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Report to the Ranking Minority Member, Committee on the Budget, House of Representatives

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BUDGET ISSUES

Budgetary Treatment of Postal Service Workers' Compensation Costs

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The Honorable Willis D. Gradison
Ranking Minority Member
Committee on the Budget
House of Representatives

Dear Mr. Gradison:

This report responds to your predecessor's request that we discuss the treatment of Postal Service workers' compensation costs. The Department of Labor makes the medical or compensation benefit payments and is subsequently reimbursed by the Postal Service, which generates revenue to pay the benefits from postal fees. We were asked specifically for information on the advisability of transferring revenues from the Postal Service's revolving fund to a dedicated trust fund and whether any such fund should be treated as on-budget or off-budget.

Results in Brief

The Service has routinely included the accrued costs of workers' compensation benefits in its rate structure. Since 1972, accrued costs have exceeded benefit payments by about $4 billion. Rather than putting these funds aside until they are needed to reimburse Labor, the Service has used them for other operating costs and investment purposes. Establishing a trust fund to reserve these and future revenues for workers' compensation benefits would not materially enhance the Service's ability to reimburse Labor. Unless it experiences a significant cost increase, the Service's substantial assets and its authority to borrow and raise postal rates minimize the risk that it will not be able to continue reimbursing Labor for benefits paid. Similarly, using these balances for other purposes will not, by itself, require increases in overall postal rates.

Accounting changes to improve the accuracy of annually accrued workers' compensation expenses and to disclose how unexpended balances are used could be either made within the current accounting system or implemented in a separate trust fund. Therefore, creating a trust fund would be primarily a policy decision to either curtail or continue existing Postal Service authority to use these accrued balances for other purposes.

If a trust fund is established, it should be on-budget. This is consistent with our general view that all federal activities, including those of the

Postal Service, should be included in budget totals. Any such fund should be established only with the proviso that its transactions not be counted as budgetary savings under the Budget Enforcement Act of 1990. Otherwise, its transactions could be viewed as gimmicks to artificially offset outlays and allow additional spending, thus reducing the potential budgetary savings enacted during late 1990.

Background

The Postal Reorganization Act of 1970 (Public Law 91-375) created the U.S. Postal Service to operate independently in a business-type environment. The Service was to (1) provide quality service and achieve financial self-sufficiency (that is, break even) over a period of years, (2) prepare a business-type budget, (3) set rates based on Postal Rate Commission recommendations, (4) retain and use postal revenues, (5) borrow for operating and investment capital, and (6) handle other organizational responsibilities.

Service revenues and expenses are channeled through a revolving fund, the Postal Service Fund. For accounting, rate-making, and internal budgeting purposes, the Service uses generally accepted accounting principles (GAAP), which include accrual-based accounting. On an accrual basis, revenues are recorded when earned and expenses are recorded when incurred regardless of when cash is received or paid. In the federal budget, the Service's activities are presented on a cash basis—receipts and expenses are recorded when cash is received or disbursed—consistent with practices for other federal departments and agencies.

The Service's budgetary status has varied. From its inception until December 1985, the executive branch administratively determined its budget status. For fiscal years 1972 and 1973, it was on-budget and thus included in the calculation of the budget surplus or deficit. It was shifted off-budget[1] in fiscal year 1974 on the premise that off-budget treatment would be more consistent with the Service's relatively independent, business-type operations. Its transfer to on-budget status in the fiscal year 1986 budget proposal was ratified by the Balanced Budget and Emergency Deficit Control Act of 1985, also known as Gramm-Rudman-Hollings (GRH). The Omnibus Budget Reconciliation Act of 1989 (Public Law 101-239) again moved it off-budget, beginning with

[1]Currently, off-budget entities are those which, according to budget concepts set forth in the 1967 Report of the President's Commission on Budget Concepts, belong on-budget and in the budget totals but have been excluded from the budget by law.

fiscal year 1990. This last shift excluded Service transactions from the GRH deficit calculations and exempted the Service from any related forced spending reductions. While these distinctions are important from the standpoint of enforcing the 1990 budget agreement, any surpluses or deficits in postal operations will affect total federal debt and interest payment obligations equally regardless of the Service's budgetary status. However, Service officials stated that the Postal Service is a "going concern" and, to the extent that it pays its operating costs out of revenues, its impact on the budget is minimal.

Like other federal civilian employees, postal workers injured on the job receive benefits under the Federal Employees Compensation Act. Labor determines eligibility and makes benefit payments. Like other federal agencies, the Postal Service reimburses Labor for administrative and benefit costs. However, these reimbursements are not financed from appropriated funds, as is the case with most agencies, but rather from postal revenues.

Postal rates for the services that generate these revenues are determined by considering previous, current, and future operating costs, including workers' compensation benefits. The workers' compensation cost component is estimated based on the net discounted present value of workers' compensation claims that have been incurred and considers factors such as the severity of injuries, age, assumed mortality, and experience trends. Annual accruals are to be sufficient to recognize the costs of future benefits for individuals injured during that year for as long as they receive benefits resulting from those injuries.[2] This financing method, based on concepts of accrual accounting, is said to provide interperiod equity, meaning that current postal users are charged for the full costs of the services that they receive, including the cost of worker injuries during that time period.

Since 1972, the annual accrual for workers' compensation benefits has substantially exceeded annual reimbursements to Labor. At the end of fiscal year 1990, the Service had accrued $7.2 billion for workers' compensation benefits, reimbursed Labor $3.1 billion, and had an outstanding liability of about $4.1 billion. Table 1 shows that annual accruals have significantly exceeded reimbursements to Labor for fiscal years 1986 through 1990.

[2]The objectives of accrual accounting require only that this cost be recognized at the time the event occurs, not that this amount be charged to customers in the year of the injury. The decision to include that cost in rates is a financial policy decision.

Table 1: Accrued Costs and Payments to Labor for Postal Service Workers' Compensation Benefits

Dollars in millions

Fiscal year	Accrued costs	Benefit payment to Labor
1986	$495	$202
1987	307	227
1988	509	235
1989	680	260
1990	753	647[a]

[a]Under the Omnibus Budget Reconciliation Act of 1989, the Service must reimburse Labor prior to the end of each fiscal year rather than shortly after the end of each fiscal year, which had been the previous requirement. Therefore, total benefit reimbursements during fiscal year 1990 included amounts for both fiscal years 1989 ($302 million) and 1990 ($345 million).

Because cash generated from the accrual for workers' compensation benefits currently exceeds yearly reimbursements to Labor and is deposited into the Service's revolving fund rather than a separate account, it becomes indistinguishable from other funds and is used for other purposes. Service officials told us that these cash surpluses are used as a general funding source for postal operations and investment in assets. Service officials stated that this is consistent with the concept of a "going concern" and that its treatment of workers' compensation costs follows generally accepted accounting principles and accepted business practices.

Objectives, Scope, and Methodology

Our first objective was to assess the arguments for and against depositing amounts the Postal Service collected for workers' compensation in a separate trust fund account. Specifically, we evaluated the effect such an action would have on

- the Service's ability to reimburse Labor for workers' compensation costs,
- postal rates,
- management prerogatives on the use of Service funds,
- the accuracy of annually accrued worker compensation costs, and
- visibility over how unexpended amounts were used.

Our second objective was to determine whether a separate trust fund, if established, should be on-budget or off-budget.

To accomplish these objectives, we examined Postal Service legislation and reports; documents obtained from the Postal Service, the Postal Rate Commission, and the Congressional Budget Office; and prior GAO studies. We also interviewed knowledgeable officials and staff of the Postal Service, the Congressional Budget Office, and the Office of Management and Budget to identify issues and arguments related to Postal Service workers' compensation. We conducted our study in Washington, D.C., between March and December 1990, in accordance with generally accepted government auditing standards. The views of responsible agency officials were sought during the course of our work and are incorporated where appropriate.

Trust Fund Would Not Affect Ability to Reimburse Labor

Some supporters of a separate trust fund[3] contend that if the accrued revenues for workers' compensation benefits continue to be used for other than their designated purpose, the Postal Service may not have funds to reimburse Labor for future benefits.[4] They state that a trust fund would help prevent such a shortfall and, thus, provide some assurance that taxpayers would not be required to subsidize postal costs.

Requiring the Postal Service to pay the accrued amounts into a Department of the Treasury or Labor trust fund would, in theory, virtually eliminate uncertainties about the Service's ability to reimburse Labor. Under this scenario, the funds could be invested in securities with the burden of raising the cash to reimburse Labor shifted from the Postal Service to the federal government as a whole. Future reimbursements to Labor would be financed through transfers from the dedicated trust fund. Another option would be to have the Postal Service set aside funds under its control that would be reserved for this purpose.

However, sound public policy does not require reserving cash to meet future obligations for this narrow segment of Service operations. Workers' compensation costs constitute a relatively small portion of the Service's costs and the Service has several readily available methods to raise funds. For these reasons, the Service will most likely be able to reimburse Labor under its present cost structure.

The annual accrual for workers' compensation benefits is small in relation to total Postal Service expenses and capital investment needs. The $753 million accrual for fiscal year 1990 represents 1.8 percent of total

[3]Establishing a trust fund in the federal government commonly means transferring receipts to Treasury in exchange for securities. These securities can be redeemed for cash in the future.

[4]There is no threat to the payment of benefits because Labor is responsible for assessing eligibility and making the payments. However, the Postal Service is required by law to reimburse Labor for benefit payments made to injured postal workers.

Postal Service expenses on an accrual basis; over the past 6 years, annual accruals have averaged about 1.5 percent.

The Postal Service has not failed to make annual payments over its 18-year history and has tangible assets and borrowing authority that could be used to generate cash if it encountered a temporary shortfall. In addition, Public Law 101-227 added $5 billion to the Service's borrowing authority, which had an unused balance of $3 billion at the end of fiscal year 1990. The dominant factors determining the Service's overall health are its monopoly for certain services, such as First-Class Mail, and its authority to raise postal rates to cover operating costs.

Service officials told us that if a trust fund were established and the entire $4 billion liability for workers' compensation benefits had to be paid in a lump sum, they would have to borrow to do so. They noted that such a requirement would add to the financial pressures imposed under the Omnibus Budget Reconciliation Act of 1990 (Public Law 101-508), which requires additional payments from the Postal Service totaling up to $4.7 billion for retirement cost-of-living allowances and post-retirement health care benefits for postal annuitants. This amount is payable over the 5-year period from fiscal years 1991 through 1995.

Trust Fund Would Not Affect Postal Rates

Another expressed concern, closely related to the cash shortage issue, was that if unexpended balances for workers' compensation benefits were not set aside in a trust fund, postal users could be "double charged" for services—initially when the accruals were included in prior year rates and subsequently to make up for any potential cash shortfall to reimburse Labor. This assertion ignores the fact that (1) the Service uses the accrual basis of accounting for rate-making purposes and (2) prudent investment decisions do not depend on the availability of cash because the Service has other financing options.

First, using excess cash generated by accruals for workers' compensation benefits would not affect future accruals for that cost element and, therefore, would not affect postal rates. As noted earlier, the annual accrued amount is based on the projected cost of paying medical and compensation benefits for those injured each year. The Service's overall cash position is not a factor in the amount of annual accruals.

Second, using excess cash for capital investments instead of borrowing for the same purpose would not materially affect overall postal rates. If funds are lost due to failed investments, future operating costs will be higher than if the investments had been successful. Costs that are higher than expected will require steeper rate hikes, but these larger increases cannot be attributed to the use of cash balances as opposed to another financing method. The same investments could have been made by borrowing or simply including capital investments in the Service's budget.

Trust Fund Would Limit Management Prerogatives

Postal officials told us that denying them access to the use of funds generated as the result of accruing workers' compensation by setting aside cash in a trust fund would decrease management flexibility, increase costs, and constitute differential treatment.

Postal officials referred to the 1971 legislation, which aimed to reduce political involvement in postal management, as support for retaining their ability to use unexpended workers' compensation balances for postal operations. While GAAP stipulate that period revenues and expenses should be matched, they neither require nor prohibit setting aside amounts equal to an accrued cost. Such a requirement could result in multiple discrete funds and substantially decrease operational and financial flexibility.

Establishing and accounting for a separate trust fund could increase Postal Service costs because the interest costs of borrowing to replace funds paid into a separate trust fund could be significant. This would occur if the interest rate on trust fund deposits was much lower than the Service's borrowing rate for replacement funds. For example, if the rates differed by 1 percentage point on the $4.1 billion unexpended balance, the Service would have to make up an additional $41 million in interest costs annually through cost-cutting measures or higher postal rates. In addition, small amounts would be needed to set up and account for any discrete fund.

With the exception of the Panama Canal Commission, government entities that charge fees to recover their operating costs do not establish separate trust funds for workers' compensation costs. The situation involving the Commission is unique because ownership of the Panama Canal is to be transferred to the Republic of Panama debt free near the turn of the century.

Accounting Accuracy Could Be Increased With or Without a Trust Fund

Over time, the Postal Rate Commission has expressed continued difficulty in identifying the various revenue and expense components associated with workers' compensation and suggested that the Service consider establishing a trust fund to provide more accurate information on the related program liability and expenses. From an accounting perspective, the Commission's basic concern was that the accrual method used did not assure that a proper amount was being charged for workers' compensation benefits each year, thus potentially overcharging in some years.

The method of accruing workers' compensation benefits is independent of the decision to establish a trust fund. This issue could be resolved only by changing the method of computing the annual and long-term accrued liability for workers' compensation costs. Addressing this concern would entail using the type of accrual method in place prior to 1982. Until then, the Service used projected health care cost trends and projected compensatory income rates to annually calculate expected cash outlays. Those amounts were then discounted based on current interest rates of certain Treasury bonds to arrive at a net present value to be factored into the rate calculations.

Since 1982, the Service has used a flat, predetermined discount rate to reflect expected long-term rates rather than current interest rates (which tend to fluctuate) to calculate the accrual. This approach is intended to generate the same revenue over the long term while eliminating large year to year cost swings which Service officials said distorted their operating results. GAO reviewed this methodology and determined that it provided a reasonable long-term estimate of annual expense. This methodology has also been reviewed and accepted by the Service's public accounting firm. However, since the Service adopted its current procedure, the Financial Accounting Standards Board has published statements on employers' accounting for pensions (No. 87, December 1985) and on accounting for postretirement benefits (No. 106, December 1990). While neither of these statements covered workers' compensation, they require using interest rates current at the time of measurement for discounting to determine the present value of similar, actuarily determined long-term obligations.

Use of Unexpended Balances Not Clear

Service officials stated that the unexpended balances were used for either general operating expenditures or investments in assets and acknowledged that their current accounting system does not identify the disposition of the balances. Added visibility over these funds could be achieved by (1) modifying the current accounting system, (2) providing this added detail in a trust fund, or (3) stipulating the uses of unexpended balances. The first two options would entail recording accounting entries showing how balances were used. The third would not prescribe any additional accounting but only restrict their use administratively.

Trust Fund May Be Appropriate for Other Liabilities

It may be prudent for the Postal Service to set funds aside for other expenses if accrued costs included in rate charges generate cash well in excess of current needs. For example, a potential exists for the accrual of post-retirement health care benefits for current postal employees under Financial Accounting Standards Board Statement No. 106 covering employers' accounting for post-retirement benefits other than pensions. If it is determined that the requirements of this statement call for the Service to change from the current cash basis to an accrual method, the accrual of post-retirement health benefits and the subsequent recovery of these accruals in the postal rates would generate far more revenue than the accrual for workers' compensation benefits. In the case of new hires, outlays would not be required for 30 or more years, thus allowing substantial balances to be built up. If such large balances remained within the Service, officials agreed that they would need to segregate them from other operating costs.

Budgetary Treatment of a Required Trust Fund

Our general view is that all federal activities, including the Postal Service, should be included in the budget and counted in annual budget deficit or surplus totals. We would also favor on-budget treatment for any separately considered trust fund for workers' compensation benefits to be administered by Treasury or Labor. Since these costs are liabilities of the federal government, it is logical that the resources to pay them should be on-budget.

Postal Service officials stated that they would prefer to retain off-budget treatment of Service activities. They said this would shelter the Service from political influence, which was one of the reasons for transferring its status in the 1989 legislation.

Creating an on-budget trust fund, would not in itself affect total federal receipts, outlays, or borrowing needs. The fund's transactions would be treated as intragovernmental transactions (transfers from one government account to another) and would have no impact on cash received from or disbursed to the public. However, any legislation authorizing a transfer of funds from off-budget to on-budget accounts could impact the outlay caps under the recently adopted Budget Enforcement Act (a component of the Omnibus Budget Reconciliation Act of 1990). In the absence of prohibiting language, the amounts transferred could be treated as a spending reduction to offset an increase in direct spending or a reduction in revenues under the pay-as-you-go[5] enforcement procedures.

Because of this possibility, such a transfer could be viewed as a gimmick to artificially offset on-budget outlays and allow additional on-budget spending or revenue reductions without triggering a sequester. In this case, the amount of the offset would depend upon whether the accumulated accrued balance ($4.1 billion at September 30, 1990) or only the annual accrual ($408 million net of reimbursements to Labor for fiscal year 1990) was transferred.

Creating an on-budget trust fund without appropriate accompanying language could result in an increased total federal deficit and debt. For example, transferring $408 million, and thus freeing up that amount under the pay-as-you-go procedures, would allow outlays to be increased or revenues to be reduced by the same amount. While such increased spending or revenue reductions would not violate the Budget Enforcement Act, the total federal deficit and the associated borrowing and debt service requirements would rise. This could be avoided by stipulating that amounts transferred may not be treated as budgetary savings under the Budget Enforcement Act. Without such instructions, this type of transaction could allow the budget savings achieved through revenue increases and spending reductions under the Omnibus Budget Reconciliation Act of 1990 to be diluted.

We are sending copies of this report to the Postmaster General, the Director of the Office of Management and Budget, the Director of the Congressional Budget Office, the Chairmen of the House and Senate

[5]Pay-as-you-go provisions of the Budget Enforcement Act require all tax and direct spending legislation to be deficit neutral in each year. Therefore, any legislation liberalizing an entitlement or reducing taxes would, if not offset by reductions in other entitlements, generate a sequester of all entitlements not specifically exempted from sequestration.

Budget Committees, and other interested congressional committees. Copies will be made available to others on request.

Please contact me on (202) 275-9573 if you or your staff have any questions. Major contributors to this report are listed in appendix I.

Sincerely yours,

James L. Kirkman
Director, Budget Issues

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