

**Oversight of Streamlined Critical Pay
Authority Could Be Improved**

June 2003

Reference Number: 2003-10-116

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

June 19, 2003

MEMORANDUM FOR COMMISSIONER EVERSON

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Assistant Inspector General for Audit, Small Business and
Corporate Programs

SUBJECT: Final Audit Report - Oversight of Streamlined Critical Pay
Authority Could Be Improved (Audit # 200210031)

This report presents the results of our review of Streamlined Critical Pay. The overall objectives of this review were to determine whether the Internal Revenue Service's (IRS) use of streamlined critical pay authority conformed to established laws and regulations and to analyze the costs associated with the program.

In summary, IRS salary rates for the critical pay hires were adequately justified, and the IRS incurred search firm costs of \$3.2 million for searches to fill critical pay positions. Candidates were often identified for positions before critical pay positions were approved, and the IRS was not always successful in recruiting qualified outside candidates under the critical pay authority. In addition, oversight of the critical pay authority could be improved to ensure that it is used appropriately as needed.

We recommended that the Commissioner obtain the IRS Oversight Board's approval on the justification, candidate selection, and compensation for all critical pay positions, and provide the Board's annual assessment of the IRS' use of the critical pay authority to the Congressional committees with IRS oversight responsibilities.

Management's Response: The IRS disagreed with the recommendation to obtain the IRS Oversight Board's approval on the justification, candidate selection, and compensation for all streamlined critical pay positions before they are filled. Management believes that additional processes or restrictions would reduce the intended benefits of the streamlined authority. Management also believes that the annual assessment of streamlined critical pay authority that the IRS Oversight Board plans to perform should be adequate to determine whether the authority has been used appropriately. The agreement between the IRS and the Board regarding the annual

assessment of the streamlined critical pay authority assumed that the results of the assessment would be provided to Congressional committees with IRS oversight responsibilities.

In addition, management stated that certain costs incurred for critical pay employees, such as bonuses and relocation expenses, may have been incurred whether or not the critical pay authority was used and, therefore, were not directly attributable to the critical pay program. Management's complete response is contained in Appendix V.

Office of Audit Comment: Because the designation of certain positions as critical indicates a high level of importance to the success of the IRS' mission, the Treasury Inspector General for Tax Administration continues to believe that the IRS Oversight Board should be a part of the approval process for all streamlined critical pay positions. Table 2, "Costs of the Critical Pay Authority," in this report now reflects the classification of costs associated with the critical pay program that may have been incurred regardless of the use of critical pay authority as "Other Related Costs."

Copies of this report are also being sent to the IRS managers shown on the distribution list. Please contact me at (202) 622-6510 if you have questions or your staff may contact Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

**Oversight of Streamlined Critical Pay
Authority Could Be Improved**

Table of Contents

Background	Page 1
Salary Rates for Critical Pay Hires Were Adequately Justified	Page 4
The Internal Revenue Service Incurred Search Firm Costs of \$3.2 Million for Searches to Fill Critical Pay Positions	Page 6
Candidates Were Often Identified for Positions Before Critical Pay Was Approved	Page 7
The Use of Critical Pay Authority Was Not Always Successful in Recruiting Qualified Outside Candidates	Page 8
Additional Oversight May Help Ensure That the Streamlined Critical Pay Authority Is Used Appropriately as Needed	Page 9
<u>Recommendation 1</u> :	Page 10
<u>Recommendation 2</u> :	Page 11
Appendix I – Detailed Objectives, Scope, and Methodology	Page 12
Appendix II – Major Contributors to This Report	Page 14
Appendix III – Report Distribution List	Page 15
Appendix IV – Streamlined Critical Pay Authority Provisions	Page 16
Appendix V – Management’s Response to the Draft Report	Page 17

Oversight of Streamlined Critical Pay Authority Could Be Improved

Background

The Congress included a number of provisions in the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98)¹ which provide personnel flexibilities to the IRS to help recruit and retain employees. One of the provisions authorizes the Secretary of the Treasury to establish one or more critical pay positions at the IRS if approval is obtained from the Office of Management and Budget (OMB).² For these positions, compensation may be set at a higher rate than the pay of most Federal Government executives, but may not exceed the Vice President's salary (\$192,600 for Calendar Year 2002).

Furthermore, the RRA 98 created streamlined critical pay authority for up to 40 positions at the IRS.³ Use of streamlined critical pay authority requires the approval of the Secretary of the Treasury but does not require the approval of the OMB. The streamlined authority lasts for 10 years, expiring on July 22, 2008. Appointments to these types of positions are limited to a term of 4 years. Use of the authority is permitted only under certain conditions including the following:⁴

1. The positions must require expertise of an extremely high level in an administrative, technical, or professional field and are critical to the IRS' successful accomplishment of an important mission.
2. Exercise of the authority must be necessary to recruit or retain an individual exceptionally well-qualified for the position.

The Senate Committee report⁵ on this provision indicated personnel flexibilities such as the streamlined critical pay authority were to provide the IRS Commissioner with the ability to bring in experts and the flexibility to revitalize the current IRS workforce. The concern was that the hiring

¹ IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

² 5 U.S.C. § 9502 (2000).

³ 5 U.S.C. § 9503 (2000).

⁴ See Appendix IV for all requirements of 5 U.S.C. § 9503 (2000).

⁵ S. Rep. No. 105-174.

Oversight of Streamlined Critical Pay Authority Could Be Improved

practices before 1998 inhibited the ability of the Commissioner to change the IRS' institutional culture.

Subsequently, there have been questions about whether the IRS has used this authority as intended. The Congress and the press have raised questions about the necessity of the costs associated with the critical pay hires, including recruiting costs, relocation costs, salaries, and bonuses, as well as the types of positions for which the IRS used this authority.

Our review was performed in the Executive Service Division (ESD) in Strategic Human Resources (SHR), Agency-Wide Shared Services, the Small Business/Self-Employed (SB/SE) Division, the Large and Mid-Size Business (LMSB) Division, Modernization and Chief Information Officer (CIO), the Wage and Investment (W&I) Division, and the Department of Treasury Assistant Secretary for Management and Chief Financial Officer (CFO). We also interviewed a search firm representative involved in identifying critical pay candidates for the IRS.

The audit period was from August 1998 to October 2002, and our fieldwork was conducted from July 2002 through October 2002. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Designation of critical pay positions

During the restructuring of the IRS in 1999, the IRS Commissioner created a committee of top-level officials from the IRS and Department of the Treasury to work with him to determine how best to allocate the 40 critical pay positions. Decisions were made based on the requirements of the various job positions in the IRS divisions and functions, the experience of existing IRS executives, and the potential for drawing experienced executives from other Federal Government agencies. In addition, the committee considered the need to bring in top-level experience from outside the IRS in order to bring new perspectives to organizational challenges.

Oversight of Streamlined Critical Pay Authority Could Be Improved

Table 1 shows the initial allocation of the 40 critical pay positions and the positions filled as of September 2002.

Table 1 – Critical Pay Positions: Initial Allocation (May 1999) and Positions Filled as of September 2002

Business/Functional Units	Initial Allocation (May 1999)	Positions Filled as of September 2002
Agency-Wide Shared Services	2	1
Communications and Liaison	1	1
Criminal Investigation	1	0
Modernization	9	10
Large and Mid-Size Business	9	8
Small Business/Self-Employed	5	5
Tax-Exempt and Government Entities	2	2
Wage and Investment	7	6
Taxpayer Advocate	3	1
Other (Director of Research)	1	1
Total	40	35

Source: Executive Service Division

Based on their allocation, the business and functional units are required to obtain authorization from the Commissioner once they decide to use critical pay authority to fill a specific position. Once critical pay is approved, the business or functional unit identifies potential candidates from either internal contacts or executive search firms. After a candidate has been identified and selected, the Treasury Assistant Secretary for Management and CFO must approve the selection.

Costs associated with critical pay

As of September 2002, the IRS had incurred costs of approximately \$8 million associated with the critical pay authority. Certain costs, such as the additional salary and search firm expenses are specifically attributable to the critical pay authority. Other costs, such as bonuses and relocation expenses, may have been incurred whether or not a candidate was hired using streamlined critical pay authority. We computed the additional salary cost by comparing the salaries actually paid to the critical pay

Oversight of Streamlined Critical Pay Authority Could Be Improved

appointees to what would have been paid to each as a top-level senior executive (we assumed they would have received the highest pay level [ES-6]) had the critical pay authority not been in existence. Table 2 shows the breakdown of costs of the critical pay authority:

Table 2 – Costs of the Critical Pay Authority

Net Increased Costs for Critical Pay Employees	
Base Salary Increase ⁶	\$2,568,591
Search Firm Costs ⁷	\$3,217,921
Other Related Costs	
Performance Bonuses	\$134,625
Recruitment Bonuses	\$686,847
Relocation Bonuses.....	\$25,000
Relocation Costs ⁸	\$1,394,479
Total	\$8,027,463

Source: Executive Service Division

Salary Rates for Critical Pay Hires Were Adequately Justified

The base pay for members of the Senior Executive Service (SES) in Calendar Year 2002 ranged from \$113,000 (ES-1) to \$130,000 (ES-6). With locality pay, the maximum salary an executive could receive was \$138,200. Under the streamlined critical pay authority, the salaries the IRS paid ranged from \$125,000 to \$192,600.

When the IRS selects a critical pay candidate to fill a position, a compensation analysis is performed to determine the candidate's base salary. To determine the base salary, the following six factors are taken into consideration:

1. Current salary rate.
2. Salary rate for the past 4 years.
3. Stock options.

⁶This represents the difference between the salaries of the critical pay positions that were filled and the salaries that would have been incurred by top-level senior executives if the critical pay program had not been in existence. The period covered was Fiscal Years 1998 – 2002.

⁷ Search firm costs from October 1997 through September 2002.

⁸ Relocation costs as of February 20, 2003.

Oversight of Streamlined Critical Pay Authority Could Be Improved

4. Industry assessment.
5. Competing offers.
6. Loss of benefits.

We reviewed the salaries for 48 critical pay hires (this includes 13 who had left the IRS as of October 2002)⁹ to determine if the salaries were computed and set according to IRS compensation guidelines. In all instances, the salaries plus performance bonuses were computed according to guidelines and did not exceed the salary of the Vice President (\$192,600).

Of the 48 critical pay appointees reviewed, 32 accepted salaries that were lower than their private sector salaries. Moreover, 9 of these 32 accepted salaries that were more than 50 percent lower than their private sector salaries. Fourteen critical pay appointees realized a salary increase when they came to the IRS; 4 of them received an increase of more than 20 percent. All of the increases were properly justified by at least one of the six factors stated above. Two of the critical pay appointees received a salary equal to their private sector salary.

The IRS paid a total of \$134,625 in performance bonuses to 8 critical pay appointees in Fiscal Years (FY) 1998 - 2002. Twenty-six critical pay appointees received a total of \$686,847 in recruitment bonuses during FYs 1998 - 2002. The dollar amount includes an adjustment (repayment) by a critical pay appointee who left the IRS approximately 4 months after being hired. All performance and recruitment bonuses were paid in accordance with the law and IRS guidelines.

Since the IRS was provided critical pay authority, 22 of the 48 critical pay appointees were authorized to use the IRS relocation program. Because of concerns with the high costs to relocate employees, particularly critical pay appointees, the IRS implemented a new policy in July 2002 to help reduce relocation costs, especially those costs associated with the use of relocation services companies to

⁹ Three additional critical pay hires have left the IRS since October 2002.

Oversight of Streamlined Critical Pay Authority Could Be Improved

assist in the sale of employees' homes. The Treasury Inspector General for Tax Administration issued a separate audit report addressing relocation expenses.¹⁰ For the relocation cases reviewed, expenses appeared to be in conformance with Federal guidelines. The IRS' new relocation policy should help in containing the costs associated with relocation services companies.

The Internal Revenue Service Incurred Search Firm Costs of \$3.2 Million for Searches to Fill Critical Pay Positions

In the past, the IRS has generally not used search firms to identify candidates for executive level positions; however, search firms were used for most critical pay positions. In fact, search firms were used in 44 instances to identify potential critical pay appointees. Total search firm costs for the critical pay authority were approximately \$3.2 million, which represents 40 percent (\$3.2 million/\$8 million) of the total costs of the program. In addition to identifying candidates, the search firms also performed background interviews, reference checks, and other search-related services.

The IRS experienced a 52 percent success rate in filling critical pay positions through the use of search firms

The search firms identified 23 of the candidates that were hired into critical pay positions at an approximate cost of \$1.7 million. However, \$1.4 million was spent on search firms for positions in which the IRS, not the search firm, ultimately identified the candidate that was hired, although the search firms also provided services related to recruiting some of the candidates identified by the IRS.¹¹ In 10 cases, the IRS identified the critical pay candidates hired (after incurring total costs of \$674,000 for search firms).

Additionally, the search firms were paid approximately \$772,000 for searches and services related to 9 positions that were ultimately filled at the SES level instead of a critical pay level. The IRS' success rate in using search

¹⁰*The Internal Revenue Service Has Implemented a New Policy to Reduce Future Relocation Costs, But Improvements Are Needed in Its Cost Tracking Systems* (Reference Number 2002-10-190, dated September 2002).

¹¹ In addition, the IRS had 2 on-going searches and incurred costs of approximately \$102,600 during the audit period.

Oversight of Streamlined Critical Pay Authority Could Be Improved

firms to identify and hire critical pay candidates is approximately 52 percent (23 placements out of 44 searches).

In certain instances the IRS paid for extensions of time for searches, contrary to standard industry practice

The original search firm contracts included a provision requiring the IRS to pay the search firms for extensions if the searches lasted longer than 120 days. The IRS Procurement staff stated that under industry standard practice, search firms typically continue to search for candidates until one is identified without any additional compensation. However, IRS officials wanted to ensure that search firms were paid for the additional time required for conducting the searches. The IRS paid a total of \$377,646 to 2 search firms for search extensions. In the contract negotiations in April 2002, the IRS and search firms agreed that the IRS would no longer be charged for search extensions. Additional contract modifications expanded the use of search firms to include identifying SES and Senior Manager candidates, as well as candidates for the IRS' Executive Development program.

Candidates Were Often Identified for Positions Before Critical Pay Was Approved

In January 2000, the IRS implemented new procedures to better define its process for using critical pay authority and hiring critical pay employees. One provision in these procedures is that a critical pay position must be justified based on a need for special skills critical to the functioning of the IRS and must be approved by the Commissioner prior to the start of the recruiting process for a candidate. However, after the new procedures went into effect, 15 of 19 critical pay employees were identified by name in the memoranda sent to the Commissioner requesting that he approve critical pay for the positions.

In certain instances, candidates were identified before positions were created

In 2 of the 15 positions noted above, the positions and the associated duties were defined after candidates were identified.

Oversight of Streamlined Critical Pay Authority Could Be Improved

- **Director, E-Learning** - The IRS contracted with a search firm to fill the Director of Learning and Education position. The search firm identified two candidates that IRS officials believed were highly qualified for the position. IRS officials then decided that the critical pay position as originally proposed was too much for one person to handle, separated the responsibilities, and made two critical pay positions, the Chief Learning Officer and the Director, E-Learning. Consequently, both individuals were hired.
- **Project Director, Web Services** - IRS officials extended a job offer to a critical pay candidate they wanted as Project Director, Web Services, using the streamlined critical pay authority. However, the IRS Commissioner had not approved the position. In this instance, because all the critical pay positions had been designated at that time, the critical pay authority, which had been designated for the position of Director, Field Operations, was used for the Project Director, Web Services, position. However, the IRS was in the process of using a search firm to identify a candidate for the Director, Field Operations, position and had already incurred two-thirds of the search fee (\$41,893) before it cancelled the search.

The Use of Critical Pay Authority Was Not Always Successful in Recruiting Qualified Outside Candidates

In 9 cases, the IRS designated positions as critical pay positions but subsequently filled them as SES positions because either qualified outside candidates could not be found, the qualified candidates who were identified ultimately declined the positions, or IRS officials identified a candidate internally that they considered to be more highly qualified. Search firms were paid a total of \$772,000 for these 9 positions. Once the positions were converted back to SES positions, the critical pay authority was then used for other positions.

For example, the IRS hired a search firm and initiated a search for the Director, Strategy Research and Program Plan (LMSB Division), in November 1999. IRS officials decided not to hire any of the candidates identified for the position by the search firm. The search was closed and the IRS paid

Oversight of Streamlined Critical Pay Authority Could Be Improved

the search firm for the list of candidates provided. Approximately 6 months later, the IRS hired a second search firm to conduct a search for the critical pay position Director, Research (LMSB Division), which was essentially the same position with a new title. The IRS did not hire any of the candidates provided by the second firm. Instead, the IRS filled the position at an SES level with a candidate identified by an internal source.

In another example, the IRS contracted with a search firm to identify individuals to fill four critical pay research director positions. The searches for the four candidates began in June and July 2000. The IRS planned to fill two critical pay research director positions within the Headquarters Operations, one within the W&I Division and one within the SB/SE Division. However, the IRS later decided to convert three of the four critical pay research director positions to SES positions and hire one candidate under the critical pay authority within the Headquarters Operations.

Additional Oversight May Help Ensure That the Streamlined Critical Pay Authority Is Used Appropriately as Needed

While there have been problems associated with determining which positions to designate for streamlined critical pay, as well as recruiting and hiring qualified outside candidates to fill the positions, additional processes or restrictions could reduce the intended benefits of the streamlined authority. The streamlined authority specifically removes the need to seek OMB approval for such positions. However, because the streamlined authority specifies that approval from the Secretary of the Treasury is required, additional scrutiny by the Secretary, as well as the IRS Oversight Board, may help ensure that the authority is used appropriately as needed.

The IRS Oversight Board's *Committee on Personnel and Organization* has worked with the ESD to draft procedures that are intended to provide more oversight of the critical pay authority. The Board has the specific responsibility to review the Commissioner's selection, evaluation, and compensation of IRS senior executives who have program management responsibility over significant functions of the IRS.¹² The Board believes that this direct oversight

¹² I.R.C. § 7802(d)(3) (2001).

Oversight of Streamlined Critical Pay Authority Could Be Improved

responsibility covers just those 13 senior executive positions that report directly to the IRS Commissioner. For these positions, the Board and IRS have agreed that the IRS will:

- Inform the Board of any impending vacancies.
- Consult with the Board when the IRS plans to fill a vacancy.
- Send the Board information about potential selectees prior to final selection.

Additionally, the IRS and the Board have agreed to expand the Board's oversight of the critical pay authority in general. The Board will conduct an annual program review of the authority as a whole rather than review individual cases of critical pay executives who do not report directly to the Commissioner. These draft procedures were reviewed by the IRS Commissioner in April 2001 and approved by the Board in its April 2001 meeting.

Recommendations

We recommend that the Acting Commissioner:

1. Obtain the IRS Oversight Board's approval on the justification, candidate selection, and compensation for all critical pay positions.

Management's Response: The IRS disagreed with this recommendation. Management believes that additional processes or restrictions would reduce the intended benefits of the streamlined authority. Management further asserted that the annual assessment of streamlined critical pay authority that the IRS Oversight Board plans to perform should be adequate to determine whether the authority has been used appropriately.

Office of Audit Comment: Because the designation of certain positions as critical indicates a high level of importance to the success of the IRS mission, the Treasury Inspector General for Tax Administration continues to believe that the IRS Oversight Board should be a part of the approval process for all streamlined critical pay positions.

Oversight of Streamlined Critical Pay Authority Could Be Improved

2. Provide the IRS Oversight Board's annual assessment of the IRS' use of the critical pay authority to the Congressional committees with IRS oversight responsibilities.

Management's Response: The IRS stated that their agreement with the IRS Oversight Board in April 2002 regarding the Board's annual assessment of the IRS' use of streamlined critical pay authority assumed that the results would be provided to the Congressional committees with IRS oversight responsibilities.

Detailed Objectives, Scope, and Methodology

The overall objectives of this review were to determine if the Internal Revenue Service's (IRS) use of streamlined critical pay authority conformed to established laws and regulations and to analyze the costs associated with the program. To accomplish these objectives, we:

- I. Evaluated the IRS' recruiting process for all critical pay hires (former and current) and determined if it conformed to established laws and guidelines.
 - A. Interviewed the Assistant Deputy Commissioner and determined the criteria used to allocate critical pay positions within the IRS.
 - B. Interviewed Large and Mid-Size Business Division, Small Business/Self-Employed Division, and Wage and Investment Division heads and the Deputy Commissioner for Modernization and Chief Information Officer and identified their processes for creating a critical pay position in their offices.
 - C. Interviewed the IRS' Executive Service Division (ESD) management in the Office of Strategic Human Resources and determined the criteria used to establish critical pay positions in the business units.
 1. Obtained and reviewed the procedures used for the Streamlined Critical Pay Authority Program by the ESD.
 2. Reviewed all critical pay position files in the ESD to determine if:
 - (a) They contained a request to establish the critical pay position that included a business case justifying the establishment of the position.
 - (b) All the elements of a business case were identified in the request.
 - (c) The appropriate reviews, approvals, and Commissioner's signature had been completed.
 - D. Determined whether the critical pay hire's qualifications met the needs of the critical pay position.
 - E. Determined if the critical pay hire's Compensation Package had been prepared in accordance with guidelines.
 - F. Determined whether all the elements in the Preliminary Package had been satisfied.
 - G. Determined whether all the elements in the Final Package had been satisfied.
 - H. Evaluated the Department of the Treasury's approval process of the Critical Pay Preliminary and Final Packages.

Oversight of Streamlined Critical Pay Authority Could Be Improved

- II. Evaluated the role of the executive search firms hired by the IRS to assist in the recruitment of critical pay candidates and the justification and costs for using these firms.
 - A. For those critical pay positions filled using search firms, determined what information the Specialist in the ESD put together when initiating job searches.
 - B. Reviewed the Procurement office process in the selection of search firms to evaluate the adequacy of the process used.
 - C. Reviewed task orders under the original contracts, compared them to task orders under renewed contracts, and identified similarities and/or differences.
 - D. Determined what information the IRS provided to the search firms prior to the firms conducting their searches for a candidate.
 - E. Determined the process used when the candidates interviewed for a critical pay position were not selected.
 - F. Determined whether the costs incurred for executive search firms were necessary and proper.

- III. Evaluated the costs associated with the critical pay employees and the performance expectations established for each.
 - A. Determined salary, bonuses (recruitment, relocation, retention, and performance), relocation cost, and search firm cost for each critical pay hire.
 - B. Determined the extent of IRS Oversight Board involvement with evaluating the Streamlined Critical Pay Authority Program.
 - C. Determined the number and cost of searches that did not result in filling a critical pay position under the original contracts.
 - D. Determined the number and cost of searches that resulted in filling a non-critical pay position under the original contracts.
 - E. Determined the number and cost of extensions for searches made to identify critical pay candidates under the original contracts.
 - F. Reconciled the number of searches made to the number of critical pay positions to be filled under the original contracts.

Major Contributors to This Report

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**Oversight of Streamlined Critical Pay
Authority Could Be Improved**

Appendix III

Report Distribution List

Internal Revenue Service Oversight Board
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Deputy Commissioner for Services and Enforcement N:DC
Director, Strategic Human Resources N:ADC:H
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Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
National Taxpayer Advocate TA
Director, Legislative Affairs CL:LA

Streamlined Critical Pay Authority Provisions

The Secretary of the Treasury may, for a period of 10 years after the date of enactment of this section (July 22, 1998),¹ establish, fix the compensation of, and appoint individuals to, designated critical administrative, technical, and professional positions needed to carry out the functions of the Internal Revenue Service, if -

- (1) the positions -
 - (A) require expertise of an extremely high level in an administrative, technical, or professional field; and
 - (B) are critical to the Internal Revenue Service's successful accomplishment of an important mission;
- (2) exercise of the authority is necessary to recruit or retain an individual exceptionally well qualified for the position;
- (3) the number of such positions does not exceed 40 at any 1 time;
- (4) designation of such positions are approved by the Secretary of the Treasury;
- (5) the terms of such appointments are limited to no more than 4 years;
- (6) appointees to such positions were not Internal Revenue Service employees prior to June 1, 1998;
- (7) total annual compensation for any appointee to such positions does not exceed the highest total annual compensation payable at the rate determined under section 104 of title 3; and
- (8) all such positions are excluded from the collective bargaining unit.

¹ 5 U.S.C. § 9503 (2000).

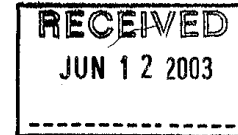
Oversight of Streamlined Critical Pay
Authority Could Be Improved

Appendix V

Management's Response to the Draft Report




DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224



May 8, 2003

MEMORANDUM FOR GORDON C. MILBOURN III
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Bob Wenzel 
Deputy Commissioner of Internal Revenue

SUBJECT: Draft Audit Report – Oversight of Streamlined Critical Pay
Authority Could Be Improved (Audit #200210031)

Thank you for the opportunity to review the draft of this report, which addresses the issue of whether the Internal Revenue Service's use of streamlined critical pay authority conformed to established laws and regulations, and the costs associated with the program. I am pleased that the audit confirms the IRS has used the critical pay authority appropriately and the salary rates for all hires were adequately justified.

The IRS has implemented policy and procedures, jointly developed with Treasury and the IRS Oversight Board, to assess the effectiveness of the authority and ensure the integrity of the program. As indicated in the report, we continue to refine and improve the process and revise policy as necessary to address concerns as they arise. For example, IRS changed policy regarding the use of relocation services contracts to reduce relocation costs and modifications were made to the new 2002 search firm contracts to eliminate charges for search extensions. This change affected all household relocations—not just those incurred under the Streamlined Critical Pay program.

We agree that the Oversight Board's annual assessment should be provided to the Congressional committees with IRS oversight responsibilities. We disagree with your recommendation to require approval from the IRS Oversight Board on all critical pay positions. We also disagree with some of the findings stated in the report regarding the costs specifically attributable to the critical pay authority and we have commented on the establishment of positions.

Attached is a detailed response to the findings and recommendations. If you have any questions, please contact David A. Mader, Assistant Deputy Commissioner, at (202) 622-4700.

Attachment

Oversight of Streamlined Critical Pay Authority Could Be Improved

ATTACHMENT

RECOMMENDATION 1

The IRS should obtain the IRS Oversight Board's approval on the justification, candidate selection, and compensation for all streamlined critical pay positions.

CORRECTIVE ACTION

The IRS disagrees with this recommendation because, as the report states, additional processes or restrictions would reduce the intended benefits of the streamlined authority. As is noted in the legislation but often overlooked, the concept of streamlined is every bit as important as the level of pay. Candidates identified for these positions are more than likely not contemplating employment with the IRS or the Federal Government until the IRS contacts them. Attracting such people is a challenging task under the best of circumstances. The streamlined process—which still often takes several months—is the most efficient way to hire such people who have the extensive experience needed for these key management, technical, and professional positions.

In April 2002, the IRS Oversight Board and IRS agreed that we would provide the Board with copies of all streamlined critical pay packages for their post review. Therefore, the recommendation for final approval would not add value to the process and would only hinder our ability to recruit the best-qualified talent.

IMPLEMENTATION DATE

N/A

RECOMMENDATION 2

The IRS should provide the IRS Oversight Board's annual assessment of the IRS' use of critical pay authority to the Congressional committees with IRS oversight responsibilities.

CORRECTIVE ACTION

The IRS/ Oversight Board agreement in April 2002 assumed that the Board's annual assessment of the IRS's use of streamlined critical pay authority would be provided to the Congressional committees with IRS oversight responsibilities.

IMPLEMENTATION DATE

Ongoing

Oversight of Streamlined Critical Pay Authority Could Be Improved

Other Report Findings with which the IRS disagrees:

FINDING

Page 3 of the report states, "As of September 2002, the IRS had incurred costs of approximately \$8 million associated with the critical pay authority. Certain costs, such as the additional salary, search firm expenses, recruitment bonuses, and relocation bonuses, are specifically attributable to the critical pay authority. Other costs, such as bonuses and relocation expenses, may have been incurred whether or not a candidate was hired using the streamlined critical pay authority." or another appointing authority.

EXPLANATION OF DISAGREEMENT

The IRS disagrees with this finding for the following reasons:

- Relocation and Recruitment bonuses are authorized in 5 U.S.C. 5753 and 5754. On September 11, 2000, the Department of Treasury approved under the authority of RRA '98, certain statutory variations to these provisions for IRS only. Although these variations are authorized under RRA '98, the provisions are not part of the streamlined critical pay authority and are available for recruitment at all levels, regardless of the appointing authority.
- Relocation bonuses may be approved for current IRS employees only and, therefore, are not available to new critical pay hires. Only one critical pay executive received a relocation bonus. The individual was already with the Service for about a year in a critical pay position, when his skills were needed for another position. The relocation bonus was approved as an offset for some of the additional costs incurred that were not covered under the relocation entitlements and the hardship associated with the expedited relocation of his family.

Therefore, *Table 2 – Costs of the Critical Pay Authority* on page 4 should reflect both recruitment and relocation bonuses under the category of "Other Related Costs". The total net increased costs, directly attributable to critical pay hires is \$5,786,512, with an overall total cost of \$8,027,463.

Oversight of Streamlined Critical Pay Authority Could Be Improved

FINDING

Page 7 states, "Candidates were often identified for positions before critical pay authority was approved."

Comments Regarding Finding

While we agree with the analysis of the facts provided in the report, it is important to note that RRA '98 provided to the Secretary of Treasury and subsequently the Commissioner of Internal Revenue Service, the Streamline Critical Pay Authority for flexibility to fill positions that require expertise of an extremely high level in administrative, technical or a professional fields that would not be available using the SES authority. To designate 40 positions as streamlined critical pay and not be able to exercise flexibility based on the job market and candidates available would negate the flexibility intended.

During the initial organizational design of the new IRS, positions were designated that could meet this criteria. In actuality, as your review confirmed, the initial designation as streamlined critical pay did not necessarily play out and many were subsequently filled through SES based upon a detailed analysis of the knowledge, skills and ability of current executives. As key requirements were identified and skills matched through a variety of ways outlined in your report, certain positions were then designated as streamlined critical pay, in the spirit of RRA '98, section 9501. Many times during monthly briefings or verbal discussions with the Commissioner regarding the identification of a good candidate for a position that required specialized technical skills a determination to fill a position as streamlined critical pay was made. The Commissioner, in fact, agreed verbally and then the paperwork to document that approval was subsequently prepared using the name of the candidate instead of just the position title. We have noted that our procedures need to be updated to accurately reflect what we have learned through this experience.