



OFFICE OF
**INSPECTOR
GENERAL**
UNITED STATES POSTAL SERVICE

**Officer Compensation for
Calendar Year 2011**

Audit Report

October 19, 2012

Report Number FT-AR-13-001



OFFICE OF
**INSPECTOR
GENERAL**
UNITED STATES POSTAL SERVICE

HIGHLIGHTS

October 19, 2012

Officer Compensation for Calendar Year 2011

Report Number FT-AR-13-001

BACKGROUND:

The Postal Accountability and Enhancement Act of 2006 (Postal Act of 2006) amended 39 U.S.C. and revised the cap on total compensation payable to U.S. Postal Service employees. Employees generally could not be paid more than \$199,700 for calendar year (CY) 2011. Exceptions allowed some to be paid up to \$230,700 (the statute defines the Postal Service's authority to award bonuses or other awards) or \$276,840 (for critical positions). Compensation includes annual salary, merit lump sum payments, bonuses, and awards. We determined whether the Postal Service complied with the Postal Act of 2006, its own policies and guidelines, and IRS regulations for CY 2011 officer compensation.

WHAT THE OIG FOUND:

We have a fundamental disagreement with the Postal Service on the proper interpretation of the compensation cap provisions of this statute. According to the law, "The Postal Service may establish one or more programs to provide bonuses or other rewards to officers and employees of the Postal Service in senior executive or equivalent positions. 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 39 U.S.C § 1003 (a), if such program has been approved. . . .If the Postal Service wishes to have the authority to award

bonuses or other awards in excess of the limitation. . .the Postal Service shall make an appropriate request to the Board of Governors (Board), and the Board shall approve any such request if the Board certifies. . .that the performance appraisal system. . .makes meaningful distinctions based on relative performance."

The law also states, "Notwithstanding any other provision of law, the Board 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. . . .The Board shall provide written notification to the director of the Office of Personnel Management (OPM) and the Congress within 30 days after the payment is made setting forth the name of the officer or employee involved, the critical nature of his or her duties and responsibilities, and the basis for determining that such payment is warranted."

We believe the compliance issues that we note in this report are a result of management's misinterpretation of the relevant statutory authority in the Postal Act of 2006. We identified three officers whose compensation exceeded or otherwise failed to comply

with the compensation caps imposed by the Postal Act of 2006 because:

- A reassignment incentive put one officer over the Level I threshold, but that incentive was not tied to the officer's relative performance, nor was the officer in a designated critical position.
- Another officer received a straight salary that exceeded the pay cap, and that officer was not included in the required written list of critical positions provided to the OPM and Congress informing them that the officer served in a critical position.
- Finally, management did not include annuity payments in another officer's compensation cap computation, thus under-reporting the total amount paid. Not only was the officer not included in the list of critical positions, this officer's total compensation exceeded the highest level of allowable salary for critical positions.

As a result, during CY 2011, the Postal Service paid \$110,011 above the caps.

In response to our CY 2010 audit, management amended an officer's employment agreement to more clearly link the incentive award to performance. However, because the amount of the

award is set in advance by contract, we believe it is neither part of an 'appraisal system' nor the result of any evaluation of 'relative performance.' This change to the language does not address the concerns we raised last year.

WHAT THE OIG RECOMMENDED:

We recommended the postmaster general coordinate with the Board to report a complete list of critical positions and request an interpretation from the Government Accountability Office on whether annuity payments are part of an employee's total compensation and subject to compensation caps.

Subsequent to receiving management's written comments, they acknowledged the fundamental disagreement with the interpretation of the law. As such, they agreed to seek advice from the Department of Justice's (DOJ) Office of Legal Counsel to resolve all the issues identified in this report. We agree that an advisory opinion from the DOJ's Office of Legal Counsel will better resolve all of the issues and other matters than our original recommendations. Subsequent to issuance of the final report, management will work with us on the precise legal questions to be submitted.

[Link to review the entire report](#)



October 19, 2012

MEMORANDUM FOR: PATRICK R. DONAHOE
POSTMASTER GENERAL

A rectangular box containing a handwritten signature in black ink that reads "John E. Cihota". There is a small black dot in the upper right corner of the box.

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

SUBJECT: Audit Report – Officer Compensation for
Calendar Year 2011 (Report Number FT-AR-13-001)

This report presents the results of our audit of Officer Compensation for Calendar Year 2011 (Project Number 12BM002FT001).

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Denice M. Millett, director, Finance, or me at 703-248-2100.

Attachments

cc: Louis J. Giuliano, Chair, Audit and Finance Committee
Ellen C. Williams, Chair, Compensation & Management Resources Committee
Joseph Corbett
Anthony J. Vegliante
Julie S. Moore
Scott J. Davis
Corporate Audit and Response Management

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Introduction

This report presents the results of our audit of calendar year (CY) 2011 compensation paid or deferred¹ to officers² of the U.S. Postal Service (Project Number 12BM002FT001). The objective of this portion of the fiscal year (FY) 2012 U.S. Postal Service Financial Statements Audit – Eagan Accounting Services – was to determine whether the Postal Service complied with the Postal Accountability and Enhancement Act of 2006 (Postal Act of 2006), Postal Service policies and guidelines, and IRS regulations for CY 2011 compensation paid to officers. We will continue to provide annual reports as part of our ongoing financial statement audit work. This audit addresses financial risk. See [Appendix A](#) for additional information about this audit.

The passage of the Postal Act of 2006 amended 39 U.S.C. and revised the cap imposed on total compensation payable to Postal Service employees. Compensation includes annual salary, merit lump sum payments,³ bonuses, awards, and annuity payments. Table 1 explains the three compensation levels for CY 2011.⁴

Table 1: CY 2011 Compensation Levels

Level	Description	Dollar Limit
I	No officer or employee shall be paid compensation at a rate in excess of the rate for Level I of the Executive Schedule under §5312 of Title 5 [39 U.S.C. §1003(a)].	\$199,700
II	The Postal Service may establish one or more programs to provide bonuses or other rewards to officers and employees of the Postal Service in senior executive or equivalent positions. 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 §1003(a), if such program has been approved. 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 §104 of Title 3 as of the end of the calendar year in which the bonus or award is paid. If the Postal Service wishes to have the authority to award bonuses or other rewards in excess of the limitation set forth in the last sentence of §1003 (a), the Postal Service shall make an appropriate request to the Board of Governors (Board), and the Board shall approve any such request if the Board certifies, for the annual appraisal period involved, that the performance appraisal system for affected officers and employees of the Postal Service (as designed and applied) makes meaningful distinctions based on relative performance. [39 U.S.C. §3686(a) & (b)].	\$230,700

¹ Compensation credited but not disbursed in CY 2011.

² Defined in this report as Postal Career Executive Schedule II employees.

³ The performance-based lump sum payment included as part of the Postal Service's National Performance Assessment program (or its annual pay-for-performance incentive program).

⁴ In 2011, seven Postal Service employees were paid at Level II, five were paid at Level III, and one was paid above Level III.

Level	Description	Dollar Limit
III	Notwithstanding any other provision of law, the Board 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 §104 of Title 3 as of the end of the calendar year in which such payment is received. For each exception made under this subsection, the Board shall provide written notification to the director of the Office of Personnel Management (OPM) and congress within 30 days after the payment is made setting forth the name of the officer or employee involved, the critical nature of his or her duties and responsibilities, and the basis for determining that such payment is warranted [(39 U.S.C. § 3686(c)]	\$276,840

Source: 39 U.S.C. §§1003(a) and 3686(b) and (c).

Postal Service officers may appropriately receive additional benefits not subject to the compensation cap, including increased annual leave exchange hours, free financial counseling, parking, life insurance, health benefits, and other perquisites.⁵ Also, in certain limited cases, officers have contractual incentive benefits that, when not tied to any performance goals and measures, are subject to the compensation cap in the year they are earned.

Conclusion

Although the Postal Service complied with Postal Service policies and guidelines and IRS regulations for CY 2011, it did not always comply with annual officer compensation caps as stated in the Postal Act of 2006. We believe failure to comply is a result of its misinterpretation of the relevant statutory authority in the Postal Act of 2006. Our findings are all tied to this misinterpretation.

Of the 38 officers reviewed, we identified three officers whose compensation exceeded or otherwise failed to comply with the compensation caps imposed by the Postal Act of 2006. As shown in Table 2, we identified one officer who received a lump sum re-assignment incentive that was not tied to performance; one officer whose position was not included on the list of critical senior executives provided to the OPM and congress; and one officer whose annuity⁶ was not considered as part of the basic salary for computing the compensation cap.

⁵ The Postal Service offers driver and personal security services through the U.S. Postal Inspection Service (Inspection Service) to the postmaster general.

⁶ Annuity benefits received by re-employed annuitant from OPM. A re-employed annuitant is a person who is receiving a Civil Service Retirement System or Federal Employee Retirement System retirement annuity and, at the same time, is earning a paycheck as a federal employee.

Table 2: Compensation Data

Officer	Basic Salary	Incentive Payment	Total Compensation	Cap	Payment Above Cap
1	\$183,861	\$20,000 ⁷	\$203,861	\$199,700	\$4,161
2	\$230,000	\$0	\$230,000	\$199,700	30,300
3	\$245,000 ⁸	\$61,250 ⁹	\$306,250	\$230,700 ¹⁰	75,550
Total Payment Above Cap					\$110,011

Sources: Employee Master File and Eagan Accounts Payable Applications.

As a result, during CY 2011, the Postal Service paid a total of \$110,011 above the compensation cap imposed by the Postal Act of 2006. See [Appendix B](#) for monetary impact.

We noted that the manager, Compensation, sometimes consults with Postal Service General Counsel on compensation issues. We take no exception to that practice in general. However, the General Counsel should have been designated as a critical senior executive or equivalent position. If issues arise specifically for that position, there could be a conflict of interest, whether in fact or appearance. We suggest the Postal Service General Counsel refrain from providing advice on any compensation issues related specifically to that position to avoid conflict of interest concerns.

Compensation Cap

Of the 38 officers reviewed, we identified three whose compensation exceeded or otherwise failed to comply with the compensation cap for CY 2011 imposed by the Postal Act of 2006. Specifically:

- We identified one officer who received a lump sum reassignment incentive that was not tied to performance. The incentive payment of \$20,000 added to the officer's basic salary of \$183,861 brought the total annual compensation to \$203,861. Bonuses or awards not directly tied to performance are subject to the cap and must be considered wages in the year they are earned, even if that compensation is deferred to a later date. Therefore the Postal Service paid the officer \$4,161 above the cap.

⁷ Lump-sum reassignment incentive award on promotion.

⁸ The employment agreement of this officer stated the officer will be compensated with the basic salary paid at the annual rate of \$245,000. It also defined basic salary as the sum of the annual salary (\$113,048) and the annuity amount (\$131,952).

⁹ Performance incentive award of 25 percent of basic salary.

¹⁰ This cap is applicable if the Board determines that a bonus or award is based on a performance appraisal system that makes meaningful distinctions based on relative performance. Management recently revised this officer's employment agreement to more clearly link the incentive award to performance. However, the U.S. Postal Service Office of Inspector General (OIG) is unsure the revision reflects a true performance measure and suggests management re-assess the language. Refer to the [Other Matters to Be Reported](#) section of this report.

- We identified one officer whose position was not included on the list of critical senior executives provided to the OPM and congress. Management advised us in discussions that this officer occupied a critical senior executive or equivalent position, 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. However, this officer was excluded from the list provided to the OPM and congress¹¹ because management believed the requirement only exists for officers who exceed the second salary cap of \$230,700. The Postal Act of 2006¹² requires written notification to the OPM and congress of all critical positions made under that provision, not just those that exceed the second salary cap. Also, officers may only be paid in excess of the Executive Level 1 pay cap if they receive a bonus based on relative performance or are listed as one of the critical positions. As a result, the Postal Service paid this officer \$30,300 above the cap of \$199,700.

- We identified one officer whose annuity was not included as part of the basic salary for computing the compensation cap. Management informed us that this officer occupied a critical senior executive or equivalent position. However, the Postal Service excluded this officer from the list provided to the OPM and congress identifying critical employees or positions. The officer received an annual salary of \$113,048, an annuity payment of \$131,952, and a performance-related incentive payment of \$61,250 for total compensation of \$306,250. The officer's employment agreement stated the officer would be compensated with the basic salary paid at the annual rate of \$245,000. It also defined basic salary as 'the sum of annual salary (\$113,048) and the annuity amount (\$131,952).' Management contended that the annuity payment should be excluded from the pay cap. They advised that they used the same method to calculate compensation subject to the cap as in FY 2010, and the OIG's previous report did not include annuity payments in the calculation of the salary cap. Further, they verified their approach through outside tax counsel.

The OIG did not report the issue with this officer previously; however, the officer's total compensation did not exceed the \$199,700 salary cap during CY 2010.¹³ Management also informed us that this officer occupied a critical senior executive or equivalent position. However, the Postal Service excluded this officer from the list provided to the OPM and congress identifying critical employees or positions. Management believed the requirement only exists for officers that exceed the Level II salary cap of \$230,700. However, the Postal Act of 2006 requires written notification to the OPM and congress for all critical positions made under that provision, not just those that exceed the second salary cap. As a result, the Postal Service paid this officer \$75,550 above the cap of \$230,700. Furthermore, by failing to include the annuity payments in the calculation of the cap, this executive

¹¹ Memorandum dated January 23, 2012.

¹² Section 3686(c), Bonus Authority.

¹³ During CY 2010, the officer received a base salary of \$39,132, a merit lump sum of \$13,000, and a recruitment bonus of \$95,000. In addition, the officer received an annuity payment of \$131,952. Since the officer began working at the Postal Service on August 14, 2010, only a prorated portion of the total annuity payment (\$45,676) was included in the salary cap calculation. Therefore, the total compensation was \$192,808, which was below the first cap of \$199,700 established for CY 2010.

received compensation in excess of the maximum allowable limit for Level III, \$276,840.

Other Matters to Be Reported

At the end of FY 2011, management amended an officer's employment agreement to more clearly link the incentive award to performance. Specifically, they added verbiage ". . .provided the Postmaster General determines (the officer) discharged his duties in a satisfactory manner during the relevant twelve-month period." However, because the amount of the award is set, in advance, by contract, we believe it is neither part of an "appraisal system" nor a result of any evaluation of "relative performance." This change to the language does not address the concerns we raised last year. We suggest management reassess language in the agreement to determine whether it makes meaningful distinctions as to the requirements necessary.

Recommendations

We recommend the postmaster general:

1. Coordinate with the Board of Governors to ensure the Postal Service reports to the Office of Personnel Management and congress a complete list of critical senior executive or equivalent positions allowed to receive total compensation in an amount not to exceed 120 percent of the total annual compensation payable to the vice president of the U.S.
2. Request an interpretation from the Government Accountability Office on whether annuity payments are considered in an employee's total compensation and subject to the Postal Act of 2006 compensation caps.

Management's Comments

Management disagreed with recommendation 1 and its corresponding monetary impact because they believe it is based on an incorrect finding that officer compensation exceeded the statutory compensation cap for FY 2011. They stated they already have a process to ensure the Postal Service adheres to the statutory compensation caps. They also stated that they coordinated with the Board on reporting requirements after the Postal Act of 2006 was enacted and since then they have continuously followed the same process for notifying congress and the OPM. In support of their position that the compensation cap was not exceeded, they provided their interpretations of 39 U.S.C. §3686.

Management agreed with recommendation 2, in part, and stated that the interpretation should come from the Department Of Justice's (DOJ) Office of Legal Counsel since they are responsible for interpreting the law affecting a component of the federal government.

Management stated that the general counsel does not provide advice on matters concerning her salary and benefits but advises the Board and management on a variety of legal matters, including compensation-related legal questions. Refraining from this would discharge her from her full responsibilities. When it is necessary to resolve legal issues affecting the general counsel's salary and benefits, the Law Department uses outside counsel.

In addition, regarding the language in an officer's agreement, management believes it satisfies the pertinent requirements.

Subsequent to receipt of management's written comments, they acknowledged that the differences stem from a fundamental disagreement with the interpretation of the law and not from the failure of systems or a lack of attention to detail. Management agreed to seek the advice of the DOJ's Office of Legal Counsel on these matters. Also, subsequent to issuance of the final report, management will work with our office on the precise legal questions to be submitted. See [Appendix C](#) for management's comments in their entirety.

Evaluation of Management's Comments

The OIG considers management's alternative action described for recommendation 2 in the report and also in subsequent discussions responsive to both recommendations. We agree that having the DOJ's Office of Legal Counsel address these concerns would be beneficial. We will work with the Postal Service on the specific questions to be submitted.

In reviewing management's response, we have a fundamental disagreement on the proper interpretation of the law described above. The OIG interprets the statute as requiring any compensation paid above Level I (\$199,700) be in the form of a bonus or other award, the receipt and amount of which is based solely and specifically on relative performance. This limitation must be applied to any bonus or award and may take an executive's total compensation from \$199,700 to the upper limit of Level II (\$230,700). Additionally, the Postal Service may designate up to 12 key officers that may receive any form of compensation (whether bonus or regular salary) up to the limit of Level III (\$276,840), as long as those key officers are identified to OPM and congress. Under this analysis, no employee, except a designated key officer, may receive a regular salary (exclusive of bonuses or other awards based on performance) of more than the \$199,700.

The Postal Service interprets this statute differently and has opined that, notwithstanding the fact that this section is titled Bonus Authority, 39 U.S.C. §3686 has given it the authority to give regular salaries up to the limit of Level II (\$230,700), as long as it generally has an evaluation system that makes distinctions based on performance. These divergent interpretations lead us to agree that an advisory opinion will better resolve the issues and other matters than our original recommendations to coordinate with the Board regarding reporting critical senior executive or equivalent

positions and to coordinate with the Government Accountability Office on whether annuity payments are considered in an employee's total compensation and subject to the Postal Act of 2006 compensation caps.

The intent of our comments on the general counsel providing advice on compensation issues specifically related to that position was to avoid conflict of interest concerns, whether in fact or appearance. The Law Department's use of outside counsel familiar with federal employment and compensation issues when it is necessary to resolve legal issues affecting the general counsel's salary and benefits should alleviate those concerns.

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

Appendix A: Additional Information

Background

Passage of the Postal Act of 2006 amended 39 U.S.C. by imposing guidelines on total compensation for the Postal Service. Compensation includes annual salary, merit lump sum payments,¹⁴ bonuses, awards, and annuity payments. 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 2011.
- With the approval of the 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 2011.
- 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 a 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 2011.

The Postal Act of 2006 requires written notification to the OPM and congress of each senior executive or equivalent position designated as critical. On January 23, 2012, the Board reported the following positions as critical for CY 2011:

- Postmaster general and chief executive officer.
- Chief financial officer and executive vice president.
- Chief human resources officer and executive vice president.
- Chief operating officer and executive vice president.
- Chief information officer and executive vice president.

In addition, the Board identified the following three positions as critical but did not notify the OPM and congress:

- Deputy postmaster general.
- President and chief marketing/sales officer.
- General counsel and executive vice president.

¹⁴ The performance-based lump sum payment included as part of the Postal Service's National Performance Assessment program (or its annual pay-for-performance incentive program).

Postal Service officers may receive additional benefits appropriately not subject to the compensation cap, including increased annual leave exchange hours, free financial counseling, parking, life insurance, health benefits, and other perquisites.¹⁵ Also, in certain limited cases, officers have contractual incentive benefits that, when not tied to any performance goals and measures, are subject to the compensation cap in the year they are earned.

In certain limited cases, the Postal Service entered into agreements to provide executive retention bonuses that may take the form of deferred compensation. As shown in Table 3, three active and two inactive officers have outstanding balances of deferred compensation.

Table 3: Cumulative Deferred Compensation as of December 31, 2011

Officer	Name	Cumulative Deferred Balance	Status
1	Anthony J. Vegliante	\$61,700	Active
2	Joseph Corbett	69,996	Active
3	Patrick R. Donahoe	7,376	Active
4	John E. Potter	786,301	Inactive
5	Ross Philo	642,999	Inactive
Total of deferred balance		\$1,568,372	

Source: Eagan Accounts Payables System (EAPS).

Objective, Scope, and Methodology

The objective of this portion of the FY 2012 U.S. Postal Service Financial Statements Audit – Eagan Accounting Services – was to determine whether the Postal Service complied with the cap, Postal Service policies and guidelines, and IRS regulations for CY 2011 compensation for officers.

To achieve our objective, we:

- Interviewed Postal Service personnel.
- Reviewed compensation information from payroll systems.
- Reviewed bonus, award, and deferred compensation information from EAPS.
- Reviewed IRS guidelines for reporting wages and taxes.
- Reviewed employment agreements of three officers.

We conducted this portion of the audit from March through October 2012, 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

¹⁵ The Postal Service offers driver and personal security services through the Inspection Service to the postmaster general.

evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. 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 16, 2012, and included their comments where appropriate.

We relied on computer-generated data from payroll systems and EAPS for testing compensation, awards, bonuses, and annual leave exchange. We assessed the reliability of this data by reviewing existing information about the data and the system that produced them and using advanced data analysis techniques to test data gathered from these systems. We also performed specific internal control and transaction tests, to include tracing selected information to supporting source records. As such, we determined this data to be sufficiently reliable for the purpose of this report.

Prior Audit Coverage

Report Title	Report Number	Final Report Date	Monetary Impact
<i>Officer Compensation for Calendar Year 2010</i>	FT-AR-11-011	9/23/11	\$59,174
Report Results:			
<p>The Postal Service did not always comply with the cap and with IRS regulations. An officer exceeded the cap because he received a retention bonus not tied to performance. The Postal Service also did not report Social Security wages or withhold and pay taxes on deferred compensation for one officer and did not timely report Medicare wages or timely withhold and pay taxes on deferred compensation for one prior and four current officers. We recommended management develop and implement policies and procedures to ensure adherence to the cap, report and pay the correct amount of Social Security and Medicare wages and taxes owed, 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. Management disagreed that the Postal Service exceeded the cap but agreed to link enhanced compensation to performance in current and future agreements. They also agreed to report and submit corrected wages and taxes, establish accounts receivables for the employees' portion of these taxes, and modify processes and/or systems to calculate appropriate taxes.</p>			
Report Title	Report Number	Final Report Date	Monetary Impact
<i>Officer Compensation for Calendar Year 2009</i>	FT-WP-10-001	4/12/10	None
Report Results:			
<p>The Postal Service complied with the compensation limits stated in the Postal Act of 2006. We made no recommendations.</p>			

Appendix B: Monetary Impact

Recommendation	Impact Category	Amount
1	Questioned Cost ¹⁶	\$110,011

¹⁶ Unnecessary, unreasonable, unsupported, or an alleged violation of law, regulation, contract, etcetera. May be recoverable or unrecoverable. Usually a result of historical events.

Appendix C: Management's Comments

PATRICK R. DONAHOE
POSTMASTER GENERAL, CEO



September 20, 2012

LUCINE M. WILLIS

SUBJECT: Draft Audit Report—Officer Compensation for Calendar Year 2011
(Report No. FT-AR-12—DRAFT)

Thank you for the opportunity to respond to your September 5 draft audit report on Officer Compensation for Calendar Year (CY) 2011. Our response to each recommendation in the report is attached.

We have rejected the first recommendation in its entirety, and accept the second recommendation only insofar as management agrees to seek yet another opinion on this matter, this time from the Department of Justice's Office of Legal Counsel.

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 Scott J. Davis, Director, Executive Compensation and Compliance, at 202-268-8008.

A handwritten signature in black ink, appearing to read "Patrick R. Donahoe".

Patrick R. Donahoe

Attachment

cc: Mary Anne Gibbons
Anthony J. Vegliante
Julie S. Moore
Scott J. Davis
Sally Haring

475 L'ENFANT PLAZA SW
WASHINGTON, DC 20260-0010
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Audit Report – Officer Compensation for Calendar Year 2011

Recommendation 1:

Coordinate with the Board to ensure the Postal Service reports to the Office of Personnel Management (OPM) and Congress a complete list of critical senior executive or equivalent positions allowed to receive total compensation in an amount not to exceed 120 percent of the total annual compensation payable to the vice president [sic] of the U.S.

Management Response:

Management rejects this recommendation. Management already employs a highly effective process to ensure the Postal Service adheres to the statutory compensation caps. To the extent this recommendation implies that management does not coordinate with the Board of Governors on reports to Congress and OPM, it is incorrect. Management coordinated with the Board of Governors on the reporting requirements after the Postal Accountability and Enhancement Act was enacted in 2006. Since that time, management has followed the same process for reporting to Congress and OPM. This process includes providing drafts of the reports to the Board's Compensation and Management Resources Committee before they are filed. The effectiveness of this process is demonstrated by the fact that for Calendar Year (CY) 2011, all of the compensation paid to every Postal Service officer and employee was within the limits set by law. Therefore, management disagrees with this recommendation.

This recommendation is based upon the audit report's incorrect finding that officer compensation in CY 2011 exceeded the statutory compensation limit by \$110,011. In fact, CY 2011 officer compensation did not exceed the compensation cap at all. The audit report's faulty conclusion rests upon its analysis of the compensation received by three officers, each of whom is discussed below.

One Officer Properly Received A Reassignment Incentive

According to the audit report, the compensation paid to one officer exceeded the cap because that officer "received a lump-sum re-assignment incentive"¹ As an earlier draft of the same audit report noted, this officer received this payment as an incentive to "relocate to a new area"² The audit report incorrectly states that only bonuses or awards "tied to performance" may exceed the limit for Executive Schedule Level I, which was \$199,700 in CY 2011.³ According to the report, as relocation incentives are not tied to performance, those incentives may not be paid when such payment would cause an officer's annual compensation to exceed the limit for Executive Schedule Level I.⁴ The report is incorrect.

¹ Draft Audit report, Sept. 5, 2012, p. 3.

² Discussion Draft Audit report, August 3, 2012, p. 3.

³ Draft Audit report, Sept. 5, 2012, p. 3.

⁴ *Id.*

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Audit Report – Officer Compensation for Calendar Year 2011

Section 3686(b) of Title 39 of the United States Code provides in relevant part:

(a) **In General.**— The Postal Service may establish 1 or more programs to provide bonuses or other rewards to officers and employees of the Postal Service in senior executive or equivalent positions to achieve the objectives of this chapter.

(b) **Limitation on Total Compensation.**—

(1) **In general.**— Under any such program, the Postal Service may award a bonus or other reward in excess [Executive Schedule Level I], 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 as of the end of the calendar year in which the bonus or award is paid.

(2) **Approval process.**— If the Postal Service wishes to have the authority, under any program described in subsection (a), to award bonuses or other rewards in excess of the limitation set [for Executive Schedule Level I] —

(A) the Postal Service shall make an appropriate request to the Board of Governors of the Postal Service in such form and manner as the Board requires; and

(B) the Board of Governors shall approve any such request if the Board certifies, for the annual appraisal period involved, that the performance appraisal system for affected officers and employees of the Postal Service (as designed and applied) makes meaningful distinctions based on relative performance.

(Emphasis supplied). The terms of the statute do not require that every payment made to an officer be based on performance; instead the statute requires that the compensation “system” “make[] meaningful distinctions” based on performance. The audit report does not suggest that the Postal Service lacks a performance-driven compensation system; indeed, the contrary is true. Further, the statute provides that where such a system is in place, the total annual compensation of an officer may not exceed the annual compensation of the Vice President, which was \$230,700 in CY 2011. The Calendar Year 2011 compensation for the officer who received the relocation incentive was significantly below this limit.

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Senior employees of federal agencies with certified performance appraisal systems may receive relocation incentives as long as their total annual compensation does not exceed the Vice President's.⁵ These other federal employees may receive non-performance-based incentives as long as their total annual compensation does not exceed the Vice President's and their agency has a system that, as a whole, makes meaningful distinctions based on performance. The statute that establishes this rule for other federal employees is section 5307(d) of Title 5 of the United States Code. This statute is substantially similar to section 3686(b) of Title 39 of the United States Code, which governs Officer one's compensation. Sections 5307(d)(1) and (2) of Title 5 provide in relevant part:

[n]otwithstanding any other provision of this section, [the limit on total annual compensation for employees of agencies with] a performance appraisal system certified under this subsection as making, in its design and application, meaningful distinctions based on relative performance" [shall be the] total annual compensation payable to the Vice President.⁶

Pursuant to section 5307(a) of Title 5, the limitation on compensation includes every "allowance, differential, bonus, award, or other similar cash payment under this title" Title 5 expressly allows employees in agencies with certified performance appraisal systems to receive relocation bonuses, per section 5753 of Title 5.

OPM's compensation regulations further amplify that relocation incentives may be paid to employees of agencies with certified performance appraisal systems, as long as an employee's total annual compensation does not exceed that of the Vice President. Section 203(b)(2) of Title 5 of the Code of Federal Regulations provides that senior employees in agencies with certified performance appraisal systems may not receive "aggregate compensation to exceed the total annual compensation payable to the Vice President under 3 U.S.C. 104 on the last day of that calendar year (i.e., the aggregate limitation)." In turn, section 530.202 of Title 5 of the Code of Federal Regulations defines "aggregate compensation" to include all of the following:

- (1) Basic pay received as an employee of the executive branch or as an employee outside the executive branch to whom the General Schedule applies;
- (2) Premium pay under 5 U.S.C. chapter 53, subchapter IV;
- (3) Premium pay under 5 U.S.C. chapter 55, subchapter V;

⁵ 5 U.S.C. § 5307(d)(1).

⁶ 5 U.S.C. § 5307(d)(1), (2). (Emphasis supplied).

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- (4) Incentive awards and performance-based cash awards under 5 U.S.C. chapters 45 and 53;
- (5) Recruitment and relocation incentives under 5 U.S.C. 5753 and retention incentives under 5 U.S.C. 5754 ;
- (6) Extended assignment incentives under 5 U.S.C. 5757 ;
- (7) Supervisory differentials under 5 U.S.C. 5755 ;
- (8) Post differentials under 5 U.S.C. 5925 ;
- (9) Danger pay allowances under 5 U.S.C. 5928 ;
- (10) Post differentials based on environmental conditions for employees stationed in nonforeign areas under 5 U.S.C. 5941(a)(2);
- (11) Physicians' comparability allowances under 5 U.S.C. 5948 ;
- (12) Continuation of pay under 5 U.S.C. 8118 ;
- (13) Lump-sum payments in excess of the aggregate limitation on pay as required by § 530.204; and
- (14) Other similar payments authorized under title 5, United States Code

(Emphasis supplied). In addition to expressly allowing the payment of relocation incentives as part of "aggregate compensation" up to the amount of the Vice President's salary, the list set out above establishes that a number of bonuses other than "incentive awards and performance-based cash awards" may be properly paid. If the only bonuses that could be paid were performance-driven, there would be no reason to include such bonuses in a list with thirteen other kinds of awards that an agency may properly issue.

The statutory limit that governed this officer's Calendar Year 2011 compensation is patterned after a federal statute that allows employees to receive relocation incentives, as long as their total annual compensation does not exceed the Vice President's. This officer's total Calendar Year 2011 compensation was substantially below that of the Vice President; therefore, the Postal Service did not exceed the statutory compensation limit.

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Audit Report – Officer Compensation for Calendar Year 2011

A Second Officer's Calendar Year 2011 Salary Was Less Than the Vice President's, And Therefore, In Compliance With The Pay Cap

According to the audit report, a second officer received total Calendar Year 2011 compensation above Executive Schedule Level I, but below the Vice President's annual compensation.⁷ This officer's total compensation consisted entirely of salary; no bonuses were paid to this officer.⁸ Even though this officer's total compensation was below that of the Vice President, the audit report concludes that the Postal Service violated the statutory compensation cap in connection with this officer. In reaching this conclusion, the audit is plainly wrong. Moreover, in arriving at this conclusion, the audit report has exceeded the authority of the Office of the Inspector General, and invaded the authority reserved to management of the agency. As the audit report correctly notes "[c]ompliance with the compensation cap is management's responsibility"⁹ This is management's role, not the Inspector General's.

It is a fundamental principle of the law that the "interpretation put on the statute by the agency charged with administering it is entitled to deference" and must be upheld if the agency acts reasonably and in accordance with Congressional intent.¹⁰ "[T]he task for the [OIG] was not to interpret the statute as it thought best but rather the narrower inquiry into whether the [Postal Service]'s construction was 'sufficiently reasonable' to be accepted"¹¹ Further, another fundamental principle is that in construing a statute, every term in that law should be given meaning, *i.e.*, a statute should not be interpreted so that any part of it is rendered meaningless.¹² The audit report violates both of these basic principles, in that it afforded no deference to the agency's interpretation of the law, and, on the contrary, adopted a strained and unreasonable reading of the statute. In setting this officer's compensation, the agency reasonably and correctly construed the relevant portions of section 3686 of Title 39 of the United States Code.

Section 3686(c) of Title 39 is entitled, "Exceptions for Critical Positions," and provides:

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

⁷ Draft Audit Report, September 5, 2012, p. 2.

⁸ *Id.*

⁹ Draft Audit report, September 5, 2012, p. 4.

¹⁰ *Federal Election Commission v. Democratic Senatorial Campaign*, 454 US 27, 31-32 (1981).

¹¹ *Id.* at 39.

¹² *Duncan v. Walker*, 533 U.S. 167, 174 – 175 (2001), quoting, *United States v. Menasche*, 348 U.S. 528, 538 – 539 (1955): "It is our duty to give effect, if possible, to every clause and word of a statute." (Internal quotations and citations omitted).

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104 of title 3 as of the end of the calendar year in which such payment is received. For each exception made under this subsection, the Board shall provide written notification to the Director of the Office of Personnel Management and the Congress within 30 days after the payment is made setting forth the name of the officer or employee involved, the critical nature of his or her duties and responsibilities, and the basis for determining that such payment is warranted.

(Emphasis supplied). The audit report construes this statute to mean that the Postal Service must identify in its report to Congress every “critical senior executive” who earns more than Executive Schedule Level I, even if that officer’s total annual compensation is below that of the Vice President.¹³ The audit report further states that “officers may only be paid in excess of the Executive Schedule Level 1 pay cap if they receive a Board approved bonus based on performance or they are listed as one of the critical positions.”¹⁴ This entire interpretation is incorrect, in that it is at odds with the language of Section 3686(c) and it would render meaningless the remaining subsections of Section 3686.

As provided by subsection (a) of Section 3686 of Title 39, the Postal Service is authorized to

establish 1 or more programs to provide bonuses or other rewards to officers and employees of the Postal Service in senior executive or equivalent positions to achieve the objectives of this chapter.

(Emphasis supplied). There is no dispute that the officer in question holds a “senior executive or equivalent” position, and as such, qualifies to participate in a performance-driven compensation program. Further, it cannot be argued that any such program should be limited to bonuses, as the statute provides for “bonuses or other rewards.”¹⁵ Finally, as discussed above, in connection with the first officer, in administering a similar statute, OPM provides for all sorts of payments to be included within the compensation cap up to the Vice President’s salary, *including basic pay*.¹⁶

This second senior officer qualified for the compensation program the Postal Service established pursuant to subsection (b) of Section 3686 of Title 39. That portion of the statute authorizes the Postal Service to establish a performance-driven compensation system, with a total compensation cap set at the level of “the total annual compensation payable to the Vice President” This officer’s Calendar Year 2011 compensation was less than the Vice President’s, and therefore, was within the limits established by this statutory subsection.

¹³ Draft Audit Report, September 5, 2012, pgs. 3-4.

¹⁴ *Id.*

¹⁵ 39 U.S.C. § 3686(a).

¹⁶ 5 C.F.R. § 530.202(1).

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Audit Report – Officer Compensation for Calendar Year 2011

The audit report concludes that the Postal Service violated the statutory compensation cap even though the Postal Service complied with subsection (b) of Section 3686.¹⁷ The audit report contends that the Postal Service violated subsection (c) of Section 3686 of Title 39, because this second officer was not included in the Postal Service's report to Congress of officers in "critical positions," as purportedly required by subsection (c) of Section 3686.¹⁸ According to the report, if an officer is not included in the report to Congress of critical positions, the officer may not be paid more than the cap set by Executive Schedule Level I.¹⁹ This conclusion is wrong, and rests upon a flawed reading of subsection (c).

Subsection (c) states that "[n]otwithstanding any other provision of law,²⁰ the Board of Governors may allow up to 12 . . . critical senior executive[s] . . . to receive total compensation in an amount not to exceed 120 percent" of the Vice President's total annual compensation. This part of the statute further stipulates that "[f]or each exception made under this section²¹," OPM and the Congress are to be informed of the identity of the officer, "the critical nature of her or her duties and responsibilities, and the basis for determining that such payment is warranted."²² Although far from clear, the audit report appears to interpret this subsection of the statute as requiring the Postal Service to notify Congress and OPM of every officer in a critical position who receives total annual compensation above the limit set by Executive Schedule Level 1. This construction stands the statute on its head, and ignores Congress's clear intent to require reporting only when an officer's pay exceeds the limit set by subsection (b) of Section 3686 – the Vice President's salary. Further, this reading of the law would render section 3686(b) meaningless for certain officers, in that even if their compensation is within the limits of that subsection, the audit report would find the law to be violated. Congress could not have intended such an absurd result. Interpreting subsection (c) to apply only when compensation above the Vice President's salary is "warranted," gives meaning to subsections (b) and (c), in that subsection (c) is triggered only when compensation exceeds the limit set by subsection (b). Further, the statute's logic dictates this result. Subsection (c), which sets the highest compensation cap applicable to the Postal Service, requires that Congress be notified "within 30 days after payment is made" of the identity of each officer receiving such payment, the nature of the officer's duties and the "basis for determining that such payment is made." By contrast, subsection (b), which sets a lower cap, does not contain any such requirements. Plainly, this is because subsection (c) reflects Congress's concern that it be provided information concerning only the Postal Service's most highly-paid employees.

¹⁷ Draft Audit report, September 5, 2012, p. 3.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ Emphasis supplied.

²¹ Emphasis supplied.

²² Emphasis supplied.

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The conclusion that the Postal Service properly applied the compensation cap to this second officer is further supported by subsection (d) of Section 3686, which provides that in preparing its comprehensive statement to Congress, the Postal Service shall include:

the name of each person receiving a bonus or other payment during such period which would not have been allowable but for the provisions of subsections (b) [allowing compensation up to the Vice President's salary] or (c) [allowing compensation up to 120 percent of the Vice President's]²³

Subsection (d) of Section 3686 reflects two points, each of which establishes the Postal Service properly applied the compensation cap to this second officer. First, it demonstrates that Congress's overriding concern in enacting Section 3686 was to ensure that the Postal Service inform Congress about the Service's most highly-paid employees, *i.e.*, the criterion for informing Congress is the amount of pay an officer receives, not that officer's "criticality." Second, this subsection once again demonstrates that an officer's pay is proper if it satisfies the limits set by subsections (b) or (c), and that subsection (c) does not somehow invalidate compensation that is authorized by subsection (b).

The audit report is also based on an incorrect reading of the literal terms of the subsection (c). Subsection (c) provides that a critical officer's compensation may be paid up to 120 percent of the Vice President's "notwithstanding any other provision of law." The audit report appears to interpret this phrase to mean "without regard to any other provision of law." However, the plain meaning is otherwise. The dictionary defines "notwithstanding" to mean "without prevention or obstruction from."²⁴ Thus, subsection (c) means that even if a payment would be prevented by another section of the law, it would still be proper if the conditions of subsection (c) are satisfied. It does not mean, as the audit report states, that even if another statutory section permits a payment, subsection (c) can nevertheless prohibit it. This conclusion is buttressed by the title of subsection (c): "Exceptions for Critical Positions," meaning that even if compensation exceeds subsection (b)'s cap, it can still be authorized as an exception to that rule.

Finally, the audit report does not consider the possibility that the statute may have more than one reasonable construction, or whether management's interpretation is reasonable. In failing to consider this possibility, the audit report improperly arrogates to the Office of the Inspector General the authority to have the final word on the meaning of the Postal Service's organic statute. This is management's role, not the Inspector General's.

²³ Emphasis supplied.

²⁴ Websters' Third New International Dictionary, 1986 at p. 1545.

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The Postal Service Properly Applied The Compensation Cap To An Officer Who Is A Re-Employed annuitant

The Postal Service properly applied the compensation limit to a third officer, who is a re-employed annuitant. In Calendar Year 2011, the Postal Service paid this officer total compensation below the limit for Executive Schedule Level I. Nonetheless, the audit report concludes that this officer's compensation exceeded the cap because the sum of the compensation the Postal Service paid the officer, plus the annuity payments he received from OPM, exceeded the Postal Service's compensation cap for CY 2011.²⁵ Once again, the audit report is incorrect. The audit report does not include any support for its assertion that annuity payments must be considered when applying the Postal Service's compensation cap; there is no citation in the report to any statute, regulation or administrative or judicial decision in support of the assertion that annuity payments are subject to the compensation cap. Perhaps more importantly, the audit report's conclusion is again contrary to the plain language of the statute. Section 1003(a) of Title 39 limits "compensation" to the rate specified by Executive Schedule Level 1. Section 3686 provides for exceptions to this limit, and those exceptions also govern "compensation." "Compensation" means "payment for . . . service rendered."²⁶ This third officer's annuity was not within the compensation cap because he was entitled to receive it regardless of whether he rendered any services to the Postal Service during CY 2011, *i.e.*, his working for the Postal Service during CY 2011 had nothing to do with his receipt of the annuity payment. As the Postal Service informed the OIG during this audit, outside counsel has indicated that this officer's annuity should not be reported as compensation in the Compensation Discussion and Analysis section of the Postal Service's Annual Report, Form 10-K. This is

[b]ecause the annuity is fully vested and is his to keep whether or not he works for the USPS, the annuity does not appear to be compensation . . . for all services rendered in all capacities to the registrant . . .²⁷

The draft audit report mentions this opinion, but ignores it, and fails to mention why the OIG's conclusion is superior to outside counsel's.²⁸

The draft audit report acknowledges that the "OIG did not report the issue with this officer previously" even though the Postal Service entered into an employment agreement with this officer in 2010, and the OIG previously audited officer compensation for Calendar Year 2010.²⁹ The OIG absolves itself from any responsibility for failing to report this ostensibly improper contract because,

²⁵ Draft Audit Report, September 5, 2012, p. 4.

²⁶ Websters' Third New International Dictionary, 1986 at p. 463.

²⁷ Counsel's opinion was provided to the OIG on May 18, 2012. Internal parenthetical omitted.

²⁸ Draft Audit Report, September 5, 2012, p. 4.

²⁹ *Id.*

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says the OIG, “[c]ompliance with the compensation cap is management’s responsibility.”³⁰ Management submits that the OIG did not criticize this agreement previously because it complies with the applicable compensation cap.

Finally, the audit report levels the same criticism of this third officer’s compensation that it did with regard to the second officer’s compensation: even though this third officer was paid less than the limit for Executive Schedule Level 1, he should have been included in the report to Congress identifying critical officers.³¹ The response to this criticism is the same as stated in connection with the second officer’s compensation: it is wrong, because the only officers who must be included in the report to Congress are those whose total annual compensation exceeded the Vice President’s.

Recommendation 1 recommends that the Postmaster General “[c]oordinate with the Board to ensure” that the Postal Service provides OPM and Congress with “a complete list of senior executive or equivalent positions allowed to receive total compensation in an amount not to exceed 120 percent” of the Vice President’s total annual compensation.³² As the foregoing discussion establishes, the Postal Service presently does coordinate with the Board, and it properly reports to Congress and OPM those critical senior executives who receive compensation up to the pertinent limit.

Recommendation 2

Request an interpretation from the Government Accountability Office (GAO) on whether annuity payments are considered in an employee’s total compensation and subject to the Postal Act of 2006 compensation caps.

Management Response:

Management accepts this recommendation, in part. Management rejects the recommendation to request an interpretation from the GAO because the Department of Justice’s Office of Legal Counsel is charged with responsibility for providing an interpretation of law affecting a component of the federal government. In partially accepting this recommendation, management notes that this recommendation highlights the flaws in the OIG’s finding that the Postal Service violated the compensation cap in connection with the officer who is a re-employed annuitant. This is because the OIG has already determined that the Postal Service should have included the amount the officer receives as an annuity in determining the amounts subject to the compensation cap. If the OIG were correct, there would be no reason to request another opinion on this subject.

Other Matters:

³⁰ *Id.*

³¹ Draft Audit Report, September 5, 2012, p. 4.

³² Draft Audit Report, September 5, 2012, p. 5.

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The audit report “suggest[s] the Postal Service General Counsel refrain from providing any advice on any compensation issues related specifically to that [General Counsel] position to avoid conflict of interest concerns.”³³ The General Counsel does not provide legal advice concerning her pay or benefits. Indeed, the draft audit report does not cite a single instance where this has occurred. The General Counsel is responsible for advising the Board of Governors and management on a broad variety of legal matters, including compensation-related legal questions. Any suggestion that she refrain from rendering advice on such legal issues is unwarranted, and would prevent the General Counsel from discharging her full responsibilities. Were it to become necessary to resolve legal issues directly affecting the General Counsel’s salary and benefits, the Law Department would resort to outside counsel.

The audit report also suggests that management “re-assess language in [an officer’s] agreement to determine whether it makes meaningful distinctions as to the requirements necessary for a performance incentive.”³⁴ Management has reviewed this agreement, and has determined it satisfied pertinent requirements.

³³ Draft Audit Report, September 5, 2012, pgs. 3-4.

³⁴ Draft Audit Report, September 5, 2012, p. 5.