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Report to Congressional Requesters

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PAY FOR PERFORMANCE

State and International Public Sector Pay-For-Performance Systems

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The Honorable Norman Dicks
House of Representatives

The Honorable Vic Fazio
House of Representatives

The Honorable Steny Hoyer
House of Representatives

This report responds in part to your request to examine the federal government's pay-for-performance system. This system is known as the Performance Management and Recognition System (PMRS). As you know, prior reports provided information on how PMRS was operating and on how it was viewed by employees who were covered under the system and by federal agencies' personnel directors.

This report goes beyond the federal PMRS system and examines whether and to what extent state governments are operating pay-for-performance compensation systems. It also identifies some of the problems experienced by those systems and notes that such problems are similar to those experienced under PMRS. The report also presents some general information on the extent to which pay-for-performance systems are being used internationally.

Copies of this report are being sent to the Chairman of the House Committee on Post Office and Civil Service and the Senate Committee on Governmental Affairs; the Director of the Office of Personnel Management; the states that participated in this review; and other interested parties.

The major contributors to this report are listed in appendix V. If you have any questions on this report, please call me on 275-5074.

Bernard L. Ungar

Bernard L. Ungar
Director, Federal Human Resource
Management Issues

Executive Summary

Purpose

This report was prepared as part of GAO's response to a request for pay-for-performance information from Congressmen Norman B. Dicks, Vic Fazio, and Steny H. Hoyer. It identifies those states that employ a pay-for-performance system, describes how these systems are structured and operated, and contains insights into how the systems are viewed by state officials and employees. The report also explores whether and to what extent pay-for-performance systems are being used internationally.

The administration and Congress are giving consideration to expanding the government's use of pay for performance and will also be determining whether any changes are needed in the basic structure of the government's current pay-for-performance system. GAO believes the information contained in this report will aid in those deliberations.

Background

The Performance Management and Recognition System (PMRS) is the federal government's pay-for-performance system. Applicable to about 130,000 grade 13 through 15 managers and supervisors, the system primarily relies on performance appraisals as the basis for pay and monetary reward decisions. Through an annual performance appraisal process, each PMRS employee receives a summary rating reflecting one of five levels of performance—fully successful, two levels above fully successful, and two below.

Although the results of PMRS have been generally disappointing, Congress recently reauthorized the program through March 1991 with only minimal change. Congress decided to reauthorize PMRS in this manner because there was general support for the concept of pay for performance but little agreement on how PMRS could be improved. The Office of Personnel Management (OPM) is currently evaluating the program through a contract with the National Research Council.

To obtain the information for this report, GAO contacted a total of 51 states and territories and visited 6 state governments that operated pay-for-performance systems. Additionally, to find information on the nature of and extent to which pay for performance was being used outside the United States, GAO performed a literature review and spoke to various international personnel management officials.

Results in Brief

Although several states have adopted pay for performance, there is no clear consensus as to what constitutes an ideal pay-for-performance system. State pay-for-performance systems varied with regard to funding, methods for rewarding employees whose performance justified additional compensation, the number of performance levels in use to assess employee performance, and the percentage of the work force covered by pay for performance. Also, some state pay-for-performance programs were not fully implemented because funding for such programs was not consistently provided.

Countries other than the United States are also moving toward pay for performance. As of September 1988, 13 of the 24 countries affiliated with the Organization for Economic Cooperation and Development (OECD)—a European-based research organization—either had or were proposing a performance-based pay system.

Principal Findings

There Is a General Movement Toward Pay for Performance

GAO identified 23 states that use pay-for-performance systems. A review of the international literature on performance appraisal and pay-for-performance systems indicates that other countries are also moving toward pay for performance in the public sector. As reported by OECD, 13 of its 24 member countries have implemented or are testing the pay-for-performance concept on an experimental basis.

GAO found that, just as in the federal government, there is no general consensus on how best to structure a pay-for-performance system. However, the varying methods used by other public organizations to implement pay for performance provide information that can be helpful in considering the future direction of PMRS. For example:

- Under PMRS, persons who are eligible for a merit increase do not receive the full amount if it places their salary above the top of their pay range. Four states have compensated for this by allowing the denied salary amount to instead be paid as a bonus. (See p. 20.)
- One of the criticisms of PMRS has been that rewards are too small to act as a motivator. For fiscal year 1988, the latest year for which data was available, the average bonus award amount for PMRS was $1,149. State employees GAO interviewed generally shared that view with regard to their own systems. In the eight states from which GAO was able to obtain such information, award amounts ranged from a low of $400 to a high of $2,831 per employee. GAO also found that some state programs were not

always implemented. For the 3-year period ending in fiscal year 1989, 7 of the 23 states did not fund their pay-for-performance system during one or more of these years. (See p. 22.)

- PMRS rewards its employees by using a combination of salary increases and bonuses. Nineteen of the 23 states granted performance awards that were added to the employee's base salary; 9 of the 19 also granted bonuses; but in 4 states, only bonuses were used. In one of these latter states, a personnel official said that the general rationale for only using bonuses was a belief that a salary increase could long outlive the performance that triggered it. He also pointed out that bonuses constitute one-time payments and, as a result, are less costly. (See p. 20.)
- PMRS uses five rating levels to assess the performance of its employees and consideration has been given to reducing the number of rating levels to two (pass/fail). Twelve of the 23 states that had implemented performance-based systems used a 5-level system; but none employed 2 levels. One state official said that, in his opinion, two levels would not be sufficient to assess employee performance. He also said that because it was unlikely that many employees would fail, a two-level system would, in effect, make no distinctions at all. (See p. 19.)
- As was the case under PMRS, all states required an assessment of employee performance, and most of the 23 states also based an employee's performance reward amount directly on his/her rating. (See p. 17.)
- PMRS is currently applicable to only a portion of the federal workforce—grade 13 through 15 managers and supervisors. Data compiled by GAO show that although none of the states has made pay for performance applicable to all of its employees, some states have included employees other than supervisors and managers. (See p. 15.)

Recommendations and Comments

Because this report is informational in nature, GAO is not making any recommendations. However, GAO's findings clearly demonstrate that whatever type of pay-for-performance system is adopted for federal employees, adequate funding is critical to meeting the system's objectives and for achieving credibility among covered employees.

GAO discussed the information presented in this report with personnel officials from the various states it visited. With the exception of a few minor technical corrections that were made, the officials agreed with the information GAO presented.

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Abbreviations

EPAS	Employee Performance Appraisal System
GM	General Merit
GS	General Schedule
MPS	Merit Pay System
OECD	Organization For Economic Cooperation and Development
OPM	Office of Personnel Management
PFP	Pay for Performance
PMRS	Performance Management and Recognition System
POPS	Performance Oriented Pay System

Introduction

The Performance Management and Recognition System (PMRS) is the federal government's pay-for-performance system for approximately 130,000 grade 13 through 15 supervisors and managers.[1] The system primarily relies on annual performance appraisals as the basis for pay and monetary reward decisions. Each PMRS employee receives a summary rating based on five levels of performance with the middle level considered to constitute fully successful performance. There are also two levels above fully successful and two levels below. The lowest category is for unacceptable performance.

A rating of fully successful or higher entitles the employee to the full amount of any general pay (comparability) increase that is granted to the General Schedule (GS) workforce. A rating of at least fully successful also makes PMRS employees eligible to earn merit increases in their rates of basic pay (advancement within the ranges for their pay grades) that, for the most part, meet or exceed the salary adjustments available to GS employees in the form of within-grade increases. As shown in table 1.1, the amount of a PMRS merit increase is determined by the employees' summary ratings for the year and the employees' position in the salary range for his/her grade.

Table 1.1: Performance Increases Under PMRS

	Salary range			
Performance rating	**Lower third**	**Middle third**	**Upper third**	**At maximum rate**
Level 5	Full merit increase	Full merit increase	Full merit increase	No merit increase
Level 4	Full merit increase	One-half merit increase	One-half merit increase	No merit increase
Level 3 (fully successful)	Full merit increase	One-half merit increase	One-third merit increase	No merit increase

A rating of at least fully successful also makes employees eligible to earn performance awards—one-time "bonus" payments that are not part of basic pay. Employees who rated two levels above fully successful are required under the PMRS legislation to receive a performance award of at least 2 percent of their base salary. PMRS legislation also requires that an agency's total payout for performance awards not exceed a maximum of 1.5 percent of its aggregate PMRS salaries.

[1]PMRS was signed into law on November 8, 1984, as Title II of the Civil Service Retirement Spouse Equity Act of 1984 (Public Law 98-615, 98 Stat. 3195, 3207) and was recently reauthorized until March 31, 1991, by the Performance Management and Recognition System Reauthorization Act of 1989 (Public Law 101-103).

PMRS also reduces or withholds pay increases for less than fully successful performance. Under PMRS, employees rated one level below fully successful receive one-half of any general pay increase and no merit increase, and employees rated two levels below fully successful receive neither.

Additionally, Congress's October 1, 1989, reauthorization of PMRS legislation established new procedures requiring agencies to place each employee whose performance was below fully successful on a performance improvement plan. If the employee does not improve his or her performance to a fully successful level or higher once the performance improvement plan has been completed, he/she may be reassigned, reduced in grade, or removed.

Studies Have Identified Problems With PMRS

We and the U.S. Office of Personnel Management (OPM) have reviewed and reported on PMRS since its passage in November 1984. Essentially, these reviews have shown that the results of pay for performance under PMRS have been generally disappointing.

Results of OPM Evaluations

OPM is required by law to evaluate PMRS and has issued three annual reports on the system.[2] Although OPM's evaluations reported that PMRS employees were better paid than they were under either the Merit Pay System or the General Schedule,[3] it cited problems associated with perceptions of inequity, assessing employee performance levels, "labeling" employees, high percentages of employees receiving awards, low actual dollar awards, and the increased administrative burden placed upon supervisors. For example, OPM's June 1989 annual report on PMRS made the following statements:

- Although federal agencies showed wide variation in PMRS ratings, the performance rating distribution was inflated.

[2] Performance Management and Recognition System, OPM, June 1989, June 1988, and July 1987.

[3] The merit pay system—the system in effect prior to PMRS—was established by the Civil Service Reform Act of 1978. Merit Pay fundamentally changed the manner in which most of the government's GS-13 through -15 supervisors and managers were compensated. Under this system, employees received a reduced annual salary adjustment and had to compete for pay increases from a fixed merit pay fund on the basis of how well they performed their jobs.

- Randomly selected and interviewed employees expressed a broad range of opinions on how effective PMRS was in reaching its goals and objectives. Most employees supported the concept of pay for performance but were dissatisfied with its implementation under PMRS.

Although OPM reports identified and reported on the continuing problems with the PMRS system, no changes or remedial actions were recommended. Commenting on this issue, the Director of OPM said during congressional testimony on the reauthorization of PMRS in July 1989 that although essentially no one wanted to go back to the regular General Schedule for the PMRS population, there was no consensus as to exactly how PMRS should be changed. Also, OPM stated in its 1989 annual report on PMRS that there was no indication that continuing the current system beyond September 1989, with only minimal changes, would cause serious short-term operational problems. However, OPM also said that it appeared that more substantial changes were essential for the long-term success of the pay-for-performance concept. OPM stated that it would continue to study the PMRS system and would also examine alternative pay-for-performance systems.

In September 1989, OPM commissioned a study by the National Research Council of the National Academy of Sciences to evaluate the state of performance appraisal technology and, in particular, to find out if there were effective performance appraisal systems in place in the public and private sectors that could serve as models for redesigning the federal pay-for-performance system.[4] The underlying question to be addressed by the Council is whether a pay-for-performance or merit pay system would help promote excellence in the federal work force. According to the Council's project leader, the scope of the work will involve a review and synthesis of the research literature on (1) performance appraisal, (2) compensation linked to performance appraisal, and (3) the organizational variables potentially influencing the effectiveness of any pay-for-performance system. The period for completing the contract is 13 months, with a final report to be issued in December 1990.

[4]The National Research Council was organized by the National Academy of Sciences to associate the broad community of sciences and technology with the Academy's purposes of furthering knowledge and advising the federal government. The Academy is a private, nonprofit, self-governing corporation that was established in 1863 by congressional charter.

GAO's PMRS Reviews

We first reported on the implementation of PMRS in various federal agencies in January 1987.[5] In that report, we pointed out that factors unrelated to individual performance resulted in employees with the same grade and rating receiving significantly different award amounts. We also reported that although the PMRS legislation prohibits agencies from prescribing ratings distributions, various factors--including budgetary constraints —put pressure on agencies to influence the distribution of ratings.

In May 1989, we again reported on PMRS.[6] Despite 4 years of experience with the system, PMRS employees and the SES members we spoke with raised most of the fundamental problems initially identified in our January 1987 report. Also, in general, these individuals indicated that PMRS was not fully meeting its objective of motivating and rewarding employees. Nearly everyone we spoke with said that they believed that performance was not a major factor in determining who received performance awards and that awards were too small to act as motivators.

Although most of the people we spoke with were unhappy with PMRS, they had few suggestions for improving the system. In the absence of concrete suggestions, we solicited comments on a number of reforms that had been suggested by various personnel management groups. We found that a proposal to adopt a satisfactory/unsatisfactory two-tier rating system was not supported by most of the employees. Also, most did not support using an awards panel to make performance award decisions as a substitute for basing award decisions on an individual's performance appraisal. We also found that there was strong support for a proposal to increase the pay of managers and supervisors.

In September 1989, we obtained the views of federal agency personnel directors and issued a fact sheet entitled Pay for Performance: Agency Personnel Directors' Views (GAO/GGD-89-126FS). The problems we identified in our prior work continued to surface. For example, about 80 percent of the personnel directors who responded to our letter said that, in general, the views of employees at their agencies agreed with the views we previously presented in our May 1989 briefing report.

[5] Pay for Performance: Implementation of the Performance Management and Recognition System (GAO/GGD-87-28, Jan. 21, 1987).

[6] Pay for Performance: Interim Report on the Performance Management and Recognition System (GAO/GGD-89-69BR, May 18, 1989).

In response to other questions in our letter, about 73 percent of the personnel directors said that PMRS did not meet or only partially met the goals their agencies wanted to achieve through a pay-for-performance system. Although the personnel directors expressed little agreement on how PMRS should be changed, two suggestions frequently cited were (1) to give agencies more flexibility in designing pay-for-performance systems to fit their goals and culture and (2) to increase funding for performance awards.

Objective, Scope, and Methodology

This assignment was done as part of our response to a request from Congressmen Norman B. Dicks, Vic Fazio, and Steny H. Hoyer. Its overall objective was to identify and gather information on the design and operations of state government pay-for-performance systems.

Although there has been an increasing interest in the topic of reward systems for public employees, we were not able to find any recent survey information on state pay-for-performance systems and practices. Accordingly, we sought to fill this gap by identifying those states that use a pay-for-performance system; describing how these systems were structured and operated; finding out how these systems were viewed by state employees; and, to the extent possible, comparing these state systems to PMRS. It was our view that such information might be useful in assisting Congress and OPM in considering possible modifications and improvements to PMRS. Additionally, as agreed with the requesters, we expanded our work to include gathering information on whether and to what extent pay for performance was being used internationally.

To identify those state governments that used a pay-for-performance system,[7] we sent a letter of inquiry to a total of 51 states and territories requesting information on various aspects of pay for performance. Specifically, we requested information on

- whether the state operated a pay-for-performance system for its employees;
- the structure of the performance appraisal portion of the system;
- the process used to determine who gets awards, bonuses, and base pay increases; and

[7]For purposes of our study, we defined a pay-for-performance system as a system that discriminates between satisfactory and other higher performance levels by rewarding employees differently. The reward may be an adjustment to base pay, a one-time bonus payment, or some combination of these.

- the source of funds and the funding levels for the performance-based pay system.

We received a total of 44 responses to our letter of inquiry. Appendix I contains the letter we sent to state personnel directors and appendix II contains a list of states that responded.

To further develop our information on state experiences with pay for performance, we made field visits to a judgmentally selected sample of states that had pay-for-performance systems. These were Arizona, Florida, Idaho, Illinois, South Carolina, Tennessee, and Utah. With the exception of Tennessee—which terminated its pay-for-performance system in 1988 because of problems, such as a lack of adequate program funding—the sampled states represented a mix of pay-for-performance systems. The systems varied in terms of appraisal rating levels, employee coverage, and degree of supervisory control over performance-based pay awards. Our field visits involved gathering information from a total of 20 state personnel officials and 75 managers, supervisors, and other employees to get their perspectives and views on how well their pay-for-performance systems were meeting their needs and the needs of their state organizations. The managers, supervisors, and other employees were from various organizational levels within state government and were selected for our field interviews, in most cases, by state personnel officials. Because of the judgmental nature of employee selection, their views cannot be assumed to be representative of all state employees and supervisors nor of all employees and supervisors in the state locations or agencies we visited.

We gathered and examined available statistical information related to each state's pay-for-performance system, such as employees' summary performance ratings, performance award amounts, and general pay increases. We did not verify the accuracy of the statistical data provided to us by the various state employees and officials. Also, we did not examine the basis for the state officials' views or the validity of the statements they made. Nevertheless, we believe that the testimonial and documentary information we received provided us with a more informed perspective than we had initially on the pay-for-performance practices in operation at the state level.

To identify information on whether and to what extent pay for performance was used internationally, we reviewed pertinent literature, including international publications, professional journals, and other media articles. We also spoke with officials of the U.S. Department of

State; OPM; the National Academy of Sciences; the Federal Manager's Association; Professional Managers' Association; the International Public Management Association; and the Organization for Economic Cooperation and Development (OECD), a European-based research organization, to gather information on the use of overseas performance-based compensation systems. Lastly, we spoke to Canadian and corresponded with United Kingdom personnel management officials familiar with their countries' public sector pay compensation systems.

The information gathered on the pay-for-performance systems used by other countries was limited. We had difficulty obtaining sufficient detail on the pay arrangements that applied to public sector employees of these countries. Also, the literature indicated differences in the style of public sector management and the role of public servants from country to country. However, we were able to identify a recent study by the OECD on general trends in pay for performance among its member countries. We also gathered some detailed information on pay for performance in both the United Kingdom and Canada. We highlighted these two countries because of the availability of pay-for-performance information.

We gave state personnel officials from the various states we visited an opportunity to review the facts we presented in this report. They generally agreed with the information presented and we made the technical changes they suggested. We did our field work between August 1989 and January 1990 in accordance with generally accepted government auditing standards.

States Are Moving Toward Pay for Performance

Twenty-three states indicated that they had a system in which the pay awarded to certain employees was based on demonstrated performance. The rewards included adjustments to base pay, one-time bonus payments, or some combination of these.

The types of state pay-for-performance systems in place varied in levels of funding, methods for rewarding employees whose performance justified additional compensation, the number of performance levels in use to assess employee performance, and the percentage of the work force covered by pay for performance. In addition, as indicated in this chapter and highlighted in the case summaries included in appendix III, some of the problems reported about the federal PMRS program were also expressed to us at the state level.

Several States Have Adopted Pay for Performance

On the basis of the information provided by those 44 states and territories that responded to our letter of inquiry, we identified 23 states that use pay-for-performance systems. Most states (14 of 23) had implemented their systems within the last 10 years. At least three other respondents—Virginia, Montana, and Missouri—indicated that they were either in the process of studying or actually implementing a state pay-for-performance system. For example, Virginia officials said that in anticipation of a move toward pay for performance, the state had developed new position descriptions for all its employees and implemented a new performance evaluation process to support a closer link between pay and performance. After completing our fieldwork, we were advised that Virginia's system—"The Incentive Pay Plan"—was implemented in July 1990, with performance awards based upon the new appraisal system scheduled to begin in December 1991.

As table 2.1 indicates, not all state employees are covered under state pay-for-performance systems. For example, in Maryland, only about 400 of the state's approximately 96,000 employees are covered.

Table 2.1: State Pay for Performance (PFP) Background Information and Employee Coverage

State	Year PFP implemented	Total state employees	Employees under PFP	Employees covered: Managers or supervisors	Employees covered: Other
Alabama	1987	85,379	33,000	Yes	Yes
Arizona	1973	53,228	33,000	Yes	Yes
Arkansas	1986	46,846	19,200	Yes	Yes
California	1984	366,056	27,700[a]	Yes	No
Connecticut	1979	65,790	2,500	Yes	No
Florida	1968	156,883	98,476	Yes	Yes
Idaho	1979	14,400	9,366	Yes	Yes
Illinois	1978	159,839	10,944	Yes	Yes
Indiana	1983	102,363	37,070	Yes	Yes
Iowa	1977	59,723	3,000	Yes	Yes
Kentucky	1986	74,344	35,700	Yes	Yes
Maryland	1989	96,191	400	Yes[b]	No
Massachusetts	1987	104,930	3,600	Yes	No
Michigan	1980	158,249	400[c]	Yes	Yes
Minnesota	1985	79,597	900	Yes	No
Mississippi	1985	50,256	27,000	Yes	Yes
Nebraska	1987	34,724	14,500	Yes	Yes
New York	1981	304,628	14,000	Yes	No
Oregon	1981	59,650	1,100[d]	Yes	No
South Carolina	1970	83,040	56,853	Yes	Yes
South Dakota	1986	15,995	9,000	Yes	Yes
Utah	1969	34,531	13,631	Yes	Yes
Wisconsin	1969	88,208	9,275	Yes	Yes

[a]In 1984, California established a performance-based bonus system for 2,700 managers. In 1987, a similar bonus system was added for 25,000 supervisors.

[b]Maryland's pay-for-performance system applies only to senior executives.

[c]In 1980, Michigan established a performance-based pay system for 400 senior executives. In 1988, the state established an incentive system for 50 pension plan investors employed by the Michigan Department of Treasury.

[d]Oregon does not have a statewide pay-for-performance system, but it has two state departments that use such a system.

Our survey showed that the categories of employees most likely to be covered were managers, supervisors, professionals, technicals, and clericals. The employee groups most often not covered by pay for performance generally included educators, hourly workers, elected officials, and law enforcement personnel.

States' Performance Appraisal Systems

A review of the literature on performance management indicates that a major objective of a performance appraisal system is to provide a systematic and uniform method to evaluate an employee's job performance. Additionally, a performance appraisal system should be used to

- help employees understand their responsibilities and their relationship to organizational goals;
- advise employees of the level of performance expected of them;
- provide periodic feedback to employees on how well they are meeting expectations and coach them in improving performance;
- help employees set career goals;
- provide a basis for personnel actions, such as training, promotions, and pay; and
- recognize and help to deal with performance problems.

Employee performance appraisal systems were utilized within all 23 of the state governments that reported having a pay-for-performance system. Many of the above employee evaluation system objectives were typically cited in information we obtained that described the performance appraisal systems in place.

All but two of the reporting states required the establishment of performance standards to measure employees' actual job experience. We found that in many of the reporting states, work standards for an employee were jointly developed by the employee and the supervisor and formally agreed upon. For example, in Arizona, the evaluation portion of the pay-for-performance system —the Employee Performance Appraisal System (EPAS)—consisted of performance factors, each of which is weighted according to its degree of importance to the job. Prior to the performance appraisal period, the rater and the employee jointly selected performance factors applicable to the work being performed. The rater, with input from the employee, then determined the weight of each performance factor, and this was formally recorded on employee performance documentation forms. The performance factors included the knowledge, skills, and abilities required to complete employee tasks and included such factors as work habits, policy and procedures, interpersonal relationships, and communications skills.

With one exception, all the reporting states indicated that they annually conducted employee performance appraisal reviews. Also, we found that most states used a fixed date, either the anniversary date of a person's employment or an evaluation date for all employees, for conducting the annual performance evaluation. Table 2.2 summarizes some of the major components of the 23 state performance appraisal systems we surveyed. More details on the particular components of the appraisal systems for the six pay-for-performance states we visited are included in appendix III.

Table 2.2: Components of States' Performance Appraisal Systems

State	Standard-setting required	Ratings: Frequency	Ratings: Date[a]	Interim ratings required[b]
Alabama	Yes	Annual	Anniversary	No
Arizona	Yes	Annual	Fixed	Yes
Arkansas	Yes	Annual	Anniversary	No
California	Yes	Annual	Fixed	Yes
Connecticut	Yes	Annual	Fixed	Yes
Florida	Yes	Annual	Anniversary	No
Idaho	No[c]	Annual	Fixed	No
Illinois	No[c]	Annual	Anniversary	No
Indiana	Yes	Annual	Anniversary	No
Iowa	Yes	Annual	Anniversary	No
Kentucky	Yes	Annual	Fixed	Yes
Maryland	Yes	Annual	Fixed	No
Massachusetts	Yes	Annual	Fixed	Yes
Michigan	Yes	Annual	Fixed	Yes
Minnesota	Yes	Annual	Fixed	No
Mississippi	Yes	Annual	Anniversary	Yes
Nebraska	Yes	Annual	Fixed	No
New York	Yes	Annual	Fixed	Yes
Oregon	Yes	Annual	Fixed	No
S. Carolina	Yes	Annual	Anniversary	No
S. Dakota	Yes	Semiannual	Fixed	No
Utah	Yes	Annual	Fixed	No
Wisconsin	Yes	Annual	Fixed	No

[a]A fixed date rating period means all employees are rated at the same time during the year. This differs from rating periods, which are usually based upon some employee anniversary date, such as date of last promotion or employment start date.

[b]In many of the states, interim ratings are required for new employees hired for a probationary period.

[c]*These two state employee performance appraisal systems require ratings based on employees' accomplishments toward preestablished work objectives rather than performance standards.*

States Primarily Use a Five-Tier Rating Appraisal System

Because one of the PMRS reform proposals being considered during 1989 by Congress involved the implementation of a two-tier rating system instead of the five-tier system that was being used, we inquired as to the number of rating levels that were being used by the states.

We found that 12 of the 23 surveyed states used a five-tier rating system. The next most favored system was three rating levels, with 7 of the 23 states favoring such a system. Of the remaining four states, two used four rating levels, one used six rating levels, and one used an eight rating level system. None of the surveyed states employed a two-tier rating system.

In commenting on a two-tier rating system, one state personnel official told us that while it might be difficult at times to draw distinctions among performance levels under a five-tier system, the simple "pass or fail" rating provided for under a two-tier system does not contain sufficient information on the level of employee performance. Also, the official indicated that, in all likelihood, few employees would be rated "unsatisfactory"; thus, the two-tier rating system would, in effect, make no distinctions at all.

The results of a 1989 performance management survey of over 3,000 U.S. private and public organizations by the Wyatt Company—a private personnel management consulting firm—also showed that a five-tier rating system is the one that is most prevalently used. Wyatt reported that 57 percent of the organizations it surveyed used five performance rating levels within the organizations' performance management systems.

In reporting this information, the Wyatt Company also stated that there were some problems and challenges associated with using any number of performance levels effectively. It said that the levels must be clearly defined and that the ratings process must be carefully monitored to ensure that ratings are not interpreted and granted inconsistently.

State Performance Award Payout Process

Of the 23 states we surveyed, all contained a payout system for performance awards in which the amount of pay awarded to an employee varied depending on the employee's performance. The basis for these award payouts varied among the responding states. Most of the 23 states directly linked the performance award amount to the employee's performance rating. Some states provided a mechanism to accelerate new employees' wages toward the market rate by providing a shorter performance evaluation period, such as 6 months, for new employees as opposed to a 1-year period for senior employees. Also, a number of states applied a matrix payout system when an employee's pay position within a particular pay range and performance level together determined the amount of the performance award. For example, in Idaho, an employee at the lower end of the pay range was eligible for a larger percentage increase in base pay than an employee at the higher end of the pay range, even though both employees may have demonstrated equally commendable performance.

PMRS rewards its employees by using a combination of base pay increases and bonus performance awards. Table 2.3 summarizes the various pay-for-performance award combinations used by the 23 states we surveyed.

Table 2.3: Types of State Performance Awards

Type of performance award	Number of states
Base pay and bonus	5
Base pay only	10
Base pay with bonuses paid to employees at pay range maximum	4[a]
Bonus only	4
Total	**23**

[a]One of these states also pays bonuses for the portion of any award that exceeds 3.5 percent of an employee's base salary.

As pointed out in table 2.3, four states exclusively used a one-time lump-sum bonus under their performance award payout process. A state personnel official from one of the four states told us that the general rationale for the lump-sum option was the belief that a base salary increment could long outlive the performance that triggered it, and that work and performance are time-bound. The official said that conceptually, true pay for performance should be given in the form of lump-sum bonuses separate from salary and tied into a specific time period of performance. The official also pointed out that granting performance awards in the form of bonuses would be less costly to the state government than the alternative of increasing the base salary.

Table 2.4 summarizes the available information on the payout processes used by the reporting states.

Table 2.4: Components of States' Pay-For-Performance Systems

State	Award type and range: Base pay	Award type and range: Bonus	Comments
Alabama	0–10%	None	
Arizona	0–7.5%	2.5–5%	Bonuses for those at pay range maximum.
Arkansas	2.5–5.5%	none	
California	none	$250–5,000	Panel sometimes used for award decision.
Connecticut	0–3.5%	3.5–8%	Bonuses are given to managers at pay range maximum and those who receive awards above 3.5%.
Florida	3–5%	3–5%	Bonuses for those at pay range maximum.
Idaho	0–10%	0–$1,000	
Illinois	0–8%	none	
Indiana	0–4%	none	
Iowa	0–10%	0–5%	
Kentucky	none	0–$50	No funds have ever been appropriated by state legislature for performance awards.
Maryland	0–6%	none	Panel is used for award decision.
Massachusetts	none	$3,000	Bonuses are limited to 15 percent of eligible managers.
Michigan	4–7%	none	Bonus based, in part, on group performance.
Minnesota	0–5%	none	
Mississippi	0–3%	none	Legislature has not funded pay for performance since 1986.
Nebraska	0–7.5%	0–7.5%	
New York	0–33%[a]	$400–3,000	Bonuses only available for those at pay range maximum.
Oregon	0–10%	none	
South Carolina	0–3%	none	
South Dakota	none	1.75%	Bonuses are capped at $500.
Utah	0–6%	0–$2,000	
Wisconsin	2–10%	$100–1,000	

[a]New York's base salary award is not a percentage of base pay. It is a percentage of the salary range amount for a particular salary grade. For FY 1988, the maximum amount that could be earned was $5,500.

Using information from state personnel officials and state funding documentation we received, we determined that the pay-setting process for these 23 states typically involved 4 separate state organizations—the state personnel department or agency, the state budget office, the state governor's office, and the state legislature.

States' Pay-For-Performance Funding Levels Varied

Although generally limited, funding information we gathered from the states shows some variance as to whether and at what amounts states were funding their pay-for-performance systems. For example, for the three 1-year performance award periods from fiscal years 1987 through 1989, 7 of the 23 states did not spend any money for one or more of those periods on their pay-for-performance systems.[1] Further, one state had never spent any money for its pay-for-performance system even though the system had been established by legislation passed in 1986. In addition, during the same 3-year period, 19 of the 23 states, including 4 of the 6 states we visited, spent some funds for general salary increases (cost of living increases) in addition to the pay-for- performance awards. These general salary increases generally ranged between 3 and 5 percent of an employee's base salary.

We also found that the amount of employees' performance awards varied among the responding states. Although the funding information we gathered on state performance award payouts was limited, we identified some data on the range of performance award amounts granted to state employees. We found that the average annual performance award amount for the eight states from which we were able to obtain data ranged from a low of about $400 to a high of $2,831 per employee. The available state information we received on overall state funding levels and average performance award amounts is summarized and included in appendix IV. According to an OPM official, for fiscal year 1988, the latest year for which data was available, the average performance award amount under the federal PMRS program was $1,149.

Data on the number of state employees receiving performance awards were generally not available. However, for one state we found that about 72 percent of eligible employees received an average performance award of $1,200, which represented about a 2.5 percent increase in average salary base.

Ratings Distributions

In our prior work on PMRS, we reported a concern that management pressure and quotas were influencing performance ratings and awards. For the six states we visited, we asked management and employees about the use of forced ratings distributions for employees. State personnel

[1]Different states funded their pay-for-performance systems in different ways. Some established pay-for-performance budgets that were considered and approved by the state's legislature. In other states, no separate budget was set aside for their pay-for-performance systems, and costs have to be absorbed through vacancies and savings from other operations.

officials we spoke with said their state personnel agencies did not prescribe rating distributions but acknowledged that a number of factors, including budgetary constraints and the desire to give substantial performance awards for quality performance, exerted influence on ratings distributions. The officials generally viewed the issue of forced ratings distributions as a basic dilemma associated with having to distribute among employees a finite amount of money in amounts significant enough to reward exceptional performance without damaging the morale of those who did not receive such awards. They indicated that these issues were often considered to be part of the individual state agency's responsibility for managing its performance award budget.

We identified two examples that demonstrate how states were handling this issue. First, in Illinois, in order to assure equity in performance awards among state agencies, an average performance award increase guideline was established by the state personnel agency (see app. III, p. 38). Under this guideline, base salary increase ranges were set for each performance rating category. Each state agency was required to control its performance award increases during the year to assure that the guideline was being followed. Similarly, in New York, the state personnel agency instituted a requirement that state agencies pay performance increases to no more than 40 percent of the eligible employees.

State Employees' Views of Pay for Performance

In general, 63 of the 75 state employees we interviewed believed that although pay for performance was a means for rewarding exceptional employees, inadequate or inconsistent state funding sometimes hindered or undermined the system's goals. For example, Mississippi did not appropriate funds to award performance increases for fiscal years 1987 through 1990. A fiscal year 1989 Mississippi state legislative report cited the negative impact experienced by state agencies due to this lack of funding. Some of the reported results were as follows:

- Performance appraisal systems lost their effectiveness when funding was not provided. Employee morale and incentive to excel suffered.
- Pay for performance must be funded every year or the state will not be competitive in attracting and retaining highly qualified technicians, medical personnel, and other professionals.

Also, some state employees we interviewed said that, at times, performance increases were perceived to be too small to be an incentive for improved performance. For example, a manager from one state told us that she had difficulty motivating her supervisory employees when, due to tight state budgets, employees could at best receive a 4-percent increase in salary. She pointed out that, at the same time, unionized state employees were receiving an 8 percent salary increase.

Conclusions

The current experience in state government compensation practices suggests a trend toward the adoption of pay-for-performance-based compensation systems. Since 1980, 14 states have adopted such systems and another 3 states are in the process of designing or implementing a pay-for-performance system for their employees. This represents a change from the more traditional step-based pay plans that based employee advancement primarily upon longevity of service.

Some state pay-for-performance systems we reviewed were operated differently from the federal PMRS. For example, under PMRS, employees who are at or near the maximum rate of their salary range cannot receive a merit increase that would cause their salaries to exceed the maximum rate for their grade; but we identified four state pay-for-performance systems that have compensated for this situation by allowing employees at the top end of their pay range to instead receive a lump-sum bonus.

Just as at the federal level, however, there was no clear consensus among our surveyed states as to what constitutes an ideal pay-for-performance system. States varied in the number of performance levels they used to assess employee performance and the percentage of the work force they covered by state pay-for-performance systems. Further, some of the problems reported about PMRS were also concerns at the state level. For example, most state employees we interviewed believed that although pay for performance was a means of rewarding exceptional employees' performance, overall weaknesses, such as inadequate or inconsistent state funding, sometimes hindered or undermined the system's goals. Also some employees we interviewed told us that performance increases were sometimes perceived to be too small to be an incentive for improving performance.

Pay for Performance in Other Countries

A 1988 report on public sector pay by the Organization for Economic Cooperation and Development (OECD) indicated that other countries are moving toward pay-for-performance systems as part of a more general movement towards flexible pay structures in the public service. Although Canada and the United States were the first countries to introduce performance related pay for public servants, several other countries have recently implemented, pilot tested, or planned a pay-for-performance system. Table 3.1 lists 13 countries OECD identified as either having or proposing a pay-for-performance system.

Table 3.1: 13 Countries That Either Have or Are Planning a Pay-For-Performance System

Country	Current or proposed system
Australia	Performance-related pay system for senior executive service and middle management grades.
Canada	Performance-related pay ranges for senior civil servants. Performance bonus for senior civil servants.
Denmark	Flexible fixing of salaries in central administration agencies.
Finland	Experimental system for performance-related pay in the Customs Department, the State Computer Center, and the Department of Roads and Waterways.
France	Performance bonuses for civil servants.
Ireland	Performance-related pay ranges for senior civil servants.
Italy	Experimental productivity bonus in the Ministry of Defence and the Audit Office.
Japan	Performance allowance for National Public Employees.
The Netherlands	Flexible salary system for central civil service, including performance bonuses.
New Zealand	Performance-based pay for senior managers.
Spain	New salary system for civil servants, including a productivity complement.
Sweden	Performance-based pay increases for senior staff in state business agencies.
United Kingdom	A variety of performance-related pay components used throughout civil service.

Performance Appraisal

According to OECD, most of its 24 member countries operate performance appraisal systems of some type in the public service. These countries use performance appraisal systems for a variety of reasons. Most are designed to improve communication and performance; however, a few are also designed to directly link pay to performance. In general, according to the OECD report, while there are variations in approaches to appraisal, the primary emphasis is on employee accountability, performance review, and improving performance in the current job, as opposed to assessing potential or promotability. Appraisal is becoming integrated with other aspects of performance management, particularly the setting of work goals and standards, linking individual targets to organizational goals, and measures for performance improvement.

Some OECD member countries, require that staff be assessed annually in writing, although in other countries appraisal is less formal or is conducted at longer intervals. In a few countries there is no provision for some form of regular appraisal. The direction in which appraisal systems are moving in OECD countries is expressed in the following excerpt from an OECD report:

"The increasing concern with accountability and achievement of results has led to a major emphasis on the use of appraisal to improve performance in the current job, and this is considered to be the main purpose of an increasing number of systems. This trend is reflected in the use of appraisal systems to set individual performance objectives, and to evaluate achievements in relation to these objectives. There has been a corresponding shift away from appraisal criteria based on character traits, such as judgment, determination, and initiative, to criteria designed to reflect job content and results achieved."

Pay-For-Performance Systems

OECD countries' pay-for-performance systems vary in the groups of employees covered and in the appraisal and payout components of their pay systems. Thus, it is not possible to draw precise comparisons among those OECD countries with pay-for-performance systems. In this section, we have presented a few common pay-for-performance features and, for Canada and the United Kingdom, provided separate, more detailed descriptions of their systems. These two countries were selected due to the availability of information describing their systems. Canada introduced its pay-for-performance system in the 1960s, whereas the United Kingdom introduced its system in 1985.

According to OECD, pay-for-performance systems often exclude the highest positions in the public service and political appointees because of the difficulty of finding an appropriate person to assess performance for these positions. Also, the systems apply primarily to managerial staff, particularly senior managers, although in several countries coverage extends down to lower levels. Another pay-for-performance feature found among member countries is the use of lump-sum bonuses as a type of performance-linked pay award. They are normally awarded once a year and have to be re-earned each year. Bonuses may be expressed as a percentage of basic salary or a cash amount. The size of bonuses varies widely between systems, as does the method of selecting employees for awards.

A review of the OECD report indicates that member countries' performance appraisal systems are subject to the same types of problems associated with PMRS—insufficient performance standards, rating subjectivity, rating inflation, and a high administrative burden. For example, in the United Kingdom, a 1985 evaluation of the performance bonus system identified employee dissatisfaction with the system due to a lack of clarity in the system's criteria and procedures for distributing performance awards. Feelings of inequity were generated by the fact that the number and size of bonuses varied considerably from one department to another, and there was a perception that employees in more visible positions were more likely to get bonuses. The imposition of a 20-percent quota on the proportion of staff who could qualify for bonuses led to a widespread attitude that the bonuses were not worth competing for since only a small proportion could receive them.

The more recent performance-related pay systems, such as those used in the United Kingdom and Denmark, have sought to overcome these problems by linking rewards to performance appraisal outcomes, abandoning explicit quotas, and providing for more significant rewards. However, inadequate funding has hindered the operation of several pay-for-performance systems.

The United Kingdom's Pay-For-Performance System

The United Kingdom is progressively extending pay for performance throughout its public service after having piloted a pay-for-performance system for senior managers in 1985. After an internal evaluation of the pilot program in 1987, the system was revised and pay for performance has been gradually expanded to include other groups of employees. According to OECD, as of April 1990, virtually all nonindustrial civil servants are covered. Pay for performance has also spread in other areas of the public sector, including the National Health Service, public utilities, and local government.

The United Kingdom's system provides for step increases based on satisfactory performance and additional step increases for outstanding performance. In the United Kingdom system, employee performance is assessed annually using a five-level performance rating system. The five levels are outstanding, significantly above requirements, fully meets normal requirements, not fully up to requirements, and unacceptable. The appraisal system requires supervisors and employees to establish work objectives and performance standards upon which performance is rated.

The collective bargaining agreement establishes pay scales, divided into steps, for each covered pay grade. Each scale has a pay maximum but also has at least four steps above the maximum. These four steps are used to reward outstanding performers who have reached the normal pay maximum. Employees below the range maximum who receive an outstanding performance rating may receive an extra step increase. Employees at or above the pay range maximum are eligible for a step increase after one outstanding rating, three consecutive significantly above requirements ratings, or five consecutive fully meets normal requirements ratings. Also, there is a limit (generally 25 percent) on the number of staff that can receive step increases at any one time.

Canada's Pay-For-Performance System

Canada has had some type of pay for performance since the 1960s. It instituted a bonus program, in addition to existing performance-linked base salary increases, for senior managers in 1981, but the bonus system was not funded until 1985. In 1988, the system covered 4,537 managers—about 2 percent of total employees in the Canadian federal public service. The Treasury Board of Canada is the central agency with oversight responsibility for the pay-for-performance system. Performance appraisals are required annually at most government agencies. Employee performance is assessed using a five-level performance rating scale: outstanding, superior, fully satisfactory, satisfactory, and unsatisfactory. No more than 30 percent of employees can receive the top two ratings (outstanding and superior).

The Canadian appraisal system provides for both assessment of objectives achieved and a brief assessment of the employee's qualifications, including professional or technical competence, knowledge, skills and abilities, and responsiveness to the needs of other employees and of the public. Managers are appraised against a broad range of criteria relating to factors such as management of staff and other resources, communication with staff and the public, policy formulation, and negotiating ability. Individual agencies establish a set of performance elements under which supervisors and employees set work objectives and performance standards.

The Canadian pay-for-performance system for managerial employees was suspended for several years due to lack of funding, and even when it did operate, the rewards paid were often small. Since 1985, however, the system has been altered and funds have been made available for it to operate as intended.

There are no automatic pay increments under the Canadian pay-for-performance system. Salary increases for a given individual are determined solely on the basis of merit. Employees who are below the pay range maximum and who receive performance ratings at the fully satisfactory level and above can receive base salary increases of 0 to 10 percent. Performance award increase amounts vary by rating level as indicated in table 3.2.

Table 3.2: Canadian Performance Award Increases by Rating Level

Rating level	Increase as a percent of base salary
Outstanding	7 to 10%
Superior	5 to 7
Fully satisfactory	3 to 5
Less than fully satisfactory	0

Canada's pay-for-performance system also provides performance awards in the form of bonuses for staff who have reached the top of their salary scale. Employees who are at their salary range maximums and have performance ratings of fully satisfactory or above are eligible for performance bonuses of up to 10 percent. Individual bonus amounts are governed by the following guidelines:

- Those who receive a rating of outstanding are eligible for a bonus of up to 10 percent of their base salary.
- Those who receive a rating of superior are eligible for a bonus of up to 7 percent of their base salary.
- Those who receive a rating of fully satisfactory are eligible for a bonus of up to 5 percent of their base salary.

The Canadian pay-for-performance system controls the allocation of employee performance awards (base pay and bonus awards) through the use of quotas for the distribution of ratings. The number of employees assessed as "outstanding" should not exceed 5 percent of an agency's staff in any one year, and the number rated "superior" should not exceed 25 percent. Also, it is expected that approximately 65 percent of the staff will be rated as fully satisfactory and may be eligible for base pay increases of 3 to 5 percent of base pay.

Conclusions

As reported by OECD, 13 of its 24 member countries have implemented or are testing pay for performance concepts on an experimental basis. These countries are moving toward pay for performance as part of a more general movement towards flexible pay structures in the public service.

Much like our analysis of the states' systems, our analysis of other countries shows that OECD countries' pay-for-performance systems also vary in the groups of employees covered and in the appraisal and payout components of their pay systems. Further, these countries' pay-for-performance systems are subject to the same types of problems associated with the federal PMRS—such as insufficient performance standards and inadequate funding of performance awards for employees. Despite these problem areas, performance-based pay overseas represents a new way for many countries to attempt to motivate staff and make them more accountable for achieving results.

Letter Sent to State Personnel Agencies

GAO

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

General Government Division

August 16, 1989

Dear

The U.S. General Accounting Office, an evaluation arm of the Congress, is studying performance management systems. We are particularly interested in pay-for-performance systems--frequently called merit pay systems--that are designed to reward and motivate outstanding employees.

During our most recent studies of the federal government's pay-for-performance system for managers and supervisors, we found that the system was not functioning as well as intended. As part of our search for solutions, we are gathering information on how various state governments' pay-for-performance systems are designed and operated.

We would appreciate your help in this effort. We ask that you write to tell us whether your state operates a pay-for-performance system. If your state does operate a pay-for-performance system, we would like a brief explanation of the system and copies of any documents that explain the specific features of your performance management system as well as any studies made of it in recent years. To assist us in another area of our work, we would also like a description of the procedures your state uses to identify poor performers and to help them improve their performance.

If your state does have a pay-for-performance system, we would appreciate having the name of a person to contact for more information. Among other things, we would be interested in discussing the following questions:

-- When was it started and what number and categories of employees does it cover?

-- Who is responsible for preparing and reviewing performance appraisals, how many rating levels does the appraisal system have, and what adjectives are used to describe these levels?

-- What is the process used to determine who gets awards, bonuses, and base pay increases--for example, supervisory judgment, automatic payout based on ratings, or judgments of a "review panel"? If a review panel is used, how is it comprised?

-- What is the structure of awards, bonuses, and base pay increases, including the minimum and maximum dollar amounts and/or percentage of base pay provided for under law or regulations?

-- For the most recent year for which data are available, how many and what percentage of eligible employees received bonuses, awards, and base pay increases, and what were the range and average amounts in dollars and percentages of base pay?

-- What are employees' perceptions on the extent to which the system effectively rewards and motivates them, and whether they view the system as fair?

We would appreciate receiving your response as soon as possible. The return address is:

Bernard L. Ungar
Director, Federal Human Resource Management Issues
Room 3858A
U.S. General Accounting Office
441 G Street, NW
Washington, DC 20548.

If you have any questions, please contact Deborah Parker or Norman Stubenhofer on (202) 275-6557. Thank you for your time and contribution to our effort.

Sincerely,

Bernard L. Ungar
Director, Federal Human Resource
Management Issues

Respondents to Our Letter

1. Alabama
2. Arizona
3. Arkansas
4. California
5. Colorado
6. Connecticut
7. Delaware
8. District of Columbia
9. Georgia
10. Guam
11. Hawaii
12. Idaho
13. Illinois
14. Indiana
15. Iowa
16. Kansas
17. Kentucky
18. Louisiana
19. Maine
20. Maryland
21. Massachusetts
22. Michigan
23. Minnesota
24. Mississippi
25. Missouri
26. Montana
27. Nebraska
28. Nevada
29. New Mexico
30. New York
31. North Carolina
32. North Dakota
33. Ohio
34. Oklahoma
35. Oregon
36. Pennsylvania
37. Rhode Island
38. South Dakota
39. Utah
40. Virginia
41. Washington
42. West Virginia

43. Wisconsin
44. Wyoming

Additional Information on State Pay-For-Performance Systems

To further develop our information on state experiences with pay for performance, we visited 6 of the 23 states that reported having a pay-for-performance system. These states were Arizona, Florida, Idaho, Illinois, South Carolina, and Utah. The following information summarizes by state the type of pay-for-performance systems in use, the available statistical information on the systems, and state employees' views on how the systems are operating.

Arizona

Arizona first implemented its pay-for-performance system in January 1985. The system, entitled "Performance-Oriented Pay System" (POPS), replaced a standard governmental pay and merit system for state employees. The new pay system recognized and rewarded employees for performance rather than longevity of service. Under POPS, employees are awarded salary increases ranging from 1.2 percent to 7.5 percent of their base salary. In addition, agencies can grant 1-year special performance awards to those exceptional employees at the top of their salary range.

In order to administer the POPS program, performance standards and other job-related criteria were established in each agency to measure employees' performance. The appraisal component of the system was a management-by-objectives process entitled the "Performance Planning and Evaluation System." According to a state personnel official, however, the Performance Planning and Evaluation System was dropped in 1987 and replaced by a simpler and more uniform rating system with an automated processing capability, called the Employee Performance Appraisal System (EPAS). The change occurred due to concerns that the old system was too subjective and involved too much paperwork.

About 33,000 (62 percent) of Arizona's employees are covered by its pay-for-performance system. Generally, state legislative and judiciary, university, and public safety employees are not covered by the system. The Arizona Department of Administration oversees the system through the development of policies and procedures that address such personnel issues as awarding performance increases and annual performance assessment requirements.

Performance Appraisal System

Arizona's EPAS consists of performance factors, each of which is weighted according to its degree of importance to the job. Initially, 26 factors were available for use, but in 1988 the number was changed to 13 to simplify the process. Of the 13 possible factors, 3 are mandatory—

work habits, relationships with people, and policy and procedures. With the employee, the supervisor selects the applicable performance factors and weights. According to a state personnel department official, most supervisors use from three to six factors.

A numerical rating is determined for each performance factor based on the employee's performance appraisal documentation. Each performance factor is rated using a rating scale that contains four categories of performance, each of which is divided into two numerical scales—exceeds standard (7 and 8), standard (5 and 6), below standard (3 and 4), and unacceptable (1 and 2). A final cumulative numeric score or rating is generated by computer for each employee and is the basis for a performance award for the employee. Thus, the employee's pay is directly linked to the performance rating or appraisal.

Award Process

Arizona's performance award payout process allows state agencies to reward different levels of contributions by employees by providing base pay increases ranging from 1.2 percent to 7.5 percent. In addition, agencies could grant 1-year special performance awards to those exceptional employees at the top of their salary range. These awards are made on a lump-sum basis and must be within 2.5 percent to 5.0 percent of the employee's base salary. According to an Arizona Department of Administration official, agencies are granted a great deal of flexibility in granting performance awards. For example, the criteria for receiving special performance awards can either be the same or different from the criteria for regular base salary increases.

Employee Views

Overall, six of the eight employees we interviewed were satisfied with the pay-for-performance system and its administration by state government. They indicated that certain refinements, such as changing the biannual appraisal requirement to annual, were improvements to the system. Some of the employees thought that more money should be appropriated for the program, that higher increases should be awarded, and that subjectivity and favoritism still existed in the evaluation process at times.

Idaho

Idaho has had a pay-for-performance system since 1979. The goals and objectives of the system are to recognize different degrees of employee performance with differing salary rewards and to provide such increases solely on the basis of merit. However, until recently, Idaho's state legislature has not appropriated money specifically for its merit program. In 1989, the state legislature appropriated a 5-percent (of salary budget) increase for merit pay. Employee performance awards are in the form of salary increases and bonuses. Idaho has 9,366 state employees (about 65 percent of the state work force) covered by the state merit pay system.

The Idaho Personnel Commission has overall responsibility for overseeing the state merit pay system. However, each state department establishes its own procedures for merit pay administration within the general principles set forth by the Commission. Most state agencies within the Idaho pay-for-performance system use a five-level rating system for employee performance evaluations. The five levels are superior, very good, satisfactory, needs improvement, and unsatisfactory. Employees are evaluated once a year on their anniversary date, and there are no required interim reviews.

Performance Appraisal System

Idaho personnel law specifies that an employee's immediate supervisor is responsible for preparing the employee's performance evaluation. The performance evaluation process is individually structured by each state department or agency. The Personnel Commission makes available a standard appraisal form for this purpose; however, departments may revise or use their own appraisal forms. According to Idaho Personnel Commission officials, each department has sufficient flexibility for designing its performance appraisal process. For example, some state agencies use four rating levels rather than the five levels suggested by the Commission.

Performance Award Payout Process

The Idaho State Legislature is the funding source for pay-for-performance money. The funding for performance-based salary increases, which has to be appropriated each year by the legislature, was not provided until 1989. In that year, the State Legislature appropriated about $19 million for merit increases to be awarded, in increments of 2.5 percent, to employees rated satisfactory or above. Also, employees at their salary maximum are eligible to receive a bonus award of up to $1,000 per year.

Different state agencies implemented the performance award process in different ways in 1989. Some chose to award all eligible employees a 5 percent merit increase in order to make awards to as many employees as possible. Other agencies, such as the Idaho Personnel Commission, chose to make merit awards based on a combination of performance appraisals and employee position within the step pay range. (See table III.1.)

Table III.1: Awards as a Percentage of Base Pay in Idaho, Fiscal Year 1989

	Pay Steps		
Rating	A to C	D to H	I to M
Superior	10.0%	7.5%	5.0%
Very Good	7.5	5.0	2.5
Satisfactory	5.0	2.5%	2.5%

The state personnel director estimated that for fiscal year 1989 about 72 percent of eligible employees received merit increases. The average annual performance-based pay award was about $1,000, representing about a 2.5 percent increase. No information was available for the amount spent on bonuses.

Employee Views

Nine of 12 state employees we interviewed thought that the overall strength of Idaho's pay-for-performance system was that it offered a means for rewarding exceptional performers. However, the employees also thought that merit pay funding levels were either inadequate or inconsistently provided.

Illinois

Illinois' pay-for-performance system—the Merit Compensation System—has been in operation since 1978. The system covers approximately 11,000 employees in professional, supervisory, or managerial positions not subject to collective bargaining. It features an annual performance evaluation that requires managers to give an overall rating based on attainment of pre-established objectives. Employees' anniversary dates are used as the basis for timing the appraisal process and annual performance increases. Illinois uses four rating levels under the performance appraisal portion of its pay-for-performance system.

The Illinois Department of Central Management Services oversees the Merit Compensation System and, each year, issues a merit compensation plan to be followed by participating agencies. Under this plan, performance awards or base salary increases vary in amount, depending on the employees' level of performance and position in the state salary range. To assure equity among state agencies, an average salary increase guideline is assigned to each agency. Each agency must control its performance awards during the year to assure that the guideline is followed.

The Illinois Department of Central Management Services suggests that performance plans be updated quarterly but does not require formal interim ratings. In general, implementation of the performance appraisal system is decentralized to the state agencies and departments. Although the state personnel department does not prescribe rating distributions, a personnel official told us that some state agencies have told raters not to give superior performance ratings because of budget constraints.

Performance Appraisal System

Illinois used a management-by-objectives performance appraisal system with four rating levels—significantly surpasses, fully accomplishes, marginally accomplishes, and unacceptable.[1] State merit compensation employees are rated on each objective included in their employee performance plan, but there is no set formula to calculate an overall summary rating. Instead, managers subjectively weigh the importance of each objective in determining the summary rating.

Performance Award Process

At the beginning of the fiscal year, Illinois' Department of Central Management Services publishes suggested salary increase ranges for each rating level. The Department bases its suggested increase ranges on market pay data, the state budget situation, and the size of union contract increases. These centralized payout guidelines were adopted to ensure some degree of consistency in performance awards among state agencies. For fiscal year 1990, the Illinois Department of Central Management Services provided state agencies with merit increase guidelines or goals for the range of individual performance award amounts (expressed as a percentage of base salary) to be granted at each performance rating level. Additionally, the personnel department asked that all agencies maintain approximately a 4-percent average merit compensation increase during fiscal year 1990.

[1]Effective July 1, 1990, Illinois changed its number of rating levels to five—superior, exceeds expectations, meets expectations, needs improvement, and unacceptable.

Table III.2: Illinois Merit Increase Guidelines, Fiscal Year 1990

Rating	Increase as a percent of base salary
Significantly surpasses	5 to 8%
Fully accomplishes	2 to 5
Marginally accomplishes	0 to 2
Unacceptable	0

Merit Compensation employees do not receive general cost-of-living increases; all available funds are used for the performance-linked increases. Performance award increases are paid to employees on their anniversary dates rather than at one specific date every year. Having ratings and payouts spread out throughout the year spreads out the performance assessment work load. In addition to base pay performance awards, Illinois awards "intermittent increases" to employees for outstanding performance. Intermittent increases are permanent base salary increases that can be awarded to an employee for outstanding performance at a time other than the employee's anniversary date. Agencies awarded 384 intermittent increases in fiscal year 1989 totaling $44,000.

Employee Views

All six of the state employees we interviewed said that the size of individual performance awards (4 percent of average base pay increases) under the state's pay-for-performance system was too small to motivate employees to perform better. Further, three of the six employees believed that, due to the limited funding available for performance awards, some supervisors rated their employees similarly so that all employees received the same performance award amount. The employees said that they believed this practice undermined the principle of merit pay.

Florida

Florida has had a merit pay system since 1968, but the system has not always been funded. The goals and objectives of Florida's merit pay system are to recognize different degrees of performance with differing salary rewards and, when funded, to provide salary increases on the basis of merit. Florida uses a three-tier rating system under the performance appraisal portion of its merit pay system. Statewide appraisal guidelines issued by the Florida Department of Administration, the agency that oversees the merit pay system, require that each employee at least annually receive a performance appraisal based on standards defined and identified as being part of the requirements of their position.

Florida's merit pay system covers about 98,000 career service employees. Essentially, all state employees except those who are elected or appointed are covered. Merit funding was not appropriated for fiscal year 1990 by the state legislature. Merit funding was available in fiscal years 1985 through 1989, when the Florida legislature appropriated 1.5 percent of the total base salary paid to career service employees.

Performance Appraisal System

Florida's performance appraisal guidelines require that supervisors and employees meet at least annually, at the end of the employee's appraisal period, to assess performance in relation to the performance standards that have been set for the position. For career service employees, the performance appraisal period is based on the employee's anniversary date. Employees are rated using a three-level rating scale. The three levels are exceeds performance standards, achieves performance standards, and below performance standards.

A Florida Department of Administration analyst told us that the state has no overall policy that sets the distribution of performance ratings. In practice, however, most employees are rated as achieving performance standards.

Performance Award Process

According to an Administration official, over the last few years, merit funds were either not appropriated or the funding levels were particularly small. Although the Florida legislature did not appropriate funds for merit pay for fiscal year 1990, the occupations of Professional Health Care, Law Enforcement, and Security Services (Correctional Officers) did receive appropriations for longevity-based increases.

State instructions for merit pay for fiscal years 1986 through 1989 required that only those employees currently rated "Exceeds Performance Standards" were eligible for merit pay increases. Each state agency head is responsible for developing the specific criteria for determining which employees should receive merit increases, determining the percentage increase to be given, and informing all employees of the selection criteria. State employees at or above the maximum of the salary range were granted either a lump-sum bonus or an increase to their base rate of pay, depending on the specific instructions for that fiscal year. According to a Department of Administration official, statistical information on merit payouts for previously funded fiscal years was not readily available.

Employee Views

According to responses from 25 state employees we interviewed about the overall strengths of Florida's program, 12 said that the program provided a means for rewarding exceptional employees, 9 said that it provided hope for rewarding good performers, and only 5 said that it offered a way for employees to move through the pay range. Regarding overall weaknesses of Florida's program, 15 of 25 employees said that funding was inadequate, 6 said that funding was inconsistent, 6 said that ratings were inconsistent, and 5 said that favoritism existed in the award selection process.

South Carolina

South Carolina has had a merit pay program since 1971. However, officials said that, since 1982, the South Carolina Legislature has not shown a strong commitment to the merit pay program. During this 7-year period, merit increases were authorized in only 2 fiscal years at an average merit increase of 2 percent and 1 percent of the state salary base.

The goals and objectives of South Carolina's pay-for-performance program—the Employee Performance Management System—are to recognize different degrees of performance with differing salary rewards and to provide salary increases solely on the basis of merit. The program is centrally administered by the Human Resource Management Division of state government and covers about 57,000 state employees. Unclassified employees, such as teachers, college professors, and executive compensation employees are not covered by the state's pay-for-performance system.

Performance Appraisal

Employees are rated annually on the their employment anniversary dates. The state does not require or suggest interim performance reviews. According to a state compensation official, the employee has a role in setting expectations at the beginning of the performance appraisal period. South Carolina does not use performance standards. Normally, the employee and the supervisor jointly write the employee's position description, which lists the duties the employee is performing or has been assigned. South Carolina has four performance levels. These levels are substantially exceeds performance requirements, exceeds performance requirements, meets performance requirements, and below performance requirements.

According to a state compensation official, South Carolina does not have a policy on forced rating distributions. However, according to personnel officials from one state department, quotas on the number of employees who could be rated as exceeding performance requirements were set by the department in order to manage merit funds.

Although complete data on employee performance ratings were not readily available, the information we were able to obtain on the distribution of employee performance ratings for fiscal years 1984 through 1989 is shown below.

Table III.3: South Carolina Employee Performance Ratings by Fiscal Year

	Number of employees rated at each level					
Rating	**1989**	**1988**	**1987**	**1986**	**1985**	**1984**
Below requirements	4	4	3	5	7	8
Meets requirements	31,845	32,289	37,710	30,735	30,887	27,633
Exceeds requirements	7,321	6,556	6,166	5,997	6,798	4,249
Substantially exceeds requirements	119	[a]				

Note: Table reflects data as of June 30 each year.
[a]Substantially exceeds level was added to appraisal system in July 1989.

Performance Award Process

The South Carolina Legislature, which is the funding authority for merit pay funds, has not appropriated funds for a merit increase since fiscal year 1988. In that year, the merit increase was 1 percent. State personnel guidelines at that time provided for agencies to award increases in amounts up to 3 percent, provided that in the aggregate, all increases average 1 percent of base salary.

Although the state legislature did not consistently fund the merit pay program in recent years, state employees continued to receive annual cost-of-living increases. In the last 2 years the cost-of-living increases were 4 percent a year. In addition to these increases, during fiscal year 1989, the state gave out $12 million in bonus funding at an average of $365 per employee. This bonus was not related to performance and was provided to state employees. To be eligible for a merit increase, an employee must have a current performance appraisal with a rating of at least "meets performance requirements."

Employee Views

In general, 6 of the 11 South Carolina employees we interviewed considered the overall strength of the state's pay-for-performance program to be that it provided a way for exceptional employees to move through the pay range. Also, 8 of the 11 employees cited merit pay funding as an area needing reform.

Utah

Utah first implemented pay-for-performance in 1969 with the intent to promote open communication between managers and employees and to assess employee performance according to predefined standards. Currently, Utah requires that each employee have a performance plan and receive an annual performance rating based on this plan. Utah uses a three-tier rating system under the performance appraisal component of its merit pay system.

About 14,000 of the state's approximately 35,000 employees are covered by the merit pay system. State elected officials, members of the judiciary, and various state boards are not covered. The Utah Department of Human Resource Management oversees the merit system through the development of rules and policies that address such governmentwide issues as the number of performance rating levels, how performance should be related to pay, and annual performance assessment requirements. State agency responsibilities include setting internal time frames for conducting performance appraisals, establishing a performance management implementation strategy, educating and training employees about performance management, maintaining the performance management system, and reviewing its internal effectiveness.

Performance Appraisal System

Employees are rated annually in May, and, although the state does not require them, the Department of Human Resource Management strongly suggests that state agency supervisors complete quarterly interim reviews. At the beginning of the rating period, supervisors and employees are required to mutually establish work objectives and performance expectations in a written performance plan. Employees are rated as either exceptional, successful, or unsuccessful. Although Utah Department of Human Resource Management officials said the state does not have a policy on setting performance rating distributions, the Department issues to the agencies an expected rating distribution to guide agencies in monitoring ratings for the forthcoming fiscal year. The following guidelines were in effect for the 1989 fiscal year performance appraisal period:

Table III.4: Utah Performance Appraisal Guidelines, Fiscal Year 1989

Rating	Expected distribution
Exceptional	20%
Successful	78
Unsuccessful	2

Salary Increases and Bonuses

Utah merit pay employees are eligible for cost-of-living or general increases and also for merit increases that are additions to base salaries based upon performance ratings. The state legislature appropriates funds annually for each type of increase as a percentage of covered employees' aggregate payroll. The state legislature did not fund merit pay increases in 6 of the last 11 years, as table III.5 indicates. The 1989 merit increase appropriation of 2.5 percent of payroll was equal to approximately $6.3 million.

Table III.5: Utah Merit Increase Funding as a Percent of Payroll, Fiscal Years 1979-1989

Year	Merit increase	Year	Merit increase
1979	0.0%	1985	2.0
1980	0.0	1986	0.0
1981	4.0	1987	0.0
1982	4.55	1988	0.0
1983	0.0	1989	2.5
1984	1.25		

As shown in table III.6, for fiscal year 1989, the Department of Human Resource Management provided state agencies with rules on the range of individual merit increase amounts. These increases are expressed as a percentage of base salary and are to be granted at each performance rating level.

Table III.6: Utah Merit Increase Guidelines, Fiscal Year 1989

Rating	Increase as a percent of base salary
Exceptional	3.0 to 6.0%
Successful	2.0 to 2.5
Unsuccessful	0.0

Because 1989 merit increase funding was limited to 2.5 percent of agency payroll, when one employee received an increase of greater than 2.5 percent, another employee had to receive less than 2.5 percent. Employees at the top of their pay ranges are not eligible for merit increases. Department of Human Resource Management officials told us that data on merit increase amounts broken down by performance rating levels were not readily available.

Employee Attitudes

In our initial meeting to discuss plans for gathering information on Utah's pay-for-performance system, state personnel officials requested that we not present employee views.

Amounts Spent by States on Performance Awards for Fiscal Years 1987 Through 1989

Dollars in millions

State	Performance award amounts FY 1987	FY 1988	FY 1989	Average annual performance award amount per employee
Alabama	N/A	N/A	N/A	N/A
Arizona	N/A	N/A	$14.3	[a]
Arkansas	N/F	$8.5	8.6	$460
California	$1.4	1.4	1.4	[b]
Connecticut	3.5	3.9	4.1	1,650
Florida	N/A	N/A	N/A	4%[c]
Idaho	N/A	N/A	$19.0	$1,000
Illinois	N/A	N/A	15.9	1,616
Indiana	[d]	[d]	N/F	4%[d]
Iowa	N/A	N/A	N/A	N/A
Kentucky	N/F	N/F	N/F	N/F
Maryland	N/A	N/A	N/A	N/A
Massachusetts	N/F	N/F	N/F	N/F
Michigan	$0.4	$0.5	N/A	$2,831
Minnesota	N/A	N/A	N/A	N/A
Mississippi	N/F	N/F	N/F	N/F
Nebraska	$5.0	$6.0	$6.0	400
New York	N/A	N/A	9.6	N/A
Oregon	N/A	N/A	N/A	N/A
South Carolina	N/F	N/A	N/F	1%[e]
South Dakota	N/F	N/F	N/F	[f]
Utah	N/F	N/F	$6.3	$495
Wisconsin	N/A	N/A	N/A	1,130

N/A = Performance pay funded but state financial data not available.

N/F = State pay-for-performance system not funded.

[a]No statewide performance award data were available. However, range of awards was available for one of the larger state agencies—$391 to $952 per employee for FY 1989.

[b]Average performance award amount for FY 1989 was $1,750 for managers and $500 for supervisors.

[c]In fiscal years 1985-1989, the Florida legislature appropriated 1.5 percent of the total base rate of pay for all career service employees, resulting in increases ranging from 3 percent to 5 percent for eligible employees. For the FY 1990 performance pay period, no performance increase funds were appropriated. No other performance payout statistics were available.

[d]Performance award amounts were not available. State pay for performance funded in FY 1987 at 4 percent and FY 1988 at 4.25 percent of total state salary base. For FY 1988, the average annual employee performance award was 4 percent of base pay.

[e]Performance award amounts were not available. For FY 1988, the average annual employee performance award was 1 percent of base pay.

[f]A performance-based cash bonus program entitled "merit cash" was authorized in 1990. South Dakota state employees may receive, in cash, 1.75 percent of base pay up to a maximum of $500.

Major Contributors to This Report

General Government Division, Washington, D.C.

Norman A. Stubenhofer, Assistant Director, Federal Human Resource Management Issues
William Trancucci, Evaluator-in-Charge
Deborah L. Parker-Junod, Evaluator
Ernestine Burt, Secretary

Atlanta Regional Office

Clyde James, Evaluator
Kathy Alexander, Evaluator

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