OFFICE OF
INSPECTOR
GENERAL
UNITED STATES POSTAL SERVICE

Officer Compensation for Calendar Year 2010

Audit Report

September 23, 2011

Report Number FT-AR-11-011

OFFICE OF
INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

HIGHLIGHTS

September 23, 2011

Officer Compensation for Calendar Year 2010

Report Number FT-AR-11-011

IMPACT ON:
The U.S. Postal Service's compliance with the Postal Accountability and Enhancement Act of 2006 (Postal Act of 2006) salary cap limits (the cap).

WHY THE OIG DID THE AUDIT:
Our objective was to determine whether the Postal Service complied with the cap, Postal Service policies and guidelines, and Internal Revenue Service (IRS) regulations for calendar year (CY) 2010 officer compensation.

WHAT THE OIG FOUND:
The Postal Service did not always comply with the cap and with IRS regulations. We identified an officer who exceeded the cap because he received a retention bonus that was not tied to performance. An additional officer is at risk of exceeding the cap in CY 2011 if a similar retention bonus is paid. The Postal Service also did not report Social Security wages or withhold and pay taxes on deferred compensation for one officer. Furthermore, the Postal Service did not timely report Medicare wages or timely withhold and pay taxes on deferred compensation for one prior and four current officers.

WHAT THE OIG RECOMMENDED:
We recommended management develop and implement policies and procedures to ensure adherence to the cap. We also recommended they report and pay the correct amount of Social Security and Medicare wages and taxes, establish accounts receivables for officers' portions of Social Security and Medicare taxes on deferred compensation, and modify the payroll system to calculate Social Security and Medicare taxes on deferred income.

WHAT MANAGEMENT SAID:
Management disagreed that the Postal Service exceeded the cap and also with the related monetary impact, but agreed to link enhanced compensation to performance in current and future agreements. They also agreed to report and submit corrected Social Security and Medicare wages and taxes, establish accounts receivables for the employees' portion of these taxes, and modify processes and/or systems to calculate appropriate taxes.

AUDITORS' COMMENT:
The OIG considers management's comments responsive to the recommendations and corrective actions should resolve the issues identified in the report. However, we maintain that the Postal Service exceeded the cap for one officer, because the retention bonus was not tied to performance.

Link to review the entire report

OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

September 23, 2011

MEMORANDUM FOR: PATRICK R. DONAHOE
POSTMASTER GENERAL

TIMOTHY F. O'REILLY
VICE PRESIDENT, CONTROLLER

FROM: John E. Cihota
Deputy Assistant Inspector General
for Financial Accountability

SUBJECT: Audit Report – Officer Compensation for Calendar Year 2010 (Report Number FT-AR-11-011)

This report presents the results of our audit of officer compensation for calendar year 2010 (Project Number 11BM003FT001).

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Lorie Nelson, director, Financial Reporting, or me at 703-248-2100.

Attachments

cc: Joseph Corbett
Mary Anne Gibbons
Julie S. Moore
Mia Han
Jean D. Parris
Dean R. Rodman
Corporate Audit and Response Management

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Introduction

This report presents the results of our audit of calendar year (CY) 2010 compensation paid or deferred to officers[1] based on the limits established in the Postal Accountability and Enhancement Act of 2006 (Postal Act of 2006) and U.S. Postal Service policies and guidelines (Project Number 11BM003FT001). The objective of this portion of the fiscal year (FY) 2011 Financial Statements Audit – Eagan Information Technology and Accounting Service Center (IT/ASC) was to determine whether the U.S. Postal Service complied with the Postal Act of 2006 limits (the cap), Postal Service policies and guidelines, and Internal Revenue Service (IRS) regulations for CY 2010 compensation for officers. We will continue to provide a report annually as part of our ongoing financial statement audit work. This self-initiated audit addresses financial risk. See Appendix A for additional information about this audit.

The passage of the Postal Act of 2006 amended Title 39 and revised the cap imposed on total compensation payable to Postal Service employees. Postal Service officers receive additional benefits including increased annual leave exchange hours, free financial counseling, parking, life insurance, and health benefits.[2] These items are not generally subject to the compensation guidelines defined in the Postal Act of 2006. Also, in certain limited cases, the Postal Service entered into agreements to provide executive retention bonuses that may take the form of deferred compensation. In a letter to the postmaster general dated November 23, 2010, Senator Susan M. Collins, Ranking Member, Homeland Security and Governmental Affairs Committee, inquired about these bonuses. In a response dated December 7, 2010, the Postal Service provided information on these agreements and stated that it uses them only when necessary to recruit or retain talent.

Conclusion

The Postal Service did not always comply with the compensation cap as stated in the Postal Act of 2006 and with IRS wage and tax regulations. Compensation that is not directly tied to performance is subject to the cap, even if that compensation is deferred to a later date. In one case, we identified an officer who exceeded the cap because he received a retention bonus that was not tied to performance. The Postal Service is at risk in CY 2011 of exceeding the cap on an additional officer if it pays a similar retention bonus.

The Postal Service also did not report Social Security wages or withhold and pay associated taxes on deferred compensation for one officer. Furthermore, the Postal

[1] Defined in this report as Postal Career Executive Schedule II employees.
[2] The Postal Service offers driver and personal security services through the U.S. Postal Inspection Service to the postmaster general.

Service did not timely[3] report Medicare wages or timely withhold and pay associated taxes on deferred compensation for one prior and four current officers.

Compensation Cap

Of 42 officers reviewed, we identified one whose salary, merit pay,[4] and retention bonus exceeded the highest compensation cap imposed by the Postal Act of 2006. We noted that the retention bonus was deferred[5] and was not tied to any performance goals and measures and, therefore, should have been subject to compensation caps.[6] The Postal Service contended that deferred guaranteed retention bonuses should be excluded from the compensation cap. However, based on several Government Accountability Office (GAO) comptroller general decisions,[7] deferred retention bonuses not related to performance are considered wages in the year they are earned. Also, compensation plans with guaranteed retention bonuses that are regular, expected and can be readily characterized as the equivalent of salary must be considered part of the compensation governed by legal limits. As a result, during CY 2010, the Postal Service paid this officer $59,174 above the compensation cap imposed by the Postal Act of 2006. In addition to this officer, we identified one other officer who might exceed the compensation cap during CY 2011 if a similar retention bonus is paid according to the contractual agreement. See Appendix B for monetary impact.

IRS Wage and Tax Regulations

The Postal Service did not always properly report Federal Insurance Contributions Act (FICA)[8] wages or withhold and pay associated taxes to the IRS. During CYs 2008 and 2009, for the only officer that deferred basic salary, the Postal Service:

- Under reported Social Security wages in the amount of $64,675.
- Under paid Social Security taxes in the amount of $8,020.

In addition, during CYs 2008, 2009, and 2010, for five[9] of the eight officers who received deferred compensation, the Postal Service:

- Did not timely[10] report Medicare wages in the amount of $1,360,598.

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[3] IRS regulations require the Postal Service to report Medicare wages when they are earned and withhold and pay associated Medicare taxes.
[4] Merit pay, or pay-for-performance, for FY 2010, paid in December 2010.
[5] The Postal Service deferred most of the retention bonus since the officer's salary, merit pay, and portion of the retention bonus equaled the maximum compensation cap of $276,840.
[6] The retention incentive was guaranteed for as long as the officer remains employed with the Postal Service.
[7] *U.S. Railway Association - Matter of Mr. Lewis, B-175155* (Comptroller General. July 1, 1976); *Tennessee Valley Authority - Matter of Patricia Schroeder, B-222334* (Comptroller. General. June 2, 1986); *Matter of: Retirement Benefits of President of Radio Free Europe*, B-253469 (Comptroller General September 9, 1993).
[8] FICA is a U.S. payroll (or employment) tax imposed by the federal government on both employees and employers to fund Social Security and Medicare federal programs that provide benefits for retirees, the disabled, and children of deceased workers.
[9] Includes one prior and four current officers where deferred compensation has not already been paid.
[10] IRS regulations require the Postal Service to report Medicare wages when they are earned and withhold and pay associated Medicare taxes.

- Did not timely withhold or pay Medicare taxes in the amount of $39,457.

As part of our audit, we found the Postal Service executed an agreement allowing one officer to defer basic salary and any incentive payments or bonuses. IRS Section 409A, *Nonqualified Deferred Compensation*, applies to compensation that employees earn in 1 year but is not paid until a future year. According to IRS regulations,[11] deferred compensation that meets the requirements of Section 409A has no effect on the employee's income taxes.[12] That compensation is subject to Social Security and Medicare taxes "as of the later of the date on which services creating the right to the amount deferred are performed or the date on which the right to the amount deferred is no longer subject to a substantial risk of forfeiture." IRS regulations also stipulate that FICA taxes apply up to the annual wage base for Social Security taxes and without limitation for Medicare taxes.

In this case, the officer deferred wages before reaching the Social Security annual wage base limit. These wages, although contractually deferred, are still subject to Social Security taxes. As shown in Table 1, by allowing the officer to defer income before reaching the Social Security annual wage limit, the Postal Service under reported wages and under withheld and paid associated taxes for the Social Security portion of FICA. The Postal Service would not likely report these wages or pay associated Social Security taxes on this officer's deferred income in a future year when it is paid because of Social Security wage base limits.

[11] *Code of Federal Regulations*, Title 26, Chapter I, §31.3121(v)(2)-1(e)(1).
[12] By contrast, under qualified deferred compensation plans (such as compensation deferred under a 401K plan) contributions and the earnings from those contributions grow tax-deferred until withdrawn. Non-qualified plans are not eligible for tax-deferral benefits.

Table 1: Social Security Wages and Taxes

Calendar Year	Social Security Annual Wage Base Limit	Wages Reported[13]	Under Reported Wages per Annual Limit[14]	Social Security Tax per Annual Wage Base Limit[15]	Social Security Tax on Wages Reported[16]	Under Payment of Social Security Taxes[17]
2008	$102,000	$66,211	$35,789	$12,648	$8,210	$4,438
2009	106,800	77,914	28,886	13,243	9,661	3,582
2010	106,800	106,800[18]	0	13,243	13,243	0
Total:		**$250,925**	**$64,675**	**$39,134**	**$31,114**	**$8,020**

Source: Employee Master File and Eagan Accounts Payables Applications.

Because wages subject to the Medicare portion of FICA are without limitation, we expanded our scope to include deferred compensation for CYs 2008, 2009, and 2010[19] to determine whether the Postal Service reported Medicare wages and withheld and paid Medicare taxes in accordance with IRS regulations. As shown in Table 2, we found the Postal Service did not timely[20] report Medicare wages or timely withhold and pay associated Medicare taxes for one prior and four current officers. Instead, the Postal Service intended to report these wages and withhold and pay associated taxes when the deferred compensation was paid.

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[13] Wages reported on U.S. Department of Treasury's IRS Form W-2, Wage and Tax Statement. Actual earned wages exceeded the amount reported on Form W-2.
[14] Difference between Social Security annual wage limit and reported wages.
[15] Calculated Social Security tax rate of 6.2 percent each for the Postal Service and the officer on Social Security annual wage base limit.
[16] Calculated Social Security tax rate of 6.2 percent each for the Postal Service and the officer on wages reported.
[17] Difference between Social Security taxes that would have been paid up to the annual wage base limit and Social Security taxes on wages reported.
[18] In addition to the $68,769 of regular salary that was not deferred, this amount also includes $185 for officer's benefits and a portion of the $44,642 of relocation benefits received in FY 2010.
[19] The statute of limitations (United States Code Title 42, Chapter 7, Subchapter II, §405 (c)(1)(B)) allows correction of FICA wages and taxes for a period of 3 years, 3 months, and 15 days.
[20] IRS regulations require the Postal Service to report Medicare wages when they are earned and withhold and pay associated Medicare taxes.

Table 2: Medicare Wages and Taxes

Calendar Year	Total of Deferred Compensation Not Timely Reported for Medicare[21]	Medicare Tax Not Paid Timely[22]
2008	$391,594	$11,356
2009	405,302	11,754
2010	563,702	16,347
Total:	**$1,360,598**	**$39,457**

Source: Employee Master File and Eagan Accounts Payables Applications.

This occurred because the Postal Service payroll system does not calculate FICA taxes on deferred income. As a result, it improperly reported FICA wages and taxes on the Department of the Treasury's IRS Form 941, Employer's Quarterly Federal Tax Return; and on individuals' IRS W-2 Forms for those years. The IRS can use administrative procedures to collect delinquent taxes when they are not paid timely. This could tarnish the Postal Service's reputation and brand image. See Appendix B for other impact.

Recommendations

We recommend the postmaster general:

1. Develop and implement policies and procedures to ensure adherence to compensation cap limitations.

We recommend the vice president, controller:

2. Report and pay the correct amount of Social Security and Medicare wages and taxes owed to the Internal Revenue Service.

3. Establish accounts receivables for current and prior officers' portions of Social Security and Medicare taxes on deferred compensation.

4. In coordination with the chief information officer, modify the Postal Service payroll system to calculate Social Security and Medicare taxes on deferred income.

Management's Comments

Management disagreed with recommendation 1 and its corresponding monetary impact, stating no officer's compensation has exceeded statutory limits. They stated that current policies and procedures are effective to ensure compliance with caps and limitations, so no changes are necessary. However, they agreed to more clearly link enhanced

[21] Total of deferred compensation not timely reported for Medicare for one prior and four current officers.
[22] Calculated Medicare tax rate of 1.45 percent each for the Postal Service and the officer on deferred compensation not reported timely.

compensation to performance in future agreements and to modify the two contracts cited in the report.

In support of their position that the cap was not exceeded, management contended that statutory pay caps for the Postal Service are significantly different than the statutes at issue in the GAO comptroller general decisions. They also noted that one of the comptroller general decisions cited in our draft report was incorrect. In addition, they believe the Postal Service has implemented its compensation cap statutes in a manner similar to Office of Personnel Management (OPM) regulations governing compensation caps, so it has not violated those statutes. Furthermore, they stated that officers serve at the pleasure of the postmaster general and cannot challenge their discharge in the same manner as other Postal Service employees.

Management agreed with recommendations 2 through 4 but stated that the U.S. Postal Service Office of Inspector General (OIG) did not report tax-related issues in the prior audits and they relied on previous audits of officer compensation practices. They also noted that the Postal Service's current practice with regard to deferred compensation is to withhold and pay Social Security taxes when the previously deferred monies are paid out. Notwithstanding, they agreed to report and submit corrected Social Security and Medicare wages and taxes to the IRS, establish accounts receivables as necessary for the employees' portion of these taxes, and modify processes and/or systems as necessary. Management plans to complete these actions by December 31, 2011.

See Appendix C for management's comments in their entirety.

Evaluation of Management's Comments

The OIG considers management's comments responsive to the recommendations and corrective actions should resolve the issues identified in the report. Although management disagreed with recommendation 1, we believe the actions cited by management to more clearly link enhanced compensation to performance in current and future agreements will address the finding.

We maintain, however, that the Postal Service exceeded its compensation cap. The OIG considered and agrees that OPM guidance on aggregate limitation on pay is relevant. However, although the Postal Service has the authority to defer compensation, it must also conform to GAO decisions addressing whether certain deferred compensation arrangements circumvent salary caps applicable to other agencies. Even though the statutes applied to different entities, the decisions addressed similar annual salary cap issues.

Further, for the instance discussed in the report, the employment agreement includes a bonus with a payment condition requiring that the officer simply remain employed as of a specified date on which the payment is to be made. The officer is not required to meet any performance measures or achieve any specific goal to receive the payment.

In addition, federal executives ultimately serve at the pleasure of the respective agency's head, so the ability to terminate is not equivalent to linking the payment to the employee's performance for salary cap considerations. We continue to believe that deferred income not linked to performance is regular and expected and can be readily characterized as the equivalent of salary. As such, this income must be included in the officer's total compensation subject to the compensation cap. We will report the amount deferred as monetary impact.

Regarding Social Security and Medicare wages and taxes, our prior audit work in this area focused only on whether the Postal Service complied with the Postal Act of 2006 limits on annual compensation for officers, not a review of IRS laws and regulations. However, when we prepared for this audit, we became aware of potential tax issues, so we expanded our objectives for this audit to include them. The fact that the OIG did not report tax-related issues in the past does not preclude the OIG from reporting non-compliance when we become aware of such situations. In addition, it is management's responsibility to comply with applicable laws and regulations. They should not solely rely on the OIG as a management function to determine compliance.

Regarding the mis-citation of a comptroller general decision, as noted by management, we agree and have revised the report accordingly. Further, as management noted, we were made aware that the current practice with regard to deferred compensation is to withhold and pay Social Security taxes when the previously deferred monies are paid out. We included references to that policy in the draft and final reports.

The OIG considers recommendation 1 significant and, therefore, requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective actions are completed. This recommendation should not be closed in the Postal Service's follow-up tracking system until the OIG provides written confirmation that the recommendation can be closed.

Appendix A: Additional Information

Background

The passage of the Postal Act of 2006 amended United States Code Title 39, imposing guidelines on total compensation[23] for the Postal Service. Under this provision, the total compensation payable to any employee is established at three levels:

- The first cap provides that no officer or employee may be paid compensation at a rate in excess of the rate for level I of the Executive Schedule. This compensation limit was set at $199,700 for CY 2010.

- With the approval of the Board of Governors (Board), however, the Postal Service may develop a program to award a bonus or other reward in excess of the above compensation cap, as long as this does not cause the total annual compensation paid to the officer to exceed the total annual compensation payable to the vice president of the U.S. at the end of the calendar year in which the bonus or award is paid. In approving any such program, the Board must determine that the bonus or award is based on a performance appraisal system that makes meaningful distinctions based on relative performance. This total compensation cap was $230,700 for CY 2010.

- In addition, the Board may allow up to 12 officers or employees of the Postal Service, in critical senior executive or equivalent positions, to be paid total annual compensation of up to 120 percent of the total annual compensation payable to the vice president of the U.S. as of the end of the calendar year in which such payment is received. This compensation cap was $276,840 for CY 2010.

Postal Service officers receive additional benefits and other perquisites, including increased annual leave exchange hours, free financial counseling and parking, life insurance, and health benefits.[24] These items are not generally subject to the compensation guidelines defined in the Postal Act of 2006.

Also, in certain limited cases, the Postal Service entered into agreements to provide executive retention bonuses that may take the form of deferred compensation. Based on GAO comptroller general decisions,[25] if this compensation is not related to performance, it is considered wages and subject to compensation cap in the year it is earned.

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[23] Compensation includes annual salary, merit lump sum payments, bonuses, awards, and deferred payments not tied to performance.
[24] The Postal Service offers driver and personal security services through the Postal Inspection Service to the postmaster general.
[25] *U.S. Railway Association - Matter of Mr. Lewis, B-175155* (Comptroller General. July 1, 1976); *Tennessee Valley Authority - Matter of Patricia Schroeder, B-222334* (Comptroller General, June 2, 1986); *Matter of: Retirement Benefits of President of Radio Free Europe*, B-253469 (Comptroller General September 9, 1993).

Objective, Scope, and Methodology

The objective of this portion of the FY 2011 Financial Statements Audit – Eagan IT/ASC was to determine whether the Postal Service complied with the Postal Act of 2006 cap, Postal Service policies and guidelines, and IRS regulations for CY 2010 compensation for officers.

To achieve our objective we:

- Reviewed information from the Employee Master File.
- Reviewed the Eagan Accounts Payables application.
- Reviewed IRS guidelines.
- Reviewed employment agreements.
- Interviewed Postal Service personnel.
- Performed benchmarking.

Our initial scope included compensation paid to all current officers as of December 31, 2010. However, we expanded it to include agreements to provide executive retention bonuses that may take the form of deferred compensation as a result of Senator Collins' inquiries. We also expanded our scope to include all officers that received deferred compensation from CYs 2008 through 2010 to facilitate our review of IRS wage and tax regulations.

We conducted this portion of the audit from January through September 2011 in accordance with generally accepted government auditing standards and included such tests of internal controls, as we considered necessary under the circumstances. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. We discussed our observations and conclusions with management on August 10, 2011, and included their comments where appropriate.

We relied on computer-generated data from payroll systems and the Eagan Accounts Payable System for testing compensation, awards, bonuses, annual leave exchange, and deferred compensation. We assessed the reliability of this data by reviewing existing information about the data and the system that produced them, interviewing agency officials knowledgeable about the data, and using advanced data analysis techniques. We also performed specific internal control and transaction tests including tracing selected information to supporting source records. We determined that the data were sufficiently reliable for the purposes of this report.

Prior Audit Coverage

Report Title	Report Number	Final Report Date	Monetary Impact	Report Results
Officer Compensation for Calendar Year 2009	FT-WP-10-001	4/12/10	$0	We made no recommendations.
Officer Compensation for Calendar Year 2008	FT-WP-09-002	6/17/09	$0	We made no recommendations.
Executive Compensation	FT-WP-09-001	12/05/08	$670	We identified one executive exceeding the compensation limit in CY 2007. Management took corrective action so we made no recommendations.

Appendix B: Monetary and Other Impacts

Monetary Impact

Finding	Impact Category	Amount
Compensation Cap	Questioned Cost[26]	$59,174

Other Impact

Finding	Impact Category	Amount
IRS Wage and Tax Regulations (Social Security Tax)	Goodwill/Branding[27]	$8,020
IRS Wage and Tax Regulations (Medicare Tax)	Goodwill/Branding	39,457
Total		**$47,477**

[26] Unnecessary, unreasonable, unsupported, or an alleged violation of law, regulation, contract, and so forth. May be recoverable or unrecoverable. Usually a result of historical events.
[27] An actual or potential event or problem that could harm the reputation of the Postal Service.

Appendix C: Management's Comments

PATRICK R. DONAHOE
POSTMASTER GENERAL, CEO

UNITED STATES POSTAL SERVICE

September 14, 2011

SHIRIAN HOLLAND
OFFICE OF INSPECTOR GENERAL

SUBJECT: Draft Audit Report—Officer Compensation for Calendar Year 2010
(Report No. FT-AR-11-DRAFT)

Thank you for the opportunity to respond to your August 22 draft audit report on Officer Compensation for Calendar Year (CY) 2010. Our response to each recommendation in the report is attached.

We disagree with both the "monetary impact" and "other impact" as identified in Appendix D in the report. The compensation cap was not exceeded so there are no savings to the Postal Service.

The audit report and management's response do not contain information that may be exempt from disclosure under the Freedom of Information Act (FOIA).

If you have any questions regarding our response, please contact Mia Han, Director, Executive Compensation and Compliance, at 202-268-8008, for questions regarding Recommendation 1 or Dean Rodman, Manager, Accounting Service Center, at 651-406-1474, for questions regarding Recommendations 2, 3, and 4.

Patrick R. Donahoe

Attachment

475 L'ENFANT PLAZA SW
WASHINGTON, DC 20260-0010
WWW.USPS.COM

SHIRIAN HOLLAND
OFFICE OF INSPECTOR GENERAL

SUBJECT: Draft Audit Report—Officer Compensation for Calendar Year 2010
(Report No. FT-AR-11-DRAFT)

cc: Joseph Corbett
Tim O'Reilly
Mary Anne Gibbons
Julie S. Moore
Mia Han
Jean D. Parris
Dean R. Rodman
Sally Haring

Recommendation 1:
We recommend the postmaster general develop and implement policies and procedures to ensure adherence to compensation cap limitations.

Management Response/Action Plan:
This is management's response to Recommendation 1, to the effect that the Postmaster General "[d]evelop and implement policies and procedures to ensure adherence to compensation caps and limitations."[1] Management disagrees with this recommendation, as no officer's compensation has exceeded statutory limits. The Postal Service's extant rules and policies already ensure compliance with these "caps and limitations." Therefore, management does not believe that additional policies and procedures need to be developed. The current policies and procedures are effective and thus, no changes are necessary.

The audit report's recommendation is based upon the following observation:

> We noted that the retention bonus was deferred, was not tied to any performance goals and measures and, therefore, should have been subject to compensation caps. The Postal Service contended that deferred guaranteed retention bonuses should be excluded from the compensation cap. However, based on several Government Accountability Office (GAO) comptroller decisions, deferred retention bonuses not related to performance are considered wages in the year they are earned. Also, compensation plans with guaranteed retention bonuses that are regular, expected and can be readily characterized as the equivalent of salary must be considered part of the compensation governed by legal limits.[2]

In support of this general statement, the audit report cites three Comptroller General opinions: *U.S. Railway Association – Matter of Mr. Lewis*, B-175155 (July 1, 1976); *Tennessee Valley Authority – Matter of Patricia Schroeder*, B-222334 (June 2, 1986); and *Radio Free Europe – Matter of Robert P. Murphy*, B-279095.2 (June 16, 1998). One of these, *Radio Free Europe*, is mis-cited, in that the Comptroller General decision decided on June 16, 1998, with number B-279095.2, does not concern Radio Free Europe, and further, does not contain an in-depth discussion of the issues treated in the audit report; instead, it largely concerns rates of pay for employees of the District of Columbia. As such, we will not address this case.

The audit report lacks any discussion or analysis of the statutes that establish the relevant Postal Service pay caps.[3] This omission is critical, because the Postal Service's statutory pay caps are significantly different from the statutes at issue in the two Comptroller General decisions upon which the audit report relies—*U.S. Railway Association* and *Tennessee Valley*. It is axiomatic that the analysis of any statute starts with the plain language of that statute.[4] In this case, that language provides, in relevant part:

> Under any such program, the Postal Service may award a bonus or other reward in excess of the limitation set forth in the last sentence of section 1003(a), if such program has been approved under paragraph (2). Any such award or bonus may not cause the total compensation of such officer or employee to exceed the total annual compensation payable to the Vice President under section 104 of title 3

[1] Audit report, p. 4.
[2] *Id.* at 2. (Footnotes omitted).
[3] While the Postal Service's pay cap statutes are described in the appendix to the report, they are not analyzed there.
[4] "The preeminent canon of statutory interpretation requires [a reviewing authority] to 'presume that [the] legislature says in a statute what it means and means in a statute what it says there' . . . Thus, [the] inquiry begins with the statutory text, and ends there as well if the text is unambiguous." *BedRoc Limited, LLC v. United States*, 541 U.S. 176, 183-84 (2004).

> *as of the end of the calendar year in which the bonus or award is paid.*[5] (Emphasis supplied).

> Notwithstanding any other provision of law, the Board of Governors may allow up to 12 officers or employees of the Postal Service in critical senior executive or equivalent positions *to receive* total compensation in an amount not to exceed 120 percent of the total annual compensation payable to the Vice President under section 104 of title 3 *as of the end of the calendar year in which such payment is received.*[6] (Emphasis supplied).

By contrast, the statute at issue in the *Tennessee Valley Authority* case merely provided in pertinent part:

> No regular officer or employee of the Corporation shall receive a salary in excess of that received by the members of the board.[7]

Similarly, the statute construed in the *U.S. Railway Association* case stated only:

> No officer of the association, including the chairman, may receive compensation at a rate in excess of that prescribed for level 1 of the executive schedule under section 5312 of title 5.[8]

These statutes are not similar to the Postal Service pay cap statutes that are the subjects of the audit report. Neither of them imposes a limit on compensation paid or received in a calendar year. As such, these cases have no bearing on the present issue. The plain language of the Postal Service salary cap statutes does have a bearing on this question; that language imposes a limit, by "calendar year" on: (1) bonuses or awards "paid;" or (2) "payment[s] . . . received."[9] No monies were paid or received in a calendar year that would cause an officer's total compensation to exceed the statutory limit.

There is a federal statute that is similar to the Postal Service's salary cap statute. The Office of Personnel Management (OPM) has construed this statute in a manner similar to the manner in which the Postal Service has implemented its salary cap laws. This statute provides:

> no allowance, differential, bonus, award, or other similar cash payment under this title *may be paid to an employee in a calendar year* if, or to the extent that, when added to the total basic pay paid or payable to such employee for service performed in such calendar year as an employee in the executive branch (or as an employee outside the executive branch to whom chapter 51 applies), such payment would cause the total to exceed the annual rate of basic pay payable for level I of the Executive Schedule, *as of the end of such calendar year.*[10] (Emphasis supplied).

The OPM regulations implementing this statute provide:

> When an agency authorizes a discretionary payment for an employee, the *agency must defer* any portion of such payment that, when added to the estimated aggregate compensation the employee is projected to receive, would cause the employee's aggregate compensation during the calendar year to

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[5] 39 U.S.C. § 3686(b)(1).
[6] 39 U.S.C. § 3686(c).
[7] 16 U.S.C. § 831b (1982).
[8] 45 U.S.C. § 712(a)(5) (1976).
[9] 39 U.S.C. § 3686(b)(1), (c).
[10] 5 U.S.C. § 5307(a).

> exceed the applicable aggregate limitation. Any portion of a discretionary payment deferred under this paragraph must be available for payment as provided in Sec. 530.204. *When a discretionary payment is authorized but not required to be paid in the current calendar year, an agency official's decision to set the payment date in the next calendar year is not considered a deferral under this paragraph.*[11] (Emphasis supplied).
>
> An agency *must pay* the amounts that were deferred because they were in excess of the aggregate . . . as a lump-sum payment *at the beginning of the following calendar year*, except as otherwise provided in this section. This payment is part of the employee's aggregate compensation for the new calendar year.[12] (Emphasis supplied).
>
> An agency must pay any excess amount regardless of the calendar year limitation under the following conditions:
>
> (1) If an employee dies, the employing agency must pay the entire excess amount as part of the settlement of accounts, . . .
>
> (2) If an employee separates from Federal service, *the employing agency must pay the entire excess amount following a 30-day break in service.*[13] (Emphasis supplied).

These regulations are significant for three reasons: First, they construe a limitation on compensation that is similar to that found in the Postal Service pay cap statutes, *i.e.*, they implement a calendar year limitation on "payment[s]" to federal employees. Second, they direct that employees not be permanently denied payments that would otherwise be prohibited by the annual compensation cap; instead, those payments are to be paid in a subsequent year. Third, once an employee ends his or her federal service, the compensation cap is not applicable, as all withheld payments are to be made after a 30-day break in service. The Postal Service has implemented its compensation cap statutes in a manner similar to these OPM regulations. Consequently, the Postal Service has not violated those statutes.

We also disagree with the audit report's conclusions for additional reasons: It incorrectly states that an officer's deferred retention bonus "was not tied to any performance goals and measures and, therefore, should have been subject to compensation caps."[14] As this officer's employment agreement specifically recognizes, the officer serves at the pleasure of the Postmaster General,[15] and the law provides that he cannot challenge his termination by invoking the same remedies that are generally available to other career postal employees.[16] Therefore, in the event the Postmaster General determines this officer's performance no longer merits his receiving a bonus, the Postmaster General may freely terminate his employment, thereby ending any entitlement to a retention bonus.

The audit report also refers to "one other officer who may exceed the compensation cap during CY 2011, if a similar retention bonus is paid according to the contractual agreement."[17] It appears that this is a reference to an officer whose employment agreement provides that he is to receive an

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[11] 5 C.F.R. § 530.203(d).
[12] 5 C.F.R. § 530.204(a).
[13] 5 C.R.R. § 534.204(b).
[14] Audit report, p. 2.
[15] See 39 U.S.C. § 204, establishing that "the Assistant Postmasters General . . . shall be appointed by, and serve at the pleasure of, the Postmaster General."
[16] 39 U.S.C. § 1005(a)(2).
[17] Audit report, p. 2.

award based upon his performance during FY2011; this is not a retention bonus. This agreement provides that the officer is entitled "to, at a minimum, a performance incentive award of 25% of his basic salary in effect as of the end of" the fiscal year.[18] As in the case of the officer discussed above, this agreement also expressly recognizes that the officer serves at the pleasure of the Postmaster General, who may terminate this officer's employment in the event he determines the officer's performance does not merit the officer's continued receipt of a performance award. Notwithstanding the forgoing discussion, as it appears it was not clear to the auditors that these awards are tied to officers' performance, we will enhance future employment agreements, if any, so that they more clearly indicate that opportunities to receive enhanced compensation are directly linked to performance. Moreover, we are working to modify the two contracts cited in the Audit Report to make clear that the right to receive the amounts referenced is based on performance.

To summarize, we disagree with the audit report's conclusions regarding the compensation cap for three basic reasons: First, it relies upon cases construing compensation statutes that are very different from those that apply to the Postal Service. Second, the report ignores the manner in which OPM implements a pay statute containing language very similar to the terms of the Postal Service compensation statutes. Third, it fails to consider the impact of the unique status of Postal Service officers, in that they serve at the pleasure of the Postmaster General and cannot challenge their discharge in the same manner as other Postal Service employees.

Management's prefatory comments on Recommendations 2-4:

As a general matter, Recommendations 2-4 were unexpected, as the Office of the Inspector General (OIG) audited officer compensation three times previously, without recommending any changes concerning withholding or payment of Social Security and Medicare taxes. As indicated on page 8 of the instant audit report, on April 10, 2010, and June 17, 2009, the OIG issued audit reports concerning officer compensation for calendar years 2008 and 2009; neither of these reports contained any recommendations for improving officer compensation practices. Similarly, as further indicated on page 8 of the instant audit report, the OIG issued a December 5, 2008, audit report on executive compensation, including officers' compensation, which did not recommend any of the changes set out in Recommendations 2-4 of the present report. Understandably, management relied upon the OIG's previous audits of officer compensation practices, as reflected in these earlier audit reports.

Additionally, in several places the audit report assumes that Medicare and Social Security taxes would never be paid on deferred income. This is incorrect. While these taxes have not been paid at the time the monies were deferred, it was always intended to pay them at the time the deferred income was paid to the employee. For example, page 3 of the audit report states:

> In this case, the officer deferred wages before reaching the Social Security annual wage base limit. These wages, although contractually deferred, are still subject to Social Security taxes. As shown in Table 1, by allowing the officer to defer income before reaching the Social Security annual wage limit, the Postal Service under reported wages and under withheld and paid associated taxes for the Social Security portion of FICA. The Postal Service would not likely report these wages or pay associated Social Security taxes on this officer's deferred income in a future year when it is paid, because of Social Security wage base limits.

While it was conducting this audit, management told the OIG several times that the current practice with regard to deferred compensation is to *withhold and pay* Social Security taxes when the previously deferred monies are paid out. Since the officer in question is no longer on the rolls and will have no other USPS wages in each of the years that the payments will be made, the maximum Social Security taxes would be taken from each payment. If the officer is working for

[18] Employment agreement, ¶ 6(b).

more than one employer during the calendar year, each employer is liable for withholding and matching Social Security and Medicare taxes. The earnings from different employers cannot be combined for purposes of determining whether the social security wage base has been reached. IRS Reg 31.3121(a)(1)-1(a)(3).

Recommendation 2:
We recommend the vice president, controller report and pay the correct amount of Social Security and Medicare wages and taxes owed to the Internal Revenue Service.

Management Response/Action Plan:
Management agrees with the recommendation. The appropriate tax reporting to correct Social Security and Medicare wages/taxes will be submitted to the IRS for non-barred tax years.

Target Implementation Date:
December 31, 2011

Responsible Official:
Manager, Eagan Accounting Services

Recommendation 3:
We recommend the vice president, controller establish accounts receivables for current and prior officers' portions of Social Security and Medicare taxes on deferred compensation.

Management Response/Action Plan:
Management agrees with the recommendation to the extent it may be necessary to establish accounts receivables to recoup funds necessary to pay the employees' portions of these taxes. That is, it may be possible that officers with balances remaining in deferred accounts will consent to have the amounts of these tax payments subtracted from those balances, thereby obviating the need for accounts receivables. Medicare and Social Security taxes on deferred compensation will be assessed in the same calendar year as the award. The officers are responsible for the employee share of Social Security taxes ($4,010) and Medicare taxes ($19,729), which are one-half of the amounts shown in Table 1 ($8,020) and Table 2 ($39,457) of the audit report.

Target Implementation Date:
December 31, 2011

Responsible Official:
Manager, Eagan Accounting Services

Recommendation 4:
We recommend the vice president, controller in coordination with the chief information officer, modify the Postal Service payroll system to calculate Social Security and Medicare taxes on deferred income.

Management Response/Action Plan:
Management agrees with the intent of the recommendation to modify the calculation. Payroll processes and/or systems will be modified as needed.

Target Implementation Date:
December 31, 2011

Responsible Official:
Manager, Eagan Accounting Services