

## IRS Modified System [11]

NOTE: The content of this document has not been reviewed by legal counsel, nor does it represent a consensus view of the Design Team or indicate any kind of preference among options presented to the Senior Review Committee.

### Summary Description:

This option is based on the IRS Performance-Based Step System. The performance-based step system was originally developed in response to a reorganization of the IRS mandated by the IRS Restructuring and Reform Act of 1998 and a concomitant change in the role of managers – flattened organizations, increased spans of control, and the complexity of managers' jobs. This new, significantly more difficult role called for a new compensation system that would recognize the increased complexity of managerial work and that would equitably reward outstanding performers. Following are the key philosophies underlying the development of the performance-based step system:

- Higher performance should result in higher pay
- Higher pay engenders higher expectations
- Consider a longer time period than the traditional one-year review for base pay decisions
- Keep the system simple and transparent

The performance-based step system has two pay components: biennial base pay adjustments based on summary performance ratings for a given two-year period and annual performance awards based on the current summary performance rating. The system architecture consists of broad paybands comprising two or more GS grades, with constant-percentage steps (larger than GS step increases), increasingly higher performance rating step criteria as salary increases, and larger average performance bonuses than typically granted under the GS system. Given the direct link of base pay decisions to performance ratings, a point budget system ensures that distinctions in performance are made. The point system in operation essentially limits the number of Outstanding ratings to the number of Met ratings within a pay pool, although managers can make a business case for additional points in order to award a higher proportion of Outstanding ratings.

The system was designed to be cost-neutral with respect to the GS system.

Sub-option alternatives are noted in the system element discussion.

### Key Features:

#### Coverage

Covers all "white-collar" DHS employees who are now covered by chapter 53 of title 5, and, additionally, all "white-collar" TSA employees under the authority provided by law to the TSA Administrator and EP&R ("Stafford Act employees) under the authority provided by law.

#### Classification

- GS classification system establishes occupational series and supervisory status.
- Modified GS grading criteria and qualification requirements establish which payband a position is classified to and the minimum qualifications for that payband (since paybands comprise two or more GS grades, the GS grading criteria provide a mechanism for converting from the GS system to the payband, and the lowest GS grade incorporated in the payband establishes the minimum qualifications requirements for that band).

#### Pay

- Upon initial implementation of and conversion to the payband system, pay is set by first adjusting salary on a pro-rata basis for time spent towards the next GS within-grade step increase, and then by placement on step (that at least equals the adjusted salary) in the payband. Employees in a career-

## IRS Modified System [11]

ladder progression can be treated similarly.

- After implementation, pay is set upon placement in or promotion to a payband using modified GS pay setting practices.
- On a biennial basis, employees may be granted one or two steps – those meeting the summary performance rating criteria for the next step will be granted that step, while employees significantly exceeding those criteria may be granted two steps.
- On an annual basis, employees may be granted a performance bonus based on the current summary performance rating.

### Performance Management

- Managers assign summary performance ratings based on the two parts of the performance evaluation tool – a three-tier assessment against balanced measures (how the work was done), and a three-tier assessment of what work was accomplished with respect to agreed-upon commitments (established at the beginning of the performance year).
- A point budget ensures that performance distinctions are made and counters ratings inflation tendencies.
- Performance Review Boards ensure consistency, fairness, and equity.

### **Sub-Options:**

- This option presents a performance management system that evaluates employees against how work is done and what work is done. This may be most appropriate for those employees who have a degree of control over what can be accomplished. However, any performance management system that enables performance distinctions to be made and that has four levels may serve as the foundation of the performance-based step system.
- One sub-option - pilot this program on managers and supervisors first.

### **Relation to Other Options:**

- This option covers the pay, classification and performance management systems, but could also work with other performance management systems that make effective distinctions in performance.
- The option could work with any labor relations, discipline and appeal system.

**Implications** (This section contains "possible advantages/benefits" and "possible problems/challenges" and "other implications" suggested by design team members. The views expressed in these "implications" represent the opinions of one or more members of the design team and therefore reflect sometimes opposing points of view. These opinions do not reflect the collective judgment of the entire design team on any of the issues addressed, nor have they been reviewed by legal counsel.):

### Possible Advantages/Benefits

- Simple, transparent, performance-based system rewards high performance and supports mission goals.
- Point budget system helps managers make performance distinctions. The ability to make a business-based case for additional points prevents an absolute forced distribution of ratings.
- Step structure and up-front advancement criteria clearly indicate the requirements to advance and exactly how much the next step is worth.
- System considers performance over a longer term (two years).
- The size of the performance-based pay increases can be larger since they are given every two years – more effective in relating higher pay to higher performance.
- The performance criteria required to advance increase as the employee moves up the payband, reflecting the principle that higher pay engenders higher expectations.
- Using existing GS classification system simplifies implementation.

## IRS Modified System [11]

- The advancement criteria are designed to permit most employees to reach a salary level that they would have achieved under the General Schedule system.
- Performance Review Board or equivalent body helps ensure department-wide consistency in the performance rating process.

### Possible Problems/Challenges

- Cost-neutrality feature of this option could lessen acceptance of this system for employees who receive lower increases than they would have under the GS system, since these funds are used to fund higher increases for top performers.
- Needs a strong performance management system acceptable to employees.
- Requires extensive communication effort to both managers and employees.
- Application of performance standards should theoretically allow employees to achieve ratings with no additional controls. Use of the point budget system does not allow for this.
- Employees may not perceive the system as transparent and fair due to the end of year application of rating controls, which are not factored into mid year performance assessments.
- Complexity of this system would create greater disruption and loss of focus on mission, in both transition and in administration.
- Review of employee ratings by members of Performance Review Board who do not have direct knowledge or observation of employee performance may raise concerns among employees about the objectivity of ratings.
- Use of share-type system for distributing pay increases (suboption 7) may be viewed as contrary to team concept, with employees competing against one another for pay increases. Although organizational or team-based performance could be included as a factor in individual performance and pay determinations, this will necessarily lessen the extent to which pay is differentiated based on individual performance.
- Some believe that not providing external appeal rights to an independent third party could reduce management accountability and may lessen acceptance of the system.
- Imposes additional administrative burdens on supervisors and managers (e.g., in administering a pay-for-performance system and in dealing with complaints).
- Some employees may not have confidence in current performance appraisal process, which could result in concerns about implementation of a pay for performance system.
- Some believe that pay for performance could result in competition between employees and lessen incentive for teamwork and cooperation or that distinctions based on individual performance are not possible in some positions given the mission and nature of the work.
- Some believe that not providing external appeal rights to an independent third party could reduce management accountability and may lessen acceptance of the system.

### Other Implications

- Unless the current labor relations system is modified, a DHS independent pay system, including the rates of pay, would be subject to collective bargaining.
- Pay-for-performance systems may not be appropriate for all occupational groups.
- In order to implement this system effectively, a strong and well-managed performance management system is required.
- Performance rating controls are not popular, but some management control is necessary when pay adjustments are directly linked to performance ratings. (Another way to address this could be by utilizing a SHARE distribution of funds as described in the Suboption 7 below.)

## IRS Modified System [11]

### Cost

- Transition of employees to the system would require “buying out” employees for accrued time toward their next increase, in order to promote employee acceptance of the new system. The system would also require placing them on steps in the new system. However, ongoing payroll adjustments compare favorably with the GS system.
- Increase to performance award budget required to sustain larger average performance bonuses.

### **Evaluation in Terms of Guiding/Design:**

#### Mission Centered

- Provides equitable compensation for higher individual performance, leading to higher organizational performance.
- Well-designed performance management system can focus on relationship of individual performance to organizational success and mission accomplishment.
- Increased complexity of pay and performance management systems, and forced distribution of ratings based on point budget system, may be disruptive to many employees, and distract them from focus on the mission.

#### Performance Focused

- Recognizes, rewards, and reinforces high performance.
- Performance management system ensures meaningful distinctions in performance.
- Providing employees who are doing an acceptable job meeting all performance standards with smaller pay increases than received under the current system may de-motivate a significant segment of employees.

#### Contemporary and Excellent

- Enhances ability to attract and retain high-performing employees.

#### Generate Trust and Respect

- Simplicity and transparency generate trust and respect.
- System may not be trusted or respected if there is no employee input (through collective bargaining or otherwise) into identification of what is being measured and evaluated for determining employee performance and pay increases.
- Success of system will depend largely on the strength and credibility of the performance management system, including providing training so that supervisors have the resources and skills to properly administer the system.

#### Based on Merit System Principles and Fairness

- Provides equitable compensation for higher individual performance in accordance with merit system principles.
- Failure to assess performance solely against performance standards may be perceived as unfair.

### **Transition & Implementation:**

- Performance management system must enable performance distinctions to be made.
- There needs to be extensive communication with employees with respect to conversion procedures, how base pay increases and bonuses are granted, and how the point budget system works.

**Detailed Description  
By System Component and System Element**

<b>B</b>		<b>Base Pay System</b>
System elements:		Summary description:
1	Structure of pay ranges	<ul style="list-style-type: none"> <li>• System consists of seven broad pay ranges - three for managers and four for non-managers. The organizational and General Schedule (GS) grade level of managers determines initial placement in the bands. Front line managers supervising administrative work at GS-1 through GS-10 levels are covered by the FM-I band. Front line managers supervising technical work at GS-5 through GS-14 would be covered by the FM-II band. Non-supervisory work would fall into one of four bands, equivalent to GS-1 to GS-5, GS-5 – GS-11, GS-11 to GS-13, and GS-14 to GS-15.</li> <li>• Each payband consists of a number of constant-percentage steps – 4.8% for the Senior Manager band and approximately 4% for each of the remaining bands.</li> <li>• Each payband is divided into performance levels. The performance rating criteria needed to advance into and through each level increase at each successive level.</li> </ul> <p style="margin-left: 40px;"><b>Suboption 1.</b> Tailor the GS range definition of paybands associated with groups of occupations. For example, the non-supervisory paybands associated with a group of GS-11 journey positions might be: GS-5 to GS-9 – Entry/Developmental Band GS-11 to GS-13 – Journey Band GS-14 – Senior/Expert Band</p> <p style="margin-left: 40px;"><b>Suboption 2.</b> Each band is an open range, divided into performance levels. Upon meeting the performance rating criteria to move into or through a given performance level, the employee is granted a “virtual step”, that is, a fixed percentage increase in salary. Substantially exceeding the criteria would result in two virtual steps. The advantage here is that implementation costs are reduced since employees do not have to be placed on a step in the new system.</p> <p style="margin-left: 40px;"><b>Suboption 3.</b> Each band is delinked from the GS grade structure – this requires a change to the classification system. The advantage is that bands could be more closely tailored to specific occupational environments.</p> <p style="margin-left: 40px;"><b>Suboption 4.</b> Each band is an open range, but the band ranges can be extended beyond the current GS grade structure. Advancement through the range using a SHARE type system (see Suboption 7 below.)</p>
2	Adjustment of pay ranges	<ul style="list-style-type: none"> <li>• Basic pay ranges are adjusted consistent with GS general increases.</li> <li>• Locality payments are adjusted consistent with GS locality payments.</li> <li>• Both adjustments also apply to incumbents.</li> </ul>

		<p><b>Suboption 5.</b> Structural payband adjustments apply only to the payband minimums and maximums and do not automatically apply to incumbents. This creates a bigger pay pool and requires a different step or virtual step structure for the bands to account for the larger pay pool. The larger pool permits greater flexibility in granting step increases, but likely increases complexity. Use of this Suboption could result in erosion of employee pay vis-a-vis the labor market, and is not compatible with Suboption 7 below.</p>																																																												
3	Pay progression methodology	<ul style="list-style-type: none"> <li>Pay progression is a function of two performance ratings during a scheduled biennial review cycle. If the two performance ratings meet or exceed the criteria to advance into or through the performance level, a step increase is granted. Substantially exceeding the criteria results in a two-step increase (fast-track increase). If an employee has only one performance rating for the biennial salary review, meeting the higher of the two ratings normally required to advance will be sufficient to gain a step increase. Fast-track increases are not possible with only one rating during the cycle.</li> </ul> <p><b>Suboption 6.</b> Use an annual rather than a biennial salary review cycle. The number of steps or virtual steps doubles (and the value of each step is halved). Criteria to advance a given number of steps are expressed either as a single rating or a rolling two-year cycle that takes the last two ratings into account.</p> <ul style="list-style-type: none"> <li>The Senior Manager (SM) band shown below illustrates the payband step and performance level structure. A step increases salary by 4.8%. Pay progression is based on a biennial salary review. Employees must meet the performance criteria for the next step to advance to that step. For example, to advance to step 3 from step 2 requires at least one Met and one Exceeded performance rating during the two-year salary review period. In addition to the standard step increase, employees can qualify for a “fast-track” or 2-step increase. A fast-track increase requires ratings that significantly exceed the criteria normally required to advance. For example, to go from step 2 to step 4 requires an Exceeded and an Outstanding rating.</li> </ul> <table border="1" data-bbox="446 1501 1409 1743"> <thead> <tr> <th colspan="10">Senior Manager Band</th> </tr> <tr> <th colspan="2">Level I</th> <th colspan="4">Level II</th> <th colspan="2">Level III</th> <th colspan="2">Level IV</th> </tr> <tr> <th>1</th> <th>2</th> <th>3</th> <th>4</th> <th>5</th> <th>6</th> <th>7</th> <th>8</th> <th>9</th> <th>10</th> </tr> </thead> <tbody> <tr> <td>72k</td> <td>76k</td> <td>80k</td> <td>83k</td> <td>87k</td> <td>92k</td> <td>96k</td> <td>101k</td> <td>106k</td> <td>111k</td> </tr> <tr> <td colspan="2">MM</td> <td colspan="4">ME</td> <td colspan="2">EE</td> <td colspan="2">EO</td> </tr> <tr> <td colspan="2">EE</td> <td colspan="4">EO</td> <td colspan="2">OO</td> <td colspan="2"></td> </tr> </tbody> </table> <p>Employees not awarded a step maintain their current pay rate.</p> <ul style="list-style-type: none"> <li>Other bands are similarly constructed – see the attached chart for a graphic representation of suggested DHS bands in addition to the senior manager band –</li> </ul>	Senior Manager Band										Level I		Level II				Level III		Level IV		1	2	3	4	5	6	7	8	9	10	72k	76k	80k	83k	87k	92k	96k	101k	106k	111k	MM		ME				EE		EO		EE		EO				OO			
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Step

Salary

Standard Progression

Fast-Track Progression

Progression Criteria Key  
M – Met  
E – Exceeded  
O – Outstanding

IRS Modified System [11]

		<p>two front line manager bands and four non-manager bands. These bands were constructed with approximately 4% steps.</p> <p><b>Suboption 7.</b> Employees progress in open range bands through application of a SHARE type distribution of funds on an annual basis. Shares allocated to employees based on their performance rating (e.g. NM = 0 shares, M = 1 share, E = 2 shares, O=3 shares). Share value determined by dividing available funds by total number of shares distributed. Funded from monies previously available for step progression.</p>
4	Pay administration rules	<p><i>New Hire.</i> Generally placed at step one of the current band. Use of highest previous rate is authorized.</p> <p><i>Promotion.</i> First promotion into a management payband is compensated with a 10% promotion benefit – subsequent promotions at 8%.</p> <p><i>Geographic Movement.</i> Use GS locality pay structure.</p> <p><i>Use of Past Rates.</i> Authorized at management discretion.</p> <p><i>Pay Reduction.</i> No pay reduction for unsatisfactory performance per se, but uncorrected poor performance could result in a change to lower grade or payband which could result in a pay reduction. Voluntary change to a lower GS grade or payband could also result in a pay reduction.</p> <p><i>Pay Retention.</i> Authorized for management-initiated (but not for cause) change to lower grade or payband.</p>
5	Managerial compensation	<ul style="list-style-type: none"> <li>• Opportunities for advancement are greater compared with GS – promotion from band to band is better, step increases are greater, and in many cases the top salary level is greater.</li> </ul>
6	Appeals	<ul style="list-style-type: none"> <li>• Performance rating appeals are subject to an expedited appeals process in view of the short time frame from the end of the performance year (September 30) and targeted bonus pay out (December 15) and base pay payout (January 1 in alternate years). The expedited process centers primarily on compressing the time for each level of review.</li> </ul> <p><b>Suboption 8.</b> All pay decisions subject to external appeal and negotiated grievance procedure.</p>
7	Evaluation	<ul style="list-style-type: none"> <li>• The system has been in place for several salary review cycles, with the following indicators of system success:</li> <li>• Performance distinctions have been made, evidenced by the approximate 20% Met, 60% Exceeded, 20% Outstanding performance rating distributions.</li> <li>• Average payroll increases resulting from pay for performance decisions approximate payroll increases under the GS system.</li> </ul>

**IRS Modified System [11]**

		<ul style="list-style-type: none"> <li>Formal complaints regarding performance ratings were under 3% for the first salary review cycle in IRS.</li> <li>However, this system has thus far been used only for management employees in the IRS, and has never been used for bargaining unit employees.</li> </ul>																								
8	Other compensation	<ul style="list-style-type: none"> <li>Performance bonuses are an integral part of the system, and both the larger (2% of payroll) bonus pool and lower rate of performance awards contribute to a higher average award than under the GS system. As with base pay increases, the size of potential awards increases with higher levels in the payband. Only Outstanding ratings have mandatory minimum bonuses. Bonuses may be awarded for Exceeded ratings and are generally not awarded for Met ratings – see the chart below:</li> </ul> <table border="1" data-bbox="444 659 1443 810"> <thead> <tr> <th>Rating</th> <th>Level I</th> <th>Level II</th> <th>Level III</th> <th>Level IV</th> <th>Level V</th> </tr> </thead> <tbody> <tr> <td>Met</td> <td>N/A</td> <td>N/A</td> <td>N/A</td> <td>N/A</td> <td>N/A</td> </tr> <tr> <td>Exceeded</td> <td>Optional</td> <td>Optional</td> <td>Optional</td> <td>Optional</td> <td>Optional</td> </tr> <tr> <td>Outstanding</td> <td>6 shares</td> <td>6 shares</td> <td>7 shares</td> <td>8 shares</td> <td>8 shares</td> </tr> </tbody> </table> <p>The value of a share is calculated each year, truncated to \$50 increments. The calculation is basically the size of the total award pool for each band in dollars divided by the total shares available to be distributed (at 4 shares per manager).</p> <p><b>Suboption 9.</b> Establish mandatory minimum bonuses at the Exceeds level.</p>	Rating	Level I	Level II	Level III	Level IV	Level V	Met	N/A	N/A	N/A	N/A	N/A	Exceeded	Optional	Optional	Optional	Optional	Optional	Outstanding	6 shares	6 shares	7 shares	8 shares	8 shares
Rating	Level I	Level II	Level III	Level IV	Level V																					
Met	N/A	N/A	N/A	N/A	N/A																					
Exceeded	Optional	Optional	Optional	Optional	Optional																					
Outstanding	6 shares	6 shares	7 shares	8 shares	8 shares																					

<b>C</b>		<b>Classification System</b>
System elements:		Summary description:
1	Functions	<ul style="list-style-type: none"> <li>GS classification system used with modifications, e.g., the minimum qualifications for a pay band are those of the lowest GS grade incorporated into the pay band.</li> </ul>
2	Categorization of type of work	<ul style="list-style-type: none"> <li>GS series determination remains unchanged.</li> </ul>
3	Work valuation method	<ul style="list-style-type: none"> <li>GS factor evaluation.</li> </ul>
4	Qualifications	<ul style="list-style-type: none"> <li>See 'functions' above.</li> </ul>
5	Applying system	<ul style="list-style-type: none"> <li>Pay bands are defined by GS grade and level of supervision. The job is first classified to a GS grade, then a specific pay band based on the level of supervision.</li> </ul>
6	Appeals	<ul style="list-style-type: none"> <li>Unchanged.</li> </ul> <p><b>Suboption 10.</b> All classification decisions subject to external</p>



**IRS Modified System [11]**

		appeal and negotiated grievance procedure.
7	Evaluation	N/A

<b>P Performance Management System</b>																							
System elements:		Summary description:																					
1	Purpose	Provides feedback to employees and differentiates levels of performance. The system is integrated with balanced measures and focused on results.																					
2	Measures	Assessed on two dimensions: <ul style="list-style-type: none"> <li>• Core Responsibilities (Leadership, Customer Satisfaction, Employee Satisfaction, Business Results, Equal Employment Opportunity) - How We Lead and Work...</li> <li>• Individual Performance Commitments - What We Promise to Achieve, and What We Achieve...</li> </ul>																					
3	Appraisal	<p>Rating of Not Met, Met or Exceeded for Core Responsibilities and Individual Commitments - see Summary Rating Matrix below.</p> <p>Note: Impact beyond the normal scope of the job needed for Outstanding rating</p> <table border="1"> <thead> <tr> <th colspan="2" rowspan="2">Summary Rating Matrix</th> <th colspan="3">Individual Commitments</th> </tr> <tr> <th>Not Met</th> <th>Met</th> <th>Exceeded</th> </tr> </thead> <tbody> <tr> <td rowspan="3">Core Responsibilities</td> <td>Not Met</td> <td><b>Not Met</b></td> <td><b>Not Met</b></td> <td><b>Not Met</b></td> </tr> <tr> <td>Met</td> <td><b>Not Met</b></td> <td><b>Met</b></td> <td><b>Met or Exceeded</b></td> </tr> <tr> <td>Exceeded</td> <td><b>Not Met</b></td> <td><b>Met or</b></td> <td><b>Exceeded or</b></td> </tr> </tbody> </table>	Summary Rating Matrix		Individual Commitments			Not Met	Met	Exceeded	Core Responsibilities	Not Met	<b>Not Met</b>	<b>Not Met</b>	<b>Not Met</b>	Met	<b>Not Met</b>	<b>Met</b>	<b>Met or Exceeded</b>	Exceeded	<b>Not Met</b>	<b>Met or</b>	<b>Exceeded or</b>
Summary Rating Matrix		Individual Commitments																					
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	Exceeded	<b>Not Met</b>	<b>Met or</b>	<b>Exceeded or</b>																			
4	Communication vehicles	Satellite TV, web tools, briefings.																					
5	Appeals	<p>Expedited appeal process (to fit salary review timeframe) for rating.</p> <p><b>Suboption 11.</b> All performance management decisions subject to external appeal and negotiated grievance procedure.</p>																					
6	Evaluation	The system is successful if it facilitates making distinctions in performance. To date, using this system within the IRS has resulted in a distribution of ratings that suggests that distinctions in performance are being made. However, this system has thus far been used only for management employees in the IRS, and has never been used for bargaining unit employees.																					

# IRS Modified System [11]

