The Awards Program Complied With Federal Regulations, but Some Employees With Tax and Conduct Issues Received Awards

March 21, 2014

Reference Number: 2014-10-007

<u>Redaction Legend</u>:
1 = Tax Return/Return Information
3 = Identifying Information – Other Identifying Information of an Individual or Individuals

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THE AWARDS PROGRAM COMPLIED WITH FEDERAL REGULATIONS, BUT SOME EMPLOYEES WITH TAX AND CONDUCT ISSUES RECEIVED AWARDS

Highlights

Final Report issued on March 21, 2014

Highlights of Reference Number: 2014-10-007 to the Internal Revenue Service Human Capital Officer.

IMPACT ON TAXPAYERS

For Fiscal Year 2011, the IRS awarded almost $92 million in cash and almost 520,000 hours of time off to 70,500 of its approximately 104,400 employees. For Fiscal Year 2012, the IRS awarded $86 million in cash and almost 490,000 hours of time off to 67,870 of its approximately 98,000 employees. These awards are designed to recognize and reward IRS employees for their performance. Oversight and control over these awards is important to ensure proper stewardship of Government funds and the effectiveness of the awards system.

WHY TIGTA DID THE AUDIT

This audit was initiated because new Federal guidance issued in Fiscal Year 2011 requires agencies to reduce spending on awards programs beginning in Fiscal Year 2012. The overall objectives of this review were to evaluate the IRS's compliance with procedures for expenditures on awards and to review the IRS's controls over awards made to employees with conduct and performance issues.

WHAT TIGTA FOUND

The IRS awards program complied with Federal requirements to limit awards expenditures and saved additional funds by keeping aggregate incentive payments, individual employee compensation, and aggregate awards below the Federal limits. According to the IRS, it took further actions in Fiscal Year 2013 to limit awards to the extent allowable by law.

However, between October 1, 2010 and December 31, 2012, more than 2,800 employees with recent substantiated conduct issues resulting in disciplinary action received approximately $2.8 million in monetary awards, more than 27,000 hours in time-off awards, and 175 quality step increases. Among these, more than 1,100 IRS employees with substantiated Federal tax compliance problems received more than $1 million in cash awards, more than 10,000 hours in time-off awards, and 69 quality step increases within a year after the IRS substantiated their tax compliance problem.

With few exceptions, the IRS does not consider tax compliance or other misconduct when issuing performance awards or most other types of awards. Governmentwide policies do not provide guidance on providing awards to employees with conduct issues. The IRS Restructuring and Reform Act of 1998 does not specifically mention awards, but does make mandatory the removal of IRS employees who are found to have intentionally committed certain acts of misconduct, including willful failure to pay Federal taxes. Thus, while not specifically prohibited, providing awards to employees with conduct issues, especially those who fail to pay Federal taxes, appears to create a conflict with the IRS's charge of ensuring the integrity of the system of tax administration.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS Human Capital Officer determine the feasibility of implementing a policy requiring management to consider conduct issues resulting in disciplinary actions, especially the nonpayment of taxes, prior to awarding all types of performance and discretionary awards.

The IRS agreed with TIGTA's recommendation. The Human Capital Officer plans to conduct a study by June 30, 2014, for the implementation of a policy requiring management to consider conduct issues resulting in disciplinary actions prior to awarding all types of performance and discretionary awards.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

March 21, 2014

MEMORANDUM FOR INTERNAL REVENUE SERVICE HUMAN CAPITAL OFFICER

FROM: Michael E. McKenney
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Awards Program Complied With Federal Regulations, but Some Employees With Tax and Conduct Issues Received Awards (Audit # 201310025)

This report presents the results of our review to evaluate the Internal Revenue Service's (IRS) compliance with procedures for expenditures on employee awards and to review the IRS's controls over awards made to employees with conduct and performance issues. This audit was included in our Fiscal Year 2013 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 IRS managers affected by the report recommendation. If you have any questions, please contact me or Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations).

Table of Contents

Abbreviations

ALERTS	Automated Labor and Employee Relations Tracking System
C.F.R.	Code of Federal Regulations
CY	Calendar Year
FY	Fiscal Year
IRS	Internal Revenue Service
NTEU	National Treasury Employees Union
OPM	Office of Personnel Management
SES	Senior Executive Service
SL	Senior-Level
ST	Scientific and Professional
TY	Tax Year

Background

The Internal Revenue Service (IRS) has an awards and recognition program in place to reward and retain competent and talented employees by appropriately recognizing their achievements and contributions to the IRS's mission and to promote an organizational culture in which managers recognize and appreciate their employees' contributions and achievements. Oversight and control over awards is important to ensure proper stewardship of Government funds and the effectiveness of the awards system.

An agency may grant a cash, honorary, or informal recognition award or grant time off with pay[1] to an employee as an individual or member of a group. These awards and recognitions are granted on the basis of merit, within applicable budget limitations, as a result of a suggestion, invention, superior accomplishment, productivity gain, or other personal effort that contributes to the efficiency, economy, or other improvement of Government operations. Additionally, if an employee achieves a significant reduction in paperwork, performs a special act or service in the public interest in connection with or related to official employment, or achieves successful performance as reflected in the employee's most recent rating of record, they can be eligible for an award. For IRS employees, it is at the manager's discretion for any award to be paid as cash only, time off only, or as a combination of cash and time off (except for executives and political appointees who are not eligible for time-off awards). The IRS's awards and recognition program components include:

- **Performance Awards** recognize an individual employee's performance as reflected in the most recent rating of record. When granted, these awards must be based on an employee's most recent performance rating of "fully successful" or higher.
- **Special Act and Managers Awards** are contribution awards granted for commendable individual employee or group achievements in connection with or related to official employment or otherwise in the public interest. These awards may be granted to employees as individuals or members of a group.
- **Suggestion Awards** are based on the adoption of employee suggestions to improve the efficiency or effectiveness of Government operations.
- **Quality Step Increases** are awarded to employees who earn an "outstanding" rating in at least two of the three immediately preceeding annual rating periods. A quality step increase is an additional "within-grade" pay increase used to recognize and reward

[1] A time-off award is a monetary award granted in the form of time off from duty without charge to leave or loss of pay.

General Schedule (GS) employees at any grade level who display outstanding performance.

- **Presidential Rank Awards** are recognized by the President for career senior executives who achieve results and consistently demonstrate strength, integrity, industry, and a relentless commitment to excellence in public service.

Generally, bargaining unit employees receive their annual performance award payments in September even though the performance period associated with the award may have ended any time during the fiscal year. Other awards, such as special act awards, are generally paid near the time of approval. Employee eligibility for an award depends on the previously discussed requirements listed in each award description. Other criteria, such as determining whether an employee is involved in a substantiated discplinary case (including nonpayment, late filing, or willful understatement of Federal taxes), is generally not considered when issuing awards according to the National Treasury Employees Union (NTEU) agreement with the IRS.[2]

For Fiscal Year (FY)[3] 2011, the IRS awarded $91.6 million[4] in cash and almost 520,000 hours of time off to 70,500[5] of its approximately 104,400[6] employees in addition to employee salaries of $6.9 billion during that time period. For FY 2012, the IRS awarded $86.3 million[7] in cash and almost 490,000 hours of time off to 67,870[8] of its approximately 98,000[9] employees in addition to employee salaries of $6.7 billion during that time period. Performance awards made up the largest proportion of cash awards issued during the period. For FY 2011, the IRS awarded $79.3 million (87 percent) in performance awards in comparison to $12.3 million (13 percent) in group and individual discretionary awards such as special act awards, suggestion awards, and Presidential Rank awards. For FY 2012, the IRS awarded $75.6 million (88 percent) in performance awards in comparison to $10.7 million (12 percent) in group and individual discretionary awards. Figure 1 shows that the total amount spent on cash awards decreased from $91.6 million in FY 2011 to $86.3 million in FY 2012 (a 6 percent decrease), which is consistent with Federal and agency efforts to reduce awards spending during that time.

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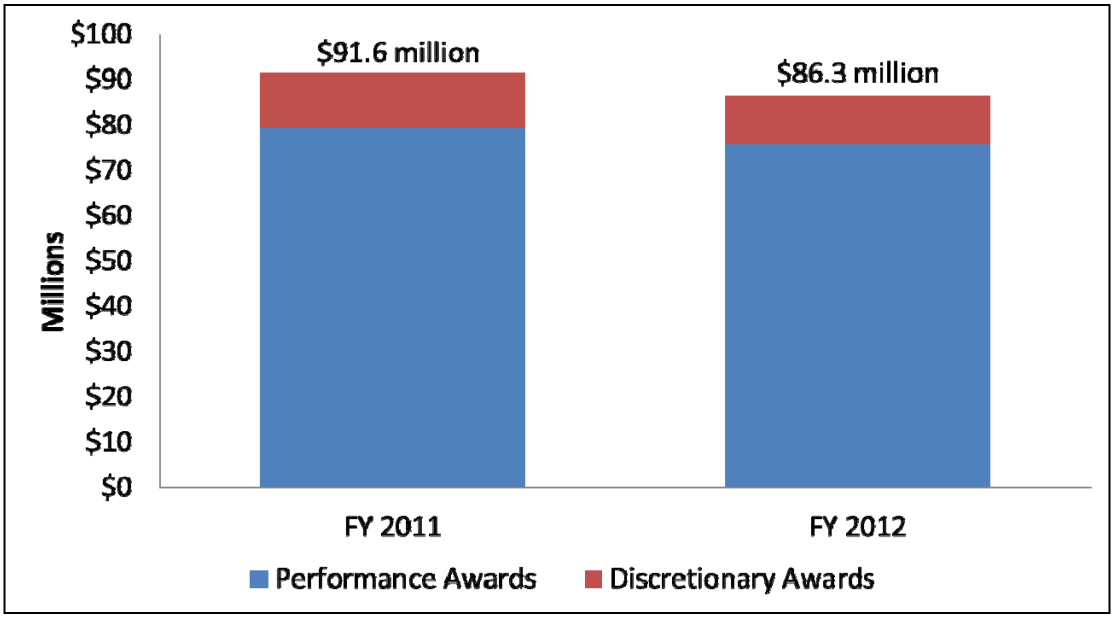
[2] Chief Counsel employees are not part of the NTEU, and their awards program is not part of the program that applies to IRS employees.
[3] See Appendix V for a glossary of terms.
[4] The $91.6 million does not include incentive payments such as recruitment, relocation, and retention.
[5] Some employees may have received more than one award.
[6] Includes a count of the total number of persons (full-time, part-time, and seasonal) employed by the IRS, including IRS Chief Counsel, during FY 2011.
[7] The $86.3 million does not include incentive payments such as recruitment, relocation, and retention.
[8] Some employees may have received more than one award.
[9] Includes a count of the total number of persons (full-time, part-time, and seasonal) employed by the IRS, including IRS Chief Counsel, during FY 2012.

Figure 1: Total Cash Awards Issued in FYs 2011 and 2012

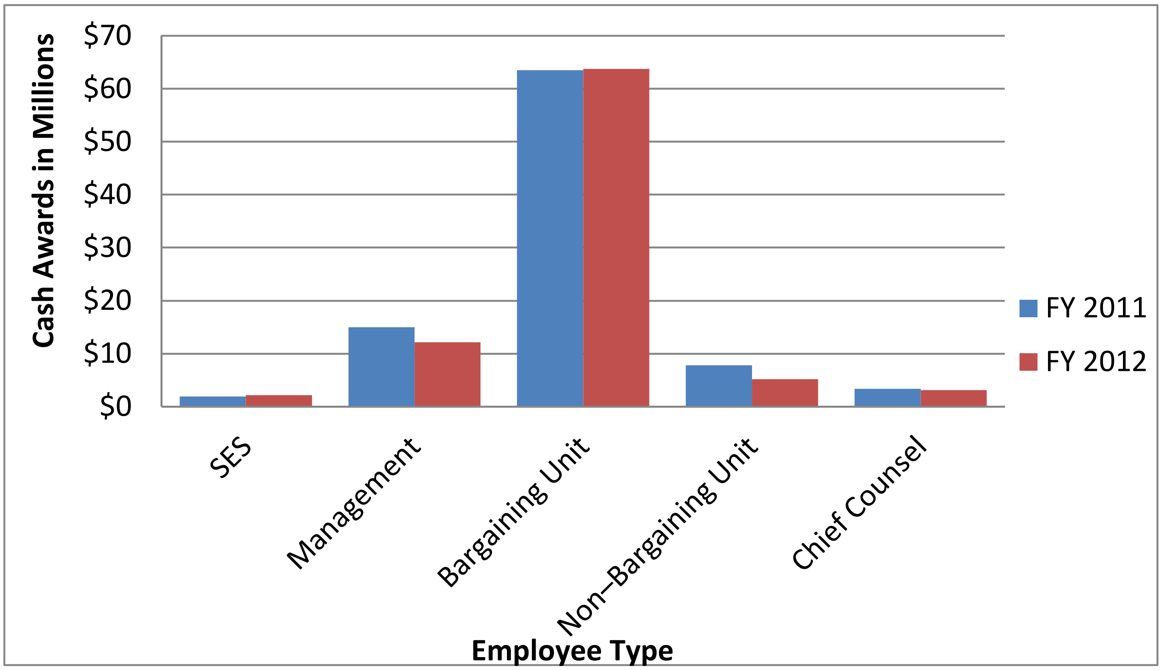


Source: Our analysis of the universe of 177,114 cash awards that IRS employees received for FYs 2011 and 2012 by fiscal year and award type.

IRS employees may be classified in five categories for the purpose of issuing awards: Senior Executive Service (SES), bargaining unit, non–bargaining unit, management,[10] and Chief Counsel.[11] Figure 2 shows that in FYs 2011 and 2012, bargaining unit employees received $63.5 million and $63.8 million in cash awards, respectively. The average value of an award granted to a bargaining unit employee was $944, while the average was $14,000 for SES employees who received awards.

[10] For reporting purposes, management-level IRS employees include the SES-in-waiting and streamlined critical pay employees.
[11] Chief Counsel employees are listed separately from the rest of IRS employees because pursuant to Treasury Order 107-07, personnel authority over personnel employed by the IRS Office of the Chief Counsel is delegated to the General Counsel.

Figure 2: Types of Employees With Cash Awards in FYs 2011 and 2012



Source: Our analysis of the universe of 177,114 cash awards that IRS employees received for FYs 2011 and 2012.

In addition to awards, the IRS uses incentive payments, which are compensation flexibilities available to help Federal agencies recruit and retain a workforce. The IRS issues incentive payments for recruitment, relocation, and retention purposes. Recruitment incentives are used to attract new employees to work in positions that are likely to be difficult to fill. Relocation incentives are used to encourage current employees to relocate to positions in a different geographic area that are likely to be difficult to fill. Finally, retention incentives are paid to current employees with unusually high or unique qualifications or to meet a special need of the agency and only when the employee would be likely to leave. The IRS made more than $4.3 million and $2.8 million in incentive payments such as retention, recruitment, and relocation in Calendar Years (CY) 2011 and 2012, respectively.[12]

Recent Federal guidance limits the amount that an agency may spend on certain types of awards. In June 2011, the Office of Management and Budget and the Office of Personnel Management (OPM) issued a joint memorandum[13] that places budgetary limits on individual awards. Under

[12] Retention, relocation, and recruitment incentives are reported to the Office of Personnel Management and Congress by calendar year instead of fiscal year.
[13] CPM 2011-10, *Guidance on Awards for Fiscal Years 2011 and 2012* (June 10, 2011).

the new guidance, agencies must meet the following spending limits for awards with effective dates in FY 2012:

- Reduce total spending on individual performance awards for SES/senior-level (SL)/ scientific and professional (ST) employees to no more than 5 percent of aggregate salaries.
- Reduce award spending for non-SES/SL/ST performance awards and individual contribution awards, *e.g.*, special act, for all employees to no more than 1 percent of their aggregate salaries.
- Ensure that other awards[14] and incentives are frozen at FY 2010 spending levels.

In July 2013, the IRS Principal Deputy Commissioner, in an effort to further cut costs, made the decision to pursue eliminating FY 2013 performance awards for senior executives. Prior to this, in March 2013, IRS leadership canceled performance awards for IRS managers and non–bargaining unit employees. In September 2013, the Principal Deputy Commissioner, after pursuing collective bargaining obligations and receiving a recommended resolution from a third-party fact finder, decided not to pay bargaining unit performance awards in FY 2013. In addition, the IRS stated that it is working on a policy that would take into account conduct issues that result in disciplinary actions prior to awarding all performance and discretionary awards. This policy applies to bargaining unit employees as well as all other IRS employees and thus will be negotiated with the NTEU. Governmentwide policies do not provide guidance on providing awards to employees with conduct issues. The IRS Restructuring and Reform Act of 1998 does not specifically mention awards, but does make mandatory the removal of IRS employees who are found to have intentionally committed certain acts of misconduct, including willful failure to pay Federal taxes.

This review was performed at the IRS National Headquarters in Washington, D.C., in coordination with the Offices of the Chief Financial Officer, IRS Human Capital Officer, and Chief Counsel during the period of November 2012 through January 2014. 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We did not evaluate the appropriateness of the awards. It was beyond the scope of this review to assess whether the employee's performance supported the overall ratings that led to the issuance of the award. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

[14] Other awards include group cash awards, cash awards recognizing achievements such as individual and group suggestion and invention, and cost saving referrals.

Results of Review

The Awards Program Complied With Federal Regulations

The IRS awards program complied with Federal requirements, and the IRS saved additional funds by keeping aggregate incentive payments, individual employee compensation, and aggregate awards below the Federal limits. In addition, our testing did not identify any IRS or Chief Counsel employees who received awards without meeting the Federally required minimum performance rating. Figure 3 outlines Federal requirements for awards programs and whether the IRS complied.

Figure 3: Awards Program Requirements and the IRS's Compliance

Requirement	Source of Requirement	Compliance With Requirement
Aggregate incentive payment limits	Federal Guidance	Yes
Individual employee pay limits	Federal Guidance	Yes
Aggregate award limits	Federal Guidance	Yes
Minimum performance ratings	Federal Guidance	Yes

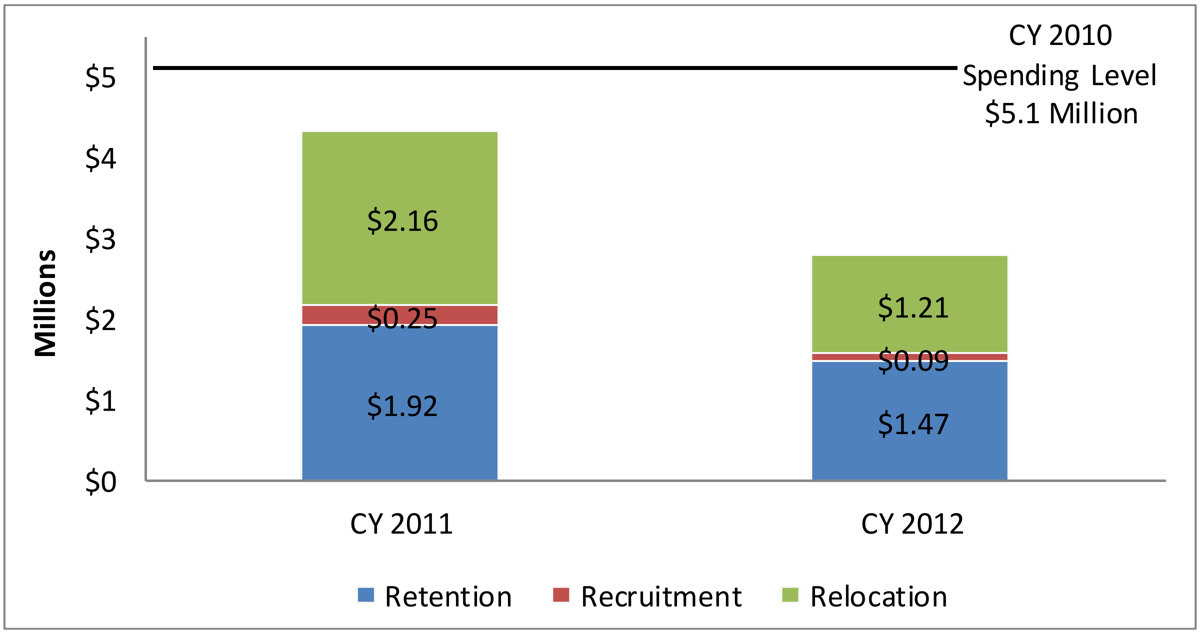
Source: Our analysis of the IRS's compliance with awards regulations from the OPM, the Office of Management and Budget, and the Code of Federal Regulations (C.F.R.) (specifically 5 C.F.R. § 530).

Incentive payment limits

Incentive payments for CYs 2011 and 2012 complied with Federal guidance on limiting incentive payments to CY 2010 levels. In fact, the CY 2011 and 2012 incentive payments were even lower than required, resulting in additional cost savings. A June 2011 joint memo from the OPM and the Office of Management and Budget required agencies to ensure that incentive payments are frozen at CY 2010 spending levels in response to established and anticipated budget constraints.[15] Incentive payments in CY 2011 were $4.3 million—$800,000 less than the CY 2010 level of $5.1 million—and CY 2012 incentive payments were further reduced to $2.8 million, for a total of more than $3.2 million in savings on incentives over the two-year period in comparison to CY 2010 levels. Figure 4 represents the totals spent on incentives in CYs 2011 and 2012 in comparison to the CY 2010 level.

[15] CPM 2011-10, *Guidance on Awards for Fiscal Years 2011 and 2012* (June 10, 2011).

Figure 4: Incentives Paid in CYs 2011 and 2012



Source: Our analysis of data provided by IRS personnel on the universe of 479 incentive payments issued to IRS employees during CYs 2011 and 2012 in comparison to the CY 2010 level of $5,131,439.

Individual employee pay limits

The IRS also complied with requirements that total compensation paid to any one IRS employee, including awards and incentives, could not exceed the Federal limit in CYs 2011 and 2012. The C.F.R. states that an employee may not receive basic pay, awards, bonuses, and similar cash payments that would cause the employee's aggregate compensation to exceed the total annual compensation payable to the Vice President in a calendar year.[16] We evaluated the total compensation of all 174 IRS employees[17] who received both incentive payments and awards in CYs 2011 and 2012 in comparison to the Vice President's salary, which remained $230,700 both years. We selected only those employees who received both incentive payments and performance awards for our review because having one or the other of these alone was not sufficient to bring any employee's salary close to the Federal limit. **********3*******
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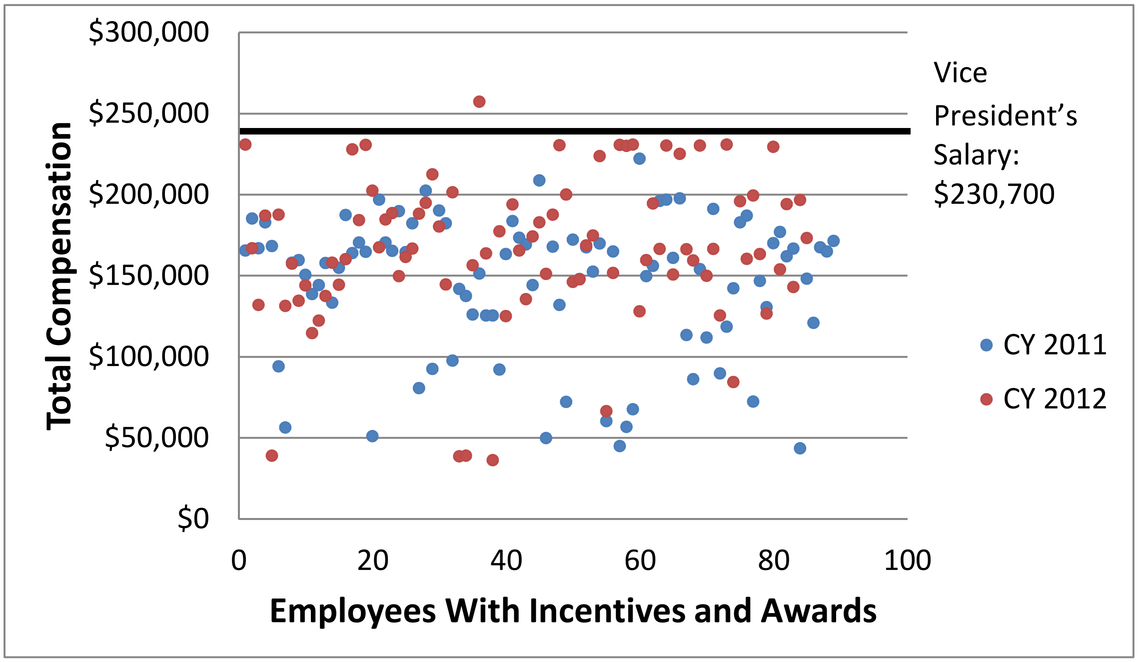
[16] 5 U.S.C. § 5307 and 5 C.F.R. § 530, subpart B.
[17] We evaluated the total compensation of all IRS employees who received incentive payments and awards in the same calendar year (89 employees in CY 2011 and 85 in CY 2012), including 27 employees who received incentive payments in both years.

*****3***.[18] Thus, the IRS complied with this requirement. Figure 5 shows the total compensation of the 174 employees in comparison to the Federal limit.

Figure 5: Total Compensation for Employees Who Received Incentives and Awards in CYs 2011–2012



Source: Our analysis of the total compensation of the universe of 174 employees who received incentive payments and awards during CYs 2011 and 2012.

Aggregate award limits

Additionally, the IRS complied with new Federal requirements to limit the aggregate amount of awards issued to its employees beginning in FY 2012, with one exception that was approved by the Department of the Treasury. Federal guidance from the OPM and the Office of Management and Budget issued in June 2011 requires that agencies:

- Reduce total spending on individual performance awards for SES/SL/ST employees to no more than 5 percent of aggregate salaries.

[18] 5 C.F.R. § 530, subpart B, *Aggregate Limitation on Pay*, states that an agency must pay any excess amount regardless of the calendar year limitation if an employee separates from Federal service. The employing agency must pay the entire excess amount following a 30-day break in service. If the individual is reemployed in the Federal service within the same calendar year as the separation, any previous payment of excess amount must be considered part of that year's aggregate compensation for the purpose of applying the aggregate limitation for the remainder of the calendar year.

- Reduce awards spending on individual performance awards for non-SES/SL/ST and individual contribution awards, *e.g.*, special act, for all employees (including SES) to no more than 1 percent of their aggregate salaries.

We found that for FY 2012, the IRS awarded SES and SL employees $2,026,100, which is $500 more than the 5 percent limit of $2,025,600 based on $40,511,700 in salaries.[19] The excess expenditure was the result of a computation error, and the Department of the Treasury authorized the difference. The IRS also reduced its FY 2012 spending for performance awards and individual contribution awards for management and non–bargaining unit employees to $17.2 million—$1.5 million less than the 1 percent limit of $18.7 million.[20]

Minimum performance requirements

Finally, based on an overall analysis of 98 percent of all awards issued in our audit period and a stratified random sample of 500 employees, we found that none of the IRS employees in our sample or overall analysis who received performance-based awards received a rating below fully successful in the appraisal period prior to the award, as required by Federal Guidance. Federal guidance states that employees must receive a rating of fully successful or higher in order to be eligible for a rating-based performance award.[21]

We conducted an overall analysis of data on all of the performance ratings that were included as part of the awards data that we received from the IRS Human Capital Office. We evaluated the performance ratings for 118,151 (98 percent) of 121,006 awards issued between October 1, 2010, and December 31, 2012.[22] Our analysis confirmed that all 118,151 employees received a rating of fully successful or higher prior to an award.

We also selected a stratified random sample of 500 IRS employees who received awards in FY 2011 through the first quarter of FY 2013 to determine whether the rating on their performance appraisal form showed that they received a rating of fully successful or higher. Our sample included 100 IRS employees in each of five categories: SES, bargaining unit, non–bargaining unit, management, and Chief Counsel. We received and reviewed performance

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[19] The IRS uses SES and SL salaries as of September 30, 2012, to determine the aggregate salary pool for FY 2012 awards to SES and SL employees.
[20] The IRS calculates the 1 percent limit for the awards to management and non–bargaining unit employees based on the aggregate salaries of all employees (including SES/SL employees but excluding bargaining unit and Chief Counsel employees).
[21] C.F.R. § 451.104, *Awards*.
[22] We evaluated performance ratings for the majority of performance awards from the IRS Human Capital Office. Nine performance awards did not have rating information. In addition, we did not evaluate Chief Counsel employees' ratings for performance awards (2,846 awards) beyond those requested in our sample of 500 IRS employees.

appraisal forms for 470 (94 percent)[23] of the 500 performance ratings from our sample and determined that all of the ratings were fully successful or higher, as required.

Employees With Recent Conduct Issues, Including Tax Compliance Issues, Received Awards

Between October 1, 2010 and December 31, 2012, some IRS employees with recent substantiated conduct issues resulting in disciplinary actions such as written reprimands, suspensions, and removal received approximately $2.8 million in monetary awards, more than 27,000 hours in time-off awards, and 175 quality step increases within one year after their disciplinary action. Employees with these conduct issues ranged from general schedule employees to managers.

Prior to awarding a permanent pay increase in the form of a quality step increase, the IRS does consider prior conduct issues that resulted in a disciplinary action of a suspension of more than 14 days; however, IRS officials stated that the IRS generally does not consider conduct issues when administering other types of awards. Specifically, for bargaining unit employees, the National Agreement II between the NTEU and the IRS states that, "The fact that an employee is the subject of a conduct investigation or has been the subject of a disciplinary action during the rating period will not preclude a performance award that would otherwise be granted *unless* such preclusion is necessary to protect the integrity of the Service." Governmentwide policies do not provide guidance on providing awards to employees with conduct issues. The IRS Restructuring and Reform Act of 1998 does not specifically mention awards, but does make mandatory the removal of IRS employees who are found to have intentionally committed certain acts of misconduct, including willful failure to pay Federal taxes.

As a result of the IRS's interpretation of the NTEU agreement for bargaining unit employees and a lack of policies requiring the IRS to consider conduct issues resulting in disciplinary actions prior to making awards to non–bargaining unit employees, more than 2,800 employees, out of the approximately 98,000 employees, received an award within one year after a disciplinary action.[24] These employees received between one and seven different awards within one year after the discipline. While not specifically prohibited by IRS policies, providing awards to employees with conduct issues, especially the failure to pay taxes owed to the Federal Government, appears to be in conflict with the IRS's charge of ensuring the integrity of the

[23] According to the IRS, it could not provide 30 performance appraisal forms because they were not available or the employees had since retired or separated.
[24] We evaluated disciplinary actions that took place within one year prior to the award's effective date because a typical IRS employee's appraisal period spans the length of one year; however, due to delays between when an award is earned, when it becomes effective, and when a payment is made, some of the conduct issues identified in these cases may have occurred after an employee earned an award.

system of tax administration. In addition, awards provided to these employees could be put to better use by providing employees who are compliant additional opportunities for awards.

IRS officials stated that in certain cases, such as when an employee has pending criminal charges against them, the IRS may withhold awards on a case-by-case basis. In addition, IRS officials informed us that in other unique cases when public attention has been raised about an event, the IRS may also withhold awards until the issue is resolved. For example, IRS officials mentioned that awards to all Exempt Organizations function employees within the Tax Exempt and Government Entities Division would be withheld due to the ongoing investigation into the inappropriate criteria used to identify certain groups applying for tax-exempt status for review. This decision was made prior to the IRS's decision to cancel awards for most employees in FY 2013. Finally, the IRS informed us that a disciplinary action history review is performed prior to making awards to SES personnel and prior to making any awards of more than $25,000. We found no instances where a SES employee received an award within one year after being disciplined for misconduct. While the IRS has controls in these limited cases, for the majority of awards, the IRS has elected not to consider recent disciplinary actions resulting from employee misconduct when determining award eligibility.

Using the Automated Labor and Employee Relations Tracking System (ALERTS) that the IRS uses to track disciplinary actions, we identified more than 2,800 employees who received an award within one year after a disciplinary action. In some cases, annual performance awards may have been earned prior to the disciplinary action because annual performance awards for bargaining unit employees are generally paid at the end of each fiscal year. Figure 6 shows more than 1,400 of these employees who had some of the most serious types of conduct issues resulting in disciplinary action brought against them. We determined that the most serious conduct issues included late payment and/or nonpayment of Federal taxes, Government travel card misuse or delinquency, Section 1203(b) violations, misconduct,[25] and fraud issues.[26] The almost 1,200 employees with tax issues and Section 1203(b) violations received awards in FY 2011 through the first quarter of FY 2013 totaling more than $1.1 million in monetary awards, almost 11,000 hours of time off valued at $256,000,[27] and 71 quality step increases.

[25] Examples of misconduct include drug use and violent threats.
[26] Examples of fraud include fraudulently claiming unemployment benefits and fraudulently entering attendance and leave on timesheets.
[27] The OPM considers a Federal employee's salary to be calculated based on 2,087 hours per year. The estimated salary associated with time-off awards comes from a calculation based on the employee's salary at the time the award was paid.

Figure 6: Employees With Substantiated Serious Conduct Issues

General Issue	Employees	Cash Awards	Time-Off Awards	Number of Quality Step Increases
Tax Issues	1,146	$1,068,912	10,582 hours	69 employees
Travel Card Misuse	246	$328,216	1,016 hours	16 employees
Misconduct	53	$31,579	541 hours	1 employee
Section 1203(b) Violations	48	$36,810	416 hours	*******1*********
Fraud	32	$22,103	396 hours	4 employees
Total*	**1,449**	**$1,429,522**	**12,456 hours**	**90 employees**

Source: Awards data from the IRS Human Capital Office and Office of Chief Counsel matched against the ALERTS database and Chief Counsel records.
**The "Total" row does not equal the sum of each column because some cases had multiple issues from these categories. For example, if a case had both a tax and a travel card issue, then it would be counted in both categories in the breakdown but only once in the "Total" row.*

We reviewed a nonrepresentative selection of 26 of the most serious conduct issues resulting in discipline cases from the population of more than 1,400 disciplinary cases for an in-depth review to determine the circumstances and reasons for the misconduct and the final adjudication of the case.[28] We selected cases that were closed with at least one issue substantiated where the employee received an award within one year after the case closure and the discipline was one or more days of suspension. Figure 7 details the findings from 5 of those cases that represent different scenarios of the types of conduct issues for which the employees were disciplined prior to receiving an award. Examples of the tax-related conduct issues associated with the 5 cases include willful understatement of tax liabilities over multiple tax years, late payment of tax liabilities, and underreporting of income.[29] Employees discussed in the 5 cases received performance awards after being disciplined for their conduct.

[28] We also conducted an in-depth review of five additional tax-related cases with lower disciplinary actions to obtain a perspective of cases that resulted in a lower disciplinary action. All of the cases that we chose for the purposes of this review were a nonrepresentative selection chosen based on the issues in the case and the resulting discipline. The results of these cases cannot be projected across the population of the more than 1,400 disciplinary cases.
[29] Delays between the tax year associated with the case and the date disciplinary action occurred is caused, in part, by the amount of time it takes IRS employee tax compliance efforts to identify, verify, and complete disciplinary actions on an individual case.

Figure 7: Selected Cases of Serious Employee Misconduct Prior to Receiving an Award

Description of Misconduct	Disciplinary Action	Award
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[30] For the five cases where performance awards were made, the employee's disciplinary cases were closed during the performance period that the award was associated with.

Description of Misconduct	Disciplinary Action	Award
• *********1***************************3*************************** *********1****************************3************************** *********1****************************3************************** *****1************3***************. • *******1************************3******************************** *******1************************3**************************. • *******1*************************3******************************* *******1*************************3******************************* *****1**************3****. • ******1********************3**********************.	**********1********** ***********1********* ******1********	Approximately $900 Performance Award in December 2012
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• ********1**********************3********************************** *********1**********************3********************. • *********1**********************3********************************** *********1**********************3********************************** *********1*************3**********. • **********1********************3********************************** **********1********************3********************************** **********1********************3********************************** ***********1*******************3************************. • ***********1********************3******************************** ***********1********************3******************************** ***********1********************3******************************** ***********1********************3******************************** ***********1********************3*************************.	10-calendar-day suspension in September 2011	Approximately $1,300 Performance Award in August 2012

Source: ALERTS database and IRS Labor Relations Office case files.

Recommendation

Recommendation 1: The IRS Human Capital Officer should determine the feasibility of implementing a policy requiring management to consider conduct issues resulting in disciplinary actions, especially the nonpayment of taxes owed to the Federal Government, prior to awarding all types of performance and discretionary awards.

> ***Management's Response:*** The IRS agreed with this recommendation. The IRS Human Capital Officer plans to conduct a feasibility study by June 30, 2014, for the implementation of a policy requiring management to consider conduct issues resulting in disciplinary actions, especially the nonpayment of taxes owed to the Federal Government, prior to awarding all types of performance and discretionary awards.

Appendix I

Detailed Objectives, Scope, and Methodology

The overall objectives of this review were to evaluate the IRS's compliance with procedures for expenditures on employee awards and to review the IRS's controls over awards made to employees with conduct and performance issues. To accomplish this objective, we:

I. Reviewed the applicable Federal laws, regulations, executive orders, and IRS guidance on employee awards programs.

  A. Reviewed the regulations, executive orders, and OPM and Office of Management and Budget memoranda and directives for guidance on spending for employee awards programs.

  B. Identified and reviewed IRS guidance on spending for employee awards including the applicable sections of the Internal Revenue Manual and any interim policy guidance.

  C. Requested documentation from the IRS that details the steps it is taking to ensure compliance with OPM limits on award spending for the period of October 1, 2010, through September 30, 2012, including the status of negotiations with the NTEU.

II. Assessed whether IRS awards were in compliance with Federal and agency requirements.

  A. Obtained a list of:

    1. Incentive payments made to employees from January 1, 2011, through December 31, 2012.[1]

    2. Performance awards paid to employees from October 1, 2010, through December 31, 2012.

    3. Discretionary awards (*e.g.*, special act, manager's awards) paid to employees from October 1, 2010, through December 31, 2012.[2]

  B. Confirmed the validity of the awards data by comparing multiple sources of data, and determined that it was reliable for our purposes.

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[1] Retention, relocation, and recruitment incentives are reported to the OPM and Congress by calendar year instead of fiscal year.

[2] Because performance and discretionary awards are paid throughout the year when they are earned and payment processing times may take a few weeks, we requested an additional three months of data (October through December 2012) beyond the fiscal year to account for awards that were earned within our audit period of FYs 2011 and 2012 but were not paid until after the close of the fiscal year.

C. Determined whether SES[3] and non-SES employee awards were in compliance with internal policies, Federal regulations, and OPM requirements.

D. Selected all employees who received incentive payments and awards from January 1, 2011, through December 31, 2012, to determine if their total compensation exceeded the Vice President's salary.

E. Evaluated a database of 118,151 out of 121,006 employee annual performance ratings to determine whether employees received ratings of fully successful or higher.

F. Selected a stratified random sample of performance appraisal forms for 500 IRS employees who received performance awards from October 1, 2010, through December 31, 2012, that included 100 IRS employees in each of five categories (SES, bargaining unit, non–bargaining unit, management, and Chief Counsel) to determine whether the rating on the performance appraisal form showed that they received a rating of fully successful or higher. Our sampling plan was reviewed and agreed upon with the assistance of our contracted statistician. We did not project the results of this sample to the population of all ratings.

III. Determined whether employees received an award in the same year they also were subject to a disciplinary action.

A. Obtained the ALERTS database for October 1, 2009, through January 26, 2012.

B. Matched the list of IRS employees who received an award October 1, 2010, through December 31, 2012, to identify any employees who also were subject to disciplinary action.

C. Requested case files for a nonrepresentative selection of 31 of 2,800 closed and adjudicated discipline cases where the employee received an award within one year after the case closure. The cases were chosen based on the type of conduct and severity of penalty in order to select the most serious cases. These included 26 cases with serious conduct issues resulting in significant disciplinary action and five cases where conduct resulted in lower disciplinary actions. We used these case files to assess the validity of the ALERTS database.

[3] See Appendix V for glossary of terms.

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 the following internal controls were relevant to our audit objectives: Department of the Treasury directives and IRS policies, procedures, and practices for administering the employee awards program. We evaluated these controls by interviewing management and analysts responsible for executing the program, reviewing applicable documentation, testing the effectiveness of the program, and analyzing selected employee awards.

Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Operations Support OS
Chief Counsel CC
Chief Financial Officer OS:CFO
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluations and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaisons:
    Chief Counsel CC
    Chief Financial Officer OS:CFO
    Internal Revenue Service Human Capital Officer OS:HC

Appendix IV

Outcome Measure

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:

- Cost Savings: Funds Put to Better Use – Potential; $1,361,805 (see page 11).

Methodology Used to Measure the Reported Benefit:

We analyzed a download of IRS employee awards between October 1, 2010, and December 31, 2012, and matched those employees against the ALERTS database of cases closed between October 1, 2009, and January 26, 2013. Our criteria included employees for whom:

- The ALERTS database case was closed and substantiated with a disciplinary action of admonishment or higher, *e.g.*, reprimand, suspension, removal.
- An award was received within one year of the ALERTS database case closed date.

We reviewed cases that related to taxes and Section 1203(b) violations.[1] These cases each substantiated one or more of those serious issues. Our analysis identified 1,194 employees who met these criteria. These employees received awards totaling $1,105,722 in monetary awards and 10,998 hours in time-off awards valued at $256,083.[2]

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[1] See Appendix V for glossary of terms.
[2] The OPM considers a Federal employee's salary to be calculated based on 2,087 hours per year. The estimated salary associated with time-off awards comes from a calculation based on the employee's salary at the time the award was paid.

Appendix V

Glossary of Terms

Term	Description
Bargaining Unit	Bargaining unit employees are covered under National Agreement II between the IRS and the NTEU, which allows employees to organize, bargain collectively, and participate through labor organizations.
Calendar Year	The 12-consecutive-month period ending on December 31.
Fiscal Year	A 12-consecutive-month period ending on the last day of any month. The Federal Government's fiscal year begins on October 1 and ends on September 30.
Nonrepresentative Selection	A nonstatistical selection, the results of which cannot be used to project to the population.
Non–Bargaining Unit	IRS employees who are not covered under National Agreement II between the IRS and the NTEU.
Scientific and Professional	Employees who are classifiable above the General Schedule-15 level but do not meet the SES functional criteria and whose work involves performance of high-level research and development in the physical, biological, medical, or engineering sciences or a closely related field.
Section 1203(b) Violations	*IRS Restructuring and Reform Act of 1998*[1] *Section 1203 "Termination of Employment for Misconduct"* (July 22, 1998) describes specific types of willful misconduct that are cause for removal. If there are mitigating factors present, the case goes to a review board to determine if the employee should be removed or if mitigating factors are enough to reduce the penalty. If the review board determines that mitigating factors warrant a lesser penalty than removal, then the board makes a penalty recommendation to the IRS Commissioner, who can reduce the penalty for Section 1203 cases.

[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.).

Term	Description
Senior Executive Service	Any position in an agency that is classified above the General Schedule–15, or an equivalent position, and in which an employee directs the work of an organizational unit. This includes SES-equivalent employees such as SL and ST employees.
SES-in-Waiting	Employees that are in Senior Manager positions that are participating in the SES Candidate Development Program.
Streamlined Critical Pay	Positions that require expertise of an extremely high level in an administrative, technical, or professional field; and are critical to the IRS's successful accomplishment of an important mission.

Appendix VI

Management's Response to the Draft Report

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

HUMAN CAPITAL OFFICE

December 31, 2013

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: David A. Krieg
IRS Human Capital Officer

SUBJECT: Draft Audit Report – The Awards Program Complied With Federal Regulations, but Some Employees With Conduct Issues Received Awards (Audit # 201310025)

Thank you for the opportunity to review the draft report entitled *The Awards Program Complied with Federal Regulations, but Some Employees With Conduct Issues Received Awards*, issued December 5, 2013. We agree that the IRS Human Capital Officer should determine the feasibility of implementing a policy requiring management to consider conduct issues resulting in disciplinary actions, especially the nonpayment of taxes owed to the Federal Government, prior to awarding performance and discretionary awards.

We take seriously our unique role as this nation's tax administrator, and we will strive to implement a policy that protects the integrity of the tax administration system and the reputation of the Service. The IRS is currently developing a policy linking conduct to performance awards for executives and senior level employees. This policy will be issued early in Calendar Year 2014. We would like to note that, even without a formal policy in place, over the past four years the IRS has not issued awards to any executives that were subject to a disciplinary action. If feasible, a policy for the entire IRS workforce will be considered, which would be subject to negotiations with the National Treasury Employees Union with respect to bargaining unit employees. We also note that the policy would not apply to Chief Counsel employees, since they are employees of the Department of the Treasury and not of the IRS.

In researching a policy linking conduct and consideration for performance awards, we have found few agencies that have such a policy. Of the 15 federal and 13 state policies we examined, only one agency specifically prohibited granting an award if conduct issues were present. However, some federal and state agencies do consider how severe or recent the offense was in deciding whether to grant an award. We would appreciate TIGTA sharing with us any information available from other federal or state agencies.

We value your continued support to strengthen the IRS's policies.

If you have any questions, please contact me at (202)-317-7600, or a member of your staff may contact Karen Becton-Johnson, Director, Worklife, Benefits and Engagement at (202)-317-5382.

Attachment

Attachment

RECOMMENDATION 1:

The IRS Human Capital Officer should determine the feasibility of implementing a policy requiring management to consider conduct issues resulting in disciplinary actions, especially the nonpayment of taxes owed to the Federal government, prior to awarding all types of performance and discretionary awards.

CORRECTIVE ACTIONS:

The IRS Human Capital Officer will conduct a feasibility study by June 30, 2014, for the implementation of a policy requiring management to consider conduct issues resulting in disciplinary actions, especially the nonpayment of taxes owed to the Federal government, prior to awarding all types of performance and discretionary awards.

IMPLEMENTATION DATE:

July 15, 2014

RESPONSIBLE OFFICIAL(S):

IRS Human Capital Officer

CORRECTIVE ACTION(S) MONITORING PLAN:

We will enter accepted Corrective Actions into the Joint Audit Management Enterprise System (JAMES) and monitor them on a monthly basis until completion.