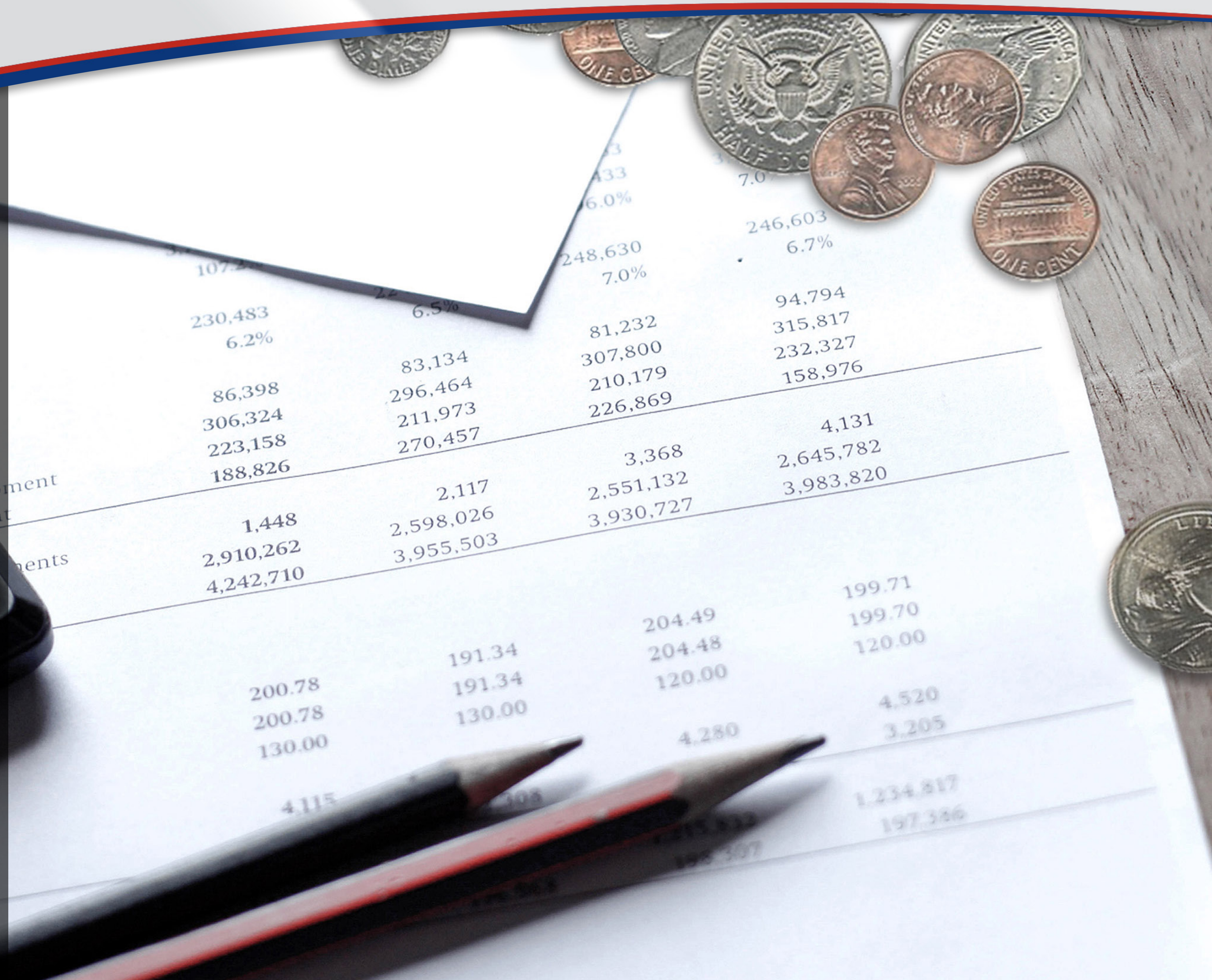
OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE



Measurement of Days of Operating Cash on Hand

Audit Report

Report Number
FT-AR-17-001

October 20, 2016

OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

Highlights

Background

The U.S. Postal Service is an independent establishment of the executive branch. It generates its cash almost entirely by selling postal products and services. The Postal Service has reached its statutory borrowing limit of $15 billion as of September 30, 2012 and cannot borrow additional money to enhance cash flow.

The Postal Service does not have sufficient cash to meet all of its legal obligations, pay down debt, and make critically needed infrastructure investments. Changes to its business model and the laws that govern the Postal Service are needed to reduce financial challenges.

The days of operating cash on hand is a financial ratio that informs an entity and its stakeholders how long the entity can sustain operations if it is unable to generate cash. The calculation divides the total amount of cash on hand, including cash equivalents that can easily be converted to cash, by total daily cash outflow. Daily cash outflow includes daily operating expenses, but not expenses such as depreciation and amortization that do not involve cash.

The Postal Service includes days of operating cash on hand in its quarterly and annual financial reports and its integrated financial plans. As of the end of FY 2015, the Postal Service reported 24 days of operating cash on hand.

The objective of this audit was to determine whether the calculation of days of cash on hand was accurate and consistent with other like entities.

What the OIG Found

The Postal Service's days of cash on hand calculation was not consistent with best practices. If it were done consistently, days of cash on hand would be 36 instead of 24, as reported by the Postal Service. The Postal Service uses banking days of 251 (excludes holidays and weekends) rather than operating days of 365 in its calculation. Additionally, capital outlays are incorrectly included in its calculation, which further dilutes days of cash on hand.

In addition, management, since FY 2013, has not defined the number of days of operating cash on hand needed to sustain operations through a short-term economic downturn. The Postal Service has stated that if it has insufficient cash, it would prioritize paying its employees and suppliers. However, the Postal Service has not defined when these contingency measures should be introduced.

With the inaccurate calculation of days cash on hand and absent a definition when liquidity contingency measures should be initiated, the Postal Service could be increasing its own liquidity risk. Further, the Postal Service could be relying on inaccurate data for critical strategic financial decisions and retaining cash it could otherwise use to improve its financial

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position. Thus, the Postal Service could use these 12 days (or $1 billion of existing cash) to continue the present approach of saving cash in case of another economic downturn, pay amounts to the Office of Personnel Management for Federal Employee Retirement System or Postal Service Retiree Health Benefits Fund obligations, reduce its debt to the Treasury, or more aggressively fund investments in its infrastructure.

The days of cash on hand method, while standard in the financial analysis community, underestimates the practical level of liquidity the Postal Service has. This standard method assumes identical costs and absolutely no revenue. It can, therefore, be misunderstood by those not familiar with such standard analysis techniques.

What the OIG Recommended

We recommended management calculate and report the number of days of cash on hand using operating days and excluding capital outlays in the calculation. We further recommended management define the number of days of operating cash on hand it should have to sustain operations through a short-term economic downturn.

Transmittal Letter

OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

October 20, 2016

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

E-Signed by John Cihota
ERIFY authenticity with eSign Deskto

FROM: John E. Cihota
Deputy Assistant Inspector General
for Finance, Pricing and Investments

SUBJECT: Audit Report – Measurement of Days of Operating Cash on Hand (Report Number FT-AR-17-001)

This report presents the results of our audit of the U.S. Postal Service's Measurement of Days of Operating Cash on Hand (Project Number 16BR003FT000).

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

Attachment

cc: Corporate Audit and Response Management

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Findings

Introduction

This report presents the results of our audit of the U.S. Postal Service's Days of Operating Cash on Hand (Project Number 16BR003FT000). We conducted this self-initiated audit based on the U.S. Postal Service Office of Inspector General's (OIG) analysis of the days of operating cash on hand calculation. The objective of our audit was to determine whether the calculation of days of cash on hand was accurate and consistent with other like entities. See Appendix A for additional information about this audit.

The Postal Service is an independent, self-financing establishment of the executive branch. It generates its cash almost entirely by selling postal products and services and holds its cash with the Federal Reserve Bank of New York. The Postal Service has no remaining borrowing capacity under its statutory debt ceiling, leaving it unable to borrow funds to generate additional cash flow.[1]

The Postal Service's fiscal year (FY) 2015 annual report on Form 10K (annual report) states that the Postal Service does not have sufficient cash balances to meet all of its existing legal obligations, pay down its debt, and make all of the critical investments in its infrastructure that were deferred in recent years because of financial losses and liquidity concerns. The annual report also states that without structural change to the Postal Service's business model and the laws that govern the organization, these losses and liquidity challenges will continue for the foreseeable future.[2]

The days of operating cash on hand describes how long an entity can sustain operations if it is unable to generate cash. The Postal Service reports its days of operating cash on hand in its quarterly and annual reports and forecasts its monthly operating cash on hand in its *Integrated Financial Plan*.[3] At the end of FY 2015, the Postal Service reported 24 days of operating cash on hand.

Summary

The Postal Service's days of cash on hand calculation was not consistent with best practices. If it were done consistently, days of cash on hand would be 36 instead of 24, as reported by the Postal Service. The Postal Service uses banking days of 251 (excludes holidays and weekends) rather than operating days of 365 in its calculation. Additionally, capital outlays are incorrectly included in its calculation, which further dilutes days of cash on hand.

In addition, management, since FY 2013, has not defined the number of days of operating cash on hand needed to sustain operations through a short-term economic downturn. The Postal Service has stated that if it has insufficient cash, it would prioritize payments to employees and suppliers ahead of payments to U.S. government entities, as has been done in the past. However, the Postal Service has not defined when these contingency measures should be introduced.

With the inaccurate calculation of days of cash on hand and absent a definition when liquidity contingency measures should be initiated, the Postal Service could be increasing its own liquidity risk. Further, the Postal Service could be relying on inaccurate data for critical strategic financial decisions and retaining cash it could otherwise use to improve its financial position. Thus, the Postal Service could use these 12 days (or $1 billion of its $6.6 billion in existing cash[4]) to continue the present approach of saving

1 The Postal Service had $2 billion in borrowing authority at the end of FY 2011. Since the end of FY 2012, it has maintained debt at its $15 billion statutory borrowing limit from Treasury.
2 Annual report on *Form 10-K* (annual report) for the Fiscal Year (FY) Ended September 30, 2015.
3 *Integrated Financial Plan* Fiscal Year 2016.
4 At September 30, 2015.

cash in case of another economic downturn, pay amounts to the Office of Personnel Management (OPM) for Federal Employee Retirement System (FERS) or Postal Service Retiree Health Benefits Fund (PSRHBF) obligations, reduce its debt to the Treasury, or more aggressively fund investments in its infrastructure.

The days of cash on hand method, while standard in the financial analysis community, underestimates the practical level of liquidity the Postal Service has. This standard method assumes identical costs and absolutely no revenue. It can, therefore, be misunderstood by those not familiar with such standard analysis techniques.

Days of Operating Cash On Hand Calculation

The elements the Postal Service uses to calculate its days of operating cash on hand do not best reflect its liquidity position. It uses banking days instead of days in the accounting period[5] and includes capital outlays in its calculation as follows:

$$\frac{\text{Cash and Cash Equivalents}^{6}}{(\text{Operating Expenses}^{7} - \text{Noncash Expenses}^{8} + \text{Capital Outlays})/\text{Banking Days}}$$

Accounting standards do not define how to calculate days of cash on hand. Research found that standards could vary, as liquidity measures are determined based on facts and circumstances of the business. Academia recommends the number of days in an accounting period be used to calculate financial ratios, including days of cash on hand.

For reporting, the Postal Service uses banking days in its calculation of days of cash on hand because financial transactions were captured and processed only on business days. However, the Postal Service operates 7 days a week processing, transporting, or delivering mail. Its use of banking days to calculate the days of operating cash on hand suggests that it operates exclusively during normal banking days. Therefore, for the Postal Service (and other comparable companies), the accounting period for a fiscal year would be 365 days. Further, this corresponds to the calculation itself, which includes operating expenses. Operating expenses primarily includes compensation for its employees and transportation of its products, which is occurring 365 days per year. We did not find other comparable entities that reported days cash on hand in their annual reports.

Using banking days further inflates the amount of cash the Postal Service needs to pay daily operating expenses, which reduces the number of days the Postal Service reports it can operate without generating additional cash.

The Postal Service also includes capital outlays to calculate its days of operating cash on hand, reasoning that these outlays are necessary to sustain operations. In doing so, the Postal Service is suggesting it would continue to acquire new assets (such as vehicles) in critical situations when it would need to use its cash on hand. But, acquiring capital assets usually is not an urgent, short-term need and could be postponed. In the past, the Postal Service preserved liquidity by limiting capital outlays to those necessary for safety and customer service. Further, the Postal Service’s own contingency plan in its FY 2015 annual report recognizes that it would prioritize paying employees and suppliers if it were unable to generate cash. Including capital outlays artificially decreases the number of days the Postal Service calculates that it could operate in such circumstances.

5 365 days.
6 Cash equivalents are short-term, highly liquid investments that are readily convertible to cash so near their maturity that they are highly unlikely to significantly change in value because of changes in interest rates.
7 Operating expenses is a category of expenditure that a business incurs when performing its normal business operations.
8 Noncash expenses include depreciation, net interest, FERS accrual, unpaid PSRHBF prefunding amounts, and actuarial valuation of workers’ compensation cases.

The number of days of operating cash on hand has steadily increased since FY 2011, as shown in Table 1.

Table 1. Days of Cash on Hand[9]

Fiscal Year	Postal Service Calculation of Days of Cash on Hand	OIG Calculation of Days of Cash on Hand	Percent Increase in Days Cash on Hand Using the OIG Calculation
2015	24	36	50%
2014	18	27	50%
2013	8	13	62%
2012	7	11	57%
2011	4	7	75%

Source: OIG analysis.

VIEW ALL ***Click on the Fiscal Year to Reveal OIG's Calculation of Days Cash on Hand*** ***CLEAR ALL***

The improvement is due to the exigent price increase,[10] the Postal Service's decision not to prefund retirement health benefits, and growth in package volume. Further, since 1995, the Postal Service has averaged about 6 and 9 days cash on hand using the Postal Service's and OIG's calculation, respectively. The Postal Service's days of cash on hand today is significantly higher than the average since 1995.[11] In its FY 2015 annual report, the Postal Service reported 24 days of operating cash on hand. If it had instead excluded capital outlays and used operating days for this calculation, it would have reported 36 operating days — a 50 percent increase.

9 Postal Service calculations reflect amounts reported in Postal Service published financial statements. For illustration purposes, the OIG calculation results include only whole days and not the resulting partial days.
10 When the exigent surcharge expired April 10, 2016, the prices of most market dominant services declined. The Postal Service reported that this will reduce revenue and cash flow by about $2 billion per year.
11 Subsequent to FY 2005, when Postal Service debt was zero, it had up to $3 billion in annual borrowing authority (measured from one fiscal yearend to the next). At the end of FY 2012, the Postal Service reached its $15 billion statutory borrowing limit.

With the inaccurate calculation of days of cash on hand or absent a definition when liquidity contingency measures should be initiated, the Postal Service could be increasing its own liquidity risk or retaining cash it could otherwise use to improve its financial position over time. Further, the Postal Service could be relying on inaccurate data for critical strategic financial decisions. It could use these 12 days (or $1,036,785,377 of its $6.6 billion in existing cash[12]) to continue the present approach of saving cash in case of another economic downturn, pay amounts to the OPM for FERS or PSRHBF obligations, reduce its debt to the Treasury, or more aggressively fund investments in its infrastructure.[13]

Prudent Number of Days of Cash on Hand

The Postal Service has not defined the number of days of operating cash on hand it should have to sustain operations through a short-term economic downturn since FY 2013. The Postal Service has stated that if it has insufficient cash, it would prioritize paying its employees and suppliers. However, the Postal Service has not defined when those contingency measures should be introduced. Absent a definition when liquidity contingency measures should be initiated, the Postal Service could be increasing its own liquidity risk. Further, the Postal Service could be relying on inaccurate data for critical strategic financial decisions and retaining cash it could otherwise use to improve its financial position.

The Postal Service, in FYs 2012 and 2013, stated in its annual *Integrated Financial Plan* that it needed about $7 billion to $10 billion in liquidity to sustain operations. We compared the Postal Service's days of cash on hand to like entities and determined the Postal Service would remain comparable to competitors if it would select 24 days, a 12-day reduction, for its contingency measure threshold. Because these entities did not report their days of cash on hand in their annual reports, we calculated the days of cash on hand using financial data in their annual or quarterly reports. In each case, these companies had the ability to obtain needed cash through other means, including borriwing. We did not include the borrowing authority available to the other entities in the calculation since the Postal Service has not had any borrowing authority since 2012. When compared to other entities, the Postal Service would have the fourth highest number of days of operating cash on hand, as shown in Table 2.

Table 2. 2015 Days of Operating Cash on Hand Comparison

Entities	OIG Calculation of Days of Cash on Hand
Entity A	6
Entity B	10
Postal Service Threshold	24
Entity C	27
Entity D	33
Entity E	90

Source: OIG analysis.

12 At September 30, 2015.
13 In FY 2016, the Postal Service is investing about $1.8 billion in its infrastructure.

The Postal Service's FY 2015 annual report states that a financially sound Postal Service continues to be vital to U.S. commerce. The U.S. needs a strong Postal Service that can continue its indispensable role as a driver of commerce and provider of reliable, affordable, and secure delivery service. Disruption of the mail would cause undue hardship to businesses and consumers and, in the event of a cash shortfall, the U.S. government would likely prevent the Postal Service from significantly curtailing or ceasing operations.

Further, the FY 2015 annual report suggests that the Postal Service's status as an independent establishment of the executive branch potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. Therefore, we believe the Postal Service may not need the same amount of cash on hand as private-sector entities. The Postal Service would have a minimum of 24 days cash on hand to use, as necessary, to continue operations should an unexpected situation occur.

Days of Cash on Hand Method

The days of cash on hand method, while standard in the financial analysis community, underestimates the practical level of liquidity the Postal Service has. This standard method assumes identical costs and absolutely no revenue. It can, therefore, be misunderstood by those not familiar with such standard analysis techniques. The assumption that on the following day that all revenue would cease coming in to the Postal Service while it continued to run its operations 24 hours per day (having carriers go out every day with no mail at all, fully staffed plants running all night with no mail at all, and having trucks driving all across the country completely empty) – all the while paying all these employees and contractors − is unrealistic. Even when revenue is described as "falling off a cliff" it is still a gradual decline – where operations and costs can be at least partially adjusted to respond.

Recommendations

We recommend the executive vice president, chief financial officer:

- Calculate and report in financial and other public reports the number of days of cash on hand using (365) operating days and excluding capital outlays in the calculation.
- Define the number of days of operating cash on hand needed to sustain operations through a short-term economic downturn.

Management's Comments

Management disagreed with both recommendations and the monetary impact. Regarding recommendation 1, management stated they disclose in financial reports that the days of operating cash on hand calculation is based on a 251 disbursement day year and agreed to expand the disclosures to make it clear that they include capital expenditures in the calculation. They also stated that changing a calculation that has been used consistently for several years to allow stakeholders to evaluate trends can only serve to create confusion rather than provide new or better information to them. Further, management stated that altering the number of days would have no impact on management decision-making. Regarding capital expenditures, management stated that many capital outlays are tied to contractual commitments that cannot be turned off on a whim.

Regarding recommendation 2, management does not believe they need to define the number of days of operating cash on hand. They monitor cash availability daily and make regular projections of future cash needs. They stated that the report reaches an unsupported conclusion that the Postal Service needs 24 days of operating cash on hand to continue operations in the event of an unexpected downturn. Management also stated the comparison to private sector entities regarding days cash on hand ignores other entities' ability to obtain additional liquidity and excludes accounts receivable as an additional source of liquidity.

Management disagreed with the $1 billion monetary impact and the contention that the Postal Service is increasing its liquidity risk by using its current calculation for days of operating cash on hand. They also disagreed with the proposed uses.

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

Evaluation of Management's Comments

The OIG considers management's comments responsive to recommendation 1 but not responsive to recommendation 2 and will partially resolve the issues identified in the report.

Regarding recommendation 1, the Postal Service started disclosing in its financial reports that the days of operating cash on hand calculation is based on a 251 disbursement day year only after we began our audit. It is unclear whether this disclosure would have occurred if we had not conducted this audit. Further, in response to this audit, they agreed to expand the disclosures to make it clear that they include capital expenditures in the calculation. While this addresses transparency in its financial reports, we continue to maintain that calculating days cash on hand using industry best practices would allow for consistent comparisons with other like entities.

Banking days represent when operating expenses can be paid, not when operating expenses occur. Accordingly, using banking days in the calculation does not accurately reflect how many days the Postal Service can operate without additional revenue, as it operates 7 days per week, and is not consistent with the definition of the ratio itself. Further, because the ratio focuses on operating expenses, we continue to believe capital expenditures should be excluded from the days of operating cash on hand calculation. Finally, the Postal Service recognizes purchases of property and equipment as an investing activity, not an operating activity.

Regarding recommendation 2, we continue to believe management should define the number of days operating cash needed to sustain operations during a short-term economic downturn. The purpose of defining a threshold is to provide management with an educated target for determining when contingency plans should be initiated. We recommended that management establish its own threshold and suggested 24 days, based on what the Postal Service had at September 30, 2015, in the absence of a Postal Service definition of minimal numbers of days of cash on hand.

Regarding the monetary impact, we agree the $1 billion represents cash the Postal Service already has, not cash being created, or additional liquidity. The Inspector General Act of 1978, as amended, defines funds put to better use as “funds (that) could be used more efficiently if management of an establishment took actions to implement and complete the recommendation.[14] By correctly determining the days of operating cash on hand in conjunction with establishing a threshold needed to sustain operations through a short-term economic downturn, we believe the Postal Service could use part of their current cash balances to improve its financial position.

Because management is taking actions in its financial reports to further clarify how they calculate the days of operating cash on hand, we do not intend to take these recommendations through the audit resolution process. As a result, we consider recommendations 1 and 2 closed, but not implemented by the Postal Service.

14 Inspector General Act of 1978, 5 U.S.C. app. 3, § 5(f)(4) (2012).

Appendices

Click on the appendix title to the right to navigate to the section content.

Appendix A: Additional Information

Background

The Postal Service is an independent, self-financing establishment of the executive branch. It generates its cash almost entirely through the sale of postal products and services and holds its cash with the Federal Reserve Bank of New York. The Postal Service has no remaining borrowing capacity under its statutory debt ceiling, leaving it unable to borrow funds to generate additional cash flow.

The Postal Service said its operations will require significant capital investment over the next few years to modernize and improve its processing and delivery infrastructure and update its delivery fleet to continue meeting its statutory obligation to provide prompt, efficient, reliable service to the nation. Furthermore, given its inability to raise cash through the issuance of additional debt, the Postal Service believes its current level of available liquidity may be insufficient to support operations in the event of another significant downturn in the U.S. economy.

The Postal Service's FY 2015 annual report states that it does not have a sufficient cash balance to meet all of its existing legal obligations, pay down its debt, and make critical investments in its infrastructure that were deferred in recent years because of losses and liquidity concerns. The annual report also states the Postal Service's business model and the laws that govern it need to change or it will continue to experience losses and liquidity challenges for the foreseeable future.

Objective, Scope, and Methodology

Our objective was to determine whether the calculation of days of cash on hand was accurate and consistent with other like entities. To accomplish our objective we:

- Reviewed and analyzed financial information, including cash, available borrowing, and expenses, included in annual reports from 1995 to 2015, quarterly reports from FY 2016, the *Integrated Financial Plan*, and congressional testimony.
- Researched best practices related to financial analyses and ratios.
- Reviewed and analyzed like entities' annual reports' financial information to compare against the Postal Service.

We conducted this performance audit from January through October 2016, in accordance with generally accepted government auditing standards except for the level of testing of internal controls. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. We discussed our observations and conclusions with management on August 11, 2016, and included their comments where appropriate.

We did not audit the effectiveness of the internal controls over the days of cash on hand calculation. Our objective was to determine whether the calculation of days of cash on hand was accurate and consistent with other like entities, not to provide assurance on the level of internal controls. This did not significantly affect our audit conclusions. We also did not assess the reliability of any computer-generated data for the purposes of this report. The scope of this audit was to review the elements of the calculation only, not information supporting specific calculations. We did not plan to report on the reliability of published data used in this audit.

Prior Audit Coverage

The OIG did not identify any prior audits or reviews related to the objective of this audit.

Appendix B: Management's Comments

JOSEPH CORBETT
CHIEF FINANCIAL OFFICER
EXECUTIVE VICE PRESIDENT

UNITED STATES POSTAL SERVICE

September 2, 2016

LORI LAU DILLARD
DIRECTOR, AUDIT OPERATIONS

SUBJECT: Measurement of Days of Operating Cash on Hand (Report Number FT-AR-16-DRAFT)

The Postal Service believes this report is analytically flawed and reaches misleading conclusions. The conclusion that simply changing the calculation of the days of operating cash on hand metric can somehow create $1 billion in additional liquidity that could be "put to better use" is incorrect. Further, the report reaches an unsupported conclusion that the United States Postal Service requires only 24 days of operating cash on hand to continue operations in the event of an unexpected economic downturn.

At its core, the report fails to understand the purpose of this metric. The days of operating cash on hand metric is not intended to be an all-encompassing measure of financial stability, as it excludes defaults on legally obligated payments, long-term liabilities, etc. It is a way of demonstrating how available cash on hand corresponds to what the Postal Service must expend for operations in order to continue to provide universal postal services and meet its other statutory obligations. It is therefore a useful way, in a situation in which the Postal Service lacks any access to further borrowing authority, to discuss its overall financial situation relative to the achievement of its statutory mission. Altering the number of days used in the denominator of the calculation changes nothing about the absolute amount of cash on hand, and therefore would have no impact on management decision-making whatsoever.

The report's assertion that the Postal Service is improperly calculating the metric is of little consequence. To begin with, on page one the report says the Postal Service's calculation of days of operating cash on hand is "not consistent with best practices." However, on page two it is noted that "[a]ccounting standards do not define how to calculate days of cash on hand." This latter statement is correct; nowhere in the FASB's *Accounting Standards Codification* is the manner in which financial ratios are calculated prescribed.

The report goes on to note that "academia" recommends that an "accounting period" be used to calculate days of cash on hand. The report then concludes that an accounting period should equate to a 365 day fiscal year. Although it may be an accepted practice to use 365 days when calculating "days of cash on-hand" the Postal Service calculates "days of <u>operating</u> <u>cash</u>". Our calculation includes capital expenditures as part of <u>operating</u> disbursements (as they are absolutely necessary to run the business) and uses a number of days of 251 to reflect full <u>operating</u> days/banking days. If we had available debt to borrow, we would also consider that as a source of operating cash. The fact that our calculation differs from anecdotal academia examples of "days of cash on hand" is inconsequential. The Postal Service clearly discloses that the days of operating cash calculation in its public financial reports is based on a 251 banking day year, which allows the financial statement reader to make adjustments to the calculation if/as the reader deems appropriate. We have used this measure consistently for several years, allowing

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stakeholders to evaluate trends in this measure. Also, to avoid any possible future stakeholder confusion, we will further define our measure in financial filings to include the fact that capital expenditures use operating cash and therefore are included in our calculation.

In sum, the draft report fails to demonstrate that there actually are "best practices" with which the Postal Service is failing to comply. More importantly, the contention that the Postal Service should use a different number of operating days in the denominator of the calculation is arbitrary and creates a meaningless distinction. The underlying purpose of the calculation is to provide Postal Service stakeholders with a benchmark against which they can measure improvement (or deterioration) in one aspect of the Postal Service's financial condition. Changing a calculation that has been used consistently for a number of years (from "days operating cash", to days of cash on hand" can only serve to create confusion amongst Postal Service stakeholders, rather than to provide new or better information to them.

The OIG report concludes that we should ignore capital expenditures in our "days operating cash" calculation. We believe that capital outlays should be considered to be an essential component of Postal Service operating outlays and as such we include them in our calculation. The distinction between expense and capital outlays is an accounting device intended to identify an expenditure that is expected to benefit future accounting periods. The determination of whether a particular outlay is treated as a capital outlay or an expense for accounting purposes has nothing to do with its business necessity. Further, arbitrarily excluding capital outlays ignores the reality that many of these are tied to contractual commitments that cannot be "turned off" on a whim. Our capital expenditures average over a $1 billion per year, and to ignore these commitments would be irresponsible.

The report goes on to state that if the Postal Service had calculated days of cash on hand "correctly"—by excluding capital outlays and using a 365-day accounting period—the number of "operating" days of cash on hand would increase by 50 percent. These additional days of cash on hand are excess, according to the report, because the Postal Service only needs 24 days of cash on hand. The report therefore calculates that the Postal Service has $1 billion of cash that it could "put to better use," and suggests various ways of using those funds. However, the report fails to justify any of these conclusions.

As noted above, the report asserts that the Postal Service only needs 24 days of cash on hand. There does not appear to be any analytical basis for concluding that 24 days is the proper number of days of cash for the Postal Service to hold. To come up with that number, the OIG does not actually analyze the Postal Service's current circumstances, but simply: (1) compares the Postal Service to five unidentified entities and (2) notes that the Postal Service's cash on hand is much higher than its average in prior years.

The report's comparison of the Postal Service to unnamed private sector entities is analytically flawed. From this flawed comparison, the report draws an unfounded conclusion that the Postal Service needs less cash on hand than comparable private sector entities. The premise of making a simple comparison of the Postal Service's' calculated days of cash on hand to that of other, unnamed, "like entities" is itself problematic, as there are no other entities in the public or private sectors like the Postal Service. Ignoring the probable ability of comparative entities to obtain additional liquidity by accessing the capital markets for additional debt or equity financing, drawing upon unused lines of credit, using commercial paper programs, sale leasebacks, factoring receivables, etc. is an analytical flaw. In addition, the comparison, by focusing only on cash on hand, also excludes accounts receivable as an additional source of liquidity, leading to additional distortions. Whereas the Postal Service has relatively small receivables balances, the receivables for UPS and FedEx, for example, were $7.1 billion and $7.3 billion respectively at the end of their most recent fiscal years, while the Postal Service had net receivables of only $930 million on September 30, 2015. The comparison also ignores the fact that unlike these "like entities", the Postal Service has stakeholders that have a substantial claim against our cash on hand, such as for money orders outstanding and customer deposits.

It should be obvious that if a firm has access to other forms of financing, it has less of a need to maintain significant cash on hand in order to maintain a healthy financial position. However, the Postal Service has no more borrowing capacity. Further, the report completely ignores the fact that the Postal Service has already defaulted on $28.1 billion in legal obligations. We believe it is safe to assume that none of the comparator entities has defaulted on any of its legal obligations. It is also illegitimate for the report to state that the Postal Service needs a lesser amount of cash on hand because of the implied guaranty of our liabilities by the U.S. Government; a fundamental principle underlying the Postal Service is that it is intended to be self-sufficient.

In addition, the report's comparison of the Postal Service's current cash on hand to previous levels is seriously flawed. First, it must be noted that the increase in cash on hand is a good thing; the 2011 level (irrespective of whether the Postal Service's or the OIG's calculation is used) was unsustainable and extremely risky. Second, it must be noted that the increase in cash is largely due to the temporary exigent price increase (which provided $4.6 billion and has since expired, so will no longer be a source of cash) and the defaults on $28.1 billion in obligations to the Postal Service Retiree Health Benefits Fund (PSRHBF). Finally, prior to the enactment of the Postal Accountability Enhancement Act (PAEA), the Postal Service had less of a need to have a large amount of cash on hand because it had available borrowing authority and was able to manage to a rate case cycle that was based on a cost-reimbursement model that guaranteed breakeven financial results in an environment of rising or stable mail volumes. Therefore, what was suitable cash on hand in the past has no relevance to what is appropriate today, considering the environment in which the Postal Service is operating.

Monetary Impacts

Management strongly disagrees with the monetary impact calculated by the OIG and the contention that the Postal Service is increasing its liquidity risk by using its current calculation of days operating cash on hand. The report asserts that by using the OIG's recommended approach, the Postal Service would have had just over $1 billion in cash on hand at the close of FY2015 that could have been "put to better use." For the reasons discussed above, OIG has failed to demonstrate that the Postal Service actually has $1 billion in funds that could be "put to better use" because, in fact, we do not.

The lack of support for this assertion is further demonstrated by considering the OIG's proposed uses of this purportedly excess $1 billion. The OIG asserts that the Postal Service "could use these 12 days (or $1 billion of its $6.6 billion in existing cash) to continue the present approach of saving cash in case of another economic downturn, pay amounts to the Office of Personnel Management (OPM) for the Federal Employee Retirement System (FERS) or PSRHBF obligations, reduce its debt to the Treasury, or more aggressively fund investments in its infrastructure."

The first proposed use is illogical—if the Postal Service wanted to maintain a reserve in case of an economic downturn, it would be kept as cash on hand, just as is being done today. How is that putting it to a "better use"? Furthermore, the fact that the Postal Service has not made the FERS amortization payments for the past two years is based on the fact that we do not believe that OPM has properly determined the Postal Service's FERS accrued actuarial liability, and that if it did so it would find that no amortization payments are owed for the periods involved. The OIG does not explain why the Postal Service should nevertheless make payments that we do not believe are owed and have therefore appealed.

Finally, the report claims that these excess days of operating expenses could then be used for such things as paying down debt to the Federal Finance Bank or investing in infrastructure. In terms of liquidity, there is no difference between having cash on hand and available borrowing authority. Furthermore, excluding capital outlays from the calculation of cash on hand only to say that the "excess" cash thereby created could then be used to "aggressively fund investments in infrastructure" is contradictory. Lastly, making a one-time payment to the PSRHBF would be meaningless in terms of our overall obligation and would leave a smaller buffer against future economic downturns.

Recommendation 1:
Calculate and report in financial and other public reports the number of days of cash on hand using (365) operating days and excluding capital outlays in the calculation.

The Postal Service disagrees with this recommendation but agrees to clearly explain our calculation. We are calculating days of operating cash. Again, it must be noted that the Postal Service clearly discloses the number of days used in its calculation; however we will expand our disclosures in this area to make it clear that we include capital expenditures in our calculation. The report implies that by calculating day's cash on hand using 365 days in the denominator, the Postal Service is increasing its liquidity risk. Further, the report suggests that changing the methodology would somehow create $1 billion of additional liquidity that could be used to pay down obligations to OPM for FERS, or PSRHBF obligations, reduce debt to the Treasury, or more aggressively fund investments in our infrastructure. Spending more to reduce liquidity risk is a contradiction in itself.

The contention that the Postal Service should use a different number of operating days in the denominator of the calculation is arbitrary and creates a meaningless distinction. The Postal Service discloses in its financial reports that the days of operating cash on hand calculation is based on a 251 disbursement day year. Changing a calculation that has been used consistently for a number of years can only serve to create confusion for stakeholders, rather than providing new or better information to them.

Recommendation 2:
Define the number of days of operating cash on hand needed to sustain operations through a short-term economic downturn.

The Postal Service disagrees with this recommendation. Why should the Postal Service jeopardize its universal service obligation, by risking running out of cash during a "short-term" economic downturn? First, the knowledge of what is or is not a "short-term economic downturn" is available only in retrospect. Second, the Postal Service monitors its cash availability on a daily basis, making regular projections of future cash needs. Third, every recession is different, and while most economists agree the US may see a recession in the next few years, there is no consensus that this will be a "short-term' issue. The proper response to any given recession will vary with the circumstances.

It should also be noted that, in the 2008 recession, the Postal Service lost almost $7 billion of revenue in a single year. Should the next recession be as bad, or worse, the Postal Service may run out of cash. So far, the Postal Service, and its Board of Governors have taken actions to help ensure that the Postal Service does not face this possibility.

Please call me if you have any questions.

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