United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Treasury, Postal Service, and General Government, Committee on Appropriations, House of Representatives

July 1993

FINANCIAL MANAGEMENT

Estimate of Interest on Selected Benefits Received by Postal Service Retirees

149847

RESTRICTED--Not to be released outside the General Accounting Office unless specifically approved by the Office of Congressional Relations.

557681 RELEASED

GAO

United States
General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

B-253629

July 29, 1993

The Honorable Steny H. Hoyer
Chairman, Subcommittee on Treasury, Postal
Service, and General Government
Committee on Appropriations
House of Representatives

Dear Mr. Chairman:

This report is in response to your March 11, 1993, request and subsequent discussions with your office. The Omnibus Budget Reconciliation Act (OBRA) of 1990 required the Postal Service to reimburse the government for certain cost-of-living adjustments (COLAS) and health benefits Service retirees received during fiscal years 1972 through 1990. As requested, we prepared independent estimates of interest on the amounts the 1990 OBRA required the Service to pay and compared our estimates with the amounts contained in the President's 1994 budget proposal.

Results in Brief

We estimated a total of $1,728.5 million in interest, $782.5 million higher than the $946 million contained in the President's proposal. The estimates differed because of the choice of interest rates and principal balances used in the calculations. Over the period covered by the calculations, our interest rates averaged about 9 percent annually for COLAS and about 8 percent annually for health benefits, whereas 5 percent was used in calculating amounts in the President's proposal. We applied our calculated interest rates to the $2.1 billion included in the 1990 OBRA, while the amount included in the budget was based on a higher $3.0 billion figure calculated by the administration.

Background

The Postal Reorganization Act, enacted in 1970 (Public Law 91-375), created the U.S. Postal Service, which replaced the Post Office Department. The Postal Service began operations July 1, 1971, the beginning of fiscal year 1972. It was to operate as an independent, business-type entity and was to (1) provide quality service and achieve financial self-sufficiency (that is, break even) over a period of years, (2) set rates based on Postal Rate Commission recommendations, (3) retain and use postal revenues, and (4) borrow for operating and investment capital.

Retroactive Payments of COLAs and Health Benefits

For the service period[1] July 1, 1971, through September 30, 1986, the government's share of the Postal Service retirees' COLAS and health care costs were paid through annual appropriations to the Civil Service Fund and the Federal Employees Health Benefits Plan (FEHBP) Fund, respectively. However, as a result of the OBRA of 1990, the Postal Service was required to reimburse those funds retroactively for postretirement COLAS and health care costs paid to or on behalf of Service retirees for that service period. Also, beginning in fiscal year 1991, the 1990 OBRA required the Service to periodically pay the costs related to that service period for all future years. Costs related to post-fiscal year 1986 service periods are covered by other legislation.

The OBRA of 1990 specified that $1,685 million be paid to the Civil Service Retirement and Disability Fund and that $455 million be paid to the FEHBP over a 5-year period beginning in fiscal year 1991. The $1,685 million represented COLAS provided by the Civil Service Fund to Postal Service retirees during fiscal years 1972 through 1990[2] and the $455 million represented postretirement health care benefits provided by FEHBP on behalf of Postal Service retirees during the same period.

Proposed Payments

The President's 1994 budget proposes that the Postal Service reimburse the government additional amounts for COLAS and health benefits paid Postal Service retirees between fiscal years 1972 through 1990, covering the service period of fiscal years 1972 through 1986. Currently, the Service is not required by law to make any payments in addition to the $1,685 million or $455 million in either interest or principal related to that service period. The administration's proposal specifies an additional $630 million to be paid to the Civil Service Fund and $316 million to be paid to FEHBP beginning in fiscal year 1995. The proposal assumes that these amounts and the existing legislated reimbursements of $1,685 million and $455 million represent the full cost of benefits that retirees received applicable to that service period.

Objectives, Scope, and Methodology

Our objectives were to (1) estimate the amount of interest on the $1,685 million related to COLAS and $455 million related to health benefits

[1]Service period refers to the period worked by employees in which postretirement benefits (in this case, COLAs and health care) were earned or to which benefits are attributable.

[2]This report refers to three periods: (1) the service period described in footnote 1 relates to fiscal years 1972 through 1986, (2) the period during which benefits were paid, fiscal years 1972 through 1990, and (3) the period for which we estimated interest, fiscal years 1972 through 1992.

and (2) compare our estimated interest amount with the related amounts contained in the President's 1994 budget proposal. We did not attempt to determine the actual amounts of benefits related to the fiscal years 1972 through 1986 service period paid to Postal Service retirees.

In order to estimate the interest amount, we (1) used interest rates that approximated the prevailing rates earned on the balances of government securities held by the two funds when payments were made by those funds to or on behalf of Postal Service retirees during fiscal years 1972 through 1990, (2) allocated portions of the $1,685 million and $455 million, representing the principal amounts of benefits provided to Service retirees, to each fiscal year during that period, based on the relative allocations contained in the estimates originally prepared for consideration during the passage of the 1990 OBRA, (3) calculated the yearly interest on a monthly basis with semiannual compounding of interest, and (4) added all the years' interest to obtain a total estimated amount.

To compare the interest amount we estimated and the amounts contained in the President's proposal, we identified the assumptions and techniques used in determining the amounts cited in the President's proposal.

We conducted our study in Washington, D.C., from April through June 1993, in accordance with generally accepted government auditing standards. We met with the Postal Service to discuss our estimates and included their comments, where applicable, in our report.

Estimated Interest Exceeds the Amount in the President's 1994 Budget Proposal

As shown in table 1, we estimated the total interest to be $1,728.5 million, which exceeds the amounts contained in the President's 1994 budget proposal by $782.5 million. Appendix I contains a detailed description of our assumptions and the methodology we used in calculating the interest. Appendix II lists the annual estimated interest.

Table 1: Estimated Interest Amounts Calculated by GAO Compared to the Amounts in the President's 1994 Budget Proposal

Dollars in millions

	GAO calculations	President's 1994 budget proposal	Difference
COLAs	$1,465.6	$630	$835.6
Health benefits	262.9	316	(53.1)
Total	**$ 1,728.5**	**$ 946**	**$ 782.5**

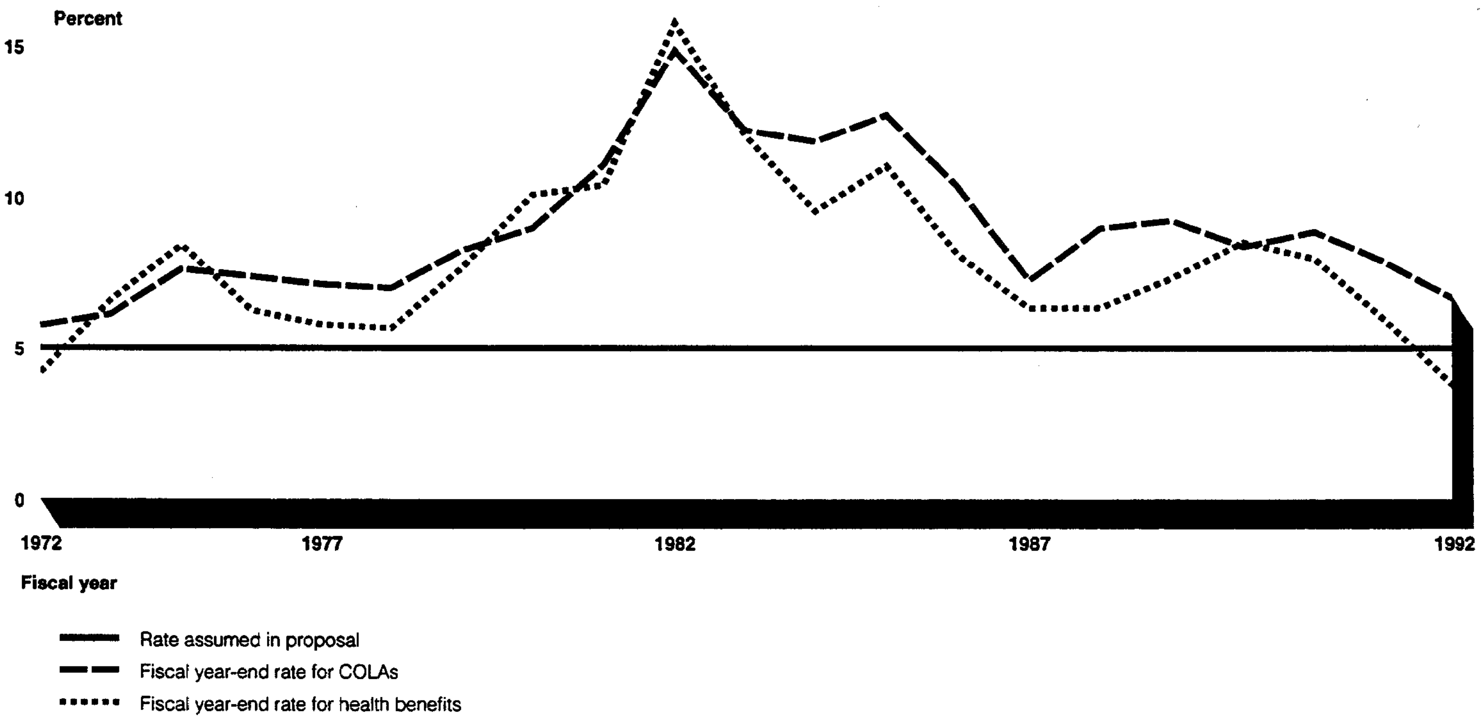
The two primary reasons for the difference are (1) the interest rates used and (2) the principal amounts representing payments made to or on behalf of Postal Service retirees.

Lower Interest Rates Were Used in Determining the President's Proposed Amounts

In determining the amount to include in the President's 1994 proposed budget, a 5-percent interest rate was used for each fiscal year for both the COLAS and health benefits, primarily because the Office of Personnel Management (OPM) uses this rate in long-term actuarial determinations. The interest rates used in our calculations—which were based on the average interest rate on each fund's outstanding balance during the last month of each fiscal year—were significantly higher. We applied the fiscal year-end rates to each year's payments. In essence, our calculations show the amount of interest that would have been earned by the funds had the payment amounts been available for investment. During the 21-year period, the average rate for the Civil Service Fund which financed the COLAS was about 9 percent and ranged from a low of 6.125 percent to a high of 14.875 percent. For the same period, the average rate for the FEHBP Fund was about 8 percent, with a range of from 3.712 percent to 15.781 percent.

Figure 1 shows the interest rates we used for the 21-year period compared to the 5 percent used in the President's proposal.

Figure 1: Comparison of Interest Rates Used for Fiscal Years 1972 Through 1992



Different Estimated Principal Amounts Were Used

The principal amounts represent the costs of COLAS and health benefits received by Postal Service retirees during fiscal years 1972 through 1990 for the service period of fiscal years 1972 through 1986. The principal amounts used in our calculations were the $1,685 million representing COLAS and the $455 million representing health benefits, both contained in the 1990 OBRA. We chose these amounts because they were contained in law.

However, the principal amounts used in determining the President's proposed budget amounts were higher. The President's proposal used amounts originally determined as a basis for legislative consideration during the passage of the 1990 OBRA. The amounts were determined by the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO) with input from OPM. The principal amounts for COLAS was $1,947 million and for health benefits, $1,087 million. However, numerous adjustments—primarily credits allowed for Postal Service payments pursuant to other OBRAS—reduced those amounts to the $1,685 million and $455 million in the 1990 OBRA.

As shown in table 2, the amounts contained in the President's 1994 proposal were determined by (1) calculating an approximate annual 5-percent interest on each year's allocated portion of the total principal amounts of $1,947 million for COLAs and $1,087 million for health benefits, and compounding the interest annually, (2) summing the principal and total interest, and (3) subtracting the $1,685 million and $455 million contained in the 1990 OBRA and other credits and related interest on payments made (or to be made) by the Service pursuant to the 1990 OBRA and other OBRAs.

Table 2: Interest To Be Paid by the Postal Service as Calculated for the President's 1994 Budget Proposal

Dollars in millions

	COLAs	Health benefits
Principal	$ 1,947	$ 1,087
Interest	977	500
Subtotal	2,924	1,587
Less credits:		
1990 OBRA	(1,685)	(455)
Other[a]	(609)	(816)
Amounts contained in the proposal	**$ 630**	**$ 316**

[a]This amount includes credits allowed from the 1986 and 1987 OBRAs and related interest as well as interest related to the reimbursed portions of the $1,685 million and $455 million, per the 1990 OBRA.

Even though the higher principal amounts increased the amounts contained in the President's proposal, the higher interest rates used in our calculations resulted in a higher overall interest amount. The principal amount related to COLAs used in the proposal was $262 million more than the $1,685 million used in our calculations. However, the higher interest rate we used yielded $835.6 million more in interest than the amount contained in the proposed President's budget.

The opposite was true for health benefits. The principal used in deriving the amounts in the proposal was $632 million higher than the $455 million we used. However, even though our average annual interest rate was about 3 percent higher than the 5 percent used in the proposal, the higher principal used in the proposal yielded $53.1 million more than our calculations.

As agreed with your office, unless you publicly announce the contents of this report earlier, we will not distribute it until 30 days from the date of this letter. At that time, we will send copies to the Postmaster General; the Director of the Office of Management and Budget; the Director of the Congressional Budget Office; the Chairmen and Ranking Minority Members of the House and Senate Appropriations Committees, House and Senate Budget Committees, House Post Office and Civil Service Committee, Senate Governmental Affairs Committee, House Committee on Government Operations, Senate Subcommittee on Treasury, Postal Service, and General Government of the Committee on Appropriations, and Senate Subcommittee on Federal Services, Postal Services, and Civil Service of the Committee on Governmental Affairs; the Ranking Minority Member of the House Subcommittee on Treasury, Postal Service, and General Government of the Committee on Appropriations; and other interested congressional committees. Copies will be made available to others on request.

Please contact me at (202) 512-8549 if you or your staff have any questions concerning this report. Major contributors to this report are listed in appendix III.

Sincerely yours,

John W. Hill Jr.

John W. Hill, Jr.
Director, Audit Support and
Analysis Group

Contents

Abbreviations

CBO	Congressional Budget Office
COLA	cost-of-living adjustment
FEHBP	Federal Employees Health Benefit Plan
OBRA	Omnibus Budget Reconciliation Act
OMB	Office of Management and Budget
OPM	Office of Personnel Management

GAO Assumptions and Methodology for Interest Calculation

The assumptions we made and the methodology we used in calculating the interest amount reflect existing interest rates and principal payments made from fiscal years 1972 through 1992, when the Civil Service Fund and FEHBP made payments to or on behalf of Postal Service retirees. We believe these amounts reasonably approximate the interest.

Assumptions Made on the Principal

The principal amounts we assumed—$1,685 million for COLAS and $455 million for health benefits—were the amounts contained in the 1990 OBRA that the Postal Service was required to pay. We assumed that these amounts represented the principal amount of payments made to or on behalf of Postal Service retirees by the two funds. Although these amounts may actually include interest as well as principal, we chose them because they had gone through the scrutiny of the legislative process and are contained in law.

In estimating the principal amounts for consideration during the passage of the 1990 OBRA, OMB and CBO obtained input from OPM (administrators of both the Civil Service Fund and FEHBP) and employed actuarial techniques and present value computations. The original amounts estimated were $1,947 million for COLAS and $1,087 million for health benefits. However, the Congress reduced these amounts, primarily by numerous credits allowed for previous OBRAS, to arrive at the $1,685 million and $455 million.

The original OMB and CBO principal estimates were calculated on a fiscal year basis. We allocated the $1,685 million and $455 million to each of the fiscal years based on the same relative annual amounts contained in the original OMB and CBO principal estimates. In addition, the allocation of the $1,685 million included adjustments for the 15-year period during which OPM normally amortizes the COLAS.

Assumptions Made on the Interest Rates

We selected two interest rates, one applicable to the Civil Service Fund and one to FEHBP, rather than one rate applicable to overall government borrowings. We used the rates applicable to both funds because they financed the benefits received by the Postal Service retirees.

In operation, these funds invest in various Treasury securities when payments are received and redeem the securities back to Treasury to acquire cash for required benefit payments. Consequently, the interest rates applicable to the $1,685 million and the $455 million represent, in effect, the interest earnings lost because these amounts were unavailable for investment.

The interest rate used on the $1,685 million applicable to the Civil Service Fund was the rate applicable for its investments. All excess Civil Service Fund receipts are required to be invested in nonmarketable Treasury securities, commonly referred to as par value specials, and can be redeemed at any time at their face, or "par." The interest rate for these securities is based on the average rate for comparable marketable securities, as defined by Treasury, with 4 or more years to maturity. This rate is determined monthly and all investments during the month must bear the same rate. Although the interest rate is subject to monthly fluctuations, we used the fiscal year-end rate, because at fiscal year-end[3] the Civil Service Fund receives from the Postal Service a lump-sum payment for certain specified liabilities in accordance with 39 U.S.C. 1005(d) and 5 U.S.C. 8348(m). Also, we compounded the interest semiannually on June 30 and December 31, because interest on the trust fund investments is compounded on those dates.

Unlike the Civil Service Fund, FEHBP is not allowed to invest in par value specials. Instead, its excess funds are invested in nonmarketable Treasury securities that correspond to securities that Treasury has issued to the public. The investments available to FEHBP carry several interest rates and maturity periods. The three main types of investments are Treasury bills which mature in 1 year or less, notes which mature between 1 year and 10 years, and bonds with maturity dates beyond 10 years. We assumed FEHBP would have purchased Treasury bills.

Treasury bills have three basic maturities: 91 days, 182 days, and 364 days. However, we selected the average yield rate during the last month of the fiscal year on the Treasury bills. This rate is based on an average yield of the three maturities. Also, over the 21-year period covered by our calculations, the Treasury bill rate was lower than the yields on (1) 3-year bonds and notes and (2) 10-year-and-beyond bonds, resulting in the lowest calculated interest amount. Since all investments, except 91-day and 364-day bills, pay interest semiannually, we compounded the interest semiannually. Although the semiannual payment date may vary, we used June 30 and December 31 for consistency with the Civil Service Fund.

[3]Fiscal years 1972 through 1975 were 12-month periods ending June 30; fiscal year 1976 was a 15-month period ending September 30; and fiscal years 1977 through 1992 were 12-month periods ending September 30.

Annual Estimated Interest

We calculated each fiscal year's interest, on a monthly basis, separately for the COLAS and health benefits and then added the monthly amounts to arrive at a total for each year. Each month's calculation involved dividing the related year's interest rate by 12 and multiplying it by the sum of three figures. The first figure was one-twelfth of the annual allocated amount of principal.[4] For simplicity, we assumed that payments were made from the Civil Service Fund and FEHBP in equal monthly amounts. The second figure was the accumulated amounts of all prior periods' allocated principal less any related repayments made in accordance with the 1990 OBRA. The third figure was the amount of the monthly accrued interest compounded semiannually.

Because (1) interest is calculated monthly and compounded semiannually and (2) the prior periods' principal is added to each period's principal for the interest calculation, interest amounts in these tables cannot be derived by simply multiplying the annual allocated principal by the related years interest rate. The estimated interest related to COLAS and health benefits appears in tables II.1 and II.2, respectively.

[4]There were two exceptions. Fiscal year 1976 covered a 15-month period, making the fraction one-fifteenth. Fiscal year 1973 covered only a 6-month period (for COLAs only), making the fraction one-sixth.

Table II.1: Interest Related to COLAs Paid to or on Behalf of Postal Service Retirees for the Service Period for Fiscal Years 1972 Through 1986

Dollars in thousands

Fiscal year	Annual allocated principal	Interest rate (percent)	Interest
1972	$ [a]	[a]	$ [a]
1973[b]	168.5	6.125	3.0
1974	1,516.5	7.625	76.6
1975	4,381.0	7.375	309.3
1976	8,762.0	7.125	1,015.1
1977	14,322.5	7.000	1,706.2
1978	20,388.5	8.250	3,643.9
1979	29,487.5	9.000	6,644.9
1980	47,180.0	11.125	13,485.3
1981	69,759.0	14.875	29,453.9
1982	94,023.0	12.250	38,188.2
1983	120,646.0	11.875	54,943.0
1984	125,532.5	12.750	82,612.9
1985	142,214.0	10.375	89,806.1
1986	148,617.0	7.250	79,610.5
1987	156,031.0	9.000	120,914.0
1988	187,709.0	9.250	152,067.7
1989	231,013.5	8.375	168,335.4
1990	283,248.5	8.875	217,536.6
1991	[a]	7.875	220,326.2
1992	[a]	6.625	184,966.6
Total	**$1,685,000.0**		**$1,465,645.4**

[a]We did not calculate this interest amount because the fiscal year 1972 Postal Service Retirees' COLA was not included in the OBRA of 1990.

[b]Interest was calculated for only 6 months in fiscal year 1973 since at that time COLAs were paid on the calendar year basis, and the calendar year began in January.

[c]Beginning in fiscal year 1991, the 1990 OBRA required the Service to pay the costs related to the service period 1972-86, periodically, in all future years.

Table II.2: Interest Related to Health Benefits Paid on Behalf of Postal Service Retirees for the Service Period for Fiscal Years 1972 Through 1986

Dollars in thousands

Fiscal year	Annual allocated principal	Interest rate (percent)	Interest
1972	$ 45.5	4.188	$ 1.0
1973	227.5	6.591	11.3
1974	500.5	8.416	47.6
1975	864.5	6.253	82.5
1976	1,456.0	5.784	188.7
1977	1,547.0	5.656	244.4
1978	4,368.0	7.668	592.2
1979	6,097.0	10.110	1,396.8
1980	8,372.0	10.436	2,375.3
1981	12,421.5	15.781	5,770.7
1982	17,017.0	12.089	6,932.1
1983	23,569.0	9.560	8,138.8
1984	32,077.5	11.069	13,607.9
1985	39,903.5	8.113	14,005.6
1986	45,136.0	6.324	14,518.2
1987	47,729.5	6.338	18,496.2
1988	59,696.0	7.329	26,878.4
1989	76,667.5	8.527	39,707.4
1990	77,304.5	7.976	46,548.5
1991	[a]	5.954	39,503.8
1992	[a]	3.712	23,863.0
Total	**$455,000.0**		**$262,910.4**

[a]Beginning in fiscal year 1991, the 1990 OBRA required the Service to pay the costs related to the service period 1972-86, periodically, in all future years.

Major Contributors to This Report

Accounting and Information Management Division, Washington, D.C.

Bruce Michelson, Assistant Director
Gordon Filler, Evaluator-in-Charge
John C. Martin, Advisor

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1000
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000
or by using fax number (301) 258-4066.

United States
General Accounting Office
Washington, D.C. 20548

Official Business
Penalty for Private Use $300

First-Class Mail
Postage & Fees Paid
GAO
Permit No. G100