WRITTEN TESTIMONY OF
RICHARD A. SPIRES
DEPUTY COMMISSIONER, OPERATIONS SUPPORT
INTERNAL REVENUE SERVICE
BEFORE THE
HOUSE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
SUBCOMMITTEE ON THE
FEDERAL WORKFORCE, POSTAL SERVICE AND THE DISTRICT OF COLUMBIA
ON
IMPLEMENTATION OF PAY FOR PERFORMANCE

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Good afternoon Chairman Davis, Ranking Member Marchant, and Members of the Subcommittee. My name is Richard Spires and I am the Deputy Commissioner for Operations Support of the Internal Revenue Service. I am pleased to be here today to discuss IRS' efforts to implement pay for performance and respond to questions from the Subcommittee.

The IRS is not new to the pay for performance issue. We have been dealing with it for over seven years as we have tried to move deliberately to implement such a system for our more than 7,000 managers. Though there have been some bumps along the way, the creation of paybands and compensating employees for the quality of their work rather than their longevity with the agency has helped the IRS respond to the challenges presented in turning the agency into a modern and more efficient, 21st century organization.

What I would like to do today is offer you some background on how we got into pay for performance, discuss a report issued by the Treasury Inspector General for Tax Administration (TIGTA) and how we responded to their recommendations, stress the importance of performing evaluations in a fair, non-discriminatory manner, and finally offer some observations on what our seven years of experience has taught us about implementing pay for performance.

Background

In 1998, Congress passed the IRS Restructuring and Reorganization Act (RRA-98). As the name of the new law indicates, RRA-98 totally transformed the IRS and changed dramatically the way that we did business.

For example, prior to enactment of the RRA-98, IRS was organized geographically with leadership organizations and decision-making by managers dispersed across the country. After enactment, however, we reorganized along functional lines to support the different taxpayer segments – Wage and Investment, Small Business/Self-Employed, Large and Mid-Sized Businesses, and Tax Exempt/Government Entities – with much of the senior leadership based at the IRS headquarters located in Washington.

Recognizing the dramatic shift that this and other changes included in RRA-98 required and the potential impact on the tens of thousands of employees that might be affected, the Congress included personnel flexibility provisions that authorized the Secretary of the Treasury to establish one or more paybanding systems covering all or any portion of the IRS workforce under the General Schedule (GS) pay system, subject to guidance to be issued by the Office of Personnel Management (OPM). Accordingly, OPM prescribed criteria for IRS paybanding systems that followed the principles included in RRA-98 in December 2000.

In providing this flexibility, Congress recognized that the IRS needed the ability to recruit and retain high-quality leadership to transform the Service into what Congress envisioned when it enacted RRA-98 – an efficient, modern, and responsive organization designed around the needs of taxpayers. Accordingly, IRS would have the flexibility to design its salary and incentive structures to support mission accomplishment, base pay decisions on performance rather than length of service, and implement a new Performance Management System that was aligned to organizational performance.

Program Implementation

We implemented the first payband in March 2001. It was for Senior Managers (SM) and it consolidated Grades 14 and 15 in the GS schedule into a single 10-step payband which had salaries ranging from the equivalent of a GS-14 Step 1 through a GS-15 Step 10. Under this new system, Senior Managers continued to receive their basic pay, including locality pay, similar to that provided to GS employees. However, the entitlement to step increases that were previously available under the GS system was removed. Employees were eligible every two years for a performance based increase, and progressed to the next step within the payband only if their performance ratings met or exceeded certain performance standards.

A similar payband structure was implemented in November 2001 for the new IRS campus functions including Accounts Management, Submission Processing, and Compliance. This payband for Department Managers (DM) incorporated salary grades GS-11 through GS-13 into a single 16-step payband.

Implementation of the flexibilities afforded was critical in successfully carrying out the mandates of RRA-98 from two critical perspectives.

First, implementation of the new Performance Management System allowed us to link manager performance to the functional goals of the organization. Managers and their supervisors would develop specific goals and objectives designed to further the goals of the functional unit and the IRS. The manager could then be evaluated at the end of the year based on his or her success in meeting the agreed to goals.

Second, implementation of the paybands helped us realign Senior Management positions as the organization shifted from a decentralized, geographic based hierarchy to an organization where leadership was based on functional needs. It also helped realign Department Managers in our campus functions.

Former IRS Commissioner Everson decided to continue expansion of pay for performance in line with the President's Management Agenda. In September 2005, the IRS implemented a Frontline Manager (FM) payband using the same criteria as for the Senior Manager and Department Managers – the Office of Personnel Management criteria from 2000. Beginning in 2002, the IRS had an independent contractor conduct multiple evaluations of the SM and DM paybands. The results of these evaluations and feedback from Executives and SM and DM employees afforded the IRS the opportunity to incorporate modifications to the design of the FM payband.

Unlike the SM and DM paybands, the FM payband consisted of 11 single-grade bands (GS 5 through 15) with open-rate ranges of pay (no steps) that are the same as the GS Pay System for the correlating grade. Also unlike the original paybands, Frontline Managers are eligible for a performance based increases to their salary each year. The performance based increase replaces the GS Pay System within-grade step increases, quality step increases, and annual across-the-board pay adjustments.

Effective March 2006, the SM and DM paybands were modified to incorporate a stepless design (range of rates) and an annual review, just like the FM payband. However, SM and DM paybands remained multi-grade paybands. For example, the SM payband has a minimum rate of GS-14 Step 1 and a maximum rate of GS-15 Step 10. Only the 10 steps within this range that were established when the program was originally designed were eliminated. Similarly, the DM payband ranged from GS-11 Step 1 to GS-13 Step 10 and the 16 steps were removed. All managers continue to receive the GS locality pay for where they work.

TIGTA Report and IRS Response

In July 2007 the Treasury Inspector General for Tax Administration (TIGTA) published a report entitled *The Internal Revenue Pay-for-Performance System May Not Support Initiatives to Recruit, Retain, and Motivate Future Leaders* (Ref. Number 2007-10-106).

The overall objective of this review was to determine whether the IRS pay for performance system effectively links compensation to individual performance. The report analyzed the implementation of the IRS pay for performance program, more specifically implementation of the FM payband, and made four specific recommendations for program improvement.

The first recommendation concerned the fact that the payband system for Frontline Managers essentially retained the GS Schedule pay system and only removed the incremental steps within each grade. The single grade band structure was implemented to meet the diverse needs of the IRS workforce and mission; and recognized the wide variety of occupations and grades that were difficult to group into common levels of work. And while the creation of broad occupational paybands has some obvious benefits, this allowed the focus to shift to performance based pay, and preserve the current classification framework until other occupations are banded.

The second recommendation related to the fact that the IRS Commissioner retains the authority to determine the level of pay increases for managers, and TIGTA recommended that the IRS Commissioner guarantee a salary increase to those mangers who are rated as having "Met" performance expectation. Specifically, the fear was that the Commissioner could determine not to provide an increase to managers who were classified as having "Met" performance expectations. This would mean such a manager could end up with less of an increase than a comparably situated employee under the GS system. This in turn could possibly act as a disincentive for individuals to move into management slots.

While in theory, the IRS Commissioner could withhold such an increase, since the inception of the IRS paybands in 2001, the Commissioner has never done so. Those managers with a "Met" performance expectation have received a performance based increase that was the same as the increase provided to all GS employees.

The third recommendation was that the IRS should consider alternative sources of funding for the performance based salary pools and ensure amounts dedicated for increases are sufficient to both reward top performers and compensate other managers equitably, based on their performance.

Finally, TIGTA recommended the Chief Human Capital Officer should offer employees an opportunity to express concerns and questions about the new pay system directly to Human Capital Office experts. TIGTA further recommended that that there be an effort to communicate more openly and timely with employees before implementing any new changes to the employee's compensation and benefits.

The IRS takes seriously the TIGTA recommendations. We have already implemented one of the recommendations by improving communications with affected managers. Late last year, we completed a strategic communication framework. As part of this we partnered with management associations such as the Federal Managers Association and the Professional Managers Association as well as our internal stakeholders on communications relating to performance based increases and other aspects of pay for performance. Through this partnership, specific communications were developed to address questions surrounding performance based increases and shared with all managers. Last year managers expressed frustration and discontent that they were not informed until October 2006 that a "Met" rating would receive an increase equivalent to the GS. Consequently, this year managers were informed in June that managers with a "Met" performance rating would receive a performance based increase equivalent to the

GS. We continue to update our Payband Resource Center for Managers (website) as information becomes available, and posted the performance based increased values, updated salary calculator, and other frequently asked questions relative to these issues.

We also agreed with two other recommendations. In fact, prior to the TIGTA audit we had already initiated a third-party evaluation of the IRS Pay for Performance System in its entirety, including an assessment of the Frontline Manager payband and a review of the performance-based salary pools. Since the IRS just implemented the FM payband in 2005, and redesigned the SM and DM in 2006, the IRS has just completed its second performance based increase and now can begin to evaluate trends. That evaluation is being conducted in three phases over a five year period, and will determine whether, and how strongly, our current pay-for-performance system supports our human capital organizational goals to recruit, retain, and motivate future leaders. We are also considering the TIGTA recommendation for modifying the IRS FM pay systems.

The one recommendation that we did not agree with was the one that would inappropriately reduce the authority of the IRS Commissioner and guarantee a salary increase to those managers that were rated as having “Met” expectations. As I indicated earlier, the Commissioner has always approved a standard increase for those that are rated as having “Met” expectations.

Performing Evaluations Fairly

IRS has approximately 7,200 permanent managers. Of this total, approximately 5,300 are permanent Frontline Managers; 1,500 are permanent Senior Managers; and 350 are permanent Department Managers. During filing season, the IRS may have an additional 1,000+ temporary managers.

To maintain credibility in the performance management evaluation process, it is important that performance evaluations be done in a fair, non-discriminatory manner. IRS is committed to that.

The performance evaluation process really begins a year in advance when managers meet with their supervisors to discuss their goals for the year and how they plan to meet those goals. They meet again mid-way through the year to discuss progress toward those goals. Finally at the end of the year, the supervisor meets again with the manager and rates him or her based on one of five levels of performance: Outstanding, Exceeded, Met, or Minimally Satisfactory or Not Met.

In an effort to further monitor the performance evaluation process and to insure objectivity and consistency, the initial evaluation of a supervisor will be reviewed by a Performance Review Board (PRB). It is the policy of the IRS that annually each division/function will review the summary evaluation ratings of their managers on a corporate basis. Each PRB ensures ratings consistently reflect similar performance across work unit lines, and validates that the ratings support individual and organizational performance.

Within the IRS, performance based increases as well as bonus parameters are consistent across all functional units. That means that a manager within our Wage and Investment Division who is rated as "Outstanding" will receive the same performance increase as a manager in our Small Business division with an identical rating. Managers across all functional units with the same rating will receive the same performance based increase. Each functional unit has discretion to determine the specific performance bonus amount; however, the overall performance bonus parameters are applied across functional units.

Accordingly, the performance based increases for Outstanding will always be greater than for someone who was rated as "Exceeded," which in turn will be higher than someone rated as "Met." Someone who was rated "Not Met" would not receive any increase.

A similar system exists for bonuses. A manager receiving an "Outstanding" summary evaluation will receive a bonus. Someone who exceeds ***may*** receive a bonus and someone who is rated as "Met" would only receive a bonus under extraordinary circumstances.

It is also important that evaluations be made free of any discrimination based on race, gender or national origin. We asked the third party contractor that is conducting the overall evaluation of the entire program to look at this issue and offer its assessment. The contractor has reported that it has completed its preliminary analysis of the ratings data and found that since Fiscal Year 2004, there has been no disparate impact on any group of employees in the Senior Manager (SM), Department Manager (DM), or Frontline Manager (FM) paybands. The contractor analyzed the trends of the ratings data grouped by gender, age (Over 40 and Under 40) and ethnicity. In each group, ratings trended in a similar path to the average ratings across all groups. As part of their more detailed analysis, the contractor will also analyze the same data across business units, Mission Critical Occupations and individual paybands.

Lessons Learned

As the interest in pay for performance escalates across the Federal government, the IRS finds itself in the unique position of having information to share. We have certainly gained experience along the way, made adjustments to our system, and are still learning as we go. We will continually assess and reassess all aspects of our pay for performance system and refine it to support the mission and goals of the IRS.

However, based on our seven years of experience with our own program, we can offer some suggestions that might prove useful to agencies that might pursue paybanding or pay for performance in the future.

Specifically, we have found first-hand that a successful pay-for-performance system must incorporate the following key elements:

- Agencies should move deliberately and cautiously to implement the program that is “right” for its organization;

- Communication is critical. Managers must understand how the program will work and how they will be affected. There also must be forums to have their concerns and questions answered;

- An effective performance evaluation system must be in place. Managers must understand the basis for their evaluation and there should be a review system in place to make sure evaluations are being made on a consistent basis;

- Supervisors/managers must be trained properly on how to use the system and make sound evaluations; and

- On-going program evaluation is essential to ensure that the pay for performance system is operating as intended. Agencies must be willing to modify and revise its system to meet the changing needs of the organization.

Summary

We have found that a properly implemented pay-for-performance plan can have obvious positive benefits for any agency. Perhaps most important of these is the fact that employees are rewarded for the quality of their work and not the tenure in their job. But perhaps equally important is the fact that such a system necessitates that managers at all levels are forced to interact in such a way that they discuss the agencies goals and how their individual performance relates to those goals.

As I indicated at the beginning, we tried to move deliberately in terms of implementing pay-for-performance, but we still faced numerous bumps in the road. However, the benefits far outweigh the problems. It has helped us make the organizational transition required by RRA-98 and link compensation to performance.

Thank you again, Mr. Chairman for the opportunity to be here and I am happy to respond to any questions.