

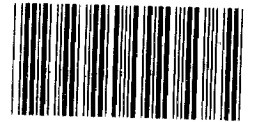
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STATEMENT OF

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BEFORE THE

SUBCOMMITTEE ON COMPENSATION AND EMPLOYEE BENEFITS
OF THE HOUSE POST OFFICE AND CIVIL SERVICE COMMITTEE

ON

[THE FEDERAL MERIT PAY PROGRAM]

Madam Chair and Members of the Subcommittee:

We are pleased to be here today to discuss our work on the Federal Merit Pay Program.

Under the Civil Service Reform Act of 1978 (CSRA), pay increases for management officials and supervisors in grades GS-13 through 15 are, by October 1, 1981, to be based on their performance. The Office of Personnel Management (OPM) estimates that approximately 100 agencies will be required to implement pay-for-performance systems. These systems could be used to compensate as many as 152,000 employees.

Merit pay is a dramatic departure from past compensation practices. It represents a new, previously untried approach for the Federal Government and will be watched closely by many observers, particularly those employees whose livelihoods are

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affected. We, too, have been monitoring the program as it develops. If merit pay is to work, it is crucial that it be implemented properly.

As the October 1 deadline nears, we are concerned about whether agencies are ready to make sound merit pay decisions on the basis of performance appraisals. Also, we believe OPM's method for computing agencies' merit pay funds does not accurately reflect the amount of money allowed under CSRA.

With regard to agency readiness, performance appraisal experts in private industry say good performance appraisal systems take 3 to 5 years to develop with much testing and evaluation. By October 1, many agencies will not have pretested their systems. Officials at several agencies that have pretested believe more work is needed before sound pay decisions can be made. Because pay decisions affect so many Federal managers, the Government has a responsibility to insure that sound, pretested pay-for-performance systems are in place before pay decisions are made.

In connection with funding, OPM's method for computing agencies' merit pay funds will result in the Government spending more than is permissible under the law. Unless the method is changed, the Government will spend more each year than it would otherwise have spent had merit pay employees remained under the General Schedule.

Our March 1981 report 1/ highlighted concerns with the Federal Government's planned implementation of pay-for-performance

1/"Federal Merit Pay: Important Concerns Need Attention," (FPCD-81-9, Mar. 3, 1981).

systems. For that assignment, we examined, during 1979 and early 1980, the progress OPM and 23 Federal agencies were making in developing performance appraisal and merit pay systems. Our report pointed out several problem areas that needed further work before payouts were made: (1) many agencies were not planning to pretest their systems, (2) additional pay-for-performance training needed to be developed, (3) many agencies had not defined the specific objectives they wanted their systems to accomplish, nor were they developing or using evaluation plans, (4) implementation cost information was not being maintained, and (5) criteria for determining who to include or exclude from merit pay was not clear.

We made recommendations to OPM to help correct those problems. While OPM agreed with the concerns brought out in this report, it has not taken appropriate corrective action.

In late 1980 and early 1981, we reviewed six of the eight agencies that made merit payouts in October 1980 and analyzed data on employees' attitudes from a Merit Systems Protection Board (MSPB) questionnaire to evaluate how well those six agencies did under "live" conditions. We reviewed merit payouts at OPM, Small Business Administration (SBA), Environmental Protection Agency (EPA), Commission on Civil Rights (CCR), Civil Aeronautics Board (CAB), and Farm Credit Administration (FCA). We did not review the Selective Service and Metric Board because of the small number of merit pay employees involved. To assess the readiness of the Federal Government in meeting the October 1981

deadline, we also had discussions with 15 agencies that will be making merit pay decisions this October.

This work has shown that great effort and resources are being expended, but we have serious concerns over the quality of systems that will be used to make pay decisions. As a result of our work, we are convinced that OPM needs to take further action to resolve existing performance appraisal and merit pay problems.

MERIT PAY COMPUTATION AND COVERAGE

OPM's method for computing agencies' merit pay funds will result in the Government spending from \$58 to \$74 million more each year than it would have if employees remained under the General Schedule pay system. At the three largest agencies that made merit payouts in 1980, payroll costs for merit pay employees were approximately \$1 million, or 1.2 percent, more than they would have been under the General Schedule. Furthermore, OPM's merit pay computation formula permits funds that cannot be paid to employees at the \$50,112.50 statutory pay ceiling to be used to reward employees below the ceiling. The increase in payroll costs and the use of "capped money" is not permissible, however, because the CSRA restricts the amount available for merit pay to the amount which would have been spent on within-grade step increases, quality step increases and comparability adjustments under the pre-merit pay system. Thus, the sum in each agency's salary and expense appropriation for merit pay is limited to these amounts.

As we noted in our earlier report on merit pay implementation, concerns have emerged as to which GS-13 through GS-15

employees should be included or excluded from merit pay. CSRA states that supervisors and management officials in grades GS-13, 14, and 15 are to be included in the merit pay program. However, several officials in the eight agencies that made payouts in 1980 agreed that the coverage guidance provided by OPM was general and allowed them considerable leeway in deciding whom to include in merit pay. As a result of this latitude, some employees who are not actually management officials may be included in merit pay. One agency official, for example, speculated that some "problem" employees were probably put into merit pay simply so they could be "dealt with," since the official felt it was practically impossible to take punitive actions against General Schedule employees.

PERFORMANCE APPRAISAL

The CSRA requires that merit pay decisions be based on performance appraisals and our work indicated that the adequacy of performance appraisals will ultimately affect the quality of employee performance. Merit pay employees in the eight agencies that made payouts in October 1980 responded to the MSPB questionnaire that, when performance appraisals were fair, merit pay distributions would be fair, and good or improved performance would be encouraged. Unfortunately, where performance appraisal problems exist and appraisals are not viewed as being fair, the opposite of this is probably true.

Our review at the six agencies making payouts in October 1980 disclosed numerous performance appraisal problems that are critical

to implementation. Unless actions are taken to correct these problems, chances of success are questionable.

Pretest

We have previously recommended that OPM require all agencies to pretest their entire pay-for-performance systems prior to full implementation. This would allow agencies and OPM to identify potential problems and assess agencies' readiness to implement merit pay. In addition, pretests would give managers experience in conducting appraisals and enhance employee acceptance of merit pay. Four of the six agencies did not completely and adequately pretest their appraisal systems before making merit pay determinations. Some of these agencies had problems which seriously affected the integrity of their pay-for-performance programs.

We recognize that pretesting is not an end in itself. The way an agency handles the problems identified by pretest also affects its value. For example, OPM pretested its own system three times before making an actual merit payout, refining and testing again until major problems were corrected. As a result, OPM's merit pay employees' attitudes toward performance appraisal and merit pay are more positive than at any other agency.

SBA, on the other hand, identified problems through pretests but management action to address these problems did more harm than good.

Seven of the 15 agencies that we visited that plan to make initial payouts this October did not conduct a pretest of their system and one did so in only certain areas of their system.

Several officials said tests were not conducted because they did not have adequate time.

Standard-setting

Standard-setting is a crucial phase of the performance appraisal process because it is the basis for all appraisal actions. Each of the six agencies experienced difficulty with performance standard-setting. Lack of employee participation in standard setting and the use of overly quantitative standards to the exclusion of qualitative measures were the primary problems.

All of the 15 agencies preparing to payout in October 1981 that we visited have set performance elements and standards for their merit pay employees. However, ten of the 15 agencies will have performance appraisal periods of less than 1 year. For most employees, the Federal Personnel Manual states that 120 days is considered to be the minimum amount of time in which a supervisor would be able to make an objective performance appraisal of a newly promoted or reassigned employee. However, in two agencies, the appraisal periods will be as short as 90 days for some employees.

Higher level review

OPM regulations require an agency official at a higher level than the supervisor to review the performance appraisals used in determining merit pay to make sure consistent performance criteria are used to appraise employees. All six agencies we visited had developed procedures for this higher level review; however, here too, we found problems. Two of the six agencies used arbitrary and subjective criteria rather than preestablished

performance standards to make management review changes to appraisals. This has resulted in numerous employee grievances being filed.

READINESS FOR OCTOBER 1981
MERIT PAYOUTS

We questioned officials at 15 agencies about performance appraisal and merit pay systems they would be implementing this October. Merit pay employees in these 15 agencies comprise between 40 and 50 percent of the approximately 120,000 to 152,000 merit pay employees throughout the Government. The results of this review reinforce our concerns over the limited extent pre-testing is being done before payouts and the questionable quality of performance standards on which to base pay decisions. These concerns, in our opinion, raise serious questions over the readiness of some agencies to implement merit pay. While the degree of preparation varied considerably, many of the agencies do not appear ready to effectively implement merit pay.

One item of particular concern to these agencies is OPM's policy guidance on the number of performance standards required for each job element. In January 1981, OPM's General Counsel issued an opinion saying that agencies could not project more than one level above or below a defined standard of performance. According to OPM, however, agencies making merit payouts effective October 1, 1981, may choose to comply with this new guidance in 1981 or wait until fiscal year 1982 to comply. While this could relieve the problem of having to redefine standards in the middle of an appraisal period for those agencies choosing

to postpone compliance, it causes another potentially serious problem. OPM has warned agencies choosing not to comply that, technically, their systems are not in accordance with OPM guidance. This could leave the agency open to lawsuits from employees who wish to contest any personnel decisions made as a result of their performance appraisals.

OPM LEADERSHIP

Under the CSRA, OPM has the responsibility to assure the effective implementation of the merit pay program. This responsibility covers a broad range of activities from policy development to insuring agency compliance with civil service rules and regulations. In fulfilling these duties, OPM has taken what it terms a decentralized and nonprescriptive approach in order to give agencies considerable flexibility to design their own systems. However, this approach may not be providing the leadership needed to insure quality merit pay programs.

OPM's current priority is to insure that all agencies meet the October 1, 1981, deadline for merit pay determinations. Most of its efforts have been spent on reviewing and approving agencies' performance appraisal and merit pay plans for compliance with the law, rather than on assessing the quality of these systems or assuring that they operate properly.

OPM officials have stated publicly that they expect some systems will be poor and even anticipate failures. They believe this should be expected when implementing a program of this magnitude. We believe that the merit pay program is too important to allow agencies to implement programs that OPM believes may fail.

We believe that OPM needs to take a more aggressive leadership role in assuring that agency merit pay systems are fairly and effectively implemented. Without assessing the quality of each agency's system, and because OPM is required to implement by October 1981, the likelihood of system success is questionable.

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In summary, we believe OPM needs to provide more aggressive leadership in insuring the effective implementation of pay-for-performance systems. We have serious concerns about the quality of agency systems on which pay decisions will be made and believe several actions should be taken before agencies make merit payouts.

We believe the Congress should enact legislation to postpone the October 1981 mandatory merit payout date. This would enable OPM to require agencies to pretest their entire pay-for-performance systems, from standard-setting through the performance appraisal and the merit payout, before making actual merit pay determinations. We believe pretesting will help to gain employee acceptance and increase system credibility.

We recognize there is some danger in delaying payouts because it could remove some of the impetus that agencies had to implement this year. However, we believe delaying payouts and risking some change in the program's momentum is outweighed by the benefits of pretesting and the avoidance of possible grievances or lawsuits from inadequate performance appraisal and merit pay systems.

At the very least, OPM should require agencies that have not pretested their entire pay-for-performance systems to petition the President for exclusion from the October 1981 deadline. Only

those agencies that have already fully pretested and demonstrated the reliability of their systems should be permitted to pay out in October 1981 as originally scheduled.

In addition, OPM should be directed to work closely with the individual agencies to establish and meet new mandatory dates which allow for full pretesting and debugging. OPM should also be required to certify, before payouts are made, that agencies have demonstrated, through pretesting, that their programs fairly and accurately link pay to performance. Agencies unable to meet the new deadline established for them would be required to petition the President for further exclusion.

We also believe all agencies, before they make merit pay determinations, should be required to comply with OPM's guidance and General Counsel opinion stating that agencies cannot project more than one level above or below a defined standard of performance. Otherwise, according to OPM, agencies could be open to employee lawsuits.

Because the CSRA restricts the amount available for merit pay to the amount which would have been spent under the previous pay system, OPM must:

- Revise its merit pay computation formula to conform with CSRA provisions to insure that payroll costs under merit pay do not exceed what would have been paid had the General Schedule pay system remained in place for merit pay employees.
- Insure that merit pay funds attributable to employees at the \$50,112.50 ceiling are not used to reward employees below the ceiling.

Our other tentative recommendations are that OPM should require agencies to:

- Insure employee participation in developing performance standards that address the most important elements of the employee's job in both qualitative and quantitative terms.
- Use performance standards that have been agreed to at the beginning of the appraisal period as the basis for performance evaluations and require those managers responsible for reviewing performance appraisals to also review and approve performance standards early in the appraisal period.
- Have performance standards in place a minimum of 120 days before making pay decisions based on those standards.

In addition, OPM should develop clearer and more specific guidance for determining who should be covered by merit pay.

We plan to issue a report later this summer on our work at six of the eight agencies to implement merit pay in 1980 and at selected agencies preparing to make payouts in 1981. This report will include our detailed findings as well as some specific recommendations for changes in the merit pay program.

This concludes my statement. My colleagues and I will be happy to answer any questions you may have.