Some Managerial Salaries Were Calculated Incorrectly Due to Complex Pay-Setting Rules

March 29, 2017

Reference Number: 2017-10-023

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SOME MANAGERIAL SALARIES WERE CALCULATED INCORRECTLY DUE TO COMPLEX PAY-SETTING RULES

Highlights

Final Report issued on March 29, 2017

Highlights of Reference Number: 2017-10-023 to the Internal Revenue Service Human Capital Officer.

IMPACT ON TAXPAYERS

The pay system for managers at the IRS differs from the pay system used for nonmanagerial employees. Errors in calculating pay when moving between the two pay systems can cause improper overpayments or underpayments, which in turn result in an inefficient use of resources to correct the pay errors.

WHY TIGTA DID THE AUDIT

The audit was initiated to determine whether existing processes provide reasonable assurance that salary overpayments or underpayments are prevented and detected when employees move into, within, and out of IRS paybands.

WHAT TIGTA FOUND

Based on a statistical sample of employees who received salary increases of greater than 10 percent for promotions into management positions between Fiscal Years 2006 and 2015, 31 percent of sampled employees were not paid correctly. TIGTA estimates that the IRS overpaid more than 600 employees by approximately $4.2 million and underpaid more than 900 employees by approximately $2.7 million.

These errors occurred for a variety of reasons. The errors were generally due to the complexities associated with setting pay when employees move between the pay systems for managerial and nonmanagerial employees. The procedures for setting pay in these circumstances require IRS personnel to apply cumbersome and oftentimes confusing rules which vary depending on, for example, the management position that the employee will be occupying. While the IRS has made efforts to train employees, the IRS advised TIGTA that individual offices responsible for setting pay did not receive the same training. Also, the seasonal nature of some of the IRS's work contributes to the complexity involved in setting pay because the IRS often promotes permanent employees to temporary management positions, and employees may move back and forth between their temporary management position and their permanent position within a short period of time.

Salary errors can have a significant impact on employees. TIGTA interviewed all current IRS employees who had debt of more than $5,000 resulting from salary overpayments when they were promoted to management positions. Employees stated that they were unaware of any overpayment until notified by the IRS and did not understand how pay calculations were made. Several expressed frustration with these pay issues, with some employees stating that they had delayed retirement, experienced medical issues, contacted their Member of Congress, or turned down management offers as a result.

The IRS has taken action to increase the accuracy of pay calculations going forward, including the addition of a second level of quality review and formed a team to review the pay actions associated with almost 1,000 current IRS employees who were potentially overpaid.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS Human Capital Officer 1) address the salary overpayments and underpayments TIGTA identified and 2) consider simplifying pay calculation processes in areas in which pay errors continue to be identified.

In their response, IRS management agreed with both recommendations and stated that the IRS will 1) take action to process corrective personnel actions for salary overpayments and underpayments TIGTA identified and 2) review results and recommendations from TIGTA, an internal review, and other sources to simplify pay policy and/or training.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

March 29, 2017

MEMORANDUM FOR INTERNAL REVENUE SERVICE HUMAN CAPITAL OFFICER

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Some Managerial Salaries Were Calculated Incorrectly Due to Complex Pay-Setting Rules (Audit # 201610010)

This report presents the result of our review to determine whether existing processes provide reasonable assurance that salary overpayments or underpayments are prevented and detected when employees move into, within, and out of Internal Revenue Service paybands. This review is included in our Fiscal Year 2017 Annual Audit Plan and addresses the major management challenge of Achieving Program Efficiencies and Cost Savings.

Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Greg Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations).

Table of Contents

Abbreviations

GS	General Schedule
IRS	Internal Revenue Service

Background

The Internal Revenue Service (IRS) Restructuring and Reform Act of 1998[1] authorizes the IRS to establish pay systems that are different than the General Schedule (GS) pay system, which is the standard pay system used by most Federal agencies.[2] The Office of Personnel Management developed criteria for the IRS to follow when developing the new pay system, including a requirement that the grades and steps of the GS pay system be incorporated into the new pay system.

The IRS exercised the authority provided by the Restructuring and Reform Act of 1998 and developed the IRS Payband System (hereafter referred to as the management pay system), which is a performance-based pay system for IRS managers, excluding executives.[3] Increases in pay result from performance ratings. There are three types of managers covered under the management pay system:

- **Senior Managers –** These managers are second-level supervisory/management positions. Additionally, they are first-level management positions that report directly to IRS executives. Their pay can be as low as a grade GS-14, Step 1, and as high as grade GS-15, Step 10. The pay structure for these managers was developed in March 2001.
- **Department Managers –** These managers are second-level management positions located in the IRS processing centers. Their pay can be as low as a grade GS-11, Step 1, and as high as a grade GS-13, Step 10. The pay structure for these managers was developed in November 2001.
- **Frontline Managers**[4] **–** These are management positions that are not classified as senior managers or department managers. Their pay can be as low as a grade GS-5, Step 1, and as high as a grade GS-15, Step 10. The pay structure for these managers was developed in September 2005.

[1] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 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] The GS pay system is used by most Federal agencies and covers most nonmanagerial employees at the IRS. The GS pay system provides pay raises to employees based on the length of time an employee is in a job, as long as their work performance is satisfactory.
[3] The senior level (executive) category of high-level Federal jobs replaced grades GS 16, 17, and 18.
[4] There are 11 management positions classified as frontline managers. An increase in pay is appropriate when moving from a lower frontline manager position to a higher frontline manager position.

IRS employees move from the GS pay system to the management pay system upon promotion to either a temporary or permanent management position, which makes them eligible for a pay increase.

- Employees selected for a first-time, competitive permanent management position are eligible for a *one-time* 10 percent pay increase. Additionally, employees promoted from a management level to a higher management level may receive an additional 10 percent pay increase.[5]
- Employees with prior management experience or selected for a temporary promotion into a management position are eligible for an 8 percent pay increase.
- All pay increases for pay-setting actions to the management pay system must be between the minimum and maximum rate of the position to be filled.

When IRS employees move to the management pay system, all pay increases are calculated using the IRS employee's base pay.[6] Calculating an employee's pay is not completed until adding a locality factor, which is based on the location of the IRS office where the employee works. The locality increase is added to the base pay of the employee.

For example, the base pay for all employees who are grade GS-13, Step 6, is $86,156, which applies to all employees who are a grade GS-13, Step 6, around the country.[7] However, if an employee lives in a location that receives a 15 percent locality increase, their actual salary would be $99,079.[8] If the employee received a permanent promotion to a senior manager position in the same locality, the new salary would be calculated using the steps shown in Figure 1.

Figure 1: Example Pay Calculations for a First-Time, Competitive Permanent Promotion to a Senior Manager Position

Step	Action
A	Multiply the employee's base pay by 10 percent to determine the salary increase that the employee is entitled to receive. Add the salary increase to the employee's base pay. $86,156 x 10% = $8,616 $86,156 + $8,616 = $94,772

[5] Movement from 1) a frontline manager to a department manager, 2) a frontline manager to a senior manager, and 3) a department manager to a senior manager all result in additional 10 percent increases. However, movement from a frontline manager position to a higher frontline manager position does not qualify for a 10 percent increase.

[6] A rate of pay, without locality pay, that is continuing and is set by law or administrative action before any additional payments or deductions of any kind.

[7] The pay settings used in the example are from Fiscal Year 2016.

[8] $86,156 x 0.15 = $12,923. $86,156 + $12,923 = $99,079.

B	Compare the $94,772 to the minimum and maximum rates for senior managers in the management pay system. In this example, the new base pay amount falls within the minimum and maximum base pay for a senior manager. Therefore, the new base pay for the employee is $94,772. However, if the calculated amount was lower than the minimum base pay for a senior manager, the new base pay would be adjusted to be the minimum base pay for a senior manager. If the calculated base pay was higher than the maximum base pay for a senior manager, the new base pay would be adjusted to be the maximum base pay for a senior manager.
Step	**Action (Cont.)**
C	Complete the calculation by adding the 15 percent locality increase. $94,772 x 15% (locality) = $14,216 $94,772 + $14,216 = $108,988

Source: IRS Pay-Setting Desk Guide.[9]

There are other rules that further complicate the setting of pay for management employees. For example, employees who are promoted to a similar position to one they previously held may be entitled to receive increases that exceed the 10 percent and 8 percent increases generally paid for permanent and temporary positions. In addition, there are specific rules for setting pay when managers move out of the management pay system. These rules depend specifically on whether the position the manager is receiving is a promotion, a demotion, or a return to the position they occupied prior to receiving a temporary promotion.

Upon changing to a position that requires an employee to move into the management pay system or move back to the GS pay system, IRS procedures require a review of the employee's salary history. The salary history review should include a check that all prior pay-setting calculations were accurate and correct. Additionally, procedures adopted in Fiscal Year 2013 require Human Capital Office personnel to perform a secondary review. Errors in setting pay may cause a salary overpayment or salary underpayment. Salary overpayments occur when errors in calculating pay cause employees to receive pay that exceeds the amounts outlined in the pay-setting rules, while salary underpayments occur when pay calculation errors cause employees to receive pay that is less than the amount outlined in the pay-setting rules.

This review was performed at the Human Capital Office's Human Resource Employment Office in Philadelphia, Pennsylvania, during the period November 2015 through December 2016. Additionally, we conducted telephone interviews with IRS employees in the Small Business/ Self-Employed, Tax Exempt and Government Entities, and Wage and Investment Divisions as well as Agency-Wide Shared Services and Human Capital Office locations throughout the United States. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a

[9] We modified the example by using Fiscal Year 2016 pay rates and used a fictional locality factor.

reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Results of Review

Processes Did Not Reasonably Assure That Employees Promoted to Management Positions Were Paid Correctly

IRS processes did not sufficiently ensure that employees were being paid the correct amount when they occupied a position under the management pay system. Analysis of pay records from January 2006[10] to November 2015[11] identified 4,985 IRS employees who received a pay increase that exceeded 10 percent, which would generally be the maximum amount an employee would receive when being permanently promoted to a management position. We examined pay records for a statistically valid sample[12] of these employees and found that 85 (31 percent) of 274 employees[13] were not paid correctly.[14] Based on our sample results, we estimate that the IRS overpaid more than 600 employees by approximately $4.2 million[15] and underpaid more than 900 employees by approximately $2.7 million[16] between Fiscal Years 2006 and 2015.

Detailed procedures for setting pay are outlined in the IRS Pay-Setting Desk Guide. The guidance is more than 70 pages covering all of the rules for setting pay for IRS managers and includes numerous examples. These examples are necessary because setting pay can vary depending on several issues, including the nature of the promotion, the salary history of the employee, and the management position that is being filled. Employees responsible for setting pay have been trained in applying the procedures outlined in the guidance.

Due to the complexities for setting pay for IRS managers, the IRS made errors in calculating pay for employees moving between the GS pay system and the management pay system, resulting in improper overpayments and underpayments. However, improper payments are not the only concern. Errors in setting pay, especially those discovered years after they were made, can have a significant impact on employees because employees are required to reimburse the IRS for the amount of the overpayment. Additionally, the IRS must add interest that is due to employees for any underpayment.

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[10] This date corresponds to the oldest time and attendance information available to the audit team after the management pay system was implemented.
[11] This date corresponds to the latest data that were available when we began planning the audit.
[12] See Appendix I for details on our sampling methodology.
[13] Pay-setting errors for 11 of these employees were previously identified by IRS processes, which resulted in a correction to the employees' pay. See Appendix IV.
[14] Some IRS employees had both an overpayment and an underpayment.
[15] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between $1,306,094 and $7,158,372.
[16] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between $1,221,660 and $4,106,868.

We reviewed employee debt lists and interviewed all current IRS employees who had debt of more than $5,000 resulting from salary overpayments when they were promoted to the management pay system. The employees we interviewed stated that they were unaware of any overpayment until notified by the IRS and did not understand how the pay calculations were made. Several expressed frustration and confusion, with some employees stating that they had delayed retirement, experienced medical issues, contacted their Member of Congress, or turned down recent offers to enter management due to the salary issues they encountered.

Below are several of the key reasons for improper payments associated with movement between the GS pay system and the management pay system.

Cumbersome and confusing rules for setting pay resulted in mistakes when calculating pay for employees moving between the GS pay system and the management pay system

The procedures for setting pay require the application of cumbersome and oftentimes confusing rules that vary depending on, among other things, the nature of the promotion, the salary history of the employee, and the management position the employee will be occupying. Additionally, there are complex procedures to follow for temporary promotions that are made permanent and for moving back into the GS pay system when temporary promotions end.

Setting pay accurately requires an extensive knowledge of the rules and nuances associated with both the management pay system and the GS pay system. Not understanding these rules significantly increases the risk of errors in setting pay. For example, knowing if the movement into the management pay system is temporary or permanent is required because the type of promotion determines the appropriate salary increase. Additionally, the employee's salary history must be reviewed because the salary history will affect the percentage increase that the employee is entitled to receive.

Although IRS employees are generally permitted a one-time 10 percent pay increase on their first-time competitive permanent promotion to the management pay system, there are instances in which IRS managers may be eligible for another 10 percent increase. Additionally, it is important for the new salary to meet the minimum salary of the position the manager is entering. In some instances, employees are promoted into positions for which a 10 percent salary increase does not meet the minimum salary of the management position they will be occupying. In these circumstances, the employee pay must be set at the minimum salary for the position.

IRS employees who receive temporary promotions can later receive permanent promotions. The permanent promotion can be in the same management position[17] or a higher management position.[18] The procedures for setting pay are different for each situation. Each situation

[17] For example, an IRS employee who was temporarily promoted to a frontline manager position and the same frontline manager positon becomes permanent.

[18] For example, an IRS employee who was temporarily promoted to a frontline manager position and is then permanently promoted to a department manager position.

requires complex steps to calculate the new salary correctly. See Appendix V for simplified illustrations of how these calculations are made.

The seasonal nature of some of the IRS's work requires employees to be temporarily promoted into management positions

The seasonal nature of the IRS's work contributes to the complexity involved in setting pay because the IRS often promotes permanent employees to temporary management positions, and employees may move back and forth between their temporary management position and their permanent position within a short period of time. During peak tax season, it is common for IRS employees to be temporarily promoted to the management pay system due to the increased workload associated with the filing season.[19] The IRS will hire temporary employees for the tax filing season to process tax returns filed by taxpayers. As a result, some full-time IRS employees will be temporarily promoted to the management pay system to oversee the seasonal employees. In some instances, these full-time IRS employees are temporarily promoted to the management pay system for a single pay period and then return to their permanent position.

In other instances, employees may be temporarily promoted to the management pay system and then temporarily promoted again to a higher management position. This is called a stacked promotion.[20] In a stacked promotion, IRS employees can also move back and forth between the GS pay system and the management pay system. See Appendix V for simplified illustrations of how calculations associated with stacked promotions are made. Depending on individual circumstances, IRS employees receiving numerous temporary promotions resulting in the stacking of promotions can lead to errors in setting pay.

Employees responsible for setting pay did not receive the same training, resulting in different interpretations of pay-setting procedures

While the IRS has made efforts to train employees, the IRS advised us that individual offices responsible for setting pay did not receive the same training. After the management pay system was developed, individual offices that were responsible for calculating pay conducted their own training. However, complexities associated with calculating managers' pay resulted in different interpretations of pay-setting rules. The lack of consistent training resulted in offices reaching different conclusions on how the rules should be interpreted, leading to errors in setting pay.

Actions are being taken to increase the accuracy of pay calculations going forward

In Fiscal Year 2013, the IRS recognized that problems existed with setting pay as a result of the increasing number of salary overpayments that were being identified and took actions in an

[19] The period from January through mid-April when most individual income tax returns are filed.
[20] A stacked promotion occurs when an employee already on a temporary promotion is placed on another temporary promotion at a higher rate than the first promotion.

attempt to improve pay-setting processes. For instance, a secondary review of the pay calculations for employees moving between the GS pay system and the management pay system was initiated to prevent pay-setting errors. The IRS also formed a team during our audit to review the pay actions associated with almost 1,000 current IRS employees who were potentially overpaid. As part of this review, the IRS is analyzing the pay for current IRS employees who received a salary that was above the minimum rate for the new management position and who received a salary increase that was above 10 percent, which is the percentage generally given upon entering the management pay system. As we were completing our audit work, the IRS was continuing to work on its analysis.

Recommendations

The IRS Human Capital Officer should:

Recommendation 1: Address the salary overpayment and underpayment cases that we identified during the audit.

> ***Management's Response:*** The IRS agreed with this recommendation. The IRS Human Capital Office has already reviewed and concurred with the pay cases associated with this audit. The IRS will take action to process corrective personnel actions to address the salary overpayment and underpayment cases identified during this audit.

Recommendation 2: Analyze the results from the pay-setting risk analysis and look for opportunities to simplify pay calculation processes in areas in which common pay errors are identified.

> ***Management's Response:*** The IRS agreed with this recommendation. The IRS Human Capital Officer will:
>
> - Complete second-level reviews of on-roll, high-risk accounts identified in the review.
> - Upon completion of the IRS payband review, analyze the results and offer recommendations to simplify pay processes, *i.e.*, analyze stacked or multiple promotions.
> - Develop and issue training pay-setting job aids to ensure consistent review of common pay errors.
> - Review results and recommendations from the Treasury Inspector General for Tax Administration audit, internal review, and other sources to simplify pay policy and/or training, *i.e.*, conduct surveys and lead focus groups to determine the effectiveness of the IRS payband.
> - Provide recommendations to leadership for action.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether existing processes provide reasonable assurance that salary overpayments or underpayments are prevented and detected when employees move into, within, and out of IRS paybands. To accomplish our objective, we:

I. Evaluated IRS procedures for setting pay and for preventing and detecting erroneous salary overpayments resulting in employee debt to the IRS.

   A. Reviewed the Internal Revenue Manual to determine whether procedures include specific instructions for determining and setting pay for employees moving into, within, and out of the management pay system.

   B. Reviewed managerial and training materials available to determine whether they contain sufficient guidance on setting pay.

   C. Analyzed procedures available to Human Capital Office personnel for purposes of quality reviewing personnel actions to provide reasonable assurance that pay is set accurately.

II. Determined the reasons that existing employee debt caused by salary overpayments as a result of moving into a management position were present, including how they were identified, by analyzing debt management records of outstanding debt.

   A. Analyzed IRS debt records to identify all current IRS employees with debts greater than $5,000 that are attributable to salary overpayments as a result of the employee moving into a management position.

   B. Interviewed current IRS employees meeting the criterion in Step II.A. to determine whether they were aware of the debt before being contacted by the IRS and whether they understood the reason for the debt.

III. Determined whether IRS management was appropriately setting pay for employees moving into or within the management pay system.

   A. Obtained payroll and salary information from the Treasury Integrated Management Information System[1] file for the period of January 2006[2] through November 2015.[3]

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[1] This system contains payroll data for IRS employees per pay period, *e.g.*, post of duty, salary, grade, employee addresses.
[2] This date corresponds to the oldest time and attendance information available to the audit team after the management pay system was implemented.
[3] This date corresponds to the latest data that were available when we began planning the audit.

We were unable to perform validation tests on the Treasury Integrated Management Information System file because there was no independent source to which to compare payroll data. However, our information technology staff tested the data to ensure that all records extracted from the system were received. The Treasury Integrated Management Information System file was used to compare the existing and new pay rates to identify IRS employees who received a salary increase of more than 10 percent when moving to the management pay system. The analysis identified 4,985 employees who received a promotion to the management pay system with a salary increase of greater than 10 percent.

B. Selected and reviewed a statistically valid sample of 274 IRS employees who were stratified based on the number of times the employee moved into the management pay system. The sample was selected using an estimated error rate not to exceed 25 percent, a confidence level of 95 percent, and a ± 5 percent precision rate.[4] Each IRS employee within our sample was evaluated to determine whether IRS personnel calculated pay correctly. A statistical sample was used to allow the results to be estimated across the entire population of employees meeting our criteria.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: IRS payroll personnel policies and procedures regarding the prevention and detection of salary overpayments and underpayments. We evaluated these controls by obtaining the policies, procedures, and guidance for setting pay; interviewing IRS employees who developed the policies and procedures for setting pay; interviewing IRS employees who used the guidance developed for setting pay; and interviewing IRS employees who were affected by errors in the setting of pay causing salary overpayments. Additionally, we determined if pay was correctly set for a sample of IRS employees who entered the management pay system from January 2006 to November 2015.

[4] A contract statistician assisted with developing the sampling plans and projections.

Appendix II

Major Contributors to This Report

Greg D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations)
Troy D. Paterson, Director
James V. Westcott, Audit Manager
David M. Bueter, Lead Auditor
John M. Jarvis, Senior Auditor
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Appendix III

Report Distribution List

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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. This benefit will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Inefficient Use of Resources – Potential; $3,626,274[1] for 630 employees with salary overpayments due to errors in setting pay for IRS employees who were promoted into the management pay system between January 2006 and November 2015 (see page 5).[2]

Methodology Used to Measure the Reported Benefit:

We identified all IRS employees who moved from the GS pay system to the management pay system between January 2006 and November 2015 by analyzing IRS pay records. We then determined the number of employees who had a pay increase that exceeded 10 percent as a result of being promoted into the management pay system and selected a statistically valid sample of 274 cases. The sample was stratified based on the number of times IRS employees entered the management pay system. We analyzed pay records for the sample and determined that 35 employees had been overpaid. In consultation with a contract statistician, errors identified in each stratum were applied to the universe of 4,985 IRS employees who were promoted into management and received pay increases that exceeded 10 percent between January 2006 and November 2015. As shown in Figure 1, we estimate that the IRS overpaid more than 600 employees by approximately $3.6 million between Fiscal Years 2006 and 2015.

[1] The point estimate projections are based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between $838,556 and $6,413,993.
[2] The calculations for these estimates exclude the 11 employees who were previously identified by IRS processes, which resulted in a correction to the employees' pay.

Figure 1: Summary of Salary Overpayments by Number of Promotions to the Management Pay System

Analysis of Salary Overpayment Errors						
			Employees With Salary Overpayments			
Strata	Total Number of Employees	Sample Size	Number in Sample	Percentage in Sample	Estimated Total	Estimated Total Dollar Amount of Overpayments
One Promotion	3,229	168	19	11.31%	365	$2,870,216
More Than One Promotion	1,756	106	16	15.09%	265	$756,059
				Totals:	630	$3,626,274[3]

[3] Amounts in the column do not total to exactly $3,626,274 due to rounding.

Appendix V

Examples of Pay Calculations

The following are scenarios with step-by-step explanations to demonstrate the process of calculating pay for employees who receive various types of promotions. Upon changing to a position that requires an employee to move into the management pay system, IRS procedures require a review of the employee's salary history. For clarity, we did not add any complications to the scenarios based on previous salary history.

Temporary Promotion Made Permanent in the Same Management Position	
Scenario[1]	
The following is a scenario to demonstrate the process of calculating pay for an employee who received a temporary position that was subsequently made permanent: An IRS employee was a grade GS-12 with a base pay of $62,101 when competitively selected to a temporary department manager position. The announcement was posted as a position that was temporary, not to exceed one year, but may become permanent. Salary was set by applying the 8 percent temporary promotion rule. Management decided to remove the temporary restriction prior to the ending of the temporary promotion. The employee had never previously held a management position on a permanent basis. The current rate of base pay is $67,069.[2]	
Step	**Action**
A	Pay is calculated by adding the difference in base pay between the initial 8 percent increase for a temporary promotion and the application of a 10 percent pay increase for a first-time permanent competitive promotion into the management position. The grade GS-12 rate of base pay before applying the 8 percent increase calculation was $62,101. The 10 percent increase is applied to this amount, and the result is compared to the initial 8 percent calculation to determine the difference. $62,101 x 1.10 = $68,311 $62,101 x 1.08 = $67,069 $68,311 - $67,069 = $1,242 difference

[1] This example was outlined in the *IRS Pay-Setting Desk Guide*, dated October 2012. We modified the example to reflect a pay raise using Fiscal Year 2016 pay rates.
[2] $62,101 x 1.08 = $67,069 – This rate meets the minimum of the department management position the employee is entering.

Temporary Promotion Made Permanent in the Same Management Position (cont.)	
Step	**Action**
B	The $1,242 difference between the 10 percent and 8 percent calculations determined in Step A is added to the current management rate of base pay. $67,069 + $1,242 = $68,311
C	Compare the base pay of $68,311 to the department manager range of rates for base pay. The base pay of $68,311 falls within the Fiscal Year 2016 department manager range of rates for base pay; therefore, the new rate of base pay is $68,311 upon removing the temporary restriction. However, if the calculated amount was lower than the minimum base pay for a department manager, the new base pay would be adjusted to be the minimum base pay for a department manager. If the calculated base pay was higher than the maximum base pay for a department manager, the new base pay would be adjusted to be the maximum base pay for a department manager. Applicable locality increase is added to the employee's base pay to find the final salary.

Temporary Promotion Made Permanent to a Higher Management Position
Scenario[3]
The following is a scenario to demonstrate the process of calculating pay for an employee who received a temporary promotion to a higher management position and, subsequently, received a permanent promotion to another higher management positon: An IRS employee was a frontline manager with a base pay of $97,200 when competitively selected for a temporary promotion at a higher frontline manager position that is not to exceed five years. After two years in the temporary frontline manager position, the employee was selected for a permanent senior manager position. While being temporarily promoted to the frontline manager position, the IRS employee received performance ratings for the two years in the position that resulted in an increase in the employee's salary. The employee had not held a permanent senior manager position previously.

[3] This example was outlined in the *IRS Pay-Setting Desk Guide*, dated October 2012. We modified the example by using fictional pay rates and fictional performance increases.

Temporary Promotion Made Permanent to a Higher Management Position (cont.)	
Step	**Action**
A	**Return the employee to the original frontline manager position:** Because the employee is on a temporary promotion to a higher frontline manager position when selected for a permanent senior manager position, which is a different management position than the temporary promotion, the employee is first returned to the frontline manager permanent position of record. Pay is set upon returning to the frontline manager position as if the temporary promotion to the higher frontline manager position had not occurred. The rate of base pay is adjusted to reflect any pay increases received while on the temporary promotion to the higher frontline manager position. <u>Return to original frontline manager pay calculation</u>: Frontline manager rate of base pay = $97,200 First performance increase based on performance rating for first year in temporary management position = 1.9% $97,200 x 1.019 = $99,047 <u>New frontline manager pay calculation</u>: New frontline manager rate of base pay = $99,047 Second performance increase based on performance rating for second year in temporary management position = 2.2% $99,047 x 1.022 = $101,226 Compare the calculated base pay to the frontline manager range of rates for base pay. The base pay of $101,226 falls <u>within</u> the frontline manager range of rates for base pay; therefore, the new rate of base pay is $101,226 upon returning the employee to the original frontline manager position. However, if the calculated amount was lower than the minimum base pay for a frontline manager, the new rate of base pay would be adjusted to be the minimum base pay for a frontline manager. If the calculated new rate of base pay was higher than the maximum base pay for a frontline manager, the new base pay would be adjusted to be the maximum base pay for a frontline manager.

Temporary Promotion Made Permanent to a Higher Management Position (cont.)	
Step	**Action**
B	**Process a permanent promotion to the senior manager position:** Because the employee never held a senior manager position on a permanent basis, pay is set by applying a 10 percent increase for first-time permanent competitive selection to a higher level management position. $101,226 x 10% = $10,123 $101,226 + $10,123 = $111,349 Compare the calculated base pay to the senior manager range of rates for base pay. The base pay of $111,349 falls <u>within</u> the senior manager range of rates for base pay. By providing a 10 percent increase, the new rate of base pay would be set at $111,349. However, if the calculated amount was lower than the minimum base pay for a senior manager, the new base pay would be adjusted to be the minimum base pay for a senior manager. If the calculated base pay was higher than the maximum base pay for a senior manager, the new base pay would be adjusted to be the maximum base pay for a senior manager. Applicable locality increase is added to the employee's base pay to find the final salary.

Stacked Promotions	
Scenario[4]	
The following is a scenario to demonstrate the process of calculating pay for an employee who receives stacked promotions: An IRS employee was a grade GS-8 with a rate of base pay of $41,355. The employee is selected for a competitive temporary promotion to a frontline manager position. The employee is subsequently selected for a temporary promotion to a higher frontline manager position.	
First Temporary Promotion:	
Step	**Action**
A	Using the base pay, add 8 percent to determine the amount of pay that the employee is entitled to receive. $41,355 x 8% = $3,308 $41,355 + $3,308 = $44,663

[4] This example was outlined in the *IRS Pay-Setting Desk Guide*, dated October 2012. We modified the example by using Fiscal Year 2016 pay rates.

Stacked Promotions (cont.)	
First Temporary Promotion (cont.):	
Step	**Action**
B	Compare the calculated base pay to the range of rates that apply for frontline managers. The base pay of $44,663 falls within the frontline manager minimum and maximum rates; therefore, the new rate of base pay is $44,663. However, if the calculated amount was lower than the minimum base pay for a frontline manager, the new base pay would be adjusted to be the minimum base pay for a frontline manager. If the calculated base pay was higher than the maximum base pay for a frontline manager, the new base pay would be adjusted to be the maximum base pay for a frontline manager. Applicable locality increase is added to the employee's base pay to find the final salary.
Stacked Temporary Promotion:	
Step	**Action**
A	Using the employee's rate of base pay from his or her first temporary promotion to the frontline manager position, add 8 percent to determine the amount of pay the employee is entitled to receive. $44,663 x 8% = $3,573 $44,663 + $3,573 = $48,236
B	Compare the calculated base pay amount to the range of rates that apply for the new higher frontline manager position. The base pay of $48,236 falls within the new frontline manager minimum and maximum rates; therefore, the new base pay is $48,236. However, if the calculated amount was lower than the minimum base pay for a frontline manager, the new base pay would be adjusted to be the minimum base pay for a frontline manager. If the calculated base pay was higher than the maximum base pay for a frontline manager, the new base pay would be adjusted to be the maximum base pay for a frontline manager. Applicable locality increase is added to the employee's base pay to find the final salary.

Source: IRS Pay-Setting Desk Guide.

Appendix VI

Management's Response to the Draft Report

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

HUMAN CAPITAL OFFICE

MAR 06 2017

MEMORANDRUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Daniel T. Riordan for Edward Bell
IRS Human Capital Officer

SUBJECT: Draft Audit Report – Some Managerial Salaries Were Calculated Incorrectly Due to Complex Pay-Setting Rules (Audit # 201610010)

Thank you for the opportunity to respond to the subject draft audit report. We are committed to ensuring the Internal Revenue Service (IRS) pay-setting policies and processes support accurate pay setting and the prevention of salary overpayments or underpayments.

We agree with both recommendations and will develop and implement the corrective actions detailed in the attached response.

We have taken numerous actions to reduce pay errors. We initiated an IR pay setting risk analysis and subsequently created an IR Pay Review team chartered to conduct detailed reviews of 953 high-risk accounts. The team began operations on March 7, 2016. Additionally, we developed and delivered an eight-module pay training to HR staff in 2016 and established a second level of quality review. We delayed our internal review of the high-risk accounts to realign resources to support this audit. However, we have now resumed our efforts to finalize the review.

We acknowledge pay setting can be complex. We would like to clarify a few statements in the report related to authorities, guidance, level and bands, and highest previous rate (HPR).

- The IRS Restructuring and Reform Act of 1998 authorized the Secretary of Treasury rather than the IRS to establish pay systems that are different than the General Schedule pay system.
- Detailed procedures for setting pay are outlined in the OPM Criteria for IRS Broadbanding System, IRS Pay Policies 12, 19, and 85, and the IRS Pay Setting Desk Guide.

- There are hundreds of positions classified as front line managers but there are only 11 different levels or bands governing this group. The report cites in several instances employees are promoted into the band. While this is accurate, employees may also be placed into the band through reassignment or a change to a lower level or band.

- Lastly, the HPR provision may be considered in certain circumstances when an employee is promoted, reassigned, or demoted into a management position and previously held a higher rate. They may be eligible to receive the higher previous rate if it exceeds the 10 percent or an eight percent entitlement. The HPR provision also applies to General Schedule employees.

We concur with TIGTA's calculations of measurable benefits and believe implementation of the attached corrective actions will greatly enhance the program.

We appreciate the continued support and assistance provided by your staff led by Mr. James Westcott to evaluate and recommend improvements to our program. If you have any questions, please contact me at 202-317-7600. If there are technical questions, a member of your staff may contact Kim Swarbrick, Associate Director, Employment Operations at 978-518-7581.

Attachment (1)

Attachment

RECOMMENDATION 1:

The IRS Human Capital Officer should address the salary overpayment and underpayment cases that we identified during the audit.

CORRECTIVE ACTION:

We agree with this recommendation. The IRS Human Capital Officer has already reviewed and concurred with the pay cases associated with this audit. We will take action to process corrective personnel actions to address the salary overpayment and underpay cases identified during this audit.

IMPLEMENTATION DATE:

September 30, 2017

RESPONSIBLE OFFICIAL:

Director, Employment, Talent & Security Division, Human Capital Office

CORRECTIVE ACTION MONITORING PLAN:

HCO will enter accepted corrective actions into the Joint Audit Management Enterprise System (JAMES). These corrective actions are monitored on a monthly basis until completion.

RECOMMENDATION 2:

The IRS Human Capital Officer should analyze the results from the pay-setting risk analysis and look for opportunities to simplify pay calculation processes in areas where common pay errors are identified.

CORRECTIVE ACTION (A):

We agree with this recommendation. The IRS Human Capital Officer will:

- Complete second level reviews of on-roll high-risk accounts identified in the review
- Upon completion of the IR pay band review, analyze the results, and offer recommendations to simplify pay processes (i.e. analyze stacked or multiple promotions)
- Develop and issue training pay-setting job aids to ensure consistent review of common pay errors

IMPLEMENTATION DATE:

October 30, 2017

RESPONSIBLE OFFICIAL:

Director, Employment, Talent & Security Division, Human Capital Office

CORRECTIVE ACTION (B):

We agree with this recommendation. The IRS Human Capital Officer will:

- Review results and recommendations from TIGTA audit, internal review and other sources to simplify pay policy and/or training (i.e. conduct surveys and lead focus groups to determine the effectiveness of the IR Payband)
- Provide recommendations to leadership for action

IMPLEMENTATION DATE:

February 28, 2018

RESPONSIBLE OFFICIAL:

Director, Workforce, Benefits & Performance Division, Human Capital Office

CORRECTIVE ACTION MONITORING PLAN:

HCO will enter accepted corrective actions into the Joint Audit Management Enterprise System (JAMES). These corrective actions are monitored on a monthly basis until completion.

3