The Federal Employees' Compensation Act was not intended to serve as a retirement program, nor does it place age or time limitations on an injured worker's receipt of workers' compensation benefits. As long as the injured employee's medical evidence substantiates that the total or partial disability is related to the work injury, the individual is entitled to receive benefits. Employees who fully or partially recover from their injuries are expected to return to work. If it appears the disability will continue, employees are placed on the periodic roll.[1]

The Office of Workers' Compensation Programs adjudicates claims and pays compensation, medical, and death benefits to injured federal workers. These benefits are paid from the Department of Labor's Employees' Compensation Fund. All fund outlays are billed annually to each employing agency through chargebacks. Each agency is responsible for reimbursing the Employees Compensation Fund for expenses paid from the fund for its injured workers. The Office of Workers' Compensation Programs' chargeback year is July 1 through June 30.

The Office of Workers' Compensation Programs classifies injured employees on the periodic roll in several categories. These include totally disabled, partial wage-earning capacity, overpayment, and no wage-earning capacity or reemployment determination. Employees classified as totally disabled have little to no future reemployment. Employees eligible for Federal Employees' Compensation Act benefits receive either 66 2/3 percent or 75 percent[2] of their basic salary tax-free until they return to work. This amount also includes an annual cost-of-living adjustment. In fiscal year (FY) 2002, the program paid all injured federal workers over $2.2 billion, including $1.61 billion in wage loss

[1] Employees on the periodic roll have permanent disabilities or injuries that have lasted or are expected to last for prolonged periods (over 1 year).
[2] Only employees with dependents receive 75 percent of their basic salary.

compensation and the remainder in medical and death benefits.

Postal Service Workers' Compensation Costs	The Postal Service is self-insured for workers' compensation costs, and these costs have continued to escalate. In chargeback years 1997 to 2002, the Postal Service's workers' compensation costs increased approximately 49 percent from $538 million to $805 million.[3] The Postal Service's costs include some cases that originated over 25 years ago because the act places no age or time limitation on an injured worker's receipt of workers' compensation benefits. According to senior Postal Service officials, the rising costs of injury compensation will have a substantial negative financial impact on the Postal Service. Specifically, in chargeback year 2002, the Postal Service paid over $805 million in workers' compensation benefits and administrative fees to the Office of Workers' Compensation Programs for approximately 13,400 Postal Service employees on the periodic roll. The Postal Service's 2002 chargeback costs accounted for 35 percent[4] of all federal agency expenditures for the workers' compensation program. Furthermore, in chargeback year 2002, the Postal Service incurred approximately $94 million in compensation and medical costs for totally disabled employees.
Totally Disabled Employees on the Periodic Roll	Twenty-one percent (2,819) of the approximately 13,400 employees on the periodic roll were classified as totally disabled. Based on the periodic roll data for chargeback year 2002, approximately 89 percent (2,502) of the 2,819 employees are age 55 or older as of September 30, 2003, as shown in Table 1.

[3] This figure does not include workers' compensation costs for the Post Office Department.
[4] The percentage is based on workers' compensation benefits paid, excluding administrative fees.

Table 1

Age of Totally Disabled Employees on the Periodic Roll as of September 30, 2003

Age	Number of Employees
85 and older	382
75 to 84	1,039
65 to 74	648
55 to 64	433
54 and younger	317
Total	2,819

Fifty-five is the age at which most employees are first eligible for voluntary retirement. However, there is no requirement for an employee who has reached retirement age to be removed from the periodic roll. Consequently, some employees may remain on the periodic roll until they die.

As shown in Table 2, approximately 73 percent[5] (2,044) of the 2,819 employees have been on the Office of Workers' Compensation Programs periodic roll for 20 years or longer.

[5] Information on the number of totally disabled employees who had returned to work was not available.

Table 2

Years Totally Disabled Employees Have Been on the Workers' Compensation Programs Periodic Roll as of September 30, 2003

Years	Number of Employees
40 to 50 years	81
30 to 39	778
20 to 29	1,185
10 to 19	553
5 to 9	199
Less than 5 years	23
Total	2,819

According to a Postal Service management official, the Postal Service is quickly approaching a condition where positions will no longer be available to internally accommodate injured employees. In addition, the continued deployment of automated equipment decreases the number of available positions for injured employees.

Federal Retirement Systems

Postal Service employees are covered by one of three retirement systems, the Civil Service Retirement System, the Dual Civil Service Retirement System, or the Federal Employees Retirement System, which are administered by the Office of Personnel Management. During the period of employment, the employer and the employee contribute to the employee's retirement annuity. For the 2,819 employees, 182 participate in the Civil Service Retirement System and 245 participate in the Federal Employees' Retirement System. The National Retirement Counseling System[6] did not provide retirement data for the remaining 2,392 employees. Their records are no longer available because they are not on the Postal Service active employee roll.

[6] The National Retirement Counseling System provides computer generated annuity estimates on a semiannual basis to employees eligible for optional retirement under the Civil Service Retirement System and the Federal Employees Retirement System.

The amount of an employee's annuity depends on years of federal service, age and salary. See Appendix A for a summary description of each retirement system, including eligibility and benefits for disability and voluntary retirees.

Objective, Scope, and Methodology

Our objective was to perform a comparative cost analysis of retirement benefits to workers' compensation benefits.

To accomplish our objective, we interviewed Postal Service officials at headquarters and two district offices (Capital Metro and Dallas) on retirement and disability policy issues and received a demonstration of the National Retirement Counseling System.

We reviewed the Postal Service Employee and Labor Relations Manual, the Injury Compensation Handbook, the Office of Personnel Management Civil Service Retirement System booklet, and the Federal Employees' Retirement System booklet for disability and voluntary eligibility requirements. We also reviewed prior General Accounting Office and Office of Inspector General (OIG) audit reports on workers' compensation issues, the Federal Employees' Compensation Act, and other Department of Labor publications on the Federal Employees' Compensation Act.

To obtain the monthly medical costs, workers' compensation payments, and estimated voluntary and disability retirement annuity payments for the 2,819 totally disabled employees, we used three systems: the Postal Injury Compensation System,[7] the National Retirement Counseling System, and the Workers' Compensation Information Reporting System.[8] These three systems provided data on 255 of the 2,819 totally disabled employees. We focused our judgmental review on the 255 employees because of data availability limitation. Consequently, this constitutes a judgment selection rather than a random selection.

To determine the cost savings to the Postal Service, we performed a comparative cost analysis of the costs the

[7] The Postal Injury Compensation System is an OIG system that contains weekly medical costs and workers' compensation data from the Office of Workers' Compensation Programs for each injured Postal Service employee.
[8] The Workers' Compensation Information Reporting System records payment data for employees on the periodic roll.

Postal Service would incur if the 255 totally disabled employees remained on the periodic roll for 10 years to employees who retire under their applicable disability or voluntary retirement systems. See Appendix C for details of our methodology.

This audit was conducted from June through November 2003 in accordance with generally accepted government auditing standards and included such tests of internal controls as were considered necessary under the circumstances. We did not attempt to assess the reliability of the data from the systems as part of our audit objective. We discussed our conclusions and observations with appropriate management officials and included their comments, where appropriate.

Prior Audit Coverage

We identified one prior OIG report related to the objective of this audit.

Retirement-Eligible Postal Service Employees on the Workers' Compensation Periodic Roll (Report Number HK-MA-03-001, dated March 21, 2003). Our review disclosed Postal Service employees age 55 and older make up 49 percent (6,500) of the approximately 13,400 employees on the periodic roll. Further, 70 percent (9,345) of the employees on the periodic roll are totally disabled with little or no future reemployment potential, or reemployment has not been determined. Reform of the Federal Employees' Compensation Act is needed to address concerns the act has become, in effect, a retirement system for some workers' compensation beneficiaries. These reforms, if implemented, would decrease the number of employees on the periodic roll and would reduce compensation costs. We recommended management pursue whether congressional assistance should be sought to pay administrative fees to the Office of Workers' Compensation Programs. Management agreed with our recommendation and stated they have supported efforts to change the Federal Employees' Compensation Act, which would alter the program's structure. Management's actions taken or planned were responsive to the issues identified in the report.

AUDIT RESULTS

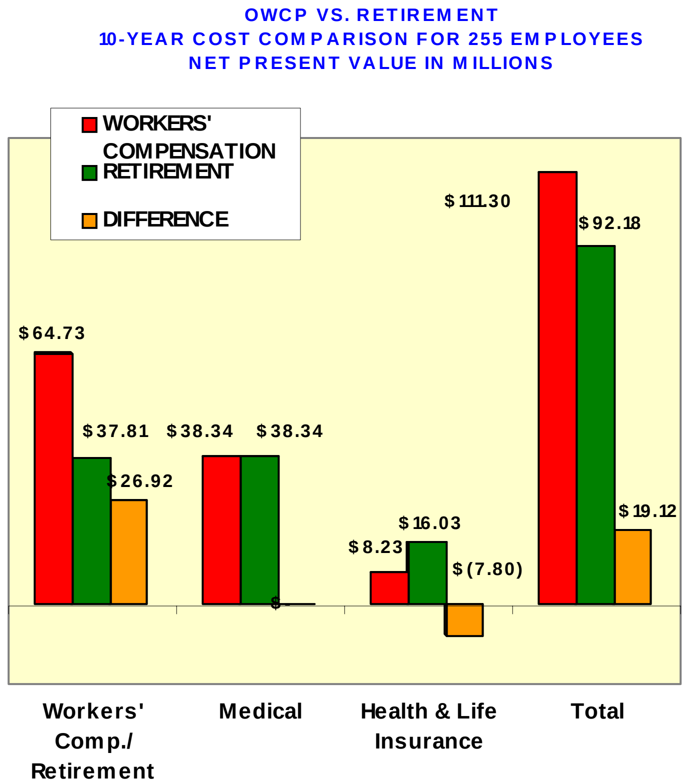
Cost Savings to the Postal Service

Our audit found the Postal Service could save $19 million[9] if 255 totally disabled employees on the periodic roll were required to retire under their applicable federal retirement systems. Furthermore, their survivors would receive benefits that may not be available under the Federal Employees' Compensation Act. Legislative reform, if enacted, would help reduce the current number of employees on the periodic roll and assist the Postal Service in reducing workers' compensation costs while providing adequate coverage to employees.

Comparative Cost Analysis of Retirement Benefits to Workers' Compensation Benefits

Costs to the Postal Service would be less if 255 totally disabled employees were required to retire. If these employees retired under the Office of Personnel Management retirement system, the Postal Service would pay only $92 million over the next 10 years.[10] However, if the 255 employees remained on the workers' compensation periodic roll, the projected estimated cost to the Postal Service would be $111 million over the next 10 years.[11] As shown in the chart on the next page, the Postal Service would save $19 million[12] over the next 10 years if these eligible employees were required to retire under their applicable retirement systems.

[9] The cost savings is the Net Present Value of the cash flow difference over the next 10 years.
[10] The Postal Service's estimated retirement cost includes its portion of life insurance, health insurance, and annual cost of living adjustments.
[11] The Postal Service's estimated workers' compensation costs includes compensation, medical, and an administrative fee for these employees if they remain on the periodic roll for the next 10 years.
[12] If these 255 employees were required to retire, this would represent a net present value annual savings of approximately $7,500 per employee.



Legend:

- **Workers' Compensation-** includes compensation and medical fee paid by the Postal Service for these employees.
- **Retirement**- includes a portion life and health insurance, and annual cost of living adjustments paid by the Postal Service.
- **Medical**- Continuous Medical care for a work-related injury.
- **Health and Life Insurance -** includes a portion employee's health and life insurance paid by the Postal Service.

Furthermore, if an employee receiving workers' compensation benefits dies from a non-work related injury, the employee's benefits terminate. As a result, the survivors may be placed in a financial hardship. However, if the employee retires under his or her applicable disability or voluntary retirement system, the survivors would receive survivors' benefits.

Management's Comments

Management agreed with our findings indicating the report makes a compelling case for changes to the Federal Employees' Compensation Act. Management further stated the findings and data depicted in the report would add support to the Department of Labor's efforts to reform the Federal Employees' Compensation Act.

Evaluation of Management's Comments

Management agreed with the findings in our report. Management's actions taken or planned are responsive to the issues identified in the report. Management's comments, in their entirety, are included in Appendix D of this report.

Legislative Reform

Legislative reform of the Federal Employees' Compensation Act is needed to require totally disabled employees to elect voluntary or disability retirement options when they become eligible. The Federal Employees' Compensation Act was not intended to serve as a retirement program nor does it place age or time limitation on an injured worker's receipt of workers' compensation benefits. The Postal Service's April 2002 Transformation Plan included strategies to reduce the agency's costs for work-related injuries. The plan describes the Postal Service's position that compensation should not be a lifetime benefit and at retirement age, compensation should be adjusted to an amount equal to what a retiree would receive from his or her applicable federal retirement system. The agency supports the proposed Department of Labor Federal Employees' Compensation Act annuity, which would calculate benefits similar to those of a normal retirement at age 65.

In December 2002, the President created the United States Commission on the Postal Service to craft a vision "to ensure the efficient operation of the Postal Service while minimizing the financial exposure of the American taxpayer." One key objective of the commission was to determine the flexibility the Postal Service should have to control costs in response to financial, competitive, and market pressures. The July 2003 report of the commission stated that since the Postal Service has a unique businesslike charter, the agency should be provided relief from provisions of the Federal Employees' Compensation Act that create costly unintended consequences.

Specifically, the commission recommended the Postal Service be permitted to transition workers' compensation recipients to the appropriate retirement system when they become eligible for retirement. Similar measures are fairly standard practice in the private sector and are aimed at controlling costs while providing adequate coverage to employees. Given the Postal Service's current $6.5 billion unfunded liability for workers' compensation, and the increasing annual chargeback costs, there is a need for legislative reform to require eligible totally disabled employees to retire on disability or voluntary retirement, under their applicable system.

Such reform would help the Postal Service reduce the number of employees on the periodic roll and would reduce future workers' compensation costs while providing adequate coverage to employees.

APPENDIX A

COMPARISON OF FEDERAL RETIREMENT SYSTEMS (DISABILITY AND VOLUNTARY)

	DISABILITY RETIREMENT	
Civil Service Retirement System (CSRS)	Federal Employees Retirement System (FERS)	Dual Civil Service Retirement System (CSRS/Dual)
	ELIGIBILITY	
• Employee's disability expected to last for 1 year. • Employee must have 5 years of service. • Employing agency must certify they cannot accommodate the injured employee.	• Employee's disability expected to last for 1 year. • Employee must have 18 months of service. • Employing agency must certify they cannot accommodate the injured employee.	• Employee's disability expected to last for 1 year. • Employee must have 5 years of service. • Employing agency must certify they cannot accommodate the injured employee.
	BENEFITS	
• Employee receives benefits equal to the projected benefit at age 60, or 40 percent of the employee's high-3 average salary, whichever is less. • If the employee has more than 22 years of service when declared disabled, accrued benefits cannot exceed 40 percent of salary. • Employees' disability benefit is offset by qualified Social Security benefits. • Cost-of-living adjustment matched at full rate of inflation. • Survivors' benefits.	• Employee receives benefits equal to 60 percent of high-3 average pay minus 100 percent of Social Security benefit. • After the first year until age 62, employee receives 40 percent of high-3 average pay. • Employee's disability benefit is offset by qualified Social Security benefit. • No cost-of-living adjustment during the first year; up to 2 percent after first year. • Disability benefit will be recomputed at age 62. • Survivors' benefits.	• Employee receives benefits equal to the projected benefit at age 60, or 40 percent of the high-3 average salary, whichever is less. • Employee's disability benefit is offset by qualified Social Security benefits. • Cost-of-living adjustment matched at full rate of inflation. • Survivors' benefits.

APPENDIX A. CONTINUED

	VOLUNTARY RETIREMENT	
Civil Service Retirement System (CSRS)	Federal Employees Retirement System (FERS)	Dual Civil Service Retirement System (CSRS/Dual)
	ELIGIBILITY	
• Age 55 and 30 years of service. • Age 60 and 20 years of service. • Age 62 and 5 years of service.	• Minimum retirement age and 30 years of service. • Age 60 and 20 years of service. • Age 62 and 5 years of service.	• Age 55 and 30 years of service. • Age 60 and 20 years of service. • Age 62 and 5 years of service.
	BENEFITS	
• Employee benefit is based on high-3 average pay over any 3 consecutive years of creditable service plus credit for unused sick leave. • Retirement annuity cannot exceed 80 percent of high-3 average pay, unless the amount over 80 percent is due to credit for unused sick leave. • Survivors' benefits.	• Employee benefit is based on high-3 average pay over any 3 consecutive years of creditable service. • Retirement benefit is equal to 1 percent of employees' high-3 average pay multiplied by years of creditable service. • If employee retires at age 62 or later with at least 20 years of service, a factor of 1.1 percent is used rather than 1 percent. • Survivors' benefits.	• Employee benefit is based on "high-3 average pay" over any 3 consecutive years of creditable service plus credit for unused sick leave. • Retirement annuity cannot exceed 80 percent of high-3 average pay, unless the amount over 80 percent is due to credit for unused sick leave. • Survivors' benefits.

APPENDIX B
WORKERS' COMPENSATION BENEFITS

Workers Compensation
ELIGIBILITY
• Job related injury. • No service time is required to be eligible for benefits.
BENEFITS
• Employee receives benefits equal to 66 2/3 percent or 75 percent (only employees with dependents) of basic salary tax-free until they return to work. • Annual cost of living adjustments while receiving benefits. • Survivors' benefits - To protect survivor benefit annuity rights the employee must apply for disability retirement with the Office of Personnel Management within a year of application for Office of Workers' Compensation benefits. • If employee dies from a non-work related injury while receiving Workers' Compensation benefits and has not applied for disability with the Office of Personnel Management, their survivors receive no benefits.

APPENDIX C

METHODOLOGY USED TO COMPARE RETIREMENT BENEFITS TO WORKERS' COMPENSATION BENEFITS

Scope

The universe was 255 employees. Ten fiscal years (FYs) from 2004 through 2014 were used in the analysis.

Methodology

The comparative discounted cash flow analysis based on the Postal Service guidelines was used to compute the potential cost avoidance.

Scenario 1

A 10-year net cash flow was computed for the Postal Service's costs for employees remaining on the workers' compensation periodic roll.

Scenario 2

A 10-year net cash flow was computed for the Postal Service's costs for employees retiring.

Comparative Net Cash Flow

The 10-year net cash flow of retirement costs was subtracted from the Office of Workers' Compensation Program cost.

Net Present Value

The Net Present Value of this cash flow difference for 10 FYs was determined by discounting it for each year at the prevailing discount rate (Postal Service's cost of borrowing). The sum of 10 yearly net present value was the potential cost avoidance.

Assumptions

- Employees continue to live for 10 FYs.
- Employees are not medically fit to be reinstated for work during 10 FYs.
- Current injury-related medical cost continues for 10 FYs under both scenarios.
- All employees keep health and life insurance under both scenarios.
- Employees are under survivor benefit plan.

Cost Items

The following identifiable cost items are used in the analysis.

Office of Workers' Compensation Programs

Federal Employees' Compensation Act payment: The data of this item was available for each of the 255 employees.

Medical Expenses: Data on this item was available for each employee.

Federal Employees Health Benefits employer share: Data on this item was not available for each employee. The Postal Service provided the total cost for FYs 2000, 2001, and 2002 and the average number of employees in each FY. The cost per employee was calculated and applied for 255 employees to estimate the cost.

Federal Employees Government Life Insurance premium employer share: Data on this item was not available for each employee. The Postal Service provided the total cost for FYs 2000, 2001, and 2002 and the average number of employees in each FY. The cost per employee was calculated and applied for 255 employees to estimate the cost.

***(*The Postal Service was not able to separate health benefits and life insurance costs.)**

Federal Retirement Systems

Annuity: Estimated data on this item was available for each employee.

Medical Expenses: Medical care for a work-related injury can be continued after a beneficiary accepts a retirement annuity. The above data for the Federal Employees' Compensation Act was used, assuming that these costs will remain the same.

Employer share of premiums for Federal Employee Health Benefits Insurance: Data on this item was not available for each employee. The Office of Personnel Management's website showed weighted average monthly premiums for Federal Employee Health Benefits. The website also showed the government's share of costs for annuitants. This data was used in the analysis to compute the costs under retirement.

Employer share of premiums for Federal Employees' Government Life Insurance: Data on this item was not available for each employees. The Postal Service provided the total cost for FYs 2000, 2001, and 2002. The Office of Personnel Management provided the total number of Postal Service employees receiving retirement benefits for FYs 2000, 2001, and 2002. The cost per employee was calculated and applied for 255 employees to estimate the cost.

Escalation

The following escalation rates were used.

Federal Employees' Compensation Act: 2.28 percent (Office of Personnel Management average for 5 years, 1999-2003).

Health benefit premium: 10.86 percent (Office of Personnel Management average for 5 years, 1999-2003).

Medical bills: 10.86 percent (same as health benefit premium).

Annuity: 1.20 percent (Office of Personnel Management average for 4 years, 1999-2002).

Life insurance premium: 0.8 percent (rate for "all other costs" in Postal Service's Decision Analysis Report).

Discount Rate

Postal Service's cost of borrowing rate of 4.5 percent, effective July 12, 2003.

Data

The audit team collected and provided the data from multiple sources, both internal and external.

APPENDIX D. MANAGEMENT'S COMMENTS

DEWITT O. HARRIS
VICE PRESIDENT
EMPLOYEE RESOURCE MANAGEMENT

UNITED STATES
POSTAL SERVICE

December 3, 2003

KIM H. STROUD

SUBJECT: Transmittal of Draft Audit Report – Comparison of Retirement Benefits to Workers' Compensation Benefits for Employees on the Periodic Roll (Report Number HM-AR-04-DRAFT)

Thank you for the opportunity to comment on the above referenced audit report. This report makes a compelling case for changes to the Federal Employees' Compensation Act (FECA) to require injured employees to retire under their appropriate federal retirement system.

The report found that if only 255 totally disabled employees were required to retire, the Postal Service would save over $19 million over the next 10 years. We believe there are substantially greater savings if the entire postal universe of retirement eligible injured employees were required to retire as defined in the report.

As you are aware, the U.S. Department of Labor (DOL) has been developing a legislative package to reform FECA. A proposal to move retirement eligible employees to the appropriate retirement system at a given time is being considered for this package. We believe that the findings and data depicted in this report will add support to DOL's efforts in moving forward to reform FECA. It is not unreasonable to expect injured employees to have their benefits adjusted to a level to what they would receive if they retired under normal circumstances.

Again, thank you for the opportunity to comment on this report.

DeWitt O. Harris

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