

1220 12
~~25915~~

United States General Accounting Office
Washington, D.C. 20548

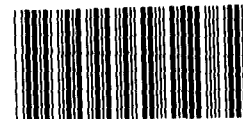
FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 a.m.
JULY 14, 1983

STATEMENT OF
WILLIAM J. ANDERSON
DIRECTOR, GENERAL GOVERNMENT DIVISION
BEFORE THE
SENATE GOVERNMENTAL AFFAIRS COMMITTEE
SUBCOMMITTEE ON CIVIL SERVICE, POST OFFICE,
AND GENERAL SERVICES
ON
MERIT PAY REFORM ACT OF 1983 AND PROPOSED AMENDMENTS

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here to discuss the subcommittee's merit pay reform bill which is being proposed as an alternative to certain Office of Personnel Management (OPM) proposed regulations for a Performance Based Incentive System. The OPM regulations were introduced in the Federal Register March 30, 1983. We understand, however, that OPM is reconsidering the specifics of its proposed system because of the considerable adverse comments that it generated.

Despite the critical reaction to OPM's proposals, it is important to keep in mind that some of the proposed regulations



122043

026327

are responsive to problems we have identified in our reviews of performance appraisal systems for merit pay and General Schedule employees. Agencies had considerable flexibility under the Civil Service Reform Act (CSRA) to design systems to meet their needs and, as a result, developed many different types. OPM's proposed regulations would, to a certain degree, standardize performance appraisal systems throughout the Government. For example, the proposed regulations would require that

- only critical elements be included in performance plans;
- each system provide for, and define, five levels of performance and five summary rating levels,
- a higher level review of performance plans take place at the beginning of appraisal periods to assist in making sure that standards are measurable and are comparable for similar positions.

We believe that these are all desirable changes.

Some of OPM's proposed regulations, however, have caused agencies and employees much concern. For example, they would tie career ladder promotions for GS-9 and above directly to an employee's latest performance rating as follows:

- Fully successful - minimum 3-year waiting period.
- Exceeds fully successful - minimum 2-year waiting period.
- Outstanding - minimum 1-year waiting period.

The minimum waiting period is now 1 year for fully successful employees. OPM's proposed change could delay career ladder promotions significantly and could adversely affect the recruitment and retention of career ladder employees.

I would like to comment briefly on one controversial aspect of OPM's proposed regulations. As you know, we were asked by the House Post Office and Civil Service Committee to determine the legality of one aspect of OPM's proposed Performance Based Incentive System. Specifically, we were asked to review the legality of the proposed revision to the Code of Federal Regulations which would have provided that to be eligible for within-grade step increases employees in steps 1 through 6 of a General Schedule grade must perform at the "Fully Successful" level, while employees in steps 7 through 9 must perform at the higher "Exceeds Fully Successful" level. We concluded that this proposed revision was illegal and could not be implemented without appropriate legislation. Our opinion on this matter, by the way, is binding upon the executive branch since it involves the expenditure of Government funds.

As you requested, we will now focus our discussion on the current status of the Government's merit pay system and on S. 958, with the subcommittee's proposed amendments. Our discussion of S. 958 will cover (1) its effect on the merit pay system, (2) the feasibility of the proposed experimental program, and (3) changes to the structure of the Senior Executive Service (SES) performance award program.

STATUS OF THE MERIT PAY SYSTEM

At the request of the Subcommittee on Compensation and Employee Benefits, House Committee on Post Office and Civil

Service, we have recently completed an analysis of 2 years' experience with merit pay systems at three Departments--Agriculture, Housing and Urban Development (HUD), and Navy. These three agencies employ about 25 percent of the total merit pay population. We noted some improvements from the 1981 to the 1982 merit payouts. For example, the process took less time of the people involved and agency employees were generally more satisfied with the performance standards that were established. However, there are certain features of the current merit pay system that need to be revised.

We found that a number of factors, other than performance, can influence the size of an employee's merit pay increase. These factors include (1) the accuracy and consistency of performance ratings, (2) the relative number of high and low ratings in a pool, (3) the composition (grade level and position in the salary range) of the merit pay pool, and (4) the agencies' formulas for distribution of the merit pay funds.

Between 37 and 52 percent of the employees sampled at the three agencies believed their 1981 and 1982 ratings did not accurately reflect their performance. In addition, over 40 percent of the merit pay employees sampled in 1982 believed that inconsistent ratings were a major problem affecting plan operation.

How ratings are distributed over the various performance levels within a merit pay pool is another factor in determining

the amount of merit pay increases. To illustrate, in one agency we reviewed, 40 percent of the employees in one merit pay pool received the highest possible rating. Grade 15s in that pool received merit increases of \$987. In another pool within that agency, 4 percent of the employees received the highest possible rating. Grade 15s in that pool received merit increases of \$3,664.

The composition of a merit pay pool--the number of employees and their grades and location in the salary range--can also affect the size of merit pay increases. The size of the merit pay fund is a function of average employee grade and salary since much of it is drawn from foregone comparability raises which vary directly with salary.

Pay increases are also affected by the way the agency chooses to distribute merit pay funds. For example, some agencies award larger merit pay increases to employees in the beginning of the salary range while other agencies do not consider an employee's current salary in setting the size of the increase.

Given these factors, it is not surprising that average merit pay increases for employees at the same grade level but at different agencies have varied, often significantly. For example, the average merit pay increase for a grade 15 working at the top performance level varied from about \$2,400 at the Department of Agriculture, to \$3,200 at the Department of Navy, to about \$4,000 at the Department of Housing and Urban Development.

Most employees in our 1981 and 1982 samples had negative perceptions of merit pay. About 80 percent of the employees responding to our questionnaire in both years believed that merit pay systems had not increased their productivity or motivation. In addition, although some respondents supported the concept of merit pay, less than 10 percent wanted to retain their current merit pay systems.

Other problems we identified at the three agencies included:

- Inconsistent use of the merit pay cash awards program (percent of employees receiving such awards in 1982 varied from 6 percent at HUD and Agriculture to 31 percent at Navy; the average amounts of such awards were about \$500 in HUD, \$1,000 in Agriculture, and \$1,100 in Navy).
- The lack of a clear definition of who should be covered under merit pay (employees with similar job descriptions are included or excluded from merit pay depending on their agency).

Again, while we believe that administration of the merit pay program is improving, it needs fundamental revisions in several respects.

EFFECTS OF S. 958 AND PROPOSED AMENDMENTS

The proposed bill, S. 958, in conjunction with the subcommittee's proposed amendments, would overcome some of the major problems we have just outlined with the existing merit pay system. Moreover, the proposed bill would help eliminate the perceived inequities that merit pay employees believe exist between merit pay and the General Schedule.

The bill would restore full annual comparability increases and a within-grade system for merit pay employees who are rated fully successful or better and are now assured of only one-half the comparability increase. In contrast to merit pay employees, fully successful General Schedule employees automatically receive annual comparability and periodic within-grade increases.

S. 958, with the proposed amendments, would provide an incentive for better performance by merit pay employees through performance awards and a performance-based within-grade advancement schedule. The performance awards system, which is to be in addition to the cash award program, would permit highly rated employees to earn amounts greater than under the General Schedule pay system, and the proposed within-grade advancement schedule would enable top performers to move more quickly toward the top of their pay scale. Each agency must spend not less than 1 percent of total covered employees' payroll on such awards. While this will result in increased agency costs for merit pay, it will also make more money available to provide incentives for better performance.

Another desirable feature of the bill is the continued prohibition against OPM or the agencies prescribing any pre-established distribution of ratings. As discussed earlier, good practice dictates that employees be evaluated against established performance standards. To apply pre-established ratings distributions would be contrary to this sound principle.

The proposed bill does not address the problem of inconsistency and uncertainty in defining who should be covered under merit pay. Since it restores full comparability and a within-grade system, however, it obviously reduces the differences that previously existed between merit pay and other employees. Given this situation, presumably the concern about being "in" or "out" will diminish.

One final note on the proposed bill. We would encourage that a provision--similar to the one included in OPM's proposed regulations--be added requiring a mandatory higher level review of performance standards at the beginning of each appraisal period. We believe this could help insure that standards are measurable, of reasonable difficulty, and comparable for employees in similar positions--thus helping agencies achieve a higher degree of consistency in ratings.

PROPOSED EXPERIMENTAL PROGRAM

We believe that the amended bill's experimental program for linking performance appraisal systems to pay and reduction-in-force procedures makes sense. The experimental program would cover 150,000 employees, at least 50 percent in units with exclusive bargaining rights, and would extend over a 3-1/2 year period. It would include a wide spectrum of grades, occupations, agencies, and geographic areas.

One of our concerns with both merit pay and SES was that these systems were not thoroughly pretested before they were

implemented. As we pointed out in our earlier reports on these issues, private sector experts said that performance appraisal systems should be thoroughly tested and evaluated before they are used for pay decisions and that it takes 3 to 5 years before such systems run smoothly.

I should note that we have a concern about GAO's role in the evaluation of the experimental program. Since there undoubtedly will be many individual projects under this program, it would not be feasible or practical for GAO to review all of them. Therefore, we recommend that language be included in the bill to give GAO some latitude in determining the scope of its reviews.

SES PERFORMANCE AWARDS

We reviewed the amendments to S. 958 on changes to the SES performance award program that would give agency management greater discretion in awarding bonuses, and favor your proposed revisions. Surveys conducted by GAO and other organizations have shown that most SES members do not believe the current bonus program stimulates excellence in performance. These perceptions primarily stem from the restrictions that have been placed on the bonus program since CSRA was passed. The act originally provided that bonuses be paid on 50 percent of SES positions in agencies. For fiscal year 1981, however, the Congress imposed a 25-percent restriction, and OPM requested agencies to further limit bonuses to 20 percent of eligible career

employees. For fiscal years 1982 and 1983, the Congress established a limit on SES performance awards of 20 percent of eligible career employees. Many SESers are of the opinion that the significant decrease in the number of available bonuses is a fundamental breach of management's agreement with them when they entered the SES.

The changes proposed in the bill eliminate the 20 percent statutory limitation and would even allow payment of bonuses beyond the 50-percent figure specified in the CSRA--but agencies' ability to pay the maximum allowable bonuses to individuals would be considerably constrained by the bill's funding arrangements.

- - - -

In summary, we support the principle of pay-for-performance for Federal employees. The changes proposed in S. 958, as amended, together with the proposed experimental program, would provide an opportunity to review the feasibility of a number of possible pay-for-performance options. At the same time, it gives OPM and the agencies additional time to debug their performance appraisal systems. It also provides time for employees to gain confidence in the system before it is used for pay decisions.

This concludes my testimony, Mr. Chairman. We will be happy to answer any questions you may have for us.