Backgrounder

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USPS (Non)Disclosure: Time to Bring in the SEC

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> *[T]he era of low standards…is over…. [T]here will not be a different ethical standard for corporate America than the standard that applies to everyone else.*
>
> *—George W. Bush, on signing the Sarbanes–Oxley Act of 2002*

The markets reeled last year from accounting scandals in the corporate world, at firms ranging from Enron and WorldCom to Tyco International and Global Crossing. America's politicians decried the state of corporate accounting and demanded more transparency, disclosure, honesty, and integrity in bookkeeping. Congress swiftly passed the Sarbanes–Oxley Act to stiffen accounting regulations, requiring—among other things—that each firm's chief executive officer (CEO) personally vouch for the firm's financial statements.

However, these new regulations, like most preexisting ones, apply only to private-sector, publicly traded companies. Yet other firms can also be vulnerable to lax, misleading, or fraudulent accounting—as recent revelations at government-sponsored Freddie Mac have shown.[1] Firms that are owned directly by the government may be even *more* susceptible to accounting woes, given the absence of stockholders to keep an eye on management.

1. Freddie Mac reported in June 2003 that it had underreported profits by some $4.5 billion.

- The U.S. Postal Service (USPS) accounts for 0.75 percent of the U.S. gross domestic product and is the second largest civilian employer.
- Due to increasing use of e-mail and other electronic alternatives, USPS mail volume has declined in recent years, leading to financial difficulty for the USPS.
- In a comprehensive November 2002 report, the GAO found significant problems in the Postal Service's financial reporting.
- Requiring the Postal Service to comply with SEC reporting requirements would be a useful short-term step.
- Ultimately, reform will require substantial structural changes, including privatization and elimination of the Postal Service's monopoly on letter mail.

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In this regard, the United States Postal Service (USPS) deserves particular attention. The Postal Service's budget for 2002 was about $67 billion, which is almost 0.75 percent of the U.S. gross domestic product (GDP). The USPS is the second largest civilian employer with 854,000 employees and a significant part of the $900 billion mailing industry.[2] Given the Postal Service's role in the economy and the investment by U.S. taxpayers in the Postal Service, it is critical that taxpayers have accurate and sufficient information so that they can fully understand the Postal Service's financial viability and assess its progress toward its goals.

Yet the USPS has had substantial difficulty in maintaining and reporting full and accurate accounting information, as documented in several recent reports by the U.S. General Accounting Office (GAO). For instance, in recent years, its financial estimates have fluctuated wildly. The USPS initially estimated its fiscal year (FY) 2001 budget deficit at $480 million, and this figure was approved by the USPS board in November 2000; then, just three months later, it grew to an estimated $2 billion–$3 billion. The next year, the Postal Service's estimated deficit of $1.35 billion grew to $4.5 billion only six months later.

In light of these problems, in July, the President's Commission on the United States Postal Service—a nine-member commission created by President George W. Bush to recommend Postal Service reforms—urged steps to improve financial transparency.[3] Specifically, the commission urged that the USPS voluntarily comply with Securities and Exchange Commission (SEC) reporting requirements.

This is a step in the right direction, but it does not go far enough. Compliance with SEC requirements should be mandated by law, rather than be voluntary, and enforced by the SEC, with its full menu of sanctions.[4]

By itself, this single step will not solve the problems of the Postal Service. Ultimately, reform will require substantial structural changes, including privatization and elimination of the Postal Service's monopoly on letter mail.[5] Such changes are critical and would help reinforce accountability as well as provide other benefits. Nevertheless, extending SEC reporting rules is a step in the right direction, and one that could be achieved quickly while the debate over broader structural reform continues.

GAO Investigations

In a comprehensive November 2002 report, the General Accounting Office found significant problems in the Postal Service's financial reporting.[6] It concluded that the USPS had failed to provide sufficient and timely information on its financial condition and outlook.

One sign of trouble at the USPS, noted by the GAO, has been its changing financial estimates. Due to increasing use of e-mail and other electronic alternatives, USPS mail volume has declined in recent years, leading to financial difficulty for the USPS.[7] The Postal Service's consistent misestimates of expected returns have only made the problem worse. For instance, the Postal Service's estimate of its FY 2001 budget deficit was $480 million in November 2000 but grew to an estimated $2 billion–$3 billion only three months later. The final deficit was $1.7 billion. The next year, the esti-

2. U.S. General Accounting Office, *Major Management Challenges and Program Risks: U.S. Postal Service*, GAO–03–118, January 2003, p. 2.
3. For a general assessment of the commission's recommendations, see James L. Gattuso, "Addressing Reform: Report of the President's Commission on the U.S. Postal Service," Heritage Foundation *Executive Memorandum* No. 898, August 21, 2003.
4. Moreover, because of its monopoly status, financial disclosure (at least to regulators) should actually go beyond SEC requirements.
5. See James L. Gattuso, "Comments of James L. Gattuso to the President's Commission on the United States Postal Service," Heritage Foundation *Web Memo* No. 206, February 14, 2003, at *www.heritage.org/Research/GovernmentReform/WM206.cfm*.
6. U.S. General Accounting Office, *U.S. Postal Service: Actions to Improve Its Financial Reporting*, GAO–03–26R, November 13, 2002.
7. See James L. Gattuso, "Real Transformation Needed at Postal Service," Heritage Foundation *Executive Memorandum* No. 821, June 28, 2002.

mated $1.35 billion deficit for FY 2002 grew to $4.5 billion only six months later.[8] The final 2002 deficit was $676 million.

The GAO report concluded that whatever the reason for these and other misestimates, USPS financial reporting provided no way either to anticipate the changes or to judge the reliability of the original estimates. In making its case, the GAO focused on the USPS's quarterly financial reports. The Securities and Exchange Commission requires that publicly traded companies issue such reports and include in them a discussion of the firm's financial condition and results of operations. Although not subject to SEC rules, the USPS also issues such reports, but the GAO found these reports inadequate.

In determining this, the GAO compared USPS quarterly reports to those filed by UPS and FedEx, two major private firms in the delivery business. It found that the private-sector reports were consistently more detailed and provided better information on the firm's financial standing and prospects. While many of the differences appeared cosmetic, technical details of reporting—such as the lack of explanatory footnotes in the USPS reports—can determine whether a report conveys an accurate picture of a firm's position.

The GAO also found that USPS reports have not been "consistent in format and content, or as readily available to the public" as those of other firms.[9] Again, while at first glance this may appear to be nit-picking detail, conventional uniformity can be critical to a correct understanding of the financial picture. As the GAO put it, "Sufficient, consistent, and accessible financial information helps provide the necessary transparency and accountability that are fundamental principles in ensuring public confidence in an organization and proper oversight."[10]

This was not the only major flaw in the Postal Service's information releases. The GAO also criticized the Postal Service for not providing information on future or contingent liabilities. UPS and FedEx, it pointed out, discuss such liabilities in considerable detail, while the USPS did not. For example, in the wake of the 2001 anthrax attacks, the USPS did not disclose or discuss the estimated $4 billion needed over the next several years to address the threat, leaving readers uninformed of an expenditure that would materially affect future results.[11]

The "Postal Year"

In addition to inadequate reporting of information, the Postal Service uses methods of compiling information that raise artificial barriers to analysis of postal activities. For example, the USPS maintains budget data in a unique 52-week "postal year format" that defies understanding, comparisons, and interpretation. Each "postal year" has the same number of days each year (364). The 364 days are divided into 13 "months" of four seven-day weeks. For this reason, the postal year starts and ends on a different calendar day each year and rotates counterclockwise around the regular calendar year. The first, second, and third quarters contain three "months" each, while the fourth quarter contains four "months."

Even if the Postal Service wanted to make comparisons by "years," "quarters," or "months," this time format would frustrate the attempt. The strong seasonal component of postal activities is buried in the iconoclastic "postal year" because holidays do not occur at the same time in each postal year. Furthermore, this postal year defies comparability with non-postal data. One might think that this data system was designed to prevent measurement, analysis, and comparisons of postal operations over time or with other economic data. The USPS recently

8. U.S. General Accounting Office, *U.S. Postal Service: Actions to Improve Its Financial Reporting*, p. 1.

9. *Ibid.*, p. 4. Last year's report was only one of many in which the GAO faulted Postal Service accounting practice. In a number of reports over the past several years, the GAO had criticized the Postal Service for inadequacies in financial reporting.

10. U.S. General Accounting Office, *U.S. Postal Service: Actions to Improve Its Financial Reporting*, p. 6.

11. *Ibid.*, p. 12. For more information on financial accounting difficulties at the USPS, see Michael Schuyler, "New GAO Study Indicates Need for More Financial Transparency at the Postal Service," Institute for Research on the Economics of Taxation *Advisory* No. 144, December 11, 2002, and Charles Guy, "Proposed Revamping of USPS Retirement Obligations Is Good News, But Highlights Need for Better Financial Reporting," Lexington Institute *Issue Brief*, November 19, 2002.

committed to a more traditional fiscal year accounting, but the longtime use of the postal year system underscores the overall lack of transparency in USPS accounting.[12]

Disclosure and Accountability in the Private Sector

The lack of transparency and accuracy in USPS finances stands in marked contrast to the recent drive for better reporting in the private sector. There has been wide agreement among the public and policymakers over the past year on the need to strengthen and enforce accounting standards. In response to accounting problems in the private sector, legislative efforts have sought to strengthen disclosure, accountability, and the usefulness of financial information in both the public and private sectors.

The key legislation resulting from these efforts has been the Sarbanes–Oxley Act of 2002, which required greater accuracy and reliability of corporate disclosures and imposed sanctions. Among other changes, CEOs now incur personal liability in signing financial statements for their corporations. Specifically, CEOs and chief financial officers must personally vouch that their company's financial statements are accurate, to the best of their knowledge. They must also certify that they understand their firm's statements, have discussed the information with the firm's audit committee, and have made every effort to ensure the statement's accuracy before release.

These new requirements are in addition to preexisting SEC financial disclosure and accounting requirements for private, publicly traded firms. Among these are:

- An annual 10-K report detailing information on—among other things—the firm's financial situation, assets, management structure, pending legal proceedings, and material contracts.
- Quarterly 10-Q reports providing information to supplement the annual 10-K forms. These provide interim financial statements, discussions of the firm's financial condition, and comparisons to prior quarters. The GAO study of the Postal Service was based on these forms.
- Form 8-K reports on current conditions. The disclosures on this form are required within a few days of an extraordinary event, such as a merger or bankruptcy.

All of these disclosure forms are available to the public, not just shareholders. In addition to SEC requirements, firms are subject to state rules and regulations on corporations regarding such things as independent boards of directors and requirements that independent firms conduct audits.

The Postal Service is not required either to prepare any of these forms or, more important, to disclose the information that would be contained in them to the public. As discussed above, the USPS voluntarily prepares some reports similar to those required by the SEC—such as quarterly financial statements—but the information falls far short of the standards for private-sector firms.

What Needs To Be Done

American taxpayers, as owners of the Postal Service, deserve the same protections and access to information as shareholders in private, publicly traded firms. To this end, the recent report of the President's Commission on the United States Postal Service recommends that the USPS "voluntarily comply with applicable Securities and Exchange Commission reporting requirements."[13]

This is a positive step, but it falls short of the mark. Voluntary acceptance of reporting requirements would arguably leave the USPS with final discretion as to what and how to disclose, and it would leave penalties and other sanctions for inadequate performance unclear. Potentially, the Postal Regulatory Commission (PRC), a new body that the commission recommends be created, could exercise such powers as part of a general regulatory authority over the USPS. Even this, however, is less than satisfactory. The new PRC would doubtless be expert in postal, not financial accounting, matters and would therefore be poorly positioned to enforce rules that are essentially SEC rules.

12. U.S. General Accounting Office, *U.S. Postal Service: Actions to Improve Its Financial Reporting*, p. 4, footnote 8.

13. President's Commission on the United States Postal Service, *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service*, July 31, 2003, p. 50.

Instead, the USPS should explicitly be treated as private-sector firms are treated. Congress should specifically require that the USPS fully comply with Securities and Exchange Commission reporting requirements, including the requirements of the new Sarbanes–Oxley Act. To ensure compliance, the SEC should be granted the same enforcement authority over the USPS that it has over private companies, including the ability to impose financial penalties and seek injunctions in court to forbid or mandate actions.

Such steps could be undertaken as a stand-alone reform, without other changes in USPS structure and management. Fannie Mae, for instance, subjected itself voluntarily to SEC reporting and disclosure requirements last year.[14]

Of course, this step—whether voluntary or mandated by Congress—would still leave the USPS under *less* pressure to provide full information than other firms, primarily because the USPS lacks stockholders. For publicly traded firms, stockholders contribute substantially to creating accountability because they have a vested interest in demanding information from management and spurring outside analysis of the firm's performance. Perhaps most important, shareholders provide continuous signals concerning a firm's performance through changes in share prices.

However, for a stock to trade and achieve these positive benefits, investors must have some prospect of a positive return. Yet, at the moment, there is little consensus that the USPS should even have profit-making as a goal, and the payment of dividends would be extremely difficult as a practical matter in the current environment. Policymakers should work on resolving these and other impediments to private stock ownership of some or all of the USPS. In the meantime, imposition of SEC disclosure rules would still provide significant benefits.

SEC reporting rules, it should be noted, are not the only reporting rules to which the USPS should be subject. Because of its monopoly on letter mail and the consequent possibility that the USPS could "cross-subsidize" competitive services with income from its monopoly services, it is important that the Postal Service be subject to extensive cost and revenue reporting beyond SEC requirements. The proposed new Postal Regulatory Commission would have substantial powers to collect such information, unlike the Postal Rate Commission—the current regulator—whose authority is limited. This information would be for PRC purposes and not necessarily available to the public. The purpose of such reporting is, of course, very different from the purpose of SEC reporting and very specific to the Postal Service, but it is also important.

Conclusion

The U.S. Postal Service needs reform. In order to have the incentive and ability to compete in today's marketplace, the Postal Service should be subject to the same pressures, incentives, and requirements as private firms. Ultimately, this should involve the abolition of the Postal Service's legal monopoly on letter mail and the privatization of the organization.[15]

In the meantime, however, some modest steps could be taken immediately. Among these is improving the Service's financial integrity and accountability by placing it under the same SEC requirements as those that apply to private-sector firms. Such action would help protect both the U.S. taxpayer and postal consumers. They deserve no less.

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14. Although its underlying statutory exemption from SEC rules was not changed, the SEC views this as a binding commitment. Freddie Mac entered into a similar commitment but has not followed through with it. The commitment does not extend to SEC securities registration requirements.

15. For more information on this issue, see Douglas K. Adie, "A Free Market Critique of Postal Reform," in Edward L. Hudgins, ed., *Mail @ the Millennium: Will the Postal Service Go Private?* (Washington, D.C.: Cato Institute, 2000), pp. 211–221.