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REPORT BY THE

Comptroller General

OF THE UNITED STATES

Federal Merit Pay: Important Concerns Need Attention

Improvements in the merit pay implementation process are needed to insure that programs will function equitably and receive the support of Federal employees. Agencies are working rapidly to install their merit pay systems so that initial payouts can be made by October 1981.

However, GAO is concerned that, if certain problems are not addressed promptly, the program may not succeed. For example, agency personnel, supervisors, and management officials need more experience and training in implementing Federal merit pay systems; also, agencies need guidelines to resolve, among other things, the question of who should be included.

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MARCH 3, 1981

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-165959

The Honorable Arch S. Ramsay
Acting Director, Office of
Personnel Management

Dear Mr. Ramsay:

This report discusses the progress the Federal Government is making in implementing merit pay. We initiated this review to determine if agencies will be adequately prepared to make merit pay determinations by October 1981. We are concerned that, if certain problems are not addressed promptly, the program may not succeed.

This report contains recommendations to you on pages 13 and 20. As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Director, Office of Management and Budget and other interested parties.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE DIRECTOR, OFFICE OF PERSONNEL MANAGEMENT

FEDERAL MERIT PAY: IMPORTANT CONCERNS NEED ATTENTION

D I G E S T

Many Federal agencies may not be adequately prepared to implement the merit pay program by the October 1981 deadline set out in the Civil Service Reform Act of 1978. Agencies are working hard to meet the deadline, but most Federal officials have not had any previous merit pay experience.

In addition, agencies have not developed methods to measure how much it is costing to implement merit pay or whether merit pay will improve agency performance. They also could use additional guidance on whom to include in the merit pay program.

GAO is concerned that if these problems are not addressed, the Federal merit pay program will be no more successful than previous attempts to base pay on performance.

MORE PREPARATION NEEDED BEFORE MERIT PAY IMPLEMENTATION

A key feature of merit pay is the objective-based employee performance appraisals with which few agencies or officials are experienced. The non-Federal organizations GAO visited which have merit pay systems reported that experience with this type of performance appraisal is very important to program success. They either had experience operating objective-based performance appraisal systems before adopting merit pay or spent several years pretesting their appraisal systems before actually linking pay to performance ratings. Pretesting gives management time to debug the system and a chance to learn to operate it before employees' pay becomes involved.

Many agencies do not plan to pretest their systems. Those that are pretesting anticipate spending only a few months doing so. Also, many agencies may not have time to conduct thorough merit pay performance training or demonstrate to employees that pay for performance is in their best interests. (See pp. 7 to 13.)

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The Office of Personnel Management (OPM) agrees that some agencies may need additional time to develop their systems and is considering some agency requests for exceptions or delays. However, OPM does not require agencies to pretest their systems before putting them into operation--a process which would help alleviate problems of untested systems.

Pretesting would also help managers adjust to devoting more of their time to appraisal efforts than in the past. One study, for example, showed that some private sector managers spend from 10 to 25 percent of their time administering merit pay.

One reason that the Government has not been successful in attempting to base pay on performance was that too much managerial time was needed to document performance distinctions among employees. If Federal managers are uncommitted to the effort that will be needed to operate a merit pay system, they may still consider large investments of time to be a distraction from their other tasks rather than a process which, if used correctly, can benefit overall management planning and evaluation. (See pp. 5 to 7.)

IMPACT AND COST OF THE PROGRAM WILL NOT BE KNOWN

Many agencies have not developed merit pay objectives or evaluation strategies. Without these, agencies will find it difficult to measure the effect of merit pay on critical areas, such as productivity, motivation, morale, recruitment, retention, leadership, and performance. (See pp. 14 to 16.)

The Civil Service Reform Act requires that OPM report to the Congress the costs of implementing merit pay throughout the Federal Government. Agencies, however, have not kept track of these costs, and OPM will probably report only the actual merit increases paid out and any consultant costs. (See pp. 17 to 18.)

Additionally, more specific guidance is needed so agencies can determine whom to include in the merit pay program. Problems have emerged regarding the inclusion of some "professional" positions in merit pay, and Federal employee associations are concerned that agencies may include in their merit pay systems more GS-13s through GS-15s than the law intends. (See p. 18 to 19.)

RECOMMENDATIONS

To minimize potential problems in the merit pay program, the Director, OPM should

--establish minimum pretest criteria which agencies must meet before making initial merit pay determinations (see p. 13),

--take a stronger role in encouraging agencies to develop additional training courses and other programs designed to increase managerial skills and gain employee acceptance of pay-for-performance systems (see p. 13),

--require agencies to define the objectives of their merit pay systems more specifically and develop evaluation strategies (see p. 20),

--require agencies to prepare more detailed information on merit pay costs (see p. 20), and

--define more clearly which employees are intended to be included in the merit pay program (see p. 20).

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ABBREVIATIONS

GAO	General Accounting Office
GS	General Schedule
OPM	Office of Personnel Management

CHAPTER 1

INTRODUCTION

The Civil Service Reform Act of 1978 established new methods of compensating supervisors and management officials in grades 13 through 15 of the General Schedule (GS).

The Reform Act provides for a merit pay program in which pay increases for those employees will be directly linked to their performance, rather than to their length of service. Pay ranges of covered employees will have only a minimum and maximum rate, rather than the 10 longevity steps in the General Schedule. In lieu of within-grade and quality step increases, employees will be eligible for merit increases under procedures developed by each agency within guidance established by the Office of Personnel Management (OPM).

Another change is that merit pay employees are only guaranteed one-half of the annual comparability adjustment unless OPM raises this portion of comparability. 1/ Merit raises will be funded from the remainder of the yearly comparability increase and from funds formerly used for within-grade and quality step increases.

The amount agencies award for merit to individual employees will be based on formal performance appraisals. Factors considered in determining merit increases will include cost efficiency, timeliness of performance, and improvements in productivity and quality of work or service. Under the law, agencies must implement merit pay by October 1981. 2/ However, some agencies made their first merit payouts in October 1980. OPM estimates that out of about 195,000 GS-13s through GS-15s Government-wide, about 120,000 will be converted to the merit pay program.

OBJECTIVES, SCOPE, AND METHODOLOGY

The basic objective of our review was to examine OPM and agencies' progress in implementing merit pay. We selected 23 agencies to visit--some large, some small, some which had progressed in their merit pay design and some which had not. (See

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1/The comparability principle, adopted in 1962, prescribes a method for annual review and adjustment of Federal white-collar salaries based on a comparison with private enterprise rates for the same levels of work.

2/Agencies may be excluded from merit pay by the President for extenuating circumstances as set forth in section 5401 of the Civil Service Reform Act.

app. II, p. 23.) At these agencies, we interviewed officials responsible for implementing merit pay systems and reviewed each agency's implementation plans.

We also researched merit pay literature and visited three private sector corporations, two State governments, one local government, and seven compensation experts to obtain and evaluate the following information on merit pay and performance appraisal systems:

--System design.

--Program operation.

--Training.

--Administrative control and evaluation.

--Grievances.

--Cost.

--General perceptions.

The private companies were chosen according to their size, the number of employees, and the type of merit pay and performance appraisal system used, and training program. State and local governments were chosen on the basis of discussions with the Urban Institute, the Council of State Governments, OPM's Office of Intergovernmental Personnel Programs, and numerous State and local personnel officials. In choosing the State and local governments and private companies we visited, we also selected a cross section of organizations that were different in size and had merit pay and performance appraisal systems similar to those envisioned for the Federal Government. Experts were recommended to us by OPM, the American Compensation Association, the Urban Institute, and other experts.

We obtained information from the private companies and State and local governments to help identify potential problem areas that could be applicable to Government agencies.

We also reviewed appropriate legislation and requlations and contacted the American Federation of Government Employees and the National Federation of Federal Employees.

CHAPTER 2

ADDITIONAL PREPARATION NEEDED

BEFORE MERIT PAY IMPLEMENTATION

The Federal Government has tried before to tie pay to performance; however, these efforts have been less than successful. Although the Reform Act's merit pay program has been designed to overcome previous shortcomings in linking pay to performance, a great deal of preparation is needed, and many agencies may not be ready to implement their programs. Because of the short period remaining before scheduled merit payouts by October 1981, many agencies may not have enough time to pretest their new systems, conduct thorough training, or demonstrate to employees that pay for performance is in their best interests. In particular, few Federal management officials or agencies have had any previous experience with an objective-based performance appraisal system--a key factor in the success of a pay-for-performance program.

PREVIOUS PAY-FOR-PERFORMANCE CONCEPT IN THE FEDERAL SECTOR

The basic structure of the present Federal white-collar pay system was established by the Classification Act of 1949 and the Federal Salary Reform Act of 1962.

These acts attempted to tie pay, in part, to job performance. The Classification Act required that pay be based on individual contributions to economy and efficiency. Later, the 1962 act required that "* * * pay distinctions shall be maintained in keeping with work and performance distinctions * * *." The Federal Pay Comparability Act of 1970 includes similar language.

The Performance Rating Act of 1950 linked pay and performance by restricting within-grade step increases to employees with satisfactory or better ratings. The 1962 act was to provide greater flexibility in pay administration. It allowed an agency head to require an "acceptable level of competence" for granting within-grade increases and to deny an increase for performance below the acceptable level. It also authorized an additional step increase in recognition of high-quality performance or performance above that normally found in the position.

Despite these attempts to make pay more dependent on performance, very few employees were affected. In 1965, 99.32 percent of all employees who became eligible for a within-grade pay increase received that increase on schedule while only 0.68 percent of all employees had step increases withheld. Only 2 percent of employees received quality step increases. These percentages managers had been either unwilling or unable to delineate between performance which was barely satisfactory and that which represented an acceptable level of competence. Another drawback of past legislation and practice was that performance ratings and the awarding of step increases were separate and distinct actions; for example, an outstanding rating was not automatically linked with a quality step increase.

NEW REQUIREMENTS OF THE REFORM ACT

The Reform Act goes beyond past legislation by explicitly linking the performance appraisal and pay adjustment processes. It also requires that objective-based, performance-oriented appraisal systems be used. Such systems will require a fundamental change in the way many Federal employees' performance is evaluated and can be difficult and time consuming to implement correctly and fairly. When the Reform Act was enacted, most appraisals were of the type where supervisors selected a subjective description of the employee's performance (for example, satisfactory, outstanding, meets job expectations). Numerical scores could be assigned to the descriptions and scores could be tallied for a combination of traits; however, this method was still subjective in nature and was of little value in assessing performance. 1/

Objective-based appraisals are a better way of assessing performance because they avoid subjective descriptions and deal with the question of whether the employee meets or fails to meet specifically defined objectives that have been agreed upon beforehand. An objective-based method is important to a workable merit pay system--it shows both the employee and the supervisor to what extent the employee meets or exceeds assigned objectives and, accordingly, helps determine merit pay entitlement.

AGENCIES MAY NEED MORE TIME TO INSURE WORKABLE SYSTEMS

Operating merit pay systems effectively will place new demands on management officials' and supervisors' time. They will also have to employ communication and counseling skills seldom used under the old appraisal system.

Under current OPM implementation time frames, many agencies may not have enough time to pretest their systems or to insure that their management officials fully develop the skills needed to operate a merit pay system.

1/See our report "Federal Employee Performance Rating Systems Need Fundamental Changes" (FPCD-77-80, Mar. 3, 1978).

Merit pay will be time consuming

Developing an equitable merit pay system involves establishing and maintaining a performance appraisal system to which pay can be linked.

Establishing an objective-based performance appraisal system requires considerable time and effort since critical elements and performance standards must be developed for all jobs. Critical elements are important since failure to meet just one of them is grounds for removal. 1/ Some well-known difficulties in developing performance standards follow:

--Setting standards and objectives of equal difficulty for equivalent employees.

--Setting standards and objectives for all employees that total to organizational success.

--Setting measurable or quantifiable standards and objectives, especially in service jobs, that meaningfully reflect successful performance.

--Setting standards and objectives that do not create conflict or competition between units or persons.

--Setting standards and objectives that push employees' performance to a higher level, yet are attainable.

--Fairly adjusting standards and objectives when organizational changes justify.

--Establishing and distinquishing "critical" elements and "important" elements.

--Getting the employee and the supervisor to mutually agree on and set objectives.

All 23 agencies we visited planned to use an objective-based system, but only 7 had even limited experience in this area. On the basis of time frames the private firms and State and local

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1/OPM defines a critical element as "any component of an employee's job that is of sufficient importance that performance below the minimum standard established by management requires remedial action and denial of a merit pay increase, and may be the basis for removing or reducing the grade level of that employee. Such action may be taken without regard to performance on other components of the job."

governments experienced in developing this type of performance appraisal system, some agencies may need more time than they now have to develop and pretest their programs.

Additionally, the time needed to operate merit pay programs effectively will be greater than that required of Federal management officials for similar activities in the past. The former Deputy Director, OPM, noted that many private sector managers spend as much as 15 percent of their time on appraisal-related activities. A Federal agency's study showed that private company managers spent considerable time on the merit pay process. Some of the companies surveyed reported that their managers spent the following amounts of time on the merit pay process:

Company	Time required
A	From 8 to 16 hours per person per session.
B	About 10 percent of a manager's time on salary determination, performance appraisal, and manpower development planning.
C	About 10 to 15 percent of a manager's time.
D	About 25 percent of a manager's time.
E	About 10 hours per employee per year.
F	Managers spend 20 to 25 percent of their time on appraisals.
G	Estimated 5 to 10 percent of a manager's time.

An OPM official noted that the merit pay process, if fully utilized, could benefit the entire management planning and evaluation procedure. However, managers could consider this kind of time allocation an unreasonable burden unless they are committed to the appraisal process and believe in the benefits resulting from such a process. OPM believed the reason the old system failed to better equate pay with performance was that managers perceived too much time was needed to operate such an ineffectual system. OPM noted that under the old system, documentation often occurred after the fact and, in many instances, without benefit of front-end management planning, objective setting, or consultation with employees on the bases for measuring different levels of performance.

Managers and supervisors will also need communication and counseling skills, which were not required under the old system, to maintain a constructive atmosphere where discussion and respect are maintained. An indication of the difficulty of training managers in these areas was best stated by one expert who commented that, despite recent efforts to design meaningful training in interpersonal communications, progress had been minimal.

Pretesting recommended as a means of debugging a new program

OPM, compensation experts, State and local governments, and private companies emphasized that pretesting is very important to the development and implementation of a successful pay-for-performance system. This process, though time consuming, provides managers with the opportunity to refine appraisal skills before making decisions which affect subordinates' pay.

Several compensation experts noted that pretesting a pay-for-performance system can help work out bugs which inevitably appear in a new program. In discussing the Federal Government's move toward pay for performance, one merit pay expert said that, since the Federal Government had little experience with objective-based performance appraisals, agencies would need about 2 years to design their appraisal systems and from 3 to 5 years to pretest before using their plans to actually make merit pay determinations.

Other experts' comments follow:

--It will take 5 years before the system will run smoothly.

--Any system should be tested for 3 years before it is used to adjust pay.

--It will take 10 years to have a good operating system.

--One agency should spend 3 years experimenting with the merit pay concept, and from 3 to 5 years would be needed for the other agencies to implement the system.

--Managers will require from 5 to 6 entire performance appraisal cycles to become proficient in administering the system.

--Managers need from 5 to 10 years to become properly skilled.

As noted, OPM agreed that pretesting is important to the success of a merit pay system. However, an OPM official also believed that pretesting, if prolonged, may cause agency personnel to lose interest.

The State and local governments we visited had experimented with objective-based performance appraisal systems before making merit pay determinations. One government developed and used its appraisal system for about 3 years before feeling comfortable enough to use it when adjusting pay. Another believed that experience in writing objectives, as well as training, enhanced managers' and supervisors' ability to accurately evaluate employees' performance. Managers and supervisors had been using some form of objective-based performance appraisal system for about 8 years and believed that experience helped them in their transition from an automatic-step system to a merit pay system.

The third government implemented pay for performance in four stages over a period of about 5 years. During the first stage, top management practiced operating the performance appraisal system. In the second stage, top management implemented the performance appraisal system while upper-level supervisors practiced writing and evaluating performance objectives. In the third stage, upper-level supervisors implemented the performance appraisal system while mid-level supervisors practiced operating the performance appraisal system. Finally, in the last stage, mid-level supervisors implemented the performance appraisal system, bringing all supervisory and managerial personnel under the merit pay system.

Officials of this government believed pretesting had been beneficial to them primarily because it gave them the opportunity to observe results and consider alternatives before pay actually became involved. It also gave employees time to familiarize themselves with the intricacies of merit pay and allowed management time to educate employees on the benefits of pay for performance.

The three private companies we visited also advocated pretesting before actually making merit pay determinations. One company, for example, pretested its system in one of its operating divisions and then in various other divisions on a semivoluntary basis before placing all divisions under the pay-for-performance system about 2 years later. Company officials strongly advocated pretesting before implementation, stating that rushing to implement a system without first testing it could lead to serious problems. By testing the system, officials said, they were able to accomplish the following objectives before actually implementing the system on a companywide basis:

--Employees began to see the benefits of performance appraisals and developed more positive attitudes toward pay for performance.

--Supervisors learned to set and evaluate objectives before all company divisions were brought on line.

--Management had an opportunity to study the system and fine-tune it before involving all employees.

OPM has also recognized the importance of pretesting pay-for-performance systems. In its July 1979 Federal Personnel Manual Bulletin, OPM said that:

> "The successful implementation of the Merit Pay System depends heavily on the solid foundation of a well designed and working performance appraisal system upon which all merit pay determinations will be based. * * *"
>
> * * * * *
>
> "It is important that employees covered by the system know from the outset of the appraisal period what the 'ground rules' are. Sound personnel management dictates that a system change as major as merit pay not be thrust upon employees or superiors. * * *"
>
> * * * * *
>
> Agencies should "* * * consider a test run of the performance appraisal system and simulation of merit pay distribution before actual implementation. This would give covered employees the opportunity for a sample, first hand look at the expectations and workings of the new system, and a simulation of merit pay distribution would give evaluators a chance to develop expertise and confidence in performance appraisal and merit pay distribution and would give the opportunity to identify system problems before decisions are made which affect employees' pay. * * *"

PRETESTING AND OTHER CRITICAL CONCERNS MAY NOT RECEIVE PROPER ATTENTION

We are concerned that some agencies may not have enough time to acquaint management officials and employees with the pay-for-performance system. Many of the 23 agencies did not have definite plans to pretest their pay-for-performance systems. Those who did plan to pretest their systems anticipated spending, on the average, only a few months doing so. Merit pay experts and State and local government officials emphasized the need for allowing enough time to properly implement a pay-for-performance system. The following chart shows the pretesting plans of the 23 agencies.

	No. of agencies	Average length of planned pretest
Planning pretest with payout or simulated payout	5	6 months
Planning pretest without simulated payout	6	6 months
No agencywide pretest planned	12	0

Even if more agencies decide to pretest their systems, only limited time will be available to pretest considering the time needed to complete the plans and gain OPM's approval. Considering the magnitude of the changes agencies must make, the remaining time before initial merit payouts may not be adequate, particularly since the process requires managerial skills most Federal employees have not used.

OPM agreed that some agencies may need additional time to develop their performance appraisal and merit pay systems and is considering some agency requests for exceptions or delays. However, it has not defined any specific pretest criteria for agencies to meet to demonstrate capability in operating an equitable performance appraisal or merit pay system. If agencies were required to pretest their systems under OPM-established criteria, they could eliminate many of the potential problems that might surface when implementation begins.

More time needed to overcome employee resistance

Pretesting can help reduce employee resistance to program changes. An indication of the resistance the system must overcome is shown in the results of a recent OPM questionnaire administered to Federal employees which contained questions concerning their performance appraisal systems. Almost one-half of the GS-13 through GS-15 managers questioned believed that their past performance appraisal was not useful in helping them assess their strengths and weaknesses. Thirty-nine percent of the employees also felt supervisors gave the same performance ratings regardless of how well subordinates performed.

Employees sampled by another agency responded to an internal questionnaire about merit pay as follows:

Statement	Response		
	Agree	No opinion	Disagree
	----------(percent)---------		
The merit pay performance appraisal process will provide accurate data for setting my pay.	42.9	11.9	45.6
The critical elements adequately cover my job.	50.5	10.7	38.7
The proposed merit pay system will improve the effectiveness of the service.	25.7	16.5	55.9
I think I will prefer the proposed merit pay system to the way I currently get paid.	34.1	6.1	59.0
The merit pay system will result in more highly motivated managers and management officials.	30.2	8.0	60.2
Under the proposed merit pay system I would trust my supervisors to set my pay fairly.	35.3	17.6	47.1

Some agencies perceived employee attitudes toward merit pay through informal interactions. For example, eight agencies thought employees had negative attitudes. Other agencies did not believe they could assess attitudes.

Most agencies recognize the importance of employee acceptance and have taken some steps to attain it. We recognize that it would be very difficult to develop a system that all employees will accept wholeheartedly, but, given the importance of employee acceptance to success and the at least perceived resistance to merit pay by some employees, agencies should be taking stronger steps to pretest their systems and to develop internal programs for assessing employee attitudes. The current time frames for implementing merit pay might make it difficult for agencies to fully gain employee acceptance, and unwelcomed changes could result in negative side effects.

Many actions can be taken to gain employee acceptance, including

--directly involving key managers in system design,

--keeping employees abreast of development,

--involving respected experts during design,

--proving the validity of the appraisal,

--testing the system,

--providing adequate training, and

--involving top management in advocating and using the system.

Additional efforts to train employees may be needed

OPM and merit pay experts stress the importance that training plays in the success of merit pay systems. Training can also be a vehicle to sway some existing negative attitudes. For example, Dr. Edward E. Lawler expressed his belief in training's importance when he concluded his article, "Performance Appraisal and Merit Pay," in the April-June 1979 "Civil Service Journal" by saying "So if I were to leave you with a concluding thought, it is to train, train, train * * *." The Congress also recognized training's importance by including performance appraisal training in the merit pay chapter of the Reform Act.

The agencies we visited planned to give the following amounts of merit pay training to employees and supervisors:

	Number of agencies (note a)		
Length of training in days	Merit pay training	Performance appraisal training	Course covering both
0 to 0.9	4	1	0
1 to 1.9	3	3	2
2 to 2.9	2	3	3
3 to 3.9	0	1	1
4	0	1	0
Unknown	1	b/ 1	7

a/Numbers do not total to 23 because agencies may be included in more than one category.

b/This agency was going to allow its offices and units to develop training independently; consequently, the length of the training course was unknown to headquarters personnel.

We are concerned whether this is sufficient training to convince managers and employees that the process is worthwhile or that it will make them proficient in the requisite skill areas. This is especially true since managers and supervisors have little, if any, previous experience in a merit pay environment, and established time frames may not permit agencies the opportunity to give employees sufficient experience during a test phase. In this regard, only 6 of the 23 agencies felt employees would be sufficiently competent in assessing performance and in making equitable merit pay adjustments the first time through the process.

CONCLUSIONS

The Reform Act should result in some worthwhile improvements in performance appraisals. However, very few Federal managers or agencies have had any previous experience with an objective-based appraisal system, such as the type required. In addition, they are not required to meet any pretest criteria before implementing their performance appraisal and merit pay programs.

Among its other advantages, pretesting a new pay-for-performance system could be especially important because it would give employees a chance to build confidence in their ability to write and evaluate performance objectives and make merit pay determinations. Some agencies may need more time to develop their systems and to pretest effectively. However, the benefits obtained from pretesting and thorough training should, in our opinion, be worth the additional time spent.

RECOMMENDATIONS TO THE DIRECTOR, OPM

We recommend that the Director establish minimum pretest criteria which agencies must successfully meet before making initial merit pay determinations. Extensions should be afforded to those agencies unable to complete pretesting activities successfully by October 1981.

We also recommend that the Director take a stronger role in encouraging agencies to develop additional training courses and other programs designed to increase managerial skills and gain employee acceptance of pay-for-performance systems.

CHAPTER 3

OTHER CONCERNS ABOUT MERIT PAY IMPLEMENTATION

Many Federal agencies are not developing objectives and evaluation strategies to measure the accomplishments of their merit pay systems. Also, OPM and the agencies are not maintaining and collecting sufficient implementation cost data to meet reporting requirements of the Reform Act. In addition, controversy is growing over which GS-13 through GS-15 employees should be converted to merit pay.

FEDERAL AGENCIES NEED TO DEVELOP MERIT PAY OBJECTIVES

The objectives set forth in the Reform Act for the Federal Government's merit pay system provide general guidance:

--Recognize and reward quality performance by varying merit pay adjustments, within available funds.

--Use performance appraisals as the basis for determining merit pay adjustments.

--Provide for training to improve objectivity and fairness in the evaluation of performance, within available funds.

--Regulate the costs of merit pay by establishing appropriate control techniques.

Although these are desirable objectives, they may not provide the details supervisors and managers need to have a clear understanding of the specific goals they will be trying to achieve through the pay-for-performance system.

Peter F. Drucker, a noted management expert and consultant, in his book "Management: Tasks, Responsibilities, Practices," stated:

> "If objectives are only good intentions they are worthless. They must degenerate into work. And work is always specific, always has - or should have - clear, unambiguous, measurable results, a deadline and a specific assignment of accountability."

Despite the importance of specific objectives, most of the 23 Federal agencies had not developed objectives for their merit pay plans that were any more detailed than the general objectives set forth in the law.

Unless agencies develop specific objectives for their merit pay plans, it will be difficult to determine successes or failures in the future. Without measurable objectives, agencies will not be able to determine how their merit pay plans are affecting productivity, motivation, morale, recruitment, retention, leadership, and performance. The Director, OPM, has stated that "Unless the Civil Service Reform Act improves governmental performance, it will not have succeeded."

Some compensation experts we talked with believed that specific objectives for a pay-for-performance system should be established if for no other reason than to provide a basis for audit and evaluation. Objectives such as attracting, retaining, and motivating employees were acknowledged as being standard but were not viewed as specific enough. For example, one compensation expert said that, for an organization to meet its broad goal of retaining good employees, it should set objectives for its merit pay system, such as the following:

> The organization will retain 80 percent of all personnel rated excellent and remove 80 percent of those rated below the minimally acceptable level.

The more specific the objectives, the better an organization will be able to measure the success or failure of its pay-for-performance system at a later date.

MORE EMPHASIS NEEDED ON EVALUATION

Agencies are unlikely to know whether their merit pay plans are operating as designed unless they have a means of evaluating them. Seventeen of the 23 agencies we visited placed a low priority on developing an evaluation strategy for their pay-for-performance programs. Some agencies indicated they might not develop their evaluation plans until sometime after their merit pay programs have been implemented.

The State and local governments we visited all stressed the importance of developing good pay-for-performance objectives and an evaluation strategy to measure success and compliance. Officials indicated that it takes a considerable evaluation effort by the central personnel office of any organization to make sure supervisors and managers are operating the pay-for-performance system as designed. Officials of one State/local government personnel office related how they had not initially monitored the individual departments to see if they were operating the pay-for-performance plan as designed because the departments complained that monitoring was an attempt by the personnel department to undermine their authority. Though the personnel office did monitor the performance ratings and merit increases the departments were awarding, it did not evaluate the process the departments were using to arrive at those ratings and increases. Consequently, merit pay employees began to complain that supervisors were not taking the time and effort to write measurable objectives and to evaluate detailed performance standards as required by the merit pay plan.

The other State/local governments we visited had similar experiences. They said that, in the absence of a concerted monitoring effort by the personnel department, some departments did not operate the system as designed. One personnel officer for a State government stated that experience had shown that, unless the central personnel organization invested the time and money to monitor and evaluate the departments' individual implementation of the merit pay plan, supervisors would not take the time to write measurable job standards which could be measured in an objective manner. He noted that, as a reviewing personnel officer at the departmental level, he had seen many performance appraisals processed that were practically blank, with only the overall rating filled in. He attributed this to the fact that the central personnel department had not developed a detailed evaluation and monitoring strategy which would show how well the system was actually working.

One State government official who reviewed his department's performance appraisals said that he turned back about one-third of the appraisals every cycle because the performance standards were not measurable and did not support the recommended merit increases. He said also that, unless the central personnel office evaluated each department's management of the performance appraisal system, the pay-for-performance program, on an agency-wide basis, would not operate as designed.

If Federal agencies do not set merit pay program objectives and evaluate the accomplishment of those objectives on a regular basis, the results could lead to

--performance standards written to be easily met or exceeded,

--poorly written performance evaluations which will not support recommended merit increases,

--forced distributions by upper level managers because of an unwillingness to invest the necessary time to operate the system correctly--but wanting to keep up appearances, and

--distrust among employees, low morale, and decreased productivity.

ADDITIONAL EFFORT NEEDED TO COLLECT IMPLEMENTATION COSTS

OPM and the agencies we contacted are not maintaining detailed information on the cost of developing and implementing merit pay systems.

The Reform Act requires that OPM report annually to the Congress on the operation of the merit pay system. It also requires that OPM include, in its first report, information on the progress and costs of the implementation of those programs. OPM has requested some cost and implementation details from the agencies--such as the cost of consultants used--but a more specific list of other implementation cost items will be needed for a complete report to the Congress.

Guidelines needed so agencies can accurately report implementation costs

Our visits to 23 Federal agencies showed only a few agencies were collecting data on development and implementation costs. In fact, only two of the agencies we visited had records of their implementation costs, and the items of cost they maintained were not identical. One agency had collected the following development and implementation costs: $1,000, training seminar; $4,800, cost of sending employees to the OPM training course; and $60,000, salaries. The other agency considered the following items to represent its development and implementation costs at the time of our visit: $74,400, computer changes; and $160,000, training (not including salaries).

Three other agencies we visited told us they had maintained "some" development and implementation costs, but they were not maintaining all costs. Most remaining agencies said they would have to go back and reconstruct cost data, and nine of those indicated that "guesstimates" would be the extent of the information they would be able to provide. The only costs all agencies were collecting were consultant fees associated with developing performance appraisal and merit pay programs--costs which OPM started collecting after the Congress expressed concern that excessive consultant costs might be incurred in developing merit pay systems.

OPM sent a merit pay questionnaire to all agencies asking them for information on implementation dates, employee coverage, etc., but no questions were directed at operational costs. Several agencies have indicated that, if they are going to be required to furnish detailed implementation cost data to the Congress, they will first need a list of those items which OPM considers to be implementation costs. Without it, agencies would be uncertain as to which items to include in their cost reports. For example, agencies would be uncertain as to whether personnel staffing costs would be considered a regular cost-of-business expenditure or an implementation expense. Without OPM guidance it is unlikely that agencies will submit comparable cost data which could be consolidated into a meaningful report. Items which might be considered implementation costs would include

--administrative costs (travel, lodging, printing, etc.),

--staff salaries,

--cost of adding additional staff,

--computer hardware and software costs,

--opportunity costs (costs associated with alternative use of resources), and

--training costs (instructors, employee class attendance time, films, supplies, etc.).

Most agencies said that, at best, they could only "guesstimate" their implementation costs to date, and some expressed no intention of collecting implementation cost data until OPM furnished instructions on what to include.

MORE SPECIFIC GUIDELINES NEEDED FOR AGENCIES TO DETERMINE WHOM TO INCLUDE IN MERIT PAY

Controversy has emerged regarding which GS-13 through GS-15 employees are to be included or excluded from the merit pay program. Federal employee associations are concerned that agencies may include more employees in the merit pay program than intended by law, thus limiting the number of upper level employees eligible for association membership. On the other hand, agency heads have been given the authority to identify employees who qualify for coverage under merit pay but have only general guidance to help them make the necessary determinations.

The Reform Act states that agency merit pay programs are to cover all GS-13 through GS-15 employees whose duties meet the definition of supervisor or management official as set forth in 5 U.S.C. 7103.

OPM guidance states that coverage determinations must coincide with agency or Federal Labor Relations Authority determinations for excluding supervisors or management officials from exclusive bargaining units. On December 16, 1980, the Federal Labor Relations Authority issued a document of interpretation and guidance which concluded:

"When an agency determines that an employee is a supervisor or management official for purposes of coverage under the "merit pay" provisions of the Civil Service Reform Act of 1978, that determination has no impact on such employee's inclusion in or exclusion from a unit of exclusive recognition under section 7112 of the Statute." (Federal Service Labor-Management Relations Statute)

OPM guidance provides that, in making coverage determinations, agencies should examine the actual duties and responsibilities assigned to the employee rather than job titles or written job descriptions.

The National Federation of Federal Employees requested the Federal Labor Relations Authority to prevent agencies from unilaterally declaring employees now in bargaining units to be covered under merit pay. The National Federation of Federal Employees alleged that at one facility an employer declared 234 of its 235 GS-13 to GS-15 employees to be under merit pay and, therefore, ineligible to be in a bargaining unit. This action, according to the employee association, severely hampered an organizing drive.

Employee organizations we contacted have recommended that their jurisdictions file unfair labor practices when it is questionable whether certain individuals should be covered by merit pay. Also, problems have emerged regarding the possible inclusion of some "professional" positions in merit pay; for example, scientists and engineers. Clarification of who is to be covered by merit pay could remove some employee apprehension about the system and enhance its implementation in agencies.

CONCLUSIONS

Most of the 23 Federal agencies had not defined the specific objectives they wanted their merit pay plans to accomplish other than the broad goals set forth in the law. Program objectives, which are necessary for an adequate evaluation, should be measurable and should later provide agencies with a means of determining the accomplishments of their merit pay programs.

Also, most of the Federal agencies were not concentrating on developing a merit pay evaluation plan. Experts we talked with and State and local government officials we visited said program evaluation was necessary to insure that the individual departments of an organization operate the merit pay system as it was designed.

Our discussions with State and local government officials and employees indicate that getting a merit pay system to operate correctly is not simply a matter of designing and implementing a performance appraisal and merit pay system. Evaluations by the central personnel organization are a necessity to insure that supervisors are capable and that they take the time to write measurable job standards and evaluate job performance correctly.

Evaluations should also serve to point out specific units in an agency where the system is not working well and should allow the agency to take corrective actions, such as providing additional training to supervisors having trouble writing performance standards.

Additionally, if steps are not taken by OPM, Federal agencies will probably be unable to provide detailed information to the Congress on the total costs of implementing their merit pay systems. Most agencies are collecting little more than data on consultant costs.

Finally, more specific guidelines are needed so agencies can determine whom to include in the merit pay program. Problems have emerged regarding the possible inclusion of some "professional" positions in merit pay, and Federal employee associations are concerned that agencies may include more GS-13s through GS-15s in the merit pay program than intended by law.

RECOMMENDATIONS TO THE DIRECTOR, OPM

We recommend that the Director:

--Require Federal agencies to define the objectives of their merit pay plans in more specific terms and develop evaluation strategies, using these objectives, to monitor operations of the merit pay plans.

--Provide more detailed cost information to the Congress on the implementation of the merit pay program. To do this, OPM will have to provide agencies with a comprehensive list of items for determining the cost of implementing merit pay.

--Issue more detailed guidance on coverage so that agency heads and employee associations will have a more clear-cut idea of those employees that should or should not be covered by merit pay.

COMPENSATION SYSTEM FOR GENERAL SCHEDULE EMPLOYEES

Under the compensation system preceding the Reform Act, there were four ways General Schedule employees could be compensated:

--Within-grade step increases.

--Comparability adjustments.

--Incentive awards.

--Quality step adjustments.

WITHIN-GRADE STEP INCREASES

Previous law (5 U.S.C. 5332) established the matrix for General Schedule salaries. Under the fiscal year 1980 matrix, grades GS-1 through GS-14 have a 30-percent pay range with 10 uniform steps; grade GS-15 has a 23-percent range with 8 steps; GS-16 has a 5-percent range with 3 steps; and GS-17 and GS-18 have a single rate. Each step is worth 3.3 percent of the minimum rate for the grade. These step increases are in addition to the general salary increases which result each year from the comparability adjustment.

Employees advance to the next step after completing 1 year in steps one through three, 2 years in steps four through six, and 3 years in steps seven through nine--provided performance is "of an acceptable level of competence." Step increases are received by 99 percent of all General Schedule employees on the date of eligibility.

COMPARABILITY ADJUSTMENTS

The Federal Salary Reform Act of 1962 established this principle which states that Federal salary rates for white-collar employees under the General Schedule should be comparable with private enterprise rates for the same levels of work. This principle has been retained in subsequent legislation dealing with pay comparability.

The Federal Pay Comparability Act of 1970, in effect, transferred primary responsibility for adjusting pay scales for General Schedule employees from the Congress to the executive branch. The law established three principal groups to carry out the comparability process--the President's Pay Agent, the Federal Employee's Pay Council, and the Advisory Committee on Federal Pay.

After considering the report of the Pay Agent, which includes the findings and recommendations of the Pay Council, and the Advisory Committee report, the President must either agree to the comparability pay adjustment recommendation to take effect in October or submit an alternative plan to the Congress which would go into effect unless a majority vote of either House disapproves it. If the alternative plan is disapproved, the President is required to make a comparability adjustment based on the reports of the Pay Agent and the Advisory Committee according to the statute's principle of comparability.

INCENTIVE AWARDS

The Government Employees' Incentive Awards Act of 1954 and the Federal Salary Reform Act of 1962 were the two basic laws that provided rewards for employees whose work contributions greatly exceeded normal performance requirements, either on a particular assignment or over a sustained period, and improved the effectiveness, efficiency, economy, or other aspects of Government operations. These rewards were either honorary or one-time, lump-sum cash awards.

QUALITY STEP INCREASES

In October 1962 the Congress passed Public Law 87-793 (5 U.S.C. 5336), the Federal Salary Reform Act. This legislation provided for the granting of additional pay step increases in recognition of exceptionally high-quality performance. This provision has been generally considered a performance award similar to the performance awards authorized under the Incentive Awards Act, differing only in the nature of the reward and the criteria. In the past, quality increases have been granted to less than 5 percent of all Federal employees each year.

FEDERAL AGENCIES REVIEWED

Defense Logistics Agency
Department of Agriculture
Department of the Army
Department of Commerce
Department of Energy
Department of Health and Human Services
Department of Housing and Urban Development
Department of Justice
Department of State
Department of Transportation
Department of the Treasury
Environmental Protection Agency
Equal Employment Opportunity Commission
Federal Home Loan Bank Board
Federal Maritime Commission
Federal Trade Commission
Internal Revenue Service
Interstate Commerce Commission
National Aeronautics and Space Administration
Occupational Safety and Health Review Commission
Office of Personnel Management
Small Business Administration
United States International Trade Commission

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