OFFICE OF
INSPECTOR
GENERAL
UNITED STATES POSTAL SERVICE

# Postal Service Financial Statements Audit − Washington, D.C. Headquarters for Fiscal Year 2013

# Audit Report

February 21, 2014

Report Number FT-AR-14-007

OFFICE OF
INSPECTOR
GENERAL
UNITED STATES POSTAL SERVICE

# HIGHLIGHTS

February 21, 2014

**Postal Service Financial Statements Audit – Washington, D.C. Headquarters for Fiscal Year 2013**

Report Number FT-AR-14-007

## BACKGROUND:

U.S. Postal Service Headquarters Finance establishes accounting policies and provides guidelines for recording and reporting Postal Service financial transactions. The Postal Service's Financial Testing Compliance group is responsible for examining key financial reporting controls.

Our objectives were to determine whether Headquarters Finance:

- Accounting transactions were fairly stated, and selected controls were designed and operating effectively.
- Ensured account balances followed the Postal Service's general classification of accounts consistent with that of the previous year.
- Complied with laws and regulations having a direct and material effect on the financial statements taken as a whole.

We also determined whether the Financial Testing Compliance group properly tested, documented, and reported its examination of key financial reporting controls.

## WHAT THE OIG FOUND:

Headquarters accounting transactions were fairly stated and general ledger account balances conformed to the general classification of accounts. Also, the Financial Testing Compliance group properly tested, documented, and reported its examination of key financial reporting controls.

However, the Postal Service did not comply with all material laws and regulations. Specifically, it defaulted on the required $5.6 billion prefunding payment to the Retiree Health Benefit Fund and continued to suffer from a severe lack of liquidity in fiscal year 2013 (which is expected to continue into fiscal year 2014).

Management also reported a significant deficiency related to the revenue, pieces, and weight process in fiscal year 2012 but took sufficient corrective actions to remediate it as of September 30, 2013. We did not propose any account balance adjustments.

## WHAT THE OIG RECOMMENDED:

Because management took corrective action to remediate the significant deficiency, we are not making any recommendations. We will continue to monitor prefunding payments in fiscal year 2014.

*Link to review the entire report*

OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

February 21, 2014

**MEMORANDUM FOR:** SCOTT G. DAVIS
ACTING VICE PRESIDENT, CONTROLLER

**FROM:** John E. Cihota
Deputy Assistant Inspector General
for Financial and Systems Accountability

**SUBJECT:** Audit Report – Postal Service Financial Statements Audit – Washington, D.C. Headquarters for Fiscal Year 2013
(Report Number FT-AR-14-007)

This report presents the results of our audit of selected financial activities and accounting records at Washington, D.C. Headquarters for the fiscal year ended September 30, 2013 (Project Number 13BM004FT000).

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Denice Millett, director, Finance, or me at 703-248-2100.

Attachment

cc: Julie S. Moore
Corporate Audit and Response Management

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## Introduction

This report presents the results of our audit of selected financial activities and accounting records at U.S. Postal Service Washington, D.C. Headquarters for the fiscal year (FY) ended September 30, 2013 (Project Number 13BM004FT000). Our objectives were to determine whether Headquarters Finance accounting transactions were fairly stated, and selected controls were designed and operating effectively; ensured account balances followed the Postal Service's general classification of accounts consistent with that of the previous year; and complied with laws having a direct and material effect on the financial statements taken as a whole. In addition, we determined whether the Financial Testing Compliance group properly tested, documented, and reported its examination of key financial reporting controls. See Appendix A for additional information about this audit.

The Postal Reorganization Act of 1970, as amended, requires annual audits of the Postal Service's financial statements. In addition, the Sarbanes-Oxley (SOX) law was enacted in calendar year 2002 to strengthen public confidence in the accuracy and reliability of financial reporting. Section 404 of SOX requires management to state its responsibility for establishing and maintaining adequate internal controls over financial reporting. The Postal Accountability and Enhancement Act of 2006 (Postal Act of 2006) requires the Postal Service to comply with Section 404 of SOX. The Board of Governors (Board) contracted with an independent public accounting firm (IPA) to express opinions on the Postal Service's financial statements and internal controls over financial reporting. Our audit augments the IPA's opinions.

## Conclusion

During our audit at Washington, D.C. Headquarters, we noted that:

- Accounting transactions were fairly stated in the general ledger, and selected key controls surrounding those transactions were designed and operating effectively.

- General ledger account balances conformed to the general classification of accounts of the Postal Service on a basis consistent with that of the previous year.

In addition, the Financial Testing Compliance group properly tested, documented, and reported its examination of key financial reporting controls.

We did not propose any adjustments or identify any issues that were material to the financial statements or that would affect the overall adequacy of internal controls. However, the Postal Service did not comply with all laws and regulations having a direct and material effect on the financial statements. Specifically, it defaulted on the $5.6 billion prefunding payment to the Retiree Health Benefit Fund due

September 30, 2013, and continued to suffer from a severe lack of liquidity posture in FY 2013. Management also reported a significant deficiency related to the revenue, pieces, and weight (RPW) process in FY 2012 but took sufficient corrective action to remediate it as of September 30, 2013.[1]

Furthermore, the IPA identified control deficiencies[2] affecting Headquarters Finance that were not in the scope of our audit and are not reported here. The IPA informed management of these issues on November 14, 2013.

## Liquidity and Retiree Health Benefit Fund Payments

As noted in its unqualified opinion on the FY 2013 financial statements dated November 15, 2013, the IPA included an emphasis of matter[3] referring to liquidity concerns discussed in Postal Service Form 10-K[4] disclosures and the expectation that this trend will continue into FY 2014.

Further, in the IPA's *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 15, 2013, the auditor did not identify any deficiencies in internal controls over financial reporting considered to be material weaknesses or significant deficiencies as of September 30, 2013. However, in its FY 2012 report, the IPA identified a significant deficiency related to the RPW process and found the Postal Service took sufficient corrective actions to remediate this deficiency as of September 30, 2013. As part of its actions to address the significant deficiency, the Postal Service completed a root cause analysis to further understand the nature of the deficiency, conducted enhanced training for all Data Collection Technicians (DCTs), implemented new field level controls, and put additional management review controls into practice to supplement existing field-level DCT control procedures.

The IPA also noted one instance of non-compliance with laws and regulations that had a material and direct effect on the financial statements. Specifically, the Postal Service defaulted on required prefunding payments to its Retiree Health Benefit Fund totaling $5.6 billion during FY 2013 and $11.1 billion during FY 2012. The Postal Service defaulted on its payments due to insufficient cash resources and is pursuing legislation to significantly reduce or eliminate the required payments.

Because management took corrective action to remediate the significant deficiency, we are not making any recommendations in this report; however, we will continue to

[1] These issues were further discussed in our *Opinion on the U.S. Postal Service's Fiscal Year 2013 Closing Package Financial Statements* (Report Number FT-AR-14-003, dated December 16, 2013).
[2] A control deficiency 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 timely.
[3] An emphasis of matter is included in an auditor's report on financial statements (Form 10-K) to indicate a significant uncertainty or other matter.
[4] A comprehensive summary report of the Postal Service's performance that must be submitted annually to the U.S. Postal Regulatory Commission.

monitor the prefunding payments to the Retiree Health Benefit Fund in FY 2014. Since there were no recommendations, management chose not to formally respond to this report.

# Appendix A: Additional Information

## Background

Postal Service Headquarters Finance establishes accounting policies and provides guidelines for recording and reporting Postal Service financial transactions. The Board contracted with an independent public accounting firm to provide overall opinions on the Postal Service's financial statements and internal controls over financial reporting. The Postal Service's Financial Testing Compliance group is responsible for examining key financial reporting controls.

The RPW system is the primary probability sampling system that estimates revenue, volume, and weight for most classes of mail and extra services. Management uses test data to develop new rates, assist in budget preparation, conduct management studies, and support management decisions concerning mail operations. DCTs observe employee work activity, sample live mail, and collect data at randomly selected sites; record the information on laptop computers; and transmit it for review. The data collectors record various mailpiece characteristics, such as revenue, weight, shape, indicia, barcode, postmark date, origin, and mail class. The Postal Service also relies on statistical programs' sample data to protect revenue and to estimate stamp usage for calculating Postage in the Hands of the Public.[5]

The Postal Service must pay about $5.6 billion annually into the Retiree Health Benefit Fund[6] to prefund future health care benefits obligations.[7] However, these annual payments, coupled with declining revenue, have tested the Postal Service's ability to meet its operational and legal obligations. As a result, the Postal Service continued to suffer from a severe lack of liquidity in FY 2013.

We will issue separate financial statement audit reports for Eagan Accounting Services, San Mateo Accounting Services, and St. Louis Accounting Services. Further, in addition to the overall opinions on the Postal Service's financial statements and internal controls over financial reporting, the Board's IPA issued a separate report on its consideration of the Postal Service's internal controls and its test of compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report was to describe the scope of testing of internal controls over financial reporting and compliance and the results of that testing, not to provide an opinion on internal controls over financial reporting or on compliance.[8] The OIG will also issue a separate report for the audit of FY 2013 information system controls at the Eagan, San Mateo, and St. Louis information technology and accounting service centers; and the Raleigh ITSC.

[5] The process of deferring the recognition of revenue for postage purchased but for which services have not yet been provided.
[6] Postal Act of 2006.
[7] The Postal Service has not yet paid the $5.5 billion for FY 2011, the $5.6 billion for FY 2012, or the $5.6 billion for FY 2013.
[8] In addition to the IPA's work, these reports encompass work the U.S. Postal Service Office of Inspector General (OIG) performed at headquarters, three integrated business systems solution centers, field sites, and the Raleigh Information Technology Service Center (ITSC).

## Objectives, Scope, and Methodology

The objectives of the audit were to determine whether Headquarters Finance:[9]

- Accounting transactions were fairly stated in the general ledger and selected controls surrounding those transactions were designed and operating effectively.
- Ensured general ledger account balances conformed to the general classification of accounts of the Postal Service on a basis consistent with that of the previous year.
- Complied with laws and regulations having a direct and material effect on the financial statements taken as a whole.

In addition, we determined whether the Financial Testing Compliance group properly tested, documented, and reported its examination of key financial reporting controls.

As part of our audit, we reviewed internal controls, processes, and significant headquarters accounts (for example, workers' compensation), manual journal vouchers (JVs),[10] and laws and regulations. We verified Board travel and miscellaneous expenses totaling about $153,000 and external professional fees totaling about $36,000; and tested about $84,000 of officers' travel and representation expenses. We will issue separate reports for audits of FY 2013 Board travel and miscellaneous expenses and officers' travel and representation expenses.

As part of our audit, we assessed internal controls, tested transactions, and verified account balances. We conducted this audit from January 2013 through February 2014[11] in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB) and the standards applicable to financial audits contained in the *Government Auditing Standards* issued by the comptroller general of the U.S. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to limit audit risk to a level that is, in our professional judgment, appropriate for supporting the overall audit opinion on the financial statements. Those standards also require considering the results of previous engagements and following up on known significant findings and recommendations directly related to the objectives of the audit. An audit also requires sufficient understanding of internal controls to plan the audit and determine the nature, timing, and extent of audit procedures to be performed. We believe the evidence obtained provides a reasonable basis for our conclusion based on our audit objectives.

[9] The IPA maintains overall responsibility for testing and reviewing significant headquarters accounts and processes. The OIG coordinated audit work with the IPA to ensure adequate coverage.
[10] Statement on Auditing Standards (SAS) Number 99, *Consideration of Fraud in a Financial Statement Audit*, as amended by SAS 113, Omnibus 2006, requires auditors to perform certain tasks to address the risk of management override of internal controls. To address such situations, SAS Number 99 requires auditors to test the appropriateness of journal entries recorded in the general ledger and other adjustments.
[11] The scope of our audit was October 1, 2012, to September 30, 2013.

We supported the IPA in obtaining reasonable assurance about whether the financial statements were free of material misstatement (whether caused by error or fraud). Absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. Therefore, an audit conducted in accordance with the PCAOB and Government Auditing Standards may not detect a material misstatement. However, the external auditors and the OIG are responsible for ensuring that appropriate Postal Service officials are aware of any significant deficiencies that come to our attention. We provided an earlier draft copy of this report to management on January 13, 2014, and, because we did not make recommendations, management chose not to meet to discuss the report contents.

We relied on computer-generated data from several Postal Service financial systems, including:

- Electronic Travel Voucher System.[12]
- Workers' Compensation Master File.
- Accounting Enterprise Data Warehouse Reporting.[13]

We assessed the reliability of these systems' data by performing specific internal control and transaction tests, including tracing selected financial information to supporting source records. For example, we traced workers' compensation master file data to paper source documents for a random sample of 60 cases. We determined the data were sufficiently reliable for the purposes of this report.

[12] The online application used to create work travel expense reports, electronically submit them to authorized approvers, and track reimbursement status.
[13] A reporting technology in the areas of accounts payable, complement, finance number control master, general ledger and financial performance, payroll summary, property and equipment, and standard accounting for retail.

## Prior Audit Coverage

<table>
<tr><th>Report Title</th><th>Report Number</th><th>Final Report Date</th><th>Monetary Impact</th></tr>
<tr><td>Fiscal Year 2012 Postal Service Financial Statements Audit – Washington, D.C. Headquarters</td><td>FT-AR-13-007</td><td>1/4/2013</td><td>None</td></tr>
<tr><td colspan="4">Report Results: We reported two instances of noncompliance. One related to the suspension of the Postal Service’s obligation to the Federal Employee Retirement System (FERS) and the other to a default on two required prefunding payments to the Postal Service's Retiree Health Benefit Fund. The Postal Service resumed the FERS obligation and repaid amounts previously suspended. The Postal Act of 2006 contains no provisions addressing a prefunding payment default. We did not propose any adjustments; however, during the year, we reviewed controls over financial reporting. Based on the results, we did not make any recommendations in this report. As a result, management chose not to respond formally to this report.</td></tr>
<tr><td colspan="4"></td></tr>
<tr><td>Fiscal Year 2011 Postal Service Financial Statements Audit – Washington, D.C. Headquarters</td><td>FT-AR-12-005</td><td>12/12/2011</td><td>None</td></tr>
<tr><td colspan="4">Report Results: We did not propose any adjustments; however, we identified a control deficiency regarding manual JV processing. Because management took corrective action, we did not make any recommendations.</td></tr>
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