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RELEASED

**Examination Into The Rationale
For Engaging A Firm Of Certified
Public Accountants** B-114874

United States Postal Service

**BY THE COMPTROLLER GENERAL
OF THE UNITED STATES**

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SEPT 7, 1972



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D C 20548

B-114874

Dear Mr Gross

AGC 00052

In response to your request of November 3, 1971, we have examined into the United States Postal Service's rationale for engaging a firm of certified public accountants (CPAs) and the cost and adequacy of the firm's work

Our examination included discussions with officials of the Postal Service and with officials of some of the firms considered for selection by the Postal Service. We also examined various contract data and documents. The results of our examination are summarized in this letter and are presented in greater detail in the report

DLG01256

The Postal Service engaged the CPA firm of Ernst & Ernst to (1) examine, and express an opinion on, the Postal Service's statement of financial condition as of July 1, 1971, for use in marketing its first bond issue, (2) examine, and express an opinion on, the Postal Service's financial statements for the fiscal year ended June 30, 1972, (3) certify to the accuracy of any financial statements used in establishing postage rates, (4) advise the Postal Service on the application of generally accepted accounting principles to its accounting system, and (5) assist the Postal Service with the 1971 postal rate hearings.

The Postal Reorganization Act (39 U.S.C. 2008(e)) requires the Postal Service to obtain a certification from a CPA firm as to the accuracy of any financial statements used in establishing postage rates. The act (39 U.S.C. 2008(d)) authorizes, but does not require, the Postal Service to hire a CPA firm to perform the other work set forth above.

The Senior Assistant Postmaster General, Support, who managed the bond issue marketed by a group of bond underwriters in January 1972, told us that he wanted the bonds to be sold to the public on the economic strength of the Postal Service and that the public would have more faith in a statement reflecting the Postal Service's economic condition if the statement were certified to by private, instead of Government, auditors

A review board--composed of the Deputy Assistant Postmaster General and Controller, the Assistant Controller for

Accounting (a CPA), and the Director of the Office of Audit (a CPA)--evaluated nine CPA firms on the basis of the proposals they submitted. The board told the Senior Assistant Postmaster General, Support, that the three top-ranked firms were best qualified to perform the required services

After he received the review board's evaluation results, the Senior Assistant Postmaster General, Support, recommended to the Postmaster General his selection of Ernst & Ernst as the CPA firm to be awarded the Postal Service contract. He stated that any one of the nine firms was qualified to perform the work required by the Postal Service and that it had been difficult to choose one particular firm. Two of the major factors influencing his selection--the seventh-ranked firm--were the firm's number of offices and its familiarity with postal operations

The Postal Service contract with Ernst & Ernst has a ceiling price of \$598,000. As of May 1972 the firm had billed the Postal Service \$392,681 for services provided during the period May through December 1971. Of this amount, \$322,577 was for auditing services and \$70,104 was for assisting the Postal Service during the rate hearings of 1971. The firm rendered an unqualified opinion that the Postal Service's balance sheet as of July 1, 1971, presented fairly its financial condition.

We plan to make no further distribution of this report unless copies are specifically requested, and then we shall make distribution only after your agreement has been obtained or public announcement has been made by you concerning the contents of the report. The CPA firm and the Postal Service have not been requested to comment on matters included in this letter and the report.

Sincerely yours,



Acting Comptroller General
of the United States

The Honorable H. R. Gross
House of Representatives

EXAMINATION INTO THE SELECTION OF
A CERTIFIED PUBLIC ACCOUNTING FIRM
UNITED STATES POSTAL SERVICE

RATIONALE FOR ENGAGING A CPA FIRM

The United States Postal Service engaged a firm of certified public accountants (CPAs) to (1) examine, and express an opinion on, the Postal Service's statement of financial condition as of July 1, 1971, for use in marketing its first bond issue, (2) examine, and express an opinion on, the Postal Service's financial statements for the fiscal year ended June 30, 1972, (3) certify to the accuracy of any financial statements used in establishing postage rates, (4) advise the Postal Service on the application of generally accepted accounting principles to its accounting system, and (5) assist the Postal Service with the 1971 postal rate hearings

The Postal Reorganization Act (39 U.S.C. 2008(e)) requires the Postal Service to obtain a certification from a CPA firm as to the accuracy of any financial statements used in establishing postage rates. The act (39 U.S.C. 2008(d)) authorizes, but does not require, the Postal Service to hire a CPA firm to perform the other work set forth above

The Postmaster General, in the fall of 1970, announced his intention to use the bonding authority provided in the Postal Reorganization Act (39 U.S.C. 2005) to obtain funds to help finance the construction of postal facilities. He said that the bond issue would establish the Postal Service's credit with the public and would develop a market for future bond issues

The Senior Assistant Postmaster General, Support, told us that the underwriters for the bond issue did not require a CPA firm's opinion on the Postal Service's financial statement. He said that he wanted the Postal Service's bonds to be sold to the public on the economic strength of the Postal Service and that the public would have more faith in a financial statement reflecting the Postal Service's economic condition if the statement were certified to by private, instead of Government, auditors, because, in his opinion, a Government certification of the financial statement would not be accepted in the bond market as being independent

On November 19, 1971, the CPA firm rendered an unqualified opinion that the Postal Service's balance sheet as of July 1, 1971, presented fairly its financial position

The \$250 million bond issue was marketed in January 1972

SELECTION PROCEDURE

In October 1970 the Postal Service requested proposals for providing the various services from nine CPA firms

A review board--composed of the Deputy Assistant Postmaster General and Controller, the Assistant Controller for Accounting (a CPA), and the Director of the Office of Audit (a CPA)--evaluated the nine firms on the basis of the proposals they submitted

Each firm was evaluated in 10 major areas, and each area was assigned a designated value depending on the importance of the individual items within the area

The 10 major areas, listed in their order of importance, were as follows

<u>Areas</u>	<u>Value</u>
Expertise in automatic data processing	
Systems development	8
Audit techniques	8
Adequacy of technical proposal	15
Expertise in statistical techniques	12
Experience in auditing organizations required to appear before rate commissions	12
Availability and qualifications of staff members to be assigned	11
Expertise in management advisory services	10
Extent firm will rely on work performed by Internal Audit	10
Location of major offices	6
Capability to begin review before July 1, 1971, for submission of policy and procedure recommendations	4
Provide Internal Audit with access to firm's working papers	4

Each of the 10 areas dealt with specific capabilities that firms should possess to be acceptable to the Postal Service. For example, "expertise in management advisory services" dealt with such matters as finance, labor management, personnel management, and retailing. Each firm was rated in each

of the areas as either nonresponsive, minimum, average, very good, or outstanding

The point score assigned to the 10 areas ranged from zero for nonresponsive to 4 for outstanding. The maximum point score that a rater could give to each area was four times the designated value. This number was used to calculate the total score for each area. For example, if a value of 3, or very good, was placed on a firm's expertise in providing management advisory services, the point score for this area would be 30 (three times the designated value of 10). The computed values for all areas were added to arrive at the total score for the firm's proposal. Each review board member evaluated each firm's proposal.

In reaching a total score, the review board considered evaluations by Postal Service experts of the technical portions of the proposals, such as the statistical and automatic data processing areas.

In a memorandum dated December 23, 1970, to the Senior Assistant Postmaster General, Support, the review board reported the following scores for the nine CPA firms:

<u>Rank of firm</u>	<u>Score</u>
1	1,405
2	1,403
3	1,398
4	1,390
5	1,319
6	1,194
7 (note a)	1,169
8	1,131
9	1,041

^aThe selected firm

The memorandum also included the firms' estimated fees but stated that the fees had been obtained for budgeting and general information purposes and were not factors in the board's evaluations. The estimated-fee ranges, as stated in the proposals, were as follows:

<u>Rank of firm</u>	<u>Estimated fees</u>
1	\$320,000 to \$ 480,000 ^a
2	350,000 or less
3	275,000 to 325,000
4	300,000 to 450,000 ^a
5	200,000 to 250,000
6	500,000 ^a
7 (note b)	500,000 to 1,000,000 ^a
8	275,000 to 325,000
9	820,000 to 910,000

^aPlus out-of-pocket (travel) expenses.

^bThe selected firm.

The review board told the Senior Assistant Postmaster General, Support, that the three top-ranked firms were the best qualified to perform the required services

Substitution of seventh-ranked firm
for third-ranked firm

After he received the review board's evaluation results, the Senior Assistant Postmaster General, Support, substituted the board's seventh-ranked firm for its third-ranked firm. The Senior Assistant Postmaster General, Support, told us that the review board's report was only advisory and that he was not bound by the board's findings. He said that, although the third-ranked firm was as qualified as any of the nine firms to audit the financial statements, he believed that the third-ranked firm could not support the Postal Service's cost analysis system before the Postal Rate Commission, because the Postal Service's system was different from the system the firm had recommended a few years previously. He did not explain, however, why he had not selected the review board's fourth-, fifth-, or sixth-ranked firm.

Selection of a CPA firm

In a memorandum to the Postmaster General, the Senior Assistant Postmaster General, Support, stated that he had reviewed the review board's report and had inspected the proposals received from the nine firms. He said that any one of the firms was qualified to perform the work required by the Postal Service and that it was difficult to choose between the three highly qualified CPA firms--the review board's first- and second-ranked firms and the substituted seventh-ranked firm.

The reasons given by the Senior Assistant Postmaster General, Support, for recommending a particular firm--the seventh-ranked firm--and our comments on those reasons follow

- 1 The recommended CPA firm had more offices (107) in the United States than any of the other firms and therefore would be able to audit all major postal installations (regional offices, postal data centers, supply centers) and to make special audits of individual post offices with a minimum of travel

GAO comment In rating the CPA firms according to the location of their major offices, the review board rated three of the four top-ranked firms higher than, and one the same as, the recommended seventh-ranked firm even though that firm had a larger number of offices Also that firm's estimated fee was \$150,000 more than the highest fee of the firms ranked first, second, and fourth by the review board (See pp 3 and 4) Therefore savings in travel expenses, if any, achieved by awarding the contract to that firm might be offset by the higher fee

- 2 The recommended firm represented a very large and varied group of clients that had many things in common with the Postal Service.

GAO comment Commonality of the recommended firm's clients' interests with the interests of the Postal Service was not considered by the review board However, experience in auditing organizations required to appear before rate commissions was one of the major areas of consideration in the review board's evaluation of firms (See p 2) The Senior Assistant Postmaster General, Support, stated that the review board's second-ranked firm had unsurpassed expertise in the general field of utility accounting and rate-making and had audited substantially more utilities than any other firm, including the seventh-ranked firm

- 3 The work done by the recommended firm for the Postal Service in the areas of information systems, facilities design, and industrial engineering had given the firm a familiarity with, and understanding of, postal operations above the level of those firms which had not done comparable work

GAO comment An understanding of postal operations was not a factor considered by the review board in evaluating the CPA firms We believe that an

understanding of postal operations would be an asset to a firm engaged to do the work required by the Postal Service

4. The recommended firm had acquired knowledge about the Postal Service's cost accounting systems when it prepared a report on cost accounting for classes of postal service for the President's Commission on Postal Organization. The firm supported the Postal Service's testimony on postal costs and rates prepared for the Postal Rate Commission.

GAO comment Knowledge about the Postal Service's cost accounting system was not a factor considered by the review board in evaluating the CPA firms. The review board's first- and second-ranked firms also supported the Postal Service's testimony prepared for the Postal Rate Commission.

5. The review board's first-ranked firm had unsurpassed expertise in the statistical field, however, its expert was a consultant rather than a full-time employee. The recommended firm's expert was a full-time employee.

GAO comment The recommended firm informed us that, for the period May through October 1971, it spent 372 partner-hours assisting the Postal Service in hearings before the Postal Rate Commission and that 24 of those 372 hours represented assistance by its statistical expert. Apparently a full-time expert was not essential for assisting the Postal Service with the rate hearings. The review board, in rating the CPA firms for statistical expertise, rated its three top-ranked firms and three other firms higher than the recommended firm.

COST OF CONTRACT AND ADEQUACY OF WORK

The Postal Service's Board of Governors approved the Postmaster General's recommendation that the CPA firm recommended by the Senior Assistant Postmaster General, Support, be awarded the contract. The contract, dated April 30, 1971, had a ceiling price of \$478,000. By an amendment dated June 30, 1971, the scope of the work was expanded and the ceiling price was increased to \$598,000.

For services provided during the period May through December 1971, the firm billed the Postal Service \$392,681, of which \$322,577 was for auditing services and \$70,104 was for assisting the Postal Service during the rate hearings of 1971. As of May 10, 1972, no further billings had been received.

On November 19, 1971, the CPA firm rendered an unqualified opinion that the Postal Service's balance sheet presented fairly the financial position of the Postal Service at the commencement of operations on July 1, 1971, after giving effect to (1) the receipt of \$1 217 billion under a joint resolution of Congress dated July 1, 1971, and (2) the investment of \$2.797 billion in U.S. Treasury securities. The CPA firm's audit working papers indicated that the firm had relied, to the extent considered appropriate, on the audit work done by the Postal Service's internal auditors.

The Postal Reorganization Act (39 U.S.C. 2002) required that the value of the assets and the amount of the liabilities transferred to the Postal Service from the former Post Office Department be determined by the Postal Service, subject to the approval of the Comptroller General. Under this mandate we audited the value of the assets and the amount of the liabilities shown on the Postal Service's balance sheet as of July 1, 1971. We relied, to the extent considered appropriate, on the audit work done by the CPA firm and by the Postal Service's internal auditors.

We reviewed the CPA firm's audit program for the examination of the Postal Service's balance sheet and examined the firm's working papers supporting its unqualified opinion. Subject to the adjustments described in our letter to the Postmaster General, dated December 16, 1971 (see app. I), the Postal Service's balance sheet presents fairly the value of the assets and the amount of the liabilities transferred to the Postal Service at the commencement of its operations on July 1, 1971, in conformity with generally accepted accounting principles. These adjustments, which the Postal Service agreed to make, did not affect the opinion rendered by the CPA firm.



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D C 20548

DEC 16 1971

B-164786

Dear Mr Postmaster General

Under the provisions of the Postal Reorganization Act (39 U S C 101), the value of assets and liabilities transferred to the United States Postal Service upon commencement of the operations of the Postal Service are subject to the approval of the Comptroller General. The Board of Governors established July 1, 1971, as the effective date for the commencement of operations. The act provides that the value of assets and the amount of liabilities are to be transferred to the Postal Service in accordance with the following guidelines

- 1 Assets shall be valued on the basis of original cost less depreciation, to the extent that such value can be determined. The value recorded on the former Post Office Department's books of account shall be prima facie evidence of asset value
- 2 All liabilities attributable to operations of the former Post Office Department shall remain liabilities of the Government of the United States, except that upon commencement of operations of the Postal Service, the unexpended balances of appropriations made to, held or used by, or available to the former Post Office Department and all liabilities chargeable thereto shall become assets and liabilities, respectively, of the Postal Service.

We have reviewed the public accounting firm's proposed report on its examination of the balance sheet of the United States Postal Service as of July 1, 1971, and the firm's working papers relating to the examination. We also reviewed, where necessary, work performed by the Postal Service's internal auditors. Also, we independently reviewed available General Services Administration records pertaining to buildings transferred to the Post Office Department.

The balance sheet of the Postal Service at July 1, 1971, is based upon the amounts as they appear in the accounts on the books of the former Post Office Department at June 30, 1971, adjusted to include the following transactions that took place on July 1, 1971 (1) the receipt of \$1,217,522,000 from the United States Treasury under the provisions of the Joint Resolution (P L 92-38 approved July 1, 1971) representing

APPENDIX I

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\$1,161,200,000 for public service costs and revenue foregone and \$56,322,000 to be paid to the Department of Labor for Workmen's Compensation claims that the Department paid to employees of the former Post Office Department during fiscal years 1970 and 1971, and (2) the investment by the Postal Service of \$2,797,000,000 in United States Treasury securities. In addition, the Postal Service has recorded in its accounts a current liability of \$300 million representing estimated postage revenue collected prior to, but unused at, July 1, 1971.

The following matters have been discussed with the Assistant Postmaster General for Finance who has agreed to make appropriate adjustments in the accounting period ending June 30, 1972

ACCOUNTS RECEIVABLE

U S Government Agencies - \$101,707,000

Following an increase in mail rates effective May 16, 1971, the Postal Service made no adjustments to previously determined postage liabilities of the U S Government agencies for the use of penalty mail privileges during fiscal year 1971. Thus, the amount on the balance sheet for this asset is understated by an amount not determinable at this time. The Postal Service is now in the process of developing billings applicable to the agencies' liabilities for amounts representing the increase in postage rates.

During the past year, our Office has issued several reports regarding undercollection of postage and fees from mail users. The Postal Service has made or plans to make studies to determine the extent of undercollections and the effect on accounts receivable values stated on the July 1, 1971, balance sheet. The Postal Service has not reached a final conclusion on this matter.

SUPPLIES, ADVANCES, AND

PREPAYMENTS - \$51,286,000

About \$25 million of this amount for that asset is represented by land held for resale to contractors who will purchase the land, under the Postal Service lease-construction program, and construct thereon postal facilities for lease-back to the Postal Service. The Postal Service has agreed to disclose the amount applicable to land held for resale on the financial statements.

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BUILDINGS - \$846,286,000

Sixty-three buildings with a recorded value in an aggregate amount of \$83 million were transferred to the Post Office Department from the General Services Administration, as provided for in the Postal Reorganization Act. Although we found no contrary evidence as to reasonableness of these amounts, we were unable to verify the reasonableness of these amounts because records identifying capital improvements made to those buildings were not readily available

The Postal Service has agreed to make adjustments which may be necessary as a result of our review of the records as they become available

ADJUSTMENTS

Adjustments and/or reclassifications totaling \$46 million were identified by the independent accounting firm but were not entered on the books on the basis that, individually and in the aggregate, the dollar amounts were not material in relation to the financial statement showing assets of about \$4.5 billion. For example, about \$12 million was included in the Construction in Progress account whereas this amount represents the amount of buildings completed and in use. The amount therefore would be more properly classified as an asset--Buildings

FOOTNOTES

No 1 - The Postal Service agreed to delete paragraph three which states "Approval of the amounts presented in the balance sheet of the Postal Service at July 1, 1971, was received from the Comptroller General of the United States on , 1971," and insert on the face of the balance sheet the following

"Section 2002(a) of Title 39, United States Code, requires the approval of the Comptroller General as to the value of assets and the amount of liabilities transferred to the Postal Service upon the commencement of operations of the Postal Service. A letter was received from the Comptroller General on December 16, 1971, giving such approval subject to adjustments which the Postal Service has agreed to make. In the opinion of the Postal Service such adjustments are not material individually or in the aggregate "

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No 4 - The Postal Service accepted the suggestion to insert, after the word "payable" on line one, the words "when used or" so that the sentence when changed will read "Employees are permitted to accumulate certain unused annual leave which is payable when used or upon severance of employment or retirement "

No 5 - The footnote shows, as of July 1, 1971, a value of \$340 million in commitments to purchase property and equipment whereas the corresponding footnote to the internal auditors' balance sheet as of June 30, 1971, identifies the amount as \$406,207,000 Postal Service agreed to expand this footnote to explain the difference between these two amounts Further, our review of the independent auditors' working papers indicates that an estimated \$3 million represents transactions which have been consummated or canceled but which have not been removed from commitment status The Postal Service has agreed to make an adjustment in the accounting period ending June 30, 1972

No 6 - The footnote states that

"In the opinion of the General Counsel, the aggregate final settlement of the above suits, claims, and proceedings will not have a material adverse effect upon the financial position of the Postal Service "

The Postal Service agreed to delete the word "adverse" from the above quote

POST-BALANCE SHEET EVENTS

Certain transactions, such as receipt in full of the fiscal year 1972 appropriation amount before the 1972 Annual Appropriation Act was signed into law, occurred subsequent to the Post Office Department's balance sheet showing the financial condition as of June 30, 1971 These transactions did not require any changes to be made to the amounts shown on Postal Service balance sheet of July 1, 1971. However, we plan to include a discussion of these matters in our report to the Congress on the results of our review of the Postal Service's balance sheet.

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CONCLUSION

Subject to the adjustments described in this letter, which the Postal Service has agreed to make, we approve the value of the assets and the amount of the liabilities transferred to the Postal Service as shown on the balance sheet of the Postal Service as of July 1, 1971

Sincerely yours,

/s/ Elmer B. Staats

Comptroller General
of the United States

The Honorable
The Postmaster General