



**OFFICE OF  
INSPECTOR GENERAL**  
UNITED STATES POSTAL SERVICE

**Update for  
Measuring  
Pension and  
Retiree Health  
Benefits  
Liabilities**

**Audit Report**

Report Number  
FT-AR-17-007

May 2, 2017





# OFFICE OF INSPECTOR GENERAL

## UNITED STATES POSTAL SERVICE

## Highlights

### Background

The U.S. Postal Service provides pension and health insurance benefits to its retirees. Postal Service employees participate in the Civil Service Retirement System (CSRS) or Federal Employees Retirement System (FERS) pension programs. The Office of Personnel Management (OPM) administers these programs, including projecting future CSRS and FERS assets and liabilities for the federal government and Postal Service.

The OPM also administers the Postal Service Retiree Health Benefits Fund, which was established by the Postal Accountability and Enhancement Act of 2006 (PAEA). This statute required the Postal Service to prefund retiree health benefits by making payments of about \$5.6 billion annually to the health benefits fund from fiscal year (FY) 2007 through FY 2016. However, beginning in FY 2012, the Postal Service defaulted on the required payments.

The OPM's pensions and retiree health benefits projections use federal employee-wide workforce demographic assumptions, such as mortality rates and retirement age, and economic assumptions, such as inflation rates, wage growth, and earnings from invested assets. In December 2016, the OPM proposed regulations that would allow use of Postal Service-specific demographic assumptions for calculating its FERS liability, provided certain conditions are met.

The Postal Service's financial challenges are well publicized. From FY 2007 to FY 2016, it lost \$62.4 billion, with \$54.8 billion of that total related to prefunding retiree health care. Furthermore, the Postal Service believes it is unlikely to make all legally required payments in FY 2017, based on availability of cash and its inability to borrow.

In an effort to reduce the retiree health benefits liability, the Postal Service has made proposals which have been incorporated into pending legislation that included mandatory enrollment in Medicare by Postal Service retirees in order to participate in the Federal Employees Health Benefits program. Since 1983, the Postal Service and its employees have contributed over \$29 billion to Medicare. The proposals also include savings with respect to prescription drug benefits under Medicare.

As of the end of FY 2016, the OPM projected the Postal Service's share of assets in the CSRS at \$174.4 billion and the liability at \$191.9 billion. For the FERS, OPM projected \$112.1 billion in assets and a \$115.9 billion liability. As of the end of FY 2016, assets in the Postal Service Retiree Health Benefits Fund were \$51.9 billion, and the OPM calculated the retiree health benefits liability at \$104.0 billion. The assets in these retirement liability accounts totaled \$338.4 billion, and the liabilities totaled \$411.8 billion, resulting in these liabilities funded at 82.2 percent.



# OFFICE OF INSPECTOR GENERAL

## UNITED STATES POSTAL SERVICE

***Our objective was to update and assess the impact of changes in assumptions on Postal Service retirement liabilities, in order to evaluate the reasons for the significant reduction in its pension funding position, and to update results produced through use of Postal Service specific assumptions.***

Between FY 2010 and FY 2014, the Postal Service's pension funding position shifted substantially. In FY 2010, assets exceeded liabilities by \$1.6 billion (CSRS) and \$10.9 billion (FERS); however, in FY 2014, liabilities exceeded assets by \$19.4 billion (CSRS) and \$3.6 billion (FERS).

Our objective was to update and assess the impact of changes in assumptions on Postal Service retirement liabilities, in order to evaluate the reasons for the significant reduction in its pension funding position, and to update results produced through use of Postal Service specific assumptions.

This report updates three reports the Office of Inspector General previously issued in FY 2013 regarding Postal Service-specific assumptions and their effect on the CSRS, FERS, and retiree health benefits liabilities.

### **What the OIG Found**

The OPM calculates the Postal Service's share of the CSRS, FERS, and retiree health benefits liabilities using demographic and economic assumptions from the federal employee workforce. However, using Postal Service-specific demographic and economic assumptions lowers these liabilities by \$10.2 billion.

Between FY 2010 and FY 2014, the funded status of the CSRS and FERS pension plans changed from a surplus to a deficit primarily due to changes in assumptions for the interest rate

and the cost of living allowances, and lower than expected investment returns on pension plan assets.

Further, the PAEA requires the Postal Service to liquidate the projected FY 2016 unfunded CSRS liability totaling \$17.5 billion by FY 2043. The OPM projected the Postal Service's first annual installment to be \$1.2 billion. The Postal Service estimates it may be required to pay the first installment as soon as FY 2017. However, the wording of the statute appears to require the first payment to be made in FY 2018. This matter is currently under review by the U.S. Department of Justice Office of Legal Counsel to confirm whether, based on its interpretation of the statute, the initial payment is due from the Postal Service beginning in FY 2017 or FY 2018.

### **What the OIG Recommended**

Although the monetary impact associated with these issues is not in the direct control of Postal Service management, we recommended management continue to work with Congress to enact legislation requiring the OPM to use Postal Service assumptions in preparing pension and retiree health benefits liabilities and Medicare participation.

Since the Office of Legal Counsel will determine when the Postal Service should make its first payment for the unfunded CSRS liability, we are not making a recommendation.

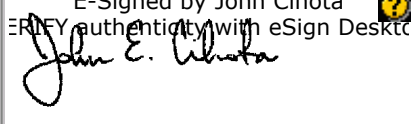
# Transmittal Letter



OFFICE OF INSPECTOR GENERAL  
UNITED STATES POSTAL SERVICE

May 2, 2017

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

E-Signed by John Cihota  
VERIFY authenticity with eSign Desktop  


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

**SUBJECT:** Audit Report – Update for Measuring Pension and  
Retiree Health Benefits Liabilities  
(Report Number FT-AR-17-007)

This report presents the results of our audit of Update for Measuring Pension and Retiree Health Benefits Liabilities (Project Number 16BR004FT000).

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 and Audit Response Management

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# Findings

## Introduction

This report presents the results of our self-initiated audit of the Update for Measuring Pension and Retiree Health Benefits Liabilities (Project Number 16BR004FT000). Our objective was to update and assess the impact of changes in assumptions on U.S. Postal Service retirement liabilities, in order to evaluate the reasons for the significant reduction in its pension funding position, and to update results produced through use of Postal Service-specific assumptions. See [Appendix A](#) for additional information about this audit.

The Office of Personnel Management (OPM) manages the federal government's two pension programs. The Civil Service Retirement System (CSRS) is a pension program offered to employees of the Postal Service and federal agencies. Career employees hired before January 1, 1984, generally participate in the CSRS. The Federal Employees Retirement System (FERS) includes a pension program offered to employees of the Postal Service and federal agencies. Career employees hired after December 31, 1983, generally participate in the FERS.

The OPM provides the Postal Service with fiscal year-end data with respect to its share of the CSRS and FERS pension plans. The information includes assets<sup>1</sup> and liabilities.<sup>2</sup> Through fiscal year (FY) 2016, the OPM projected the Postal Service's share of assets in the CSRS at \$174.4 billion and the liability at \$191.9 billion. For the FERS, assets were projected at \$112.1 billion and the liability at \$115.9 billion.

Between FYs 2010 and 2014, the funded status of the Postal Service's CSRS and FERS liabilities changed significantly. The OPM's FY 2010 reporting showed assets available to pay each pension's benefits exceeded the liabilities by \$1.6 billion for the CSRS and \$10.9 billion for the FERS. However, by FY 2014 the liabilities exceeded assets by \$19.4 billion for the CSRS and \$3.6 billion for the FERS.

Postal Service retirees may also participate in the Federal Employees Health Benefits (FEHB) program that the OPM administers. The FEHB program became effective in 1960 and covers over 8 million federal and Postal Service employees, retirees, former employees, family members, and former spouses. Over 200 health plan choices are offered under the program. Generally, employees who participate in the FEHB program for the 5 years immediately prior to retirement may participate in the program upon retirement.

The Postal Accountability and Enhancement Act of 2006 (PAEA) established the Postal Service Retiree Health Benefits Fund (PSRHBF) that would be used to pay the Postal Service's share of health benefits for retirees starting in FY 2017. The PAEA requires the Postal Service to fund the PSRHBF that the OPM administers. Through FY 2016, \$38.0 billion has been paid to the PSRHBF.<sup>3</sup> As of the end of FY 2016, assets in the PSRHBF were \$51.9 billion, and the liability was \$104.0 billion.

The OPM uses the following actuarial assumptions to estimate the liabilities for future retirement benefits:

- Economic assumptions, such as interest rates (also known as discount rates), wage increases, and inflation.
- Demographic assumptions, such as life expectancy, amount of time employees' work for the employer, and when employees retire and start collecting benefits.

<sup>1</sup> Amounts contributed by the Postal Service and employees to pay future benefits, and includes growth from investments.

<sup>2</sup> Actuarially calculated amounts that are expected to be paid in the future.

<sup>3</sup> Includes \$17.1 billion transferred from a surplus in CSRS in 2007.

***The Postal Service’s CSRS, FERS, and retiree health benefits liabilities could be reduced \$10.2 billion by using demographic and economic assumptions specific to Postal Service participants instead of assumptions specific to the federal employee workforce.***

In FY 2015, the Postal Service developed a proposal for the health benefits plan that included a requirement for Postal Service retirees to participate in Medicare Parts A and B, and prescription drug coverage through an Employer Group Waiver Plan (EGWP). Medicare Part A covers hospitalization expenses and is generally free to retirees. Medicare Part B covers outpatient and non-hospital medical expenses. Retirees must pay a monthly premium for this coverage. The Postal Service estimated the proposal would reduce the retiree health benefits liability by about \$23.9 billion, and the EGWP would further reduce the liability by \$24.4 billion.

This report updates three reports the OIG previously issued in FY 2013 regarding Postal Service-specific assumptions and their effect on the CSRS, FERS, and retiree health benefits liabilities.<sup>4</sup>

## Summary

The Postal Service’s CSRS, FERS, and retiree health benefits liabilities could be reduced \$10.2 billion by using demographic and economic assumptions specific to Postal Service participants instead of assumptions specific to the federal employee workforce. Also, between FYs 2010 and 2014, the funded status of the CSRS and FERS pension plans changed from a surplus to a deficit primarily due to assumption changes in the interest rate and the cost of living allowances (COLA), and lower than expected investment returns on plan assets.

Further, the PAEA requires the Postal Service to liquidate the projected FY 2016 unfunded CSRS liability totaling \$17.5 billion by FY 2043. The OPM projected the Postal Service’s first annual installment to be \$1.2 billion. The Postal Service estimates it may be required to pay the first installment as soon as FY 2017. However, the wording of the statute appears to require the first payment to be made in FY 2018. This matter is currently under review by the U.S. Department of Justice Office of Legal Counsel to confirm whether, based on its interpretation of the statute, the initial payment is due from the Postal Service beginning in FY 2017 or FY 2018.

Legislation was introduced in Congress in 2017 and over the past several years that would significantly impact the Postal Service’s retirement liabilities. Proposals included using Postal Service assumptions in calculating the CSRS and FERS liabilities and mandating Medicare participation by Postal Service retirees in order to participate in the FEHB program. See [Appendix B](#) for more information.

## Demographic and Economic Assumptions

The OPM has legal responsibility for calculating future CSRS and FERS liabilities and prescribing regulations for administering the pension plans. While the OPM has broad authority in calculating and reporting the liabilities, it uses federal employee workforce demographic and economic assumptions to calculate the Postal Service’s share of pension liabilities. In addition, current law<sup>5</sup> requires the OPM to determine the value of the Postal Service retiree health benefits liability based on actuarial assumptions that are consistent with those the OPM uses to report pension liabilities of federal employees.

<sup>4</sup> See [Prior Audit Coverage](#) in Appendix A for these reports.

<sup>5</sup> 5 USC § 8909a (d)(4).

***Using demographic and economic assumptions of the federal workforce has unnecessarily burdened the Postal Service with higher liabilities than if assumptions of Postal Service employees were used.***

We believe the OPM should use an approach that provides a more accurate estimate of retirement liabilities for Postal Service employees and that better matches future retirement benefits. Federal workforce demographic and economic assumptions are materially different from those of the Postal Service. For example, federal employees can receive pay increases based on merit and promotions throughout their careers, whereas bargaining employees<sup>6</sup> of the Postal Service reach the top of their pay scale in 12 or 13 years. Using demographic and economic assumptions of the federal workforce has unnecessarily burdened the Postal Service with higher liabilities than if assumptions of Postal Service employees were used.

Using FY 2015 data,<sup>7</sup> we projected the Postal Service’s CSRS, FERS, and retiree health benefits liabilities using federal and Postal Service workforce demographic and wage growth assumptions as of FY 2016.

- Using federal workforce demographic and wage growth assumptions, we estimated the retirement liabilities at \$411.8 billion. We projected assets totaling \$338.4 billion funded 82.2 percent of the retirement liabilities.<sup>8</sup>
- Using Postal Service demographic and wage growth assumptions, we estimated the retirement liabilities at \$401.6 billion, a reduction of \$10.2 billion.<sup>9</sup> Projected assets of \$338.4 billion would fund 84.3 percent of the projected retirement liabilities.

By lowering the liability estimates, the Postal Service reduces its amortization payments. The difference could be used to pay amounts to the OPM for FERS or PSRHBF obligations; reduce the Postal Service’s debt to the U.S. Department of the Treasury (Treasury); more aggressively fund investments in the Postal Service infrastructure; or reduce, slow, or delay future postage rate increases.

In December 2016, the OPM proposed regulations that would allow use of Postal Service-specific demographic assumptions for calculation of its FERS liability, provided certain conditions are met. See [Appendix B](#) for additional information on the proposed regulation.

Table 1 shows the projected liability reductions using Postal Service assumptions for all of its retirement liabilities.

**Table 1. Effect of Using Postal Service Assumptions for FY 2016 (in billions)**

<b>Projected Liabilities</b>	<b>CSRS</b>	<b>FERS</b>	<b>RHB<sup>10</sup></b>	<b>Total</b>
Using Federal Workforce Assumptions	\$191.9	\$115.9	\$104.0	\$411.8
Using Postal Service Assumptions	188.1	111.8	101.7	401.6
Projected Liability Reductions with Postal Service Assumptions	\$3.8	\$4.1	\$2.3	\$10.2

Source: U.S. Postal Service Office of Inspector General (OIG) analysis.

<sup>6</sup> Bargaining employees constitute about 90 percent of Postal Service career employees.

<sup>7</sup> This was the latest data available and is similar to that used by the OPM in its projections.

<sup>8</sup> Demographic assumptions do not impact assets.

<sup>9</sup> The OIG identified \$5.4 billion in funds put to better use in prior audit reports. Therefore, we believe an additional \$4,800,000,000 billion should be considered funds put to better use, defined as “funds that could be used more efficiently by implementing recommended actions”

<sup>10</sup> Retiree Health Benefits (RHB).



**The FY 2016 CSRS liability would decrease by \$3.8 billion**

**The FY 2016 FERS liability would decrease by \$4.1 billion**

**The FY 2016 retiree health benefits liability would decrease by \$2.3 billion**

### Civil Service Retirement System

We estimated the FY 2016 CSRS liability would decrease by \$3.8 billion, reducing the CSRS unfunded liability from \$17.5 billion to \$13.7 billion, by using Postal Service rather than federal workforce demographic and wage growth assumptions. A reduction in the mortality improvement assumption was the key reason for the different projected liabilities. See Table 2 for our FY 2016 projections.

**Table 2. Unfunded CSRS Liability for FY 2016 (in billions)**

Projections	Federal Workforce Assumptions	Postal Service Assumptions	Liability Reduction
CSRS Liability	\$191.9	\$188.1	\$3.8
CSRS Plan Assets	174.4	174.4	0.0
CSRS Unfunded Liability	\$17.5	\$13.7	\$3.8

Source: OIG analysis.

### Federal Employees Retirement System

We estimated the FY 2016 FERS liability would decrease by \$4.1 billion, changing the FERS unfunded liability from \$3.8 billion to a surplus of \$0.3 billion, by using Postal Service workforce demographic and wage growth assumptions rather than federal assumptions. Lower wage growth among Postal Service employees was the key reason for the difference in projected liabilities. See Table 3 for our FY 2016 projections.

**Table 3. Unfunded FERS Liability for FY 2016 (in billions)**

Projections	Federal Workforce Assumptions	Postal Service Assumptions	Liability Reduction
FERS Liability	\$115.9	\$111.8	\$4.1
FERS Plan Assets	112.1	112.1	0.0
FERS Unfunded Liability	\$3.8	(\$0.3)	\$4.1

Source: OIG analysis.

### Retiree Health Benefits

We estimated the FY 2016 retiree health benefits liability would decrease by \$2.3 billion, reducing the retiree health benefits unfunded liability from \$52.1 billion to \$49.8 billion, by using Postal Service workforce demographic assumptions rather than federal assumptions. Shorter life expectancies was the primary reason for the different projected liabilities. See Table 4 for our FY 2016 projections.

***The plan requires all Postal Service retirees participating in the FEHB program to enroll in Medicare Parts A and B.***

**Table 4. Unfunded Retiree Health Benefits Liability for FY 2016 (in billions)**

<b>Projections</b>	<b>Federal Workforce Assumptions</b>	<b>Postal Service Assumptions</b>	<b>Liability Reduction</b>
RHB Liability	\$104.0	\$101.7	\$2.3
RHB Plan Assets	51.9	51.9	0.0
RHB Unfunded Liability	\$52.1	\$49.8	\$2.3

Source: OIG analysis.

**Medicare Participation**

The financial picture continues to improve when the Postal Service’s FY 2015 proposed health benefits plan is considered. The plan requires all Postal Service retirees participating in the FEHB program to enroll in Medicare Parts A and B. This requirement is consistent with best practices in the private sector, and the Postal Service and its employees have paid more than \$29.0 billion into Medicare.

Under the plan, the health benefits liability would decrease by \$23.9 billion; it would decrease another \$24.4 billion by implementing an EGWP. If Congress authorized a separate Postal Service health benefits plan and implemented these provisions totaling \$48.3 billion in reductions, assets would fund 96.2 percent of the projected retirement liabilities, leaving just 3.8 percent unfunded. Table 5 shows how the OIG projected the 96.2 percent funded liability.

**Table 5. Funded Ratio Using Postal Service Assumptions and Medicare for FY 2016 (in billions)**

<b>Description</b>	<b>Projected Assets</b>	<b>Projected Liabilities</b>
CSRS using federal workforce assumptions	\$174.4	\$191.9
FERS using federal workforce assumptions	112.1	115.9
RHB using federal workforce assumptions	51.9	104.0
<b>Subtotals</b>	<b>\$338.4</b>	<b>\$411.8</b>
Less reductions from using Postal Service assumptions		(10.2)
Less reductions from implementing Medicare:		
• Medicare Parts A and B (\$23.9 billion) increased by inflation (2.9%)		(24.6)
• EGWP (\$24.4 billion) increased by 2.9% inflation		(25.1)
Liability with Postal Service assumptions and implementing Medicare		\$351.9
Funded Ratio: projected assets divided by liability with Postal Service assumptions and Medicare		96.2%

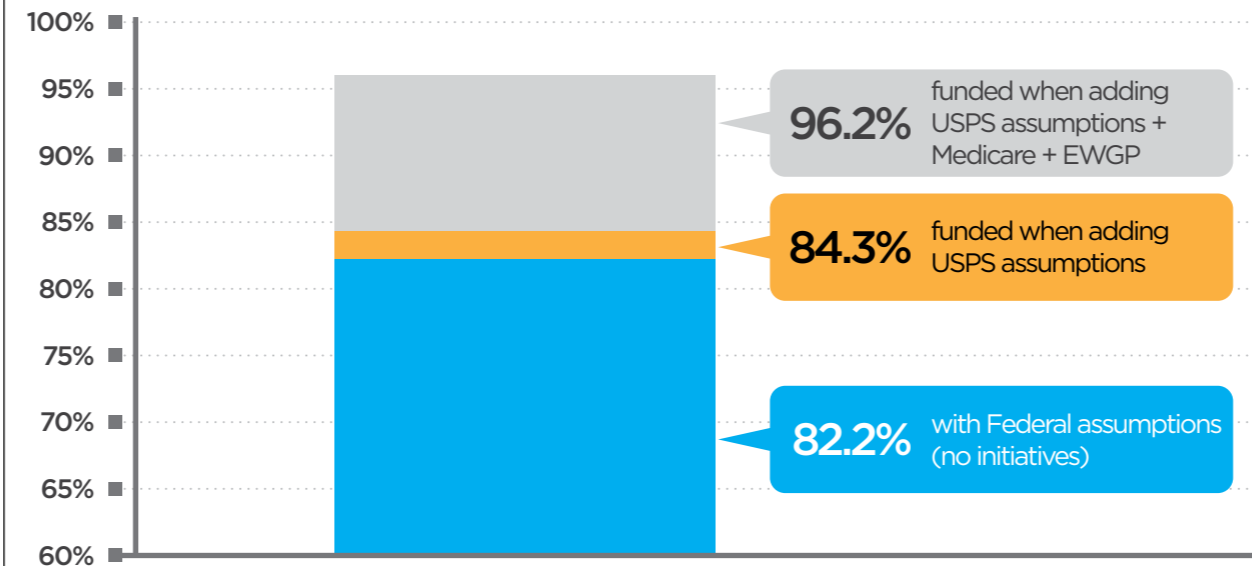
Source: OIG analysis.

**Between FYs 2010 and 2014,  
the funded status of the  
Postal Service's CSRS and FERS  
liabilities changed significantly.**

In a prior report,<sup>11</sup> we evaluated management's proposed alternative health benefits plan. We determined the proposed reduction of \$42.9 billion from mandatory Medicare participation and implementation of an EGWP as part of Medicare Part D to be reasonable. Adjusting for inflation,<sup>12</sup> we recalculated the proposed difference to be \$48.1 billion, which is near the Postal Service's 2015 proposed health benefit plan's reduction of \$48.3 billion, as previously discussed.

Figure 1 shows how much of the combined pensions and retiree health benefits liabilities are funded in FY 2016 using 1) federal workforce assumptions, 2) Postal Service assumptions, and 3) Postal Service assumptions, requiring Medicare participation by Postal Service retirees and implementing the EGWP.

**Figure 1. Effects of Cost-Savings Initiatives Percent Pensions and Retiree Health Benefits Funded as of FY 2016**



Source: OIG analysis.

### Pensions Surplus to Deficit

Between FYs 2010 and 2014, the funded status of the Postal Service's CSRS and FERS liabilities changed significantly. As of September 30, 2010, the Postal Service's portion of assets available to pay CSRS and FERS benefits to its retirees exceeded liabilities by \$1.6 billion and \$10.9 billion, respectively (surplus or overfunded position). Yet, by September 30, 2014, the Postal Service's CSRS and FERS liabilities exceeded the assets by \$19.4 billion and \$3.6 billion, respectively (deficit or unfunded position). [Table 6](#) identifies the changes, and [Table 7](#) identifies the causes of the changes from surplus to deficit.

<sup>11</sup> U.S. Postal Service Alternative Health Care Plan Proposal (Report Number FI-MA-12-014, August 22, 2012).

<sup>12</sup> April 2010 through March 2015.

**\$15.0 billion of the \$21.0 billion in CSRS changes were attributed to an interest rate reduction, an increase in COLA, and an increase in the life expectancy.**

**Table 6. Change From Surplus to Deficit FY 2010 through 2014 (in billions)**

	CSRS			FERS		
	FY 2010	FY 2014	Absolute Difference	FY 2010	FY 2014	Absolute Difference
Liabilities	\$193.0	\$201.5		\$69.9	\$104.5	
Assets	194.6	182.1		80.8	100.9	
Surplus/ (Deficit)	\$1.6	(\$19.4)	\$21.0	\$10.9	(\$3.6)	\$14.5

Source: OIG analysis.

**Table 7. Causes of Surplus to Deficit Positions for CSRS and FERS FYs 2010 through 2014 (in billions)**

Causes	CSRS	FERS
Assumption Changes (Interest Rate and COLA)	(\$15.0) <sup>13</sup>	(\$5.2)
Lower than Expected Investment Returns on Plan Assets	(7.3)	(5.1)
Interest on Deficit (Surplus) <sup>14</sup>	(2.8)	0.8
Delay in Higher Contributions	0.0	(1.1)
Liability Experience	3.7	(3.8)
Other Losses/(Gains)	0.4	(0.1)
Total Increase in Deficit	(\$21.0)	(\$14.5)

Source: OIG analysis.

**CSRS changes:**

- The assumption changes of \$15.0 billion included an interest rate reduction for FY 2011 from 5.75 percent to 5.25 percent (liabilities increase when interest rates decline), a change in the COLA for FY 2011 from 3.0 percent to 3.6 percent<sup>15</sup> that was not planned, and an increase in the assumed life expectancy of beneficiaries.<sup>16</sup>
- Assets did not achieve the 5.75 percent expected return. The lower investment returns amounted to \$7.3 billion below the estimated assets' value over the 4-year period.
- The CSRS had an unfunded liability during the four-year period. The unfunded liability grew with interest totaling \$2.8 billion.

<sup>13</sup> Increase in deficit shown as a negative number; decrease in deficit shown as a positive number.

<sup>14</sup> The unfunded portion of the liability or liability surplus grew with interest.

<sup>15</sup> Interest rates and COLAs are examples of economic assumptions; wage growth is another example.

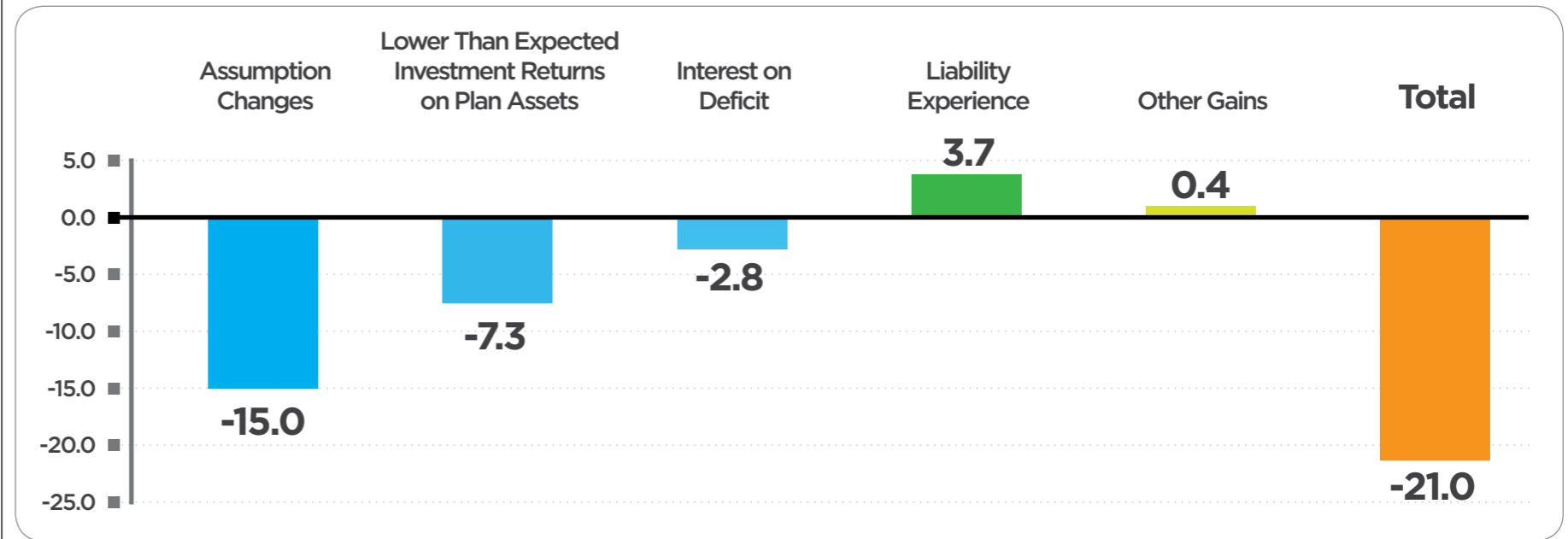
<sup>16</sup> This is a long-term assumption.

**\$10.3 billion of the \$14.5 billion in FERS changes were attributed to an interest rate reduction, an increase in COLA, an increase in the life expectancy, and lower investment returns on assets.**

- Experience gains of \$3.7 billion resulted mostly from lower COLAs and higher mortality than expected.<sup>17</sup>
- Other gains included \$0.4 billion consisting of the difference between the actual benefits paid and the actuarially projected amounts. Since benefits paid were less, this difference increases the surplus. Another gain was \$0.02 billion where contributions exceeded normal cost.<sup>18</sup>

Figure 2 depicts the causes for the change in the CSRS liability from FY 2010 through FY 2014.

**Figure 2. Causes of Surplus to Deficit Positions for CSRS (in billions of dollars)**



Source: OIG analysis.

FERS changes:

- The changes in assumptions of \$5.2 billion included an interest rate reduction for FY 2011 from 5.75 percent to 5.25 percent, a change in the COLA for 2011 from 3.0 percent to 3.6 percent that was not planned, and an increase in the assumed life expectancy of beneficiaries.
- Assets did not achieve the 5.75 percent expected return. The lower investment returns amounted to \$5.1 billion below the estimated assets' value over the 4-year period.
- The FERS had a surplus and deficits during the four-year period. The surplus and deficits for the period netted to interest on a surplus of \$0.8 billion.

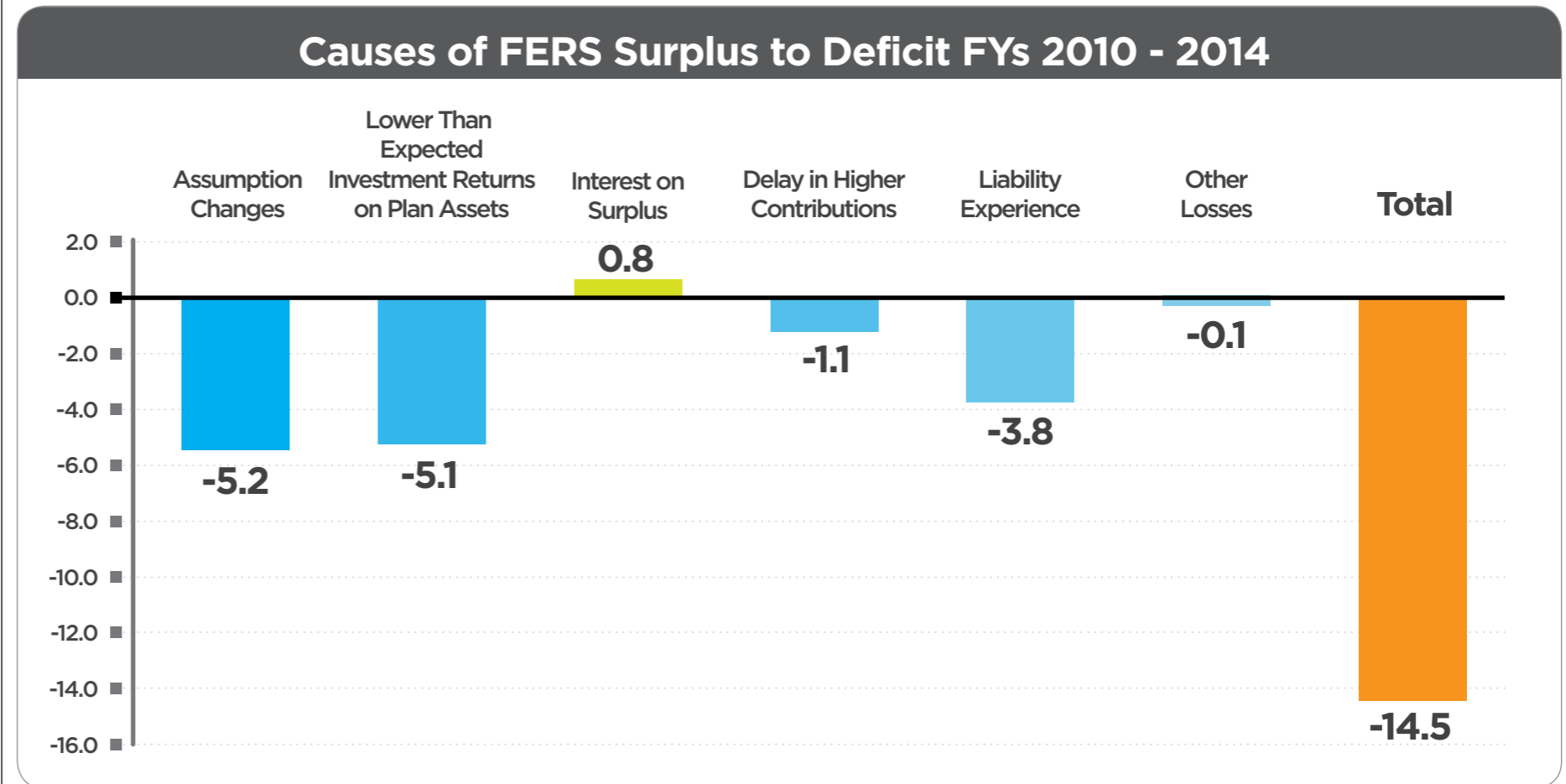
<sup>17</sup> This was a short-term experience.

<sup>18</sup> Normal cost is the benefits earned by active employees during a time period such as a year.

- The OPM reduced the interest rate from 5.75 percent to 5.25 percent in 2012. However, the resulting change in the FERS contribution rate paid by federal agencies did not appear in the *Federal Register* until May 21, 2014, and was effective October 1, 2014. The delay in the Postal Service contributing at the higher rates increased the liability by \$1.1 billion.
- Experience losses of \$3.8 billion resulted from fewer terminations than expected (thus more employees remained on the planned retirement rolls), and a greater number of employees than expected who became disabled or retired at younger ages.
- Other FERS losses of \$0.1 billion resulted from rounding.

Figure 3 depicts the causes of the change in the FERS liability from FY 2010 through FY 2014.

**Figure 3. Causes of Surplus to Deficit Positions for FERS (in billions of dollars)**



Source: OIG analysis.

### Civil Service Retirement System Unfunded Liability

The PAEA suspended the Postal Service's contributions to the CSRS until after FY 2016, although CSRS employees continued to contribute to the plan. The PAEA requires the OPM to calculate the Postal Service's CSRS liability and identify annual installments to liquidate the unfunded liability by FY 2043. The OPM projected the annual installments to be \$1.2 billion.

***The Postal Service estimates it may be required to pay the first installment as soon as FY 2017. However, the PAEA is ambiguous with regard to when amortization payments from the Postal Service should start.***

The Postal Service estimates it may be required to pay the first installment as soon as FY 2017. However, the PAEA is ambiguous with regard to when amortization payments from the Postal Service should start. The PAEA states, “Beginning June 15, 2017, if the result is a supplemental liability, the (OPM) shall establish an amortization schedule, including a series of annual installments commencing on September 30 of the subsequent fiscal year, which provides for the liquidation of such liability by September 30, 2043.”

If the Postal Service pays the \$1,230,300,000 in FY 2017, it will lose funds to pay the OPM for FERS or PSRHBF obligations; reduce its debt to the Treasury; more aggressively fund investments in its infrastructure; or reduce, slow, or delay future postage rate increases.<sup>19</sup>

As a result of our inquiry, this matter is currently under review by the U.S. Department of Justice Office of Legal Counsel to confirm whether, based on its interpretation of the statute, the initial payment is due from the Postal Service beginning in FY 2017 or FY 2018. Since the Office of Legal Counsel will be opining as to when the Postal Service should make its first payment for the unfunded CSRS liability, we are not making a recommendation.

## Outlook

In accordance with the PAEA, the Postal Service will begin payments to amortize the CSRS unfunded liabilities. The OPM’s current estimate of this obligation will be about \$1.2 billion annually, beginning in FY 2017 or FY 2018.

Beginning in FY 2017, the OPM pays the Postal Service’s share of retiree health benefit premiums from the PSRHBF. The OPM will determine payments the Postal Service will need to make through FY 2056 to amortize the PSRHBF unfunded liabilities. For FY 2017, the OPM preliminarily estimated the payment for the total \$52.1 billion unfunded portion<sup>20</sup> to be about \$2.84 billion.<sup>21</sup>

The Postal Service expects the total amount of these CSRS and PSRHBF projected cash outlays to be about \$2.1 billion less than FY 2016’s mandated obligations. However, without legislative action, the Postal Service believes liquidity concerns will make it unlikely all legally required payments will be made in FY 2017.

Further, the OPM has billed the Postal Service since FY 2014 for amortization of the FERS unfunded liability. The \$495.0 million invoiced related to the OPM’s projected unfunded liability of \$3.8 billion. The Postal Service has not paid any of the amortization amounts, pending a written appeal to the OPM to use Postal Service economic and demographic assumptions. This amount is expected to grow another \$250.0 million, roughly, in FY 2017.

See [Appendix B](#) for postal reform legislation that has been recently introduced to address these financial concerns.

<sup>19</sup> We believe these funds can be put to a better use.

<sup>20</sup> As of the end of FY 2016, assets in the PSRHBF were \$51.8 billion, and the liability was \$104.0 billion.

<sup>21</sup> OPM will provide the final amount due by June 30, 2017.

# Recommendation

***We recommend management continue to work with Congress to enact legislation that more accurately and fairly addresses Postal Service retirement liability reform, including the use of Postal Service-specific assumptions in preparing the Civil Service Retirement System, Federal Employees Retirement System, and retiree health benefits liabilities and Postal Service retiree participation in Medicare.***

We recommend the chief financial officer and executive vice president:

1. Continue to work with Congress to enact legislation that more accurately and fairly addresses Postal Service retirement liability reform, including the use of Postal Service-specific assumptions in preparing the Civil Service Retirement System, Federal Employees Retirement System, and retiree health benefits liabilities and Postal Service retiree participation in Medicare.

## Management's Comments

Management agreed with the finding and recommendation but disagreed with the monetary impact. Management stated it has worked to enact legislative and administrative change to use Postal Service-specific assumptions to calculate the liabilities. In subsequent correspondence, management provided the Postmaster General's February 7, 2017, testimony before the House Oversight and Government Reform Committee. The Postmaster General's testimony discussed the need for postal reform legislation and included topics on the Postal Service's financial condition, using Postal Service-specific assumptions to calculate pension and retiree health benefit liabilities, and Medicare participation. However, they added enactment of this change is outside the Postal Service's control. Management stated recently the OPM drafted a rule to use Postal Service specific demographic assumptions to calculate Postal Service retirement liabilities.

Regarding the monetary impact, management stated it could not unilaterally change the assumptions used in calculating the retirement liabilities. Therefore, the Postal Service could not use the funds for anything other than what the OPM mandated. Further, management stated the OIG ignored previously claimed monetary impact of \$9.48 billion for the FERS liability, resulting in an overstated monetary impact. Since the liabilities are estimates that change each year, it is unreasonable to calculate monetary impact on predictions.

Additionally, management disagreed with the monetary impact related to deferring the CSRS unfunded liability payment from FY 2017 to FY 2018. Management stated this is contrary to the OPM's position that the payment is due September 30, 2017. While the matter was referred to the Department of Justice Office of Legal Counsel, there is no assurance that a decision will be rendered prior to the September 30, 2017. Therefore, to calculate monetary impact was premature and an additional liability would be incurred if the payment is deferred.

Finally, management disagreed with the payment due in FY 2017 for the retiree health benefits amortization liability. Management stated the amount is \$0.8 billion rather than the \$2.84 billion referenced in this report.

See [Appendix C](#) for management's comments in their entirety.

## Evaluation of Management's Comments

The OIG considers management's comments responsive to the recommendation and management's ongoing actions should address the issues identified in the report. Since management's actions are ongoing and subject to legislative actions, the OIG will close the recommendation upon issuance of the report.

Monetary impacts were calculated in accordance with the Inspector General Act of 1978, as amended. The OIG calculated monetary impacts<sup>22</sup> separately for the CSRS, FERS, and Retiree Health Benefits liabilities. As the report notes, we deducted any

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<sup>22</sup> Monetary impacts were categorized as Funds Put to Better Use and defined as funds that could be used more efficiently by implementing recommended actions.



previously claimed monetary impact so as not to duplicate monetary impact. Regarding FERS specifically, we cited previously claimed monetary impact and claimed no monetary impact in this report for the change to FERS liability. The OIG recognizes that liabilities are estimates and change annually; however, we believe it is important to report that liabilities can currently decrease by \$10.2 billion to emphasize the need for corrective action.

As noted in our report, we recognized the Office of Legal Counsel's decision is pending; however, without the OIG bringing this matter to the Postal Service's attention, the Postal Service would have paid the OPM without consideration.

Regarding the retiree health benefits amortization liability, as noted in the report, the OPM preliminarily identified \$2.84 billion as the payment due based on the unfunded liability of \$52.1 billion and is consistent with the amount the Postal Service reported in its FY 2016 annual report. The \$0.8 billion amount represents amortization of the portion of the unfunded liability (about \$18.2 billion) not recognized as a liability on the balance sheet of the end of FY 2016. The OPM will provide a final payment amount due by June 30, 2017.

# Appendices

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## Appendix A: Additional Information

### Background

The Postal Service's financial challenges are well publicized. From FY 2007 to FY 2016, it lost \$62.4 billion with \$54.8 billion related to retiree health care prefunding. Furthermore, the Postal Service believes it is unlikely all legally required payments in FY 2017 will be made based on liquidity concerns.

Postal Service employees participate in retirement programs based on the starting date of their employment. The CSRS is a pension program offered to career employees of the Postal Service and federal government who were hired before January 1, 1984. Career Postal Service and federal government employees hired after December 31, 1983, generally participate in the FERS pension program.

The OPM administers the Civil Service Retirement and Disability Fund (CSRDF) that pays CSRS and FERS benefits to retirees. As part of that process, the OPM provides an annual projection of the CSRS and FERS assets and liabilities for the federal government as a whole and the Postal Service separately. A surplus exists when assets exceed the liability. Conversely, an unfunded liability exists when the liability exceeds the assets.

The Postal Service contributes the employer's share, as determined by the OPM, to the CSRDF for the FERS. The PAEA suspended the Postal Service's CSRS contributions from FY 2007 through FY 2016, while CSRS and FERS employees continued to contribute to both plans. In FY 2017, the OPM will determine whether additional funding is required by the Postal Service for the benefit of CSRS participants. The OPM's initial projection shows the Postal Service will need to contribute about \$1.2 billion annually. The Postal Service contributes to the CSRDF under provisions of the law through its business revenue and not through appropriated tax dollars.

Postal Service employees and retirees may also participate in the FEHB program. The OPM administers the PSRHBF<sup>23</sup> that will be used to pay retiree health benefits premiums starting in FY 2017. The PAEA required the Postal Service to prefund retiree health benefits by making payments to the PSRHBF ranging from \$5.4 billion to \$5.8 billion annually from FY 2007 through FY 2016.<sup>24</sup> However, the Postal Service has defaulted on required payments since FY 2012. If an unfunded liability exists with respect to retiree health benefits, the PAEA requires annual installments to liquidate the amount by FY 2056. To address the current unfunded liability, the OPM projected the Postal Service will need to contribute between \$2.8 billion and \$3.7 billion annually from FY 2017 through FY 2021.

In an effort to reduce retiree health benefits costs, the Postal Service prepared a legislative proposal in FY 2015 that recommended mandatory enrollment in Medicare Parts A and B by Postal Service retirees in order to participate in the FEHB program. The proposals also included prescription drug benefits by implementing an EGWP that supplements an employer's benefits plan for Medicare Part D. The Postal Service expects the plan to provide substantial savings.

### Objective, Scope, and Methodology

Our objective was to update and assess the impact of changes in assumptions on Postal Service retirement liabilities, in order to evaluate the reasons for the significant reduction in its pension funding position, and to update results produced through use of Postal Service specific assumptions.

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<sup>23</sup> The PAEA established the PSRHBF.

<sup>24</sup> Congress amended the PAEA's payment schedule to \$1.4 billion in FY 2009, no required payments in FY 2011, and \$11.1 billion in FY 2012.

To achieve our objective, we:

- Actuarially projected and compared the CSRS, FERS, and retiree health benefits liabilities for FY 2016 using Postal Service and federal government demographic and wage growth assumptions.
- Reviewed the PAEA's requirements for funding CSRS and retiree health benefits after FY 2016.
- Evaluated the reasons for the changes from surplus to deficit for the CSRS and FERS pensions between FYs 2010 and 2014.
- Recomputed Postal Service's savings from implementing an EGWP as part of its legislative proposal.
- Reviewed the Postal Service's cash flow projections for meeting payment requirements for pensions and retiree health benefits after FY 2016.
- Reviewed legislation in Congress affecting the Postal Service's retiree health benefits and pension liabilities.
- Contracted with Korn Ferry U.S. Government Consulting Services (Korn Ferry) for actuarial projections and analyses.
- Recomputed the CSRS, FERS, and retiree health benefits liabilities as projected by Korn Ferry.
- Reviewed reasons and recomputed amounts identified by Korn Ferry explaining changes in the CSRS and FERS liabilities between FYs 2010 and 2014.

We conducted this audit from January 2016 through May 2017 in accordance with generally accepted government auditing standards except for internal controls testing over the retirement programs. 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 October 27, 2016 and April 5, 2017, and included their comments where appropriate.

We did not perform tests of internal controls over the retirement programs, as it was not our objective to provide assurance on the effectiveness of the related internal controls. Absence of internal controls testing did not significantly affect our audit findings and conclusions. The scope of this audit was to project the retirement liabilities for FY 2016. We did not plan to consider or report on the reliability of the OPM's data. Therefore, we did not assess the reliability of any computer-generated data for purposes of this report.

## Prior Audit Coverage

Report Title	Objective	Report Number	Final Report Date	Monetary Impact (\$ Billions)
<i>Considerations in Structuring Estimated Liabilities</i>	To identify assumptions used to determine significant liability amounts. Also, to discuss the rationale behind identifying fair market value of real estate assets and the impact that could have on unfunded liabilities.	FT-WP-15-003	01/23/2015	None
<i>Using U.S. Postal Service-Specific Assumptions for Calculating the Retiree Health Care Liability</i>	To review the assumptions used for the Postal Service's retiree health care liability calculation and determine what effect those assumptions may have on the retiree health care liability calculation estimate.	FT-MA-13-022	9/27/2013	None
<i>Using U.S. Postal Service-Specific Assumptions for Calculating the Civil Service Retirement System Liability</i>	To review the assumptions used for the Postal Service's CSRS liability calculation and determine what effect those assumptions may have on the CSRS liability calculation estimate.	FT-MA-13-023	9/27/2013	\$1.3
<i>Using U.S. Postal Service-Specific Assumptions for Calculating the Federal Employees Retirement System Liability</i>	To review the assumptions used for the Postal Service's FERS liability calculation and determine what effect those assumptions may have on the FERS liability calculation estimate.	FT-MA-13-024	9/27/2013	\$9.48
<i>U.S. Postal Service Alternative Health Care Plan Proposal</i>	To evaluate the reasonableness of the critical assumptions and the impact on the unfunded health care obligation in management's proposal to offer its own health care benefits plan in lieu of remaining in the OPM's FEHB plan.	FI-MA-12-014	08/22/2012	None

## Appendix B: Legislation and Regulations

On January 31, 2017, H.R.756, *Postal Service Reform Act of 2017*, was introduced in the House of Representatives.<sup>25</sup> Provisions of the bill related to the audit objective include:

- Calculating the Postal Service's pension costs and liabilities using the salary growth and demographic assumptions that are specific to the Postal Service population instead of the government-wide population.
- Amortizing over 30 years and returning to the Postal Service any surplus within the Postal Service's CSRS or FERS accounts.
- Establishing separately rated Postal Service plans within the FEHB program beginning in January 2019.
- Authorizing FEHB carriers currently insuring at least 1,500 Postal Service employees and retirees, as well as any other carriers, to offer Postal Service plans.
- Requiring almost all Postal Service's employees and retirees who elect coverage through the FEHB program to enroll in one of the Postal Service's FEHB plans.
- Automatically enrolling Medicare eligible Postal Service retirees and family members in Medicare Parts A and B.
- Covering a decreasing portion of the Medicare Part B premium for current retirees transitioned into Medicare as a result of the legislation over a four-year transition period: 75 percent in the first year; 50 percent in the second year; 25 percent in the third year; and 0 percent in the fourth year.
- Requiring the Postal Service to make actuarially based retiree health benefits prefunding payments to cover 100 percent of the cost of the Postal Service's retiree health benefits liability within 40 years.
- Canceling the unpaid prefunding payments the Postal Service was obligated to pay into the PSRHBF from August 1, 2012, to September 30, 2016.
- Requiring the OPM to calculate the retiree health benefits liability using funding assumptions, as done with the CSRS and FERS liabilities.

The Senate's proposed legislation, S.2051, *Improving Postal Operations, Service, and Transparency Act of 2015*,<sup>26</sup> included the following provisions:

- Created a new Postal Service Health Benefits Program (PSHBP) within the FEHB program, to be implemented and administered by the OPM, for all Postal Service employees and annuitants.
- Required all Medicare-eligible Postal Service employees and annuitants enrolled in the PSHBP to enroll in Medicare.
- Restructured the pre-funding requirements for retiree health benefits by replacing the current schedule of annual payments to the PSRHBF with a schedule of annual installment payments that will liquidate the liability by September 30, 2056.

<sup>25</sup> The bill was reported favorably out of committee March 16, 2017.

<sup>26</sup> This is the latest proposed Senate legislation.

- Reduced the prefunding requirement for retiree health benefits to 80 percent of projected liability (currently 100 percent).
- Permitted refunds to the Postal Service for overpayments of unfunded pension obligations.
- Extended the Postal Service's payment schedule for unfunded CSRS liabilities from 25 to 40 years.

The Senate bill was not passed during the previous legislative session. We will continue to monitor the legislative activity as part of our ongoing analysis.

On December 22, 2016, the OPM proposed a rule in the *Federal Register* that included:

- Clarifying the process by which the secretary of the U.S. Department of the Treasury and the U.S. Postmaster General may file a request for the Board of Actuaries of the Civil Service Retirement System to reconsider an amount determined to be payable to the CSRDF with respect to a supplemental liability.
- Clarifying that it determines separate normal cost percentages for employees covered under FERS, FERS Revised Annuity Employees, and FERS Further Revised Annuity Employees.
- Proposing regulations to provide for the use of Postal Service-specific assumptions regarding demographic factors in the calculation of the FERS supplemental liability and in the determination of the normal cost percentage for Postal Service employees who do not fall under the category of "law enforcement officer."
- Proposing that requests for reconsideration of a supplemental liability determination filed by the treasury secretary or the Postmaster General must demonstrate a difference in the supplemental liability of at least 2 percent of the present value of future benefits calculated in OPM's computation of the supplemental liability.

The deadline for comments to the OPM on the proposed rule was February 21, 2017. We will monitor the status of this rule.

## Appendix C: Management's Comments

JOSEPH CORBETT  
CHIEF FINANCIAL OFFICER  
EXECUTIVE VICE PRESIDENT



April 20, 2017

LORI LAU DILLARD  
DIRECTOR, AUDIT OPERATIONS

SUBJECT: Draft Audit Report—Update for Measuring Pension and Retiree Health Benefits Liabilities (Report Number FT-AR-17-DRAFT)

The Postal Service agrees with the report's conclusion that utilizing postal-specific demographic and economic assumptions will lower these liabilities significantly. As this was the Postal Service's own conclusion years ago we have already sought these changes through both legislation and administrative change by the Office of Personnel Management (OPM) for multiple years.

The Postal Service strongly disagrees with the finding of monetary impact.

The first component of the monetary impact, assessed as "funds put to better use", valued by the OIG at \$4.8 billion, is the potential savings from using postal-specific assumptions to calculate retirement and retiree health benefits (RHB) liabilities, rather than the government-wide assumptions currently used by OPM. Postal Service management has no control over whether this occurs. We have been requesting that this change be made, either through legislation, or through administrative change by OPM for several years. The Postal Service cannot unilaterally make this change and therefore it is not reasonable for the Postal Service to be able to put these funds to any use other than what OPM has mandated.

Further, in the calculation of the monetary impact of this item, the OIG ignores the fact that you previously claimed \$9.48 billion in monetary impact on the FERS liability, while the current estimate is only \$4.1 billion. The OIG offsets their calculated \$3.8 billion Civil Service Retirement System (CSRS) "funds put to better use" with the \$1.3 billion previously claimed in their 2013 report. However, you fail to make the same offset for the Federal Employees Retirement System (FERS). By ignoring the overestimation of monetary impact on FERS in 2013, the OIG is overstating the monetary impact on 2017 by \$5.38 billion. The OIG agreed during the exit conference that the entire balance under consideration is an estimate and the balance changes each year through many factors. It is therefore unreasonable to say that any of these amounts could be put to better use as no one can predict the balance in the subsequent years.

The second component of the OIG's "funds put to better use" represents a suggestion that the Postal Service defer payments for the CSRS unfunded liability for one year, from 2017 to 2018. This is contrary to the OPM's position, which is that the payment is due by September 30, 2017. As the OIG is aware and we reiterated during the audit exit conference, this matter has been referred to the Department of Justice's Office of Legal Counsel (OLC); however there is no assurance that a decision will be rendered prior to the OPM-specified due date. Also, including this as funds put to better use is premature as we have not paid the amounts and could decide not to pay in 2017 or could be instructed to pay in 2017 by the OLC. Further it must be noted that deferring a \$1.23 billion payment to the Civil Service Retirement and Disability Fund by one year would increase future required annual payments by approximately \$87 million due to the accrual of additional interest on the liability.

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The draft audit report also contains obsolete information regarding payments due to the OPM in 2017. In December 2016, the OPM provided the Postal Service with a revised estimate of the amortization of the RHB liability, reducing that amount to \$0.8 billion, rather than the \$2.84 billion referenced in the draft report (although this could change).

This draft report contains one recommendation.

Recommendation 1:

We recommend the chief financial officer and executive vice president continue to work with Congress to enact legislation that more accurately and fairly addresses Postal Service retirement liability reform, including the use of Postal Service-specific assumptions in preparing the Civil Service Retirement System, Federal Employees Retirement System, and retiree health benefits liabilities and Postal Service retiree participation in Medicare.

Management Response/Action Plan:


As noted above, management has been working assiduously to alter the calculation of the CSRS and FERS liability amounts so that they are done based on postal-specific assumptions; however, enactment of any change is outside of management's control. In response to the Postal Service's filing of a number of requests for reconsideration of their calculation of the FERS unfunded liability, the OPM has recently circulated a draft rule proposing that they calculate the Postal Service's retirement liabilities using postal-specific demographic assumptions. Although not fully addressing the Postal Service's concerns, this is a positive development.

Target Implementation Date:

It cannot be determined when or if legislation affecting the calculation of pension or RHB liabilities will be enacted, or when or if the OPM will adopt its proposed rules on the use of postal-specific demographic assumptions in calculating Postal Service pension liabilities, therefore a target implementation date cannot be set.

Responsible Official:

As noted above, since calculation of the pension and RHB liabilities is outside of the Postal Service's control, there is no responsible official. It is our understanding that OIG intends to create a separate category in their *Semiannual Report to Congress* to clarify that the monetary impacts identified in this report are not under management's control.



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