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ABSTRACT

The Civil Service Reform Act of 1978 created the merit pay system and cash award program for federal supervisors and management officials in General Schedule grades 13 through 15. This report assesses the implementation and operation of merit pay for fiscal years 1981 and 1982 at three departments--Agriculture, Housing and Urban Development, and Navy--that employed 28,000 employees under merit pay systems (25 percent of all federal merit pay employees). Data analyzed in the reprot are from interviews with officials, reviews of performance appraisal and pay statistics, analysis of performance ratings of 475 employees, and questionnaires administered to a sample of merit pay employees. The study also separated out and analyzed the responses of top performers. Several areas requiring management attention were discovered: (1) factors other than employee performance have influenced the amount of merit pay employees have received; (2) both the performance standards and the procedures used to establish them need to be improved; (3) Office of Personnel Management efforts to evaluate agencies' merit pay programs have been limited in scope, but are improving; and (4) employee perceptions of the merit pay program were low. Half of the document is composed of 13 appendixes. (MLF)

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ED244354

BY THE COMPTROLLER GENERAL
Report To The Chairwoman, Subcommittee On Compensation And Employee Benefits Committee On Post Office And Civil Service House Of Representatives
OF THE UNITED STATES

A 2-Year Appraisal Of Merit Pay In Three Agencies

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The Civil Service Reform Act of 1978 requires agencies to establish a merit pay system for management officials and supervisors in grades 13 through 15. GAO's review of the 1981 and 1982 merit pay cycles in three agencies employing about 25 percent of the total federal merit pay population found several areas requiring management attention.

--A number of factors other than employee performance have influenced the amount of merit pay employees received.

--Although performance standards were better in 1982 than in 1981, both the standards and the procedures used to establish them need to be improved.

--OPM efforts to evaluate agencies' merit pay programs have been limited in scope, but recent initiatives to strengthen these efforts are a step in the right direction.

--Employee perceptions of the merit pay program were low.

The agencies involved, the Departments of Navy, Agriculture, and Housing and Urban Development, and the Office of Personnel Management, reviewed a draft of this report and generally agreed with its conclusions and recommendations.

UNITED STATES GENERAL ACCOUNTING OFFICE

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COMPTROLLER GENERAL OF THE UNITED STATES
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B-203022

The Honorable Mary Rose Oakar
Chairwoman, Subcommittee on
Compensation and Employee Benefits
Committee on Post Office and
Civil Service
House of Representatives

Dear Madam Chairwoman:

This report, in response to your request, assesses the merit pay experiences of the Departments of Agriculture, Navy, and Housing and Urban Development during 1981 and 1982.

The report also makes recommendations to the Director, Office of Personnel Management, for ensuring greater equity in performance ratings and pay in an effort to improve employee acceptance of the merit pay system.

As arranged with your office, unless you publicly announce it contents earlier, we plan no further distribution of this report until 7 days after the date of the report. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

Charles A. Bowsher

Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE CHAIRWOMAN, SUBCOMMITTEE ON COMPENSATION AND EMPLOYEE BENEFITS, COMMITTEE ON POST OFFICE AND CIVIL SERVICE HOUSE OF REPRESENTATIVES

A 2-YEAR APPRAISAL OF MERIT PAY IN THREE AGENCIES

D I G E S T

The Civil Service Reform Act (CSRA) of 1978 created the merit pay system and cash award program for federal supervisors and management officials in General Schedule grades 13 through 15. In fiscal year 1982, about 108,000 employees were covered by merit pay. (About 80,000 GS-13's through 15's were not designated as managers or supervisors.) Merit pay employees are not guaranteed the annual salary adjustments that most General Schedule employees receive. Instead, under this system, which became effective governmentwide in October 1981, merit pay employees are guaranteed only half the annual adjustment; the other half of the adjustment along with their within-grade increases goes to a fund for a particular organizational group called a merit pay pool. Employees within the pool compete with each other, based on their performance ratings, for permanent salary increases to be paid from the merit pay fund.

The Chairwoman, Subcommittee on Compensation and Employee Benefits, House Committee on Post Office and Civil Service, asked GAO to review agency experiences with the transition to merit pay. This report assesses its implementation and operation for fiscal years 1981 and 1982 at three Departments having about 25 percent of all federal merit pay employees: Agriculture, Housing and Urban Development, and the Navy. (See p. 1.)

A major concern of merit pay employees has been that they are not guaranteed the full annual adjustment and within-grade increases. About half the merit pay employees surveyed by GAO in 1981 and 1982 wanted to return to the General Schedule for their annual and within-grade pay increases rather than remain under merit pay as implemented in their agencies. Among the agencies' top performers who received the highest ratings, between 28 and 42 percent in each agency wanted to return to the General Schedule. About 40 percent of the employees support the concept of merit pay but many believe it has not been administered fairly and should be revised. (See pp. 49 to 50 and app. III.)

The Office of Personnel Management (OPM) has proposed regulations that would alter the merit pay program. Also, members of the Congress have introduced legislation that would make basic changes to the merit pay system. Both the proposed regulations and the legislation would guarantee the entire annual pay adjustment for employees rated satisfactory or better. In addition, OPM's proposed regulations that were scheduled to go into effect November 25, 1983, would have guaranteed these employees the equivalent of the within-grade increase they would have received under the General Schedule. The proposed regulations also contained changes to the government's reduction-in-force rules, and the Congress enacted legislation to block the implementation of the regulations. In response to a suit by the National Treasury Employees Union, and while the Congress was adjourned, on December 30, 1983, the regulations were declared null and void by the U.S. District Court, and OPM was enjoined from directly or indirectly implementing them. (See pp. 54 to 55.)

NONPERFORMANCE-RELATED FACTORS IN CURRENT MERIT PAY PRACTICES

The CSRA requires that agencies establish merit pay systems which shall

> "use performance appraisals as the basis for determining merit pay adjustments."

However, other factors unrelated to employee performance can influence merit pay increases and may never be completely eliminated. GAO's review showed that a number of nonperformance factors have influenced the size of merit increases awarded to individual employees more than is necessary. These factors have also contributed to negative employee perceptions of merit pay, even among the top performers who received the largest payouts. Among these factors were (1) inconsistencies among raters, (2) the distribution of ratings within the merit pay pool over the various performance levels, (3) the grades and types of employees in the merit pay pool, and (4) agencies' formulas for distributing increases. (See pp. 6, 7, 14, and 19.)

In judging performance, some supervisors are lenient and some are strict; this has a direct bearing on the consistency of ratings and the eventual size of merit pay increases. Consistency between raters can be a concern because of differences in perspectives of different supervisors. However, since the advent of merit pay, these differences assume greater significance because the employees' merit increases are tied directly to the appraisal. (See p. 6.)

The way ratings are distributed among members of a particular merit pay pool affects the size of the merit pay increases for pool members. For instance, if a merit pay pool contained only a few employees rated at the highest level, the merit pay increases would be more for these pool members than if the pool contained many employees rated in the highest category. OPM's proposed regulations would have authorized agencies to adjust the method used to determine funds available to the agency's merit pay pools to adapt for unusual distributions of performance ratings. Also, many employees in all three agencies believed and GAO found evidence at the Departments of Agriculture and Housing and Urban Development (HUD) that management used pre-established quotas to determine rating distributions for their merit pay pools in 1982--a practice prohibited by OPM regulations. (See pp. 7 to 14 and 23.)

Although GAO did not determine whether each of the individual ratings was an accurate reflection of the employee's performance, employees in field offices were more likely to receive lower ratings and lower merit pay increases than headquarters employees who were in the same pool. Grade 15 employees tended to receive the highest ratings, followed by grade 14's and, last, grade 13's. At HUD, Schedule C (noncareer appointees) employees were placed in merit pay pools with career employees, although OPM encouraged agencies to keep the two groups separate. These employees were more likely to receive higher ratings and larger average merit pay increases than career civil servants. This gave the appearance that these employees benefited from an unfair advantage because of the political nature of Schedule C appointments. (See pp. 16, 17, 18, and 19.)

Agencies' formulas for distributing merit pay increases varied widely and resulted in differing increases for employees receiving similar performance ratings. For example, all three agencies imposed different maximum limits on the amount of merit pay that could be awarded. (See pp. 19 and 20.)

PERFORMANCE STANDARDS

CSRA requires agencies to establish performance standards which, to the maximum extent feasible, use objective criteria to accurately measure performance. GAO's review showed that overall, performance standards in the three agencies improved slightly during the 2 years. For instance, in each agency, the percent of standards GAO reviewed that contained objective measures of performance increased from 1981 to 1982. However, overall, less than half the standards contained such objective measures. About 70 percent or more of the employees in each agency responding to GAO's questionnaires believed their standards were fair, tailored to their job, and consistent with organizational goals in both 1981 and 1982. (See pp. 25 to 28.)

OPM encourages agencies to allow all employees to be involved in setting their performance standards. Most employees at Agriculture and Navy (70 and 76 percent, respectively) said they were involved in setting their performance standards, while only about half in HUD (46 percent) believed this to be the case. When asked to what extent they were satisfied with their input in setting their standards, 51, 52, and 29 percent in Agriculture, Navy, and HUD, respectively, said they were satisfied to a great or very great extent. (See p. 31.) CSRA requires that performance standards be communicated to the employee at the beginning of each appraisal period. At HUD and Agriculture, this requirement was not always met. Of the performance standards GAO reviewed that contained the date they were communicated to the employee, 42 percent at HUD and 14 percent at Agriculture were delivered to the employee more than 6 months after the beginning of the appraisal period. (See pp. 32 and 33.)

About 75 percent of the merit pay pool officials GAO interviewed believed the standards-setting process was improving communications between subordinates and supervisors, while 9, 10, and 17 percent of employees at HUD, Agriculture, and Navy, respectively, believed this to be true. (See pp. 29 to 34.)

OPM'S EVALUATIONS AND EMPLOYEE VIEWS

The CSRA requires that OPM analyze the cost and effectiveness of the merit pay system and cash award program and annually publish the results. OPM evaluations of merit pay have been limited in scope and have not met this CSRA requirement. OPM has published several reports or pamphlets on merit pay and also contracted with three universities to study it, but these reports did not cover the cost or effectiveness of merit pay. The OPM reports were primarily statistical analyses of payouts and ratings and descriptions of the various types of merit pay systems in effect. The university-contracted studies dealt with how merit pay was implemented in several installations. None of these studies reported on the costs of implementing and operating merit pay nor did they report on the effectiveness of the merit pay system government-wide as intended by the CSRA. (See pp. 37 to 40.)

OPM increased its emphasis on evaluation of merit pay in 1983 and has two major studies underway, one of which will address the impact of merit pay on employee performance and motivation. The three agencies GAO reviewed have evaluated their merit pay systems and made several changes. For instance, Agriculture changed its merit pay formula in 1982 to provide greater rewards for its top-rated employees. (See pp. 37 to 39, 41, and 44.)

CSRA requires agencies to establish a cash awards program to be used as an integral part of the merit pay system. The agencies GAO reviewed placed different degrees of emphasis on their cash awards programs in 1981 and 1982. For instance, in 1982, Navy granted cash awards averaging about $1,100 to about 30 percent of its merit pay employees. In contrast, in 1982, Agriculture granted cash awards averaging about $1,000 to 6 percent of the merit pay employees, while HUD gave awards averaging about $500 to 6 percent. OPM has recognized that it needs to provide specific guidance to agencies on the distribution and amounts of cash awards. (See pp. 42 to 44 and app. XIII.)

According to OPM, a key factor in the eventual success of the merit pay system is how well it is accepted and judged by those employees participating in it. After completing two appraisal and pay cycles, employees' overall attitudes toward merit pay remain negative. However, there were improvements in employees' perceptions of certain aspects of the system after the October 1982 merit payouts. For example, the percentage of employees who believed their merit pay increases were an accurate reflection of their performance increased from 8 to 25 percent in Agriculture, from 10 to 26 percent in HUD, and from 15 to 27 percent in Navy from 1981 to 1982. However, about 80 percent of all employees in the three agencies do not believe the system increased their motivation or performance. Among the top performers, 75, 62, and 61 percent of the employees in Agriculture, Navy, and HUD, respectively, shared this view. (See pp. 48, 49, and 50 and app. IV.)

CONCLUSIONS AND RECOMMENDATIONS

GAO recognizes that certain practical problems with the merit pay system, such as inconsistent raters, probably cannot be completely resolved, nor can the influence of nonperformance factors on pay be totally eliminated. GAO also realizes that merit pay is still a relatively new system, and that compensation experts have stated that it may take 5 to 10 years for a merit pay system to operate as intended. However, by taking steps now to ensure greater equity in ratings and pay, and to reduce the effect of non-performance factors on pay, OPM is more likely to gain wider employee support and acceptance. This will in turn improve merit pay's chances of success. OPM's regulations that were scheduled to go into effect November 25, 1983, would have addressed some of GAO's recommendations.

These regulations, which also covered several personnel subjects other than merit pay, have been declared null and void by the U.S. District Court, and OPM has been enjoined from directly or indirectly implementing them. The court decision does not preclude OPM from sponsoring legislation or drafting new regulations to address the issues discussed in this report, and GAO believes several changes need to be made to the merit pay system. Therefore, GAO recommends that, to the extent that it is legally permissible, the Director, Office of Personnel Management,

--assess the impact of pool composition and agency formulas on merit pay increases and develop criteria that will reduce the effect of nonperformance factors on merit pay increases (see p. 23);

--reemphasize the need for agencies to establish separate merit pay pools for their career and noncareer (Schedule C) merit pay employees to avoid the appearance of their having an unfair advantage in competing for merit pay increases (see p. 23);

--enforce the regulations which prohibit forced distribution of ratings (quotas) (see p. 23);

--require that merit pay pool managers or their delegates review performance standards at the beginning of the appraisal period to ensure that, to the maximum extent feasible, they contain the desired characteristics of objectivity and measurability and that they are of comparable difficulty for similar jobs (see p. 36);

--require that employees be given the opportunity to consult with their supervisors in setting their performance standards (see p. 36);

--require that standards be communicated to employees within a reasonable and specified time from the beginning of the appraisal period (see p. 36);

--provide adequate resources to maintain its planned merit pay evaluation efforts (see p. 47);

--clarify the intended role of the cash award program for merit pay employees and provide guidance and oversight that will ensure that it is used as an integral part of merit pay (see p. 47); and

--comply with the legal requirement to publish annual reports which analyze the cost and effectiveness of the merit pay system and cash award program (see p. 47).

AGENCY COMMENTS

GAO received written comments on the draft of this report from the Departments of Defense and Agriculture and the Office of Personnel Management. GAO received oral comments from HUD. These agencies generally agreed with the report's findings and recommendations. OPM stated that it does not believe it necessary to report on the costs of the merit pay system because the total payouts under merit pay are the same as they would have been under the General Schedule. However, the law requires

that OPM publish a report on the cost and effectiveness of the merit pay system and OPM has not kept track of the costs incurred in implementing and operating this program. (See p. 47.)

Agriculture commented that although technically correct, appendix VIII creates a false impression that unfair benefits are accruing to higher graded employees. Appendix VIII shows the average actual increases received by merit pay employees in each grade and is designed to demonstrate the magnitude of the increases. The charts were not intended to imply that higher graded employees unfairly received more than lower graded employees. The complete text of all the agencies' written comments is contained in appendixes XI through XIII.

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C o n t e n t s

ABBREVIATIONS

CSRA	Civil Service Reform Act
FPM	Federal Personnel Manual
GAO	General Accounting Office
OPM	Office of Personnel Management
OPM IAG	Office of Personnel Management Interagency Advisory Group
HUD	Department of Housing and Urban Development

GLOSSARY

Acceleration factor — A mathematical factor used in some agency pay formulas to provide the largest merit pay increases to employees lower in the salary range. Awarding more money to those lower in the range allows them to catch up with similarly rated employees higher in the range.

Annual salary adjustment — The average annual percentage increase usually given each October to adjust federal salaries in the General Schedule. It is an adjustment to salaries to reflect those currently existing in the private sector for similar work and levels.

Automatic increase — The guaranteed portion of a merit pay employee's total annual increase. It can be 50 percent (or more if OPM so decides) of the annual salary adjustment granted to General Schedule employees.

Cash award — For a merit pay employee, an award, not to be included as part of base salary, given for superior accomplishment, an invention, suggestion, special act or service, or other personal effort which contributes to the efficiency, economy, or other improvement of the government. Cash awards may not exceed $10,000 unless approved by OPM.

Critical element — A component of an employee's job that is of sufficient importance that performance below the minimum standards requires remedial action and denial of a merit pay increase. Unacceptable performance may also be the basis for removing or reducing the grade of an employee. Such action may be taken without regard to performance on other job components.

Forced distribution	The result of a management decision designed to achieve a predetermined distribution of individual performance ratings. OPM has stated that "no merit pay determination may be modified in order to force a specific distribution of performance levels among merit pay employees."
Grade adjustment factor	A mathematical factor that maintains the intergrade pay differential, that is, the percentage salary difference representing the differences in difficulty and complexity among merit pay grade levels.
GM	A pay system designator used to indicate that a position is covered by the provisions of the merit pay system.
Merit pay fund	The amount of money available to an agency head for the purpose of granting merit pay increases. The merit pay fund includes the nonautomatic portion of the comparability adjustment and amounts estimated to reflect within-grade and quality step increases that would have been available to merit pay employees under the General Schedule pay system.
Merit pay increase	The amount of money added to an employee's total annual base salary that recognizes and rewards performance based on periodic appraisals of performance.
Merit pay pool	Those grouped employees who compete directly for fixed merit pay funds.
Merit pay pool official	Merit pay pool managers or their representatives interviewed during this assignment.
Performance appraisal or rating	A descriptive account which measures employee performance during an appraisal period. Under merit pay, ratings are to be based on the employee's performance measured against established criteria.

Performance element, or element	A duty or responsibility for which an employee is accountable.
Performance salary ceiling	A technique used in some merit pay plans to set a limit or limits in the salary range beyond which the employee may not advance unless his/her performance improves.
Performance standards	A description of how well an employee must perform specific tasks. These standards enable employees and supervisors to determine how well the employees are doing their work by comparing their actual performance to the standards. When feasible, performance standards should contain measures of quality, quantity, and timeliness.
Presumptive rating	Rating assigned when an employee has not been in a merit pay position or under performance standards for a requisite period of time and when the quality of the performance cannot be measured because there is insufficient information to make a meaningful assessment.
Quality step increase	An increase in an employee's basic pay rate that is designed to recognize sustained high quality performance. Merit pay employees are not eligible for quality step increases. However, the merit pay fund includes the total amount of those increases pool members would have received if they remained under the General Schedule.
Top performers	Those employees who in Agriculture, were rated at 4.5 or higher (out of 5.0); in HUD, were rated Outstanding; or in Navy, were rated at Level 1 (highest rating).

Within-grade increase

A periodic increase given to General Schedule employees as a permanent increase to base salary. General Schedule employees receive about a 3-percent increase provided their performance is acceptable. Merit pay employees are not eligible for within-grade increases, but the amount they would have received for such increases is included in the fixed merit pay fund.

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CHAPTER 1

INTRODUCTION

The merit pay system and cash award program was created by the Civil Service Reform Act (CSRA) of 1978,[1] and has been in effect since October 1981. The Chairwoman, Subcommittee on Compensation and Employee Benefits, House Committee on Post Office and Civil Service, asked us to review agency experiences in making the transition to merit pay. In response to this request, we reviewed the implementation and operation of the merit pay systems during the 1981 and 1982 pay cycles at three Departments: Agriculture, Housing and Urban Development (HUD), and Navy. These Departments combined employ about 25 percent of all federal merit pay employees.

OBJECTIVE OF CSRA: TO LINK MERIT PAY TO FAIR AND OBJECTIVE PERFORMANCE EVALUATION

The objectives of the merit pay system, as expressed in the CSRA, are to:

--Recognize and reward quality performance by varying merit pay increases using available funds.

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

--Provide for training that will help supervisors improve their objectivity and fairness in evaluating performance, again using available funds.

The merit pay system was also intended to (1) significantly improve productivity, ideas, and service to the public and (2) increase communication between supervisors and subordinates. The performance appraisal provisions, specifically, were expected to help supervisors accurately evaluate job performance based on objective criteria.

Upon signing the CSRA, former President Carter expressed hope that merit pay would put

> ". . . incentive and reward back into the Federal system . . . From now on, promotions and pay increases will be a sign of jobs well done."

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[1]Title V, Public Law 95-454, October 13, 1978, 92 Stat. 1179, now codified at 5 U.S.C. § 5401-5405 (1982).

Additionally, the first Director of the Office of Personnel Management (OPM) indicated that the performance appraisal process would be

> ". . . to the direct benefit of the vast majority of Federal workers who do their jobs well and want to be judged on the basis of their performance. The increased emphasis on meaningful appraisals will impose additional responsibilities on managers, but it will also provide them with a more effective and equitable means of managing their employees."

He further remarked that "unless the Civil Service Reform Act improves governmental performance, it will not have succeeded."

MERIT PAY INCREASES ARE BASED ON PERFORMANCE RATINGS

Merit pay fundamentally changed the way some employees' salaries are determined. At present, most merit pay employees have been through only two complete performance appraisal and payout cycles. As would be the case with any new system, problems have occurred which must be resolved for the system to achieve its intended goals. Compensation experts have stated that it may take from 5 to 10 years for such a system to operate as intended.

Under the merit pay system, pay increases for supervisors and management officials in grades 13 through 15 are based on performance. Merit pay employees are placed in organizational groups (merit pay pools) whose composition is determined by agency management. These employees do not automatically receive annual salary adjustments usually granted to General Schedule employees, nor are they eligible for within-grade and quality-step increases that General Schedule employees may receive. They are guaranteed at least half of the annual salary adjustment and compete against each other for additional merit pay increases which are based on the degree to which the employees met or exceeded performance standards established at the beginning of the appraisal period. These increases are paid out of a fixed merit pay fund which is made up of a maximum of one-half the annual salary adjustment plus an amount equal to the within-grade and quality-step increases pool members would have received had they remained under the General Schedule. According to OPM, about 108,000 employees were covered by the merit pay system in fiscal year 1982. (About 80,000 GS-13's through GS-15's were not designated as managers or supervisors.)

OPM is responsible for developing procedures for implementing and operating merit pay systems governmentwide. It is responsible for providing technical assistance to agencies, reviewing and approving merit pay plans, issuing guidance on which positions should be covered under merit pay, and evaluating the cost and effectiveness of the merit pay system and cash award program. In October 1983, OPM proposed regulations which would alter the scope of the merit pay systems and, which it stated, would address some of our recommendations contained in chapters 2, 3, and 4. However, on December 31, 1983, the regulations were determined to be null and void by the U.S. District Court, and OPM was enjoined from directly or indirectly implementing them.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives for this review were to determine how three large federal agencies implemented merit pay systems and made their pay increases for fiscal years 1981 and 1982 and how their systems have operated since then. We also wanted to (1) observe how the agencies evaluated merit pay implementation, (2) determine how merit pay was perceived and accepted by employees and managers, and (3) identify areas requiring attention. With the concurrence of the requesting Subcommittee, we decided that a 2-year study, with data collected after the October 1981 and October 1982 merit pay cycles, would meet these objectives and also allow us to evaluate how the merit pay system had evolved.

We selected the Departments of Agriculture, HUD, and Navy, because they employ large numbers of merit pay employees, represent both military and civilian agencies, and have different types of merit pay systems. Agriculture had about 9,600 merit pay employees in 1981 and 1982, HUD had about 2,200, and Navy had about 16,100. Combined, these Departments employed about 28,000 employees under merit pay systems--25 percent of all federal merit pay employees.

To find out how merit pay was implemented, we interviewed merit pay pool officials[2] and reviewed performance appraisal and pay statistics of pools in each of the Departments. Because merit pay pools in all three Departments were scattered across the country, it was not feasible to interview a statistically valid random sample of pool officials that would be projectable to each Department. Therefore we judgmentally selected merit pay pools from each Department. To get some indication of how the systems were progressing, we reviewed essentially the same pools and interviewed the same pool officials when possible during both years. More details on the number of pools reviewed, the number of pools in each agency, and the number of employees included in the pools we reviewed are included in appendix V.

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[2]Pool managers or their representatives.

We also reviewed a randomly chosen sample of performance ratings from these pools and analyzed them to determine whether they complied with requirements of the CSRA. We analyzed the 1981 and 1982 performance ratings of 475 employees (a total of 950 ratings), which included over 12,000 separate performance standards, and evaluated the quality of the standards. To do this, we analyzed each standard to determine if it contained measures of quality, quantity, or timeliness. Sample sizes for this analysis were sufficiently large so that we are 95-percent confident that the reported results are within 5 percentage points of what would have been found if we had reviewed all the ratings in these pools. A detailed discussion of the methodology followed in analyzing the performance ratings is included in appendix VI. For both years, we also analyzed summary statistics on ratings and pay increases from the pools reviewed as well as overall statistics provided by the agencies.

Finally, we administered a questionnaire to merit pay employees in the three agencies to determine their attitudes and opinions on various aspects of merit pay over the 2 years. At the time of our first survey, HUD and Agriculture were developing questionnaires of their own and agreed to attach our questionnaire to theirs. These were mailed to all HUD and Agriculture merit pay employees and were returned by 62 percent in HUD and 60 percent in Agriculture.

Since the Navy had not developed a questionnaire at the time of our first survey, we sent our questionnaire directly to a random sample of 624 Navy merit pay employees and had a response rate of 94 percent. We also received 97 unsolicited completed questionnaires from Navy merit pay employees not in our sample who wished to contribute their opinions to our study. These responses were not included in any of the statistics presented in this report. Final sample sizes for the first survey in the Departments were large enough that we are 95-percent confident that findings are within 4 percentage points or less of what would be found if all merit pay employees in the three Departments had been sampled.

For the second year, we used the same questions, but added other questions based on the results of the first year. This facilitated a comparison of first- and second-year attitudes and opinions.

Since none of the three Departments was using a questionnaire to evaluate employee attitudes about the second year of merit pay, in January 1983 we sent questionnaires to a random sample in each Department. We sent 580 questionnaires to Navy merit pay employees, 643 to HUD employees, and 586 to Agriculture employees. Response rates were 90, 90, and 89 percent in the three Departments, respectively. Sample sizes were large enough so that we are 95-percent confident that findings are within 5 percentage points or less of what would have been found if all merit pay employees in the Departments had been sampled. Confidence intervals, sampling errors, and questionnaire results for both years' surveys are included in appendixes II and III.

We also separated out and analyzed the responses of top performers--those employees in our surveys in 1982 who were rated in the top performance category by their agency. The purpose was to find out how the attitudes of those who had received the best ratings and largest merit increases differed from the rest of our sample population.

Because our work in both years covered only 3 of approximately 70 federal agencies with merit pay systems, we cannot project our findings to all agencies or merit pay employees--only to those examined. However, because Agriculture, HUD, and the Navy experienced similar merit pay problems in both years and employ about 25 percent of all federal merit pay employees, we believe our findings are a valid basis for making recommendations to OPM for improving the merit pay system.

We conducted the review at the three Departments' headquarters in Washington, D.C., and at merit pay pools from each Department in the Boston and San Francisco areas. Audit work began in December 1981 and ended in March 1983. The review was carried out according to generally accepted government auditing standards.

CHAPTER 2

FACTORS OTHER THAN PERFORMANCE AFFECT MERIT PAY

The CSRA requires agencies to establish merit pay systems which shall "use performance appraisals as the basis for determining merit pay adjustments." However, several factors independent of performance affected the size of merit pay increases at Agriculture, HUD, and Navy. These included the accuracy and consistency of the performance standards and ratings; the distribution of ratings in the pool; the formulas the Departments used to distribute merit pay; and the variable annual salary adjustment, up to half of which can be used as merit pay. Some of these factors, such as the amount of money available for merit pay increases, cannot be controlled by the agencies. Other factors, such as the merit pay formulas, can be controlled by agencies. While these factors which cause differences in merit pay are not prohibited by law and may never be completely eliminated, they have contributed to negative employee perceptions of merit pay.

STANDARDS AND RATINGS MAY BE INCONCLUSIVE MEASURES OF PERFORMANCE

Some performance standards and ratings may not accurately measure performance and can have an impact on the employee's merit pay increases. According to one recognized performance appraisal expert,

> ". . . the problem of variation in the standards of different judges has never been completely solved, nor have we succeeded in eliminating the effects of bias and prejudice in making appraisal judgments."[1]

Recognizing that standards and appraisals prepared by different supervisors may not be consistent, some managers in the three agencies reviewed employee standards and appraisals before they were finally approved. Despite the reviews for consistency that may have taken place in these and other pools, between 37 and 52 percent of the respondents in both years in each agency believed their 1981 and 1982 ratings did not accurately reflect their performance. In addition, over 40 percent of the merit pay employees surveyed in 1982 believed that inconsistencies in how raters judge performance was a great or very great problem in their pool. Employee comments regarding inconsistent ratings included:

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[1]The Human Side of Enterprise, Douglas McGregor, 1960, p. 82.

--"I do know from others and from my own performance rating that a great variation in ratings occurs. The system has to be standardized to be fair."

--"Probably the greatest difficulty, and the source of the most skepticism is the improbability of the various supervisors rating on an equitable basis . . . ."

--"The different departments in our unit rate by subjective standards. Some departments are very conservative and others are very liberal."

Some merit pay officials and employees believed that performance in their job could not be accurately measured through standards. One employee said, "It is difficult, if not impossible, to rate scientists fairly across different disciplines." Another said, "As a technical man doing highly varied work, my productivity and quantity of work are not subject to easy and concise definition." Still another said, "When brain power is used to do research and answer policy issues, performance elements are difficult to develop and evaluate." Most pool officials said there were no standard measures that would allow them to accurately assess employees' productivity.

DISTRIBUTION OF RATINGS INFLUENCES MERIT PAY

The distribution of ratings within a merit pay pool is crucial in determining the merit pay increase each employee receives. As a result, employees in pools with very different ratings distributions can receive significantly different merit pay increases even if they received a comparable rating. OPM's proposed 1983 regulations would have reduced to some extent the impact of the rating distribution by allowing agencies to adjust the methods they use to determine funds available to the pool to adapt for unusual distributions of ratings.

Appendixes VII and VIII show the agencywide distribution of ratings and the average merit pay increases by grade level and rating at the three agencies.

In each Department, the distribution of ratings in pools varied widely in both years. For example, in some pools, over 90 percent of the ratings were in the top two levels (for instance, outstanding and highly satisfactory), compared to less than 20 percent in other pools. When many people within the pool are highly rated, top performers receive less money than if most of the pool members were rated at a lower level, such as fully satisfactory. This is true even in a controlled situation in which pools are identical in makeup and have an equal amount of funds available for merit pay. Examples of differences in pay for comparable ratings in different pools at the three

Departments are shown below. In all cases, 1982 merit pay increases were much larger than in 1981. This was because merit pay funds in 1982 included half of the comparability adjustment plus 1.6 percent of salaries for within-grade pay increases. Because of a GAO decision,[2] OPM had reduced the within-grade contribution from 1.6 to .8 percent of salaries for the 1981 payouts. (For each year, two separate pools are shown. Thus, pool 1 in 1981 is not the same as pool 1 in 1982.)

Table 1
Effect of Rating Distribution on
Average Merit Increases in Four Agriculture Pools

Performance category[a]	1981 Pool 1: Ratings in category (percent)	1981 Pool 1: Merit increase for GM-14's in category	1981 Pool 2: Ratings in category (percent)	1981 Pool 2: Merit increase for GM-14's[b] in category
4.5 to 5.0	53	$383	7	$658
4.0 to 4.4	43	342	12	598
3.5 to 3.9	2	315	37	541
3.0 to 3.4	2	134	44	464
Below 3.0	0	-	0	-
	1982 Pool 1		**1982 Pool 2**	
4.5 to 5.0	30	$1,955	5	$2,364
4.0 to 4.4	45	1,754	49	1,894
3.5 to 3.9	22	1,638	32	1,446
3.0 to 3.4	3	1,266	14	578
Below 3.0	0	-	0	-

[a]Agriculture uses adjective descriptions for each performance level, with each adjective corresponding to a number, as follows: 5.0, Outstanding; 4.0, Exceeds Acceptable; 3.0, Acceptable; 2.0, Minimally Acceptable; and below 2.0, Unacceptable. The composite ratings, such as 4.5, represent the weighted average of the rating score assigned to each performance element.

[b]In pool 2, in 1981, more money was available per person for merit pay because of higher grades and salaries of the pool members, a factor which also affected the difference in final merit pay increases.

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[2]Office of Personnel Management's Implementation of Merit Pay, B-203022, September 8, 1981.

Table 2
Effect of Rating Distribution on
Average Merit Increases in Four HUD Pools

Performance category	Pool 1: Ratings in category	Pool 1: Merit increase for GM-14's in category	Pool 2: Ratings in category	Pool 2: Merit increase for GM-14's in category
1981				
	(percent)		(percent)	
Outstanding	0	$ -	11	$ 956
Highly satisfactory	23	1,797	74	477
Fully satisfactory[a]	68	-	13	-
Marginal/Unsatisfactory	5	-	0	-
Presumptive Fully Satisfactory[b]	3	-	2	-
1982				
Outstanding	18	$3,034	4	$4,252
Highly satisfactory	53	1,913	44	2,561
Fully satisfactory	20	823	47	1,103
Marginal/Unsatisfactory	0	-	1	-
Presumptive fully satisfactory	8	489	5	884

[a]HUD did not award merit pay increases to Fully Satisfactory employees in 1981.

[b]A rating of Presumptive Fully Satisfactory is given when the employee is not under standards approved by the pool manager long enough to be given a rating based on his/her actual performance.

Table 3
Effect Of Rating Distribution on
Average Merit Increases in Four Navy Pools
1981

Performance category	Pool 1: Ratings in category (percent)	Pool 1: Merit increase for GM-14's in category	Pool 2: Ratings in category (percent)	Pool 2: Merit increase for GM-14's in category
Level 1: Substantially exceeded all objectives	40	$838	9	$1,374
Level 2: Substantially above target--most significant objectives	25	419	41	687
Level 3: Above target--most significant objectives	18	140	45	229
Level 4:[a] On target--all significant objectives	17	0	5	0
Level 5: On target--some objectives	0	-	0	-
Level 6: Below target--one or more critical elements	0	-	0	-

[a]In 1981, Navy did not award merit pay to Level 4 performers.

Performance category	1982 Pool 1 Ratings in category (percent)	Pool 1 Merit increase for GM-14's in category	Pool 2 Ratings in category (percent)	Pool 2 Merit increase for GM-14's in category
Level 1: Substantially exceeded all objectives	36	$2,129	10	$2,759
Level 2: Substantially above target--most significant objectives	55	1,725	25	2,236
Level 3: Above target--most significant objectives	9	1,313	45	1,702
Level 4: On target--all significant objectives	0	-	20	1,312
Level 5: On target--some objectives	0	-	0	-
Level 6: Below target--one or more critical elements	0	-	0	-

As shown in the tables, significantly different merit pay increases were given to equally graded and rated employees who happened to be in different pools. For example, in 1982 at HUD, an Outstanding GM-14 employee in Pool 2 received over $1,200 more than a counterpart in Pool 1. At HUD in 1981, a Highly Satisfactory GM-14 in Pool 1 received almost twice as large an increase as an Outstanding employee in Pool 2.

RATING QUOTAS WERE USED IN SOME INSTANCES

OPM regulations prohibit forcing rating distributions to fit quotas. The effect of this was stated in a 1979 OPM pamphlet,

> "To allow artificial and arbitrary non-performance factors to drive the merit pay increase would . . . do irreparable harm to the Merit Pay System."[3]

Agency documents and discussions with pool officials and employees lead us to believe that some merit pay reviewing officials forced distributions of ratings to meet rating quotas by lowering ratings prepared by immediate supervisors. In one instance at HUD, a division director issued a memo stating, in part, that:

> "For [the office], the distribution is expected to be roughly: 10-15% Outstanding; 25-30% Highly Satisfactory; 40-60% Fully Satisfactory; and 5-10% Unsatisfactory . . . . No individual division is expected to deviate more than two or three percentage points from these ranges."

After this memo had been written, the HUD Assistant Secretary responsible for the division wrote his executive assistant, "I want us to aim for no more than 10% [to be rated] outstanding . . . ." Actual final ratings in the division were 13 percent Outstanding, 39 percent Highly Satisfactory, 42 percent Fully Satisfactory, and 5 percent Marginally Satisfactory. The Assistant Secretary, in a separate memo, later required a Deputy Assistant Secretary to downgrade some ratings from Highly Satisfactory to Fully Satisfactory, in order to ". . . restore a proper balance with the general pattern in [the office]." HUD officials told us that this may have been a legitimate attempt by management to ensure consistency of ratings.

Other examples of alleged forced distribution of ratings included the following:

--A HUD division director told us of being directed by higher management to lower any three subordinates' ratings.

--A memo to the staff of an Agriculture regional official stated that they should

3Your Merit Pay System, OPM, November 1979, p. 26.

". . . carefully review performance ratings in your pay pool and perhaps go back to your pay pool supervisors if the average for the pool falls outside the range 3.7 - 4.1 and the standard deviation is not at least 0.30."

--Another HUD memo stated that "any manager who anticipates a distribution deviating widely from it [an attached distribution] can expect to be asked to reconsider the distribution."

--In an Agriculture memo, a rating official complained that

> ". . . it is very obvious that the changes [your office made to ratings I submitted on my subordinates] were strictly based on the 'numbers game' and not on performance. My appraisals [of them] were right and fully justified based on [their] actual performance."

In addition, 30, 59, and 43 percent of Agriculture, HUD, and Navy respondents, respectively, thought that management used quotas to develop ratings in their pool in 1982. Between 11 and 27 percent of the merit pay employees in the three Departments believed that changes to ratings made by higher level officials was a great or very great problem. Narrative responses from merit pay employees concerning alleged forced distribution of ratings follow:

--"There was definitely a 'quota' system in my organization. My supervisor told me outright that he could give one fully and one highly satisfactory rating."

--"I think our managers felt pressured to follow a Normal Distribution Curve to come up with ratings. This is bad for an organization that has highly motivated people."

--"This year Merit Pay has created a moral[e] problem. Some of my associates had their ratings changed because of a quota system."

--"In an effort to be equitable the Agency actively pushed all ratings down, which seriously diminished some employees' self esteem."

--"Most employees perceive that quotas are established despite the restrictions on . . . pre-established or forced distribution of levels of performance."

--"Quota systems were used in both years. Such a system definitely affects motivation. I was more or less told my performance had been outstanding but due to 'other considerations' I would have to be rated highly satisfactory."

Respondents who believed management used a quota system in developing ratings generally had negative feelings toward the merit pay system. For example, when employees who believed rating distributions in their pool were forced in 1982 were compared to those who did not believe distributions were forced,

--fewer believed that the merit pay/performance appraisal system was fair;

--fewer believed that the standards were set and ratings and payouts made without favoritism;

--more believed that communication with their supervisors had gotten worse; and

--fewer believed that merit pay was fairer in fiscal year 1982 than in fiscal year 1981.

When a case of possible forced distribution is brought to its attention, OPM refers the case to the agency involved and asks the agency to investigate and report back.

COMPOSITION OF THE MERIT PAY POOL INFLUENCES PAY

The composition of a merit pay pool--the number of employees and their grades and location in the salary range--also affects individual merit pay. This is because the composition of the pool affects how much money is available to make up the fund as well as how much of it each person will receive. Because the composition of pools varies greatly, individual pay can also vary despite a similar rating. OPM has not prescribed how the membership of merit pay pools should be determined.

Extremes in pool size can accentuate impact of nonperformance factors on pay

Small pools, of 10 or fewer people, accentuate any differences (in rating, grade, or position in the salary range) among pool members. The President, who has the authority[4] to exclude agencies from the merit pay system, recognized the problems with

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[4]This authority is contained in the provisions of 5 U.S.C. § 5401(b)(2)(A).

small pools when he excluded several small agencies in 1981 and 1982. He noted that

> ". . . with very small groups, another individual's performance has nearly as much impact on one's increase as his or her own, and merit pay cannot be confidently administered."

Recognizing the effect of small pools on pay, managers may be tempted to give all pool members the same rating. For example, at Agriculture, about 47 percent of all pools (166 of 351 pools) contained 10 or fewer people. In 24 percent (40) of the small pools, all members fell into the same rating category.

In large pools (those containing several supervisors and their staffs), ratings and, therefore, pay may not be consistent. This is because some supervisors may rate harder than others, as discussed earlier. As a result, pool members with lenient supervisors may benefit at the expense of their coworkers in the same pool whose raters are more strict. One employee commented that:

> "In a pool as large as the one I am in several supervisors rating high creates an unfair distribution. . . . people in another staff were rated, by a [supervisor] without guts or a different set [of] values, higher than me and did not produce half of what I did."

The grades and salaries of pool members influence the amounts of merit pay

The combination of employees' grades and positions in the salary range affects the amount of money included in, and influences the individual merit pay increases made from, the merit pay pool fund. OPM's merit pay formula requires that different amounts be included in the pool fund for GM-13's, -14's, and -15's at different positions in the salary range. Therefore, the total fund can vary depending on the number and combination of grades and salaries in the pool.

In addition, a grade adjustment factor is used to recognize the difference in complexity, importance, and difficulty of work at the GM-13, -14, and -15 levels. This factor results in awarding the highest percentage of money from the fund to GM-15's and the lowest to GM-13's in proportion to the amount they contributed.

Despite this grade adjustment factor, managers at Agriculture, HUD, and Navy gave GM-15's higher ratings than the GM-13's and GM-14's in 1981 and 1982. (See app. VII.) Thus, GM-15's who were in a pool with many lower graded employees may have

ERIC

received higher increases than GM-15's competing primarily with other GM-15's. Dissatisfaction with this practice is expressed in the following comments:

--"Supervisor believes GM-15's deserve higher performance [ratings] than 14's and 14's higher than 13's. The 13's are supporting the merit pay system for the 14's and 15's. A separate pool should be made for each grade level."

--"Being a GS-13, and in a pay pool for GS-15's, -14's, -13's, obviously puts me and other GS-13's in an unfavorable position! The bonuses and higher ratings that go to GS-15's and 14's realistically mean less $ available for the GS-13's. I think each grade should stand on its own (!!) with its own pay pool!"

--"MPS [merit pay system] benefits higher management = GM-14's and 15's and supervisors."

--"The higher your grade, the higher your MPS [merit pay system] rating."

--"Supervisors in my division have been given disproportionately higher ratings than those they supervise."

INCLUDING EMPLOYEES WITH DIFFERENT RESPONSIBILITIES IN THE SAME POOL CAN INCREASE EMPLOYEE DISSATISFACTION

When headquarters and field or noncareer (Schedule C)[5] and career employees are included in the same pool, employees may feel they are competing in an unfair environment and that their merit pay increases may not reflect their performance. As one pool official said, "this is [like] comparing apples and oranges and plums."

Including employees from different regions, or from region/field and headquarters, in the same pool may cause problems. One study[6] showed that field employees were concerned

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[5]Upon specific authorization by OPM or under the terms of an agreement with OPM, agencies may make appointments to positions in grades GS-15 and below which involve a close and confidential working relationship with the head of an agency or other key appointed officials. Positions filled under this authority are excepted from the competitive service and constitute Schedule C.

[6]Effectiveness of Merit-Pay-Pool Management, James Perry, Jone Pearce, and Carla Hanzlik; Review of Public Personnel Administration, Vol. 2, No. 3., Summer 1982.

about being compared with employees in states of different sizes. A pool manager in Agriculture felt that, in his pool, conditions in different states varied, making comparisons of performance for the same job difficult. In addition, he had regional/field employees who were competing with headquarters employees.

In HUD and Navy, a headquarters merit pay employee was more likely to receive the highest rating than an employee in the region/field. Employees in Navy and HUD headquarters pools had about twice the percentage of Level 1 and Outstanding ratings as regional/field employees for both years. Comparable data was not available for Agriculture. The following table shows the difference in ratings in HUD and Navy headquarters and regional/field pools.

Table 4
Comparison of Headquarters and Regional/Field Ratings
HUD Performance Ratings[a]

	Outstanding		Highly satisfactory		Fully satisfactory		Marginal/ unsat.	
	1981	1982	1981	1982	1981	1982	1981	1982
	(percent)							
Headquarters	16	15	48	44	26	34	2	3
Region/field	8	6	51	41	35	46	2	3
Overall department	12	9	50	42	31	41	2	3

Navy Performance Ratings[a]

	Level 1		Level 2		Level 3		Level 4		Level 5/6	
	1981	1982	1981	1982	1981	1982	1981	1982	1981	1982
	(percent)									
Headquarters	10	16	30	34	35	32	16	10	2	1
Region/field	5	9	27	34	43	40	17	11	1	1
Overall department	7	12	28	33	40	36	17	10	1	1

[a]This table does not include Presumptive Fully Satisfactory ratings.

ERIC

The following employee comments indicate their concern over this issue.

--"My pool consists of a regional office and 4 field offices. Field office people are consistently rated lower than regional people who take the bulk of the merit pay pool."

--"The system is subject to the subjective whims of Regional Administrators. In our case, he expected the field offices to take a hard line on ratings . . . . I happen to know he did not take a hard line on his own Regional staff."

Including noncareer (Schedule C) and career employees in the same merit pay pool also caused concern at HUD in 1982. (Navy officials said they do not have any Schedule C employees under merit pay, and Agriculture has separate pools for Schedule C employees.) The following table summarizes the variance in rating distributions between headquarters Schedule C appointees and career employees at HUD.

Table 5
Comparison of HUD Headquarters Ratings for Schedule C and Career Merit Pay Employees

	Outstanding	Highly satisfactory	Fully satisfactory	Marginal/ unsat.
	(percent)			
Schedule C employees[a]	55	32	13	-
Career employees[b]	14	47	37	2

[a]Percentages based on 31 performance-based ratings (those for which the employee was in the pool long enough to be rated on his or her performance). This was the total number of performance based ratings for Schedule C employees in HUD.

[b]Percentages based on the total (778) ratings in HUD headquarters that were based on the employee's performance.

In 1982, the average merit pay increase for a Schedule C employee in headquarters was $2,314. The average merit pay increase for all HUD headquarters career employees was $1,793.

In one HUD office, all 11 Schedule C merit pay employees who received performance-based appraisals in 1982 were rated as Outstanding. They received merit pay increases averaging $2,859. Merit pay increases for that office's career employees averaged $1,983.

HUD employees objected to the policy of placing Schedule C employees in the same pool with career civil servants, as shown by their comments.

--"The system is rife with subjectivity and inherently flawed: in placing Schedule C staff in the same pool with career staff . . . ."

--"There should be a separate Merit Pay Pool for Schedule C employees--they should not be in the same pool as career employees."

--"The senior officials will find ways to reward Schedule C types."

--"Another major defect [of merit pay] is the inclusion of Schedule C merit pay personnel in the pool with career personnel. The Schedule C's were generally hand-picked by the raters or reviewers, thereby making them part of the 'new team' or 'us' vs. 'them' career types. I would like to know what the average rating and merit pay amounts were . . . to Schedule C's for FY 1982."

--"The system seems to have been politicized, with top political appointees changing the ratings of career people in order to reward themselves and their appointed subordinates."

OPM does not currently have a policy requiring separate pools for Schedule C appointees who are under merit pay, but encourages agencies to have separate pools.

AGENCY FORMULAS CAUSE DIFFERENCES IN MERIT PAY INCREASES AMONG AGENCIES

As provided for in the CSRA, OPM allows the agencies great flexibility in designing their merit pay plans and the formulas for computing merit pay increases. Formulas can include variables such as the performance salary ceiling, maximum annual merit pay increase, and acceleration factor which can be used at the discretion of the agency. In addition, different values can be used for the points or percentages assigned to performance levels, and the number of performance levels can vary. Due to the many formula variations possible for determining increases, merit pay can be very different for a similar rating.

Performance salary ceilings vary pay increases

Performance salary ceilings limit the salary within each grade according to the level of performance. For instance, in HUD, an employee rated Fully Satisfactory cannot advance past the equivalent of step 8 of the General Schedule for the grade until earning a Highly Satisfactory or Outstanding rating. An employee already at the equivalent of step 8 who receives a Fully Satisfactory rating would receive only the automatic portion of comparability and no merit pay. Agriculture and Navy do not incorporate performance salary ceilings into their merit pay formulas.

OPM merit pay simulations show that formulas using the performance salary ceiling generally reward highly rated employees with a higher percentage of merit pay than do other formulas. The 1982 pay increases (see app. VIII) show that top-rated HUD employees did receive more than their counterparts in Navy and Agriculture.

Maximum annual increases vary

Although OPM does not restrict the size of merit pay increases, some agencies do. Navy limits merit increases to no more than the annual salary adjustment plus one-third of the salary range; HUD, to the adjustment plus 15 percent of base salary; and Agriculture, to the adjustment plus 9 percent of base salary.

Acceleration factor rewards employees lower in the salary range

According to OPM, some agency formulas use an acceleration factor to award larger merit increases to employees lower in the salary range. This allows them to catch up with equally rated employees who, because of their longevity, are higher in the range. The intent is to reward performance rather than longevity. OPM encourages this practice, believing that equally graded employees getting the same rating should, over time, receive the same base salary. Agriculture's formula incorporates the acceleration factor while HUD's and Navy's do not.

The acceleration factor can result in the highest rated people, who are also near the top of the salary range, receiving smaller merit pay increases than employees lower in the range.

Points for performance vary

The different formulas assign points to different rating categories. The points are multiplied by dollars available per point to determine individual merit pay increases. (See app. IX for a description of how individual merit pay increases are calculated.) Points assigned to rating categories in the three Departments reviewed are shown below.

Table 6

Points Assigned to Performance Levels at Three Agencies

HUD

Rating	1982
Outstanding	3.0
Highly satisfactory	2.0
Fully satisfactory	1.0
Marginally satisfactory	0
Unsatisfactory	0

Navy

Rating	1982
Level 1 (highest)	2.1
Level 2	1.7
Level 3	1.3
Level 4	1.0
Level 5	0
Level 6 (lowest)	0

Agriculture

Rating	1982
5.0 (Outstanding)	3.0
4.5	2.5
4.0	2.0
3.5	1.5
3.0 (Fully Acceptable)	1.0
Less than 3.0	0

As the table shows, in 1982, an Outstanding Navy employee (Level 1) received 2.1 times more points than a Level 4 employee of equal grade. On the other hand, in 1982, an Outstanding (5.0) Agriculture employee received 3 times more than a Fully Acceptable (3.0) employee of equal grade and salary. In all instances, the dollar value of a point is the same within a pool, but would be different between pools unless the pool makeup and rating distribution are identical.

The points prescribed by the merit pay formula reflect management's decisions about the degree to which different levels of performance should be rewarded. Thus, Agriculture raised its point value in 1982 for outstanding performance to provide a greater distinction in pay between Satisfactory and Outstanding employees. Navy lowered its point value in 1982 to provide greater merit pay increases to more employees.

Number of rating categories receiving merit pay varies

Agency formulas specify how many rating categories are eligible for merit pay. For example, Navy had six categories in 1981 and 1982 and awarded merit pay to the three highest categories in 1981 but to the top four in 1982. In 1981 and 1982, HUD had five categories but increased the number of categories receiving merit pay from two to three in 1982. Agriculture in both years had five categories and awarded merit pay to employees rated Fully Satisfactory (3.0) or better. (See app. VIII.)

When more employees in more rating categories are eligible to receive merit pay from a fixed fund, less money is available to each providing other factors are equal. As a result, at Agriculture in 1981, average merit pay increases were much smaller than at HUD and Navy which awarded merit pay only to those rated higher than Fully Satisfactory. Thus, because agency merit pay formulas award increases to employees in different numbers of rating categories, employees rated as Fully Satisfactory in one agency might receive merit pay, while Fully Satisfactory performers in another agency might not. Again, the agency merit pay formula, and not the employee's performance, can cause differences in pay between equally rated employees.

CONCLUSIONS

Several factors other than performance have influenced the size of merit pay increases that employees receive. The effect of some of these factors, such as merit pay formulas and merit pay pool composition, can be reduced by OPM and the agencies. The distribution of ratings in the pool is another factor that affects the size of merit pay increases. OPM gives each agency great flexibility in setting up its merit pay system, including factors that influence pay. Because of employee concerns over the equity of merit pay, OPM and the agencies should strive to reduce the effect of these nonperformance factors on pay. These factors can never be completely eliminated, but have taken on added significance since the advent of merit pay, because merit pay adjustments are now based on the performance appraisal.

GAO's review found that these factors have influenced the size of merit pay increases more than is necessary.

OPM can help accomplish this by reemphasizing the need for Schedule C and career employees to be placed in separate pools and by enforcing OPM regulations which prohibit the forced distribution of ratings. The agencies can also help reduce the effect of nonperformance factors on pay by considering such factors as pool size and employee grade and responsibilities in establishing their merit pay pools. These efforts are needed to help boost employee acceptance of the merit pay system.

RECOMMENDATIONS TO THE DIRECTOR, OPM

We recommend that the Director, OPM, assess the impact of pool composition and agency formulas on merit pay increases and develop criteria that will minimize their possible adverse effects. We further recommend that, to the extent that it is legally permissible, the Director should:

--Reemphasize the need for agencies to establish separate merit pay pools for its career and noncareer (Schedule C) employees, so that Schedule C employees do not receive larger merit increases at the expense of career employees.

--Enforce the regulations which prohibit forced distribution of ratings.

AGENCY COMMENTS

In commenting on the report, OPM stated that it was aware of pool composition problems and that their October 25, 1983, proposed regulations would authorize agencies to take pool composition factors into consideration in disbursing merit pay funds. OPM stated it has always recommended to agencies that career and noncareer employees not be included in the same merit pay pools. OPM noted that in some cases, such as when the agency has only one or two noncareer employees, it is not appropriate to do so. OPM stated that the October regulations would reinforce the prohibition against forced ratings distributions and that it would work diligently to see that this requirement is accomplished.

In its only comment on the draft of this report, Agriculture stated that the charts in appendix VIII, although technically correct, create a false impression that unfair benefits are accruing to employees at higher grades. Agriculture noted that because higher graded individuals have higher base salaries, they contribute more money to the merit pay pool and thus receive larger increases. They also point out that an essentially flat distribution curve would result if the increases shown in appendix VIII were converted into percentages of salary. The charts in appendix VIII show the actual average increases received in the three agencies in 1981 and 1982 and were intended to show the reader the magnitude of the increases received under merit pay. The charts were not intended to imply that higher graded employees unfairly received more than lower graded employees. However, the report does show (see app. VII) that in all three agencies, higher graded merit pay employees consistently received better performance ratings than lower graded employees. This was a source of dissatisfaction to merit pay employees because it did lead to larger merit increases for higher graded employees.

HUD and DOD agreed with the findings, conclusions, and recommendations in this chapter.

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CHAPTER 3

PERFORMANCE STANDARDS BETTER,

BUT STILL NEED IMPROVEMENT

After 2 years, the quality of performance standards improved slightly, but Agriculture, HUD, and Navy managers were still having problems establishing standards which were measurable or that distinguished between performance levels.

Most merit pay employees responding to our questionnaire believed their standards were fair, tailored to their job, and consistent with organizational goals in both 1981 and 1982. Most employees from Agriculture and Navy also believed supervisors considered their views when setting standards. Many employees, however, were not satisfied with the amount of input they had in setting their standards and objected to managers establishing identical standards for different jobs.

The CSRA[1] requires that performance standards be communicated to each employee at the beginning of each appraisal period. However, 37 percent of Agriculture employees and 70 percent of HUD employees whose standards we reviewed did not receive their standards until at least 3 months after the appraisal period began.

WHAT ARE PERFORMANCE STANDARDS?

Performance standards provide the criteria for how well an employee must perform specific tasks. These standards enable supervisors and employees to determine how well employees are doing their work by comparing their actual performance to established criteria.

Although performance appraisal is an inherently subjective process, the CSRA[2] requires agencies to establish performance standards which, to the extent feasible, use objective criteria to accurately evaluate performance. To achieve this, chapter 430, subchapter 2-3(b) of the Federal Personnel Manual (FPM), promulgated by OPM, says that each standard should be objective, realistic, reasonable, and clearly stated in writing. Each standard should be defined so that both the supervisor and the employee know what is expected and whether the standard has been met.

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[1] 5 U.S.C. § 4302(b)(2).

[2] 5 U.S.C. § 4302(b)(1).

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EMPLOYEES GENERALLY SATISFIED WITH PERFORMANCE STANDARDS

Overall, surveyed employees seemed satisfied with several important aspects of their performance standards. As indicated by the following chart, most employees in both years in all three Departments felt their standards were fair, tailored to their job, and consistent with organizational goals.

Table 1

	Agriculture		HUD		Navy	
	1981	1982	1981	1982	1981	1982
	(percent)					
Standards were fair	69	75	65	63	70	73
Standards were tailored to job	76	78	68	60	78	80
Standards were consistent with organizational goals and mission	78	84	77	73	79	85

As the chart shows, acceptance of performance standards was good in all three agencies in the first year. However, at HUD, there was a statistically significant decline in employee satisfaction with these aspects of standards in the second year.

PERFORMANCE STANDARDS HAVE IMPROVED SLIGHTLY

According to a handbook[3] published by OPM's Interagency Advisory Group (IAG),[4] establishing quality performance standards is essential to a successful performance appraisal system. Also under the merit pay program, the amount of an employee's merit pay increase is dependent in large part upon his or her performance rating.

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[3] Diagnostic Guide for Improving the Quality of Performance Elements and Standards, IAG.

[4] The IAG Committee on Performance Appraisal is an OPM-sponsored group comprised of agencies' personnel directors, their representatives, and line managers to provide a forum for sharing information about performance appraisal systems and techniques.

We reviewed 12,216 performance standards from a total of 950 performance appraisals at the Departments of Agriculture, HUD, and Navy for fiscal years 1981 and 1982 as shown below:

Table 2

Agency	Performance appraisals reviewed	Performance standards analyzed 1981	1982	Total
Agriculture	326	2,299	3,035	5,334
HUD	326	1,099	2,382	3,481
Navy	298	1,714	1,687	3,401
Total	950	5,112	7,104	12,216

The quality measures in the performance standards improved in all three Departments in fiscal year 1982. However, we still found standards that

--were not measurable in terms of quality, quantity, and timeliness and

--did not distinguish between performance levels.

Quality, quantity, and timeliness criteria can improve measurability of standards

Chapter 430, subchapter 2-3(b) of the FPM states that when it is feasible, performance standards should include, among other things, measures of quality, quantity, and timeliness. They should indicate how well the work has to be done (quality), how much work is to be done (quantity), and how soon the work is to be done (timeliness). According to the IAG handbook, if performance standards do not contain these measures, a supervisor can expect difficulties in making accurate and objective appraisals.

Although we recognize that it may not be feasible for all standards to contain these measures, many performance standards at Agriculture, HUD, and Navy did not contain quality, quantity, or timeliness measures in either fiscal year 1981 or 1982. However, as shown below, in fiscal year 1982 there was a statistically significant improvement in quality criteria of standards in all three agencies.

Table 3

Agency	Standards having measures of: Quality 1981	1982	Quantity 1981	1982	Timeliness 1981	1982
	------------	(percent)	------------			
Agriculture	23	32	56	52	42	37
HUD	36	66	28	38	24	32
Navy	17	20	42	44	39	33

Standards which simply restate the employees' duties can make it difficult for supervisors to objectively evaluate an employee's performance. For example, one performance standard for an Agriculture civil engineer was to: "Respond to requests and provide assistance to Director of Engineering to help maintain the . . . safety program." This standard does not contain any measures of quality, quantity, or timeliness.

Another example of a vague and immeasurable standard is the following for a Navy Aerospace Engineer:

"Develop plans for advanced aircraft development programs (fixed wing and/or helicopters). Prepare proposals, briefings, technical rationale documents, etc., in support of advanced aircraft development programs."

Again, this standard does not tell the employee how complete the plans, proposals, etc., must be, how many there should be, or when they are due. Had the standard noted that the plans had to meet the supervisor's expectation for them, in our methodology, the quality measure would have been satisfied.

Employees surveyed who were concerned with the objectivity and/or measurability of their performance standards commented as follows:

--"Most performance standards are too vague and leave too much to opinion."

--"As long as standards are vague [and] immeasurable, management can rig ratings any way they want."

--"[Performance standards] are so broad and vague as to allow total subjectivity on part of supervisor."

--"Quality of performance standards remains the biggest obstacle to a merit pay system . . . ."

On the other hand, another employee commented that establishing quality performance standards "does help to improve each supervisor's skills in evaluating a subordinate's performance in a consistent measurable manner." The following two standards include measures of quality, quantity, and timeliness which provide a basis for determining how well the employee is doing the job. The first example is a standard defining the "on target" level of performance for a Navy Supervisory Budget Analyst:

> "Submit required Justification Back-up Book data . . . no later than 3 weeks after final dollar and manpower controls are received. Special budget exhibit requirements to be submitted NLT [not later than] 1 week after submission of above. Maximum of three major technical errors caused by failure to follow instructions or mathematical calculations."

The second example is a standard defining the fully satisfactory level of performance for an Agriculture Supervisory Management Analyst:

> "Complete 60% of the service-wide policy for electronic mail; 15% of the policy for word processing; and develop the basis for the electronic filing policy. Provide analysis and review of office information systems, 70% of the studies agreed upon for completion are accepted by the Staff Director. Provide assistance and/or leadership for major office system studies such as electronic mail; 70% of these efforts agreed upon for completion will be accomplished within the set time limits."

Distinctions between performance levels need improvement

According to the IAG handbook, a clear, concise differentiation between performance levels greatly increases the supervisor's and employee's ability to accurately assess performance. If distinctions do not exist, supervisors will have difficulty determining the employee's level of performance and justifying the rating given.

At Agriculture and HUD, many standards did not distinguish between the various performance levels. However, as the chart below shows, in fiscal year 1982, both agencies improved in developing standards that distinguish between the five performance levels used to rate employees.

Table 4

Agency	Standards which make performance distinctions from: Outstanding to highly satisfactory 1981	1982	Highly satisfactory to fully satisfactory 1981	1982	Fully satisfactory to marginally satisfactory 1981	1982	Marginally satisfactory to unsatisfactory 1981	1982
	-----------	-----------	-----------	(percent)	-----------	-----------	-----------	-----------
Agriculture	26	47	42	55	57	74	43	54
HUD	4	25	3	9	1	17	3	56

HUD requires standards for outstanding, fully satisfactory, and unsatisfactory performance to be defined. However, the following set of standards for a HUD Branch Chief are an example of standards that do not clearly distinguish between fully satisfactory, and outstanding performance:

Fully satisfactory level of performance

"Determines effectiveness of policies, procedures and methods of operation of field office. Participates in field reviews of field office operations or the resolution of specific problems in a field office."

Outstanding level of performance

"Regularly determines effectiveness of policies and procedures as they relate to the field office operations. Participates and/or coordinates field reviews and promptly resolves any problems or deficiencies noted."

Conversely, the following standards for a HUD Area Audit Supervisor do identify what performance is necessary to attain a given rating.

Fully satisfactory level of performance

"90 percent of assigned surveys and pilot audits with related reports and guides which meet [the unit's] standards are completed within negotiated timeframes."

Outstanding level of performance

"95 percent of assigned surveys and pilot audits with related reports and guides which meet [the unit's] standards are completed within negotiated timeframes."

Most of Navy's standards were distinguishable. The Navy's system consists of three levels for each element (above, below, and on target), two of which are defined (above and on target). In fiscal years 1981 and 1982, 74 and 72 percent, respectively, of the performance elements in the Navy appraisals reviewed had standards that distinguished between above target and on target.

AGENCIES NEED TO IMPROVE STANDARD-SETTING PROCEDURES

The CSRA[5] requires agencies to encourage employee participation during the standard-setting process and to communicate performance standards to employees at the beginning of each appraisal period. At the three agencies reviewed, however, these procedures were not always followed.

Employees should participate more in setting standards

According to a study conducted for OPM,[6] performance standards developed jointly by supervisors and employees tend to result in greater employee acceptance of the standards; more positive attitudes toward them; and, possibly, higher quality standards. In addition, those employees GAO surveyed who were satisfied to a great or very great extent with the input they had in setting standards were more positive about the fairness of the merit pay/performance appraisal process in fiscal year 1982. However, many employees from Agriculture, Navy, and HUD were not satisfied with the amount of involvement they had in establishing their standards.

While most employees in 1982 at Agriculture and Navy (70 and 76 percent, respectively) believed their supervisors considered their views when setting standards, only 46 percent of HUD employees believed this to be the case. We also asked to what extent respondents were satisfied with the amount of input they had into setting their standards. Fifty-one percent of the respondents in Agriculture, 52 percent in Navy, and 29 percent in HUD answered that they were satisfied to a great or very great extent. Comments from employees concerned over their lack of participation in standard setting included:

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[5] 5 U.S.C. § 4302(a)(2).

[6] Organizational Assessments of the Effects of Civil Service Reform, Case Western Reserve University, Fall 1982.

--"Individual members were not allowed to set individual objectives with supervisors."

--"Standards were set by [the] agency with no input from me."

--"Performance standards [were] not established or agreed to by supervisor and employee."

--". . . standards are imposed by headquarters, no supervisor/employee modifications are allowed."

On the other hand, one employee who was greatly satisfied with his input in setting his standards noted "I like the procedure of setting up the performance standards and the specificity of defining the work."

<u>Untimely communication of standards remains a problem</u>

The CSRA[7] requires that employees receive critical elements and performance standards at the beginning of each appraisal period. According to Chapter 430 of the FPM, effective two-way communication about a job before the appraisal period begins provides an opportunity to identify and resolve any misunderstandings.

Many employees in the merit pay pools we reviewed did not receive their set of standards until 6 months or more had elapsed in the appraisal period. In some cases, we could not determine when the employees received their standards because they had not signed and/or dated them.

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7 5 U.S.C. § 4302(b)(2).

Table 5

Agency	Sets of standards Dated	Undated	Months after period began that standards were received[a] Less than 1	1-3	3-6	6-9	9-12
			------(percent)------				
Agriculture							
1981	135	28	51	18	7	15	9
1982	129	34	36	27	22	8	6
HUD							
1981	56	107	32	9	16	11	32
1982	54	109	19	11	28	22	20
Navy							
1981	108	41	61	18	18	2	1
1982	123	26	64	24	10	0	2

[a]These percentages are based on those sets of standards for which we could determine when employees received them.

As the table shows, standards were not always promptly communicated at both Agriculture and HUD, where 14 percent and 42 percent of the employees, respectively, received their standards more than 6 months after the fiscal year 1982 appraisal period began. Receiving standards late in the appraisal period was also mentioned as a problem by employees who commented that:

--"Performance standards [are] given every year at least 6-8 months into the [appraisal] period."

--"When I asked my supervisor about the 1982 standards early in the 1982 fiscal year, . . . [he said] he couldn't discuss my standards until management had given him his own standards. I received my 1982 standards 6 months into the fiscal year."

--"In many cases, objectives have not been set until well into the fiscal year [then] backdated. . . ."

Has standard setting improved communication between supervisors and subordinates?

One of our 1982 survey questions asked if communication between respondents and supervisors has become better, worse, or remained about the same since merit pay started. Ten percent from Agriculture, 9 percent from HUD, and 17 percent from Navy believed communication had improved. On the other hand, 11 percent from Agriculture, 17 percent from HUD, and 13 percent from Navy believed communication had become worse, while 79, 73, and 70 percent, respectively, said there had been no change.

At the request of Navy officials, we also asked Navy respondents who supervised merit pay employees to what extent work-related communication between them and their employees had improved. Seven percent said that communication improved to a great or very great extent, while 63 percent said there was little or no improvement.

About 75 percent of the pool officials interviewed after the 1982 cycle stated that the performance appraisal process had increased communication between supervisor and subordinate within the pool. In fact, eight officials cited improved communications within the pool as the primary benefit of the merit pay system.

Upper level review can improve consistency of standards

According to the IAG handbook, for employees to consider a performance appraisal system fair, performance standards must be consistent for all employees in the pool. Positions with comparable duties and responsibilities should have standards of comparable difficulty. Chapter 430, subchapter 2-3(c), of the FPM provides that agencies should use the same standards for all employees who have "identical" jobs in the same grade, series, and organization. A review of performance standards at the beginning of the appraisal period by pool managers (or their designees) can help ensure that standards for similar positions are consistent.

Some reviewing officials for the merit pay pools we visited did review some or all standards of pool members at the beginning of the appraisal period even though not required by departmental merit pay plans to do so. Specifically, in 1982 reviewing officials at 18 of 22 Agriculture pools, 6 of 11 HUD pools, and 16 of 24 Navy pools said they reviewed standards at the beginning of the appraisal period.

However, many employees believed that inconsistent difficulty of elements and standards for the same or similar jobs was a problem. Of those surveyed, 36 percent from Agriculture, 30 percent from HUD, and 46 percent from Navy believed this to be a moderate to a very great problem. For example, two employees' comments were:

--"Standards and ratings are inconsistent among supervisors and even for a given supervisor for similar jobs."

--"My problem with merit pay here is that different objectives are established for similar positions and the degree of difficulty to obtain goals varies within the same unit."

Some employees also commented on the problem of having the same standards for different jobs. For example, they noted:

--"We have identical elements and standards for somewhat different jobs."

--"Standards are subjective and the same for all persons at the same grade regardless of job."

--"Regardless of the position, the job elements and performance standards are the same."

CONCLUSIONS

Although the quality of performance standards improved in 1982, less than half the standards

--contained objective measures of quality, quantity, and timeliness, and

--many did not distinguish between performance levels.

Performance standards which contain these features can help supervisors make more accurate and objective appraisals and can enhance management's use of appraisals when making personnel decisions.

Employees need to know what is expected of them and what their overall final rating will be based on. This communication of standards early in the appraisal period can also reduce the likelihood of disagreement when the rating is completed at the end of the appraisal period. Requiring greater employee participation in setting standards should help tailor them to the duties of each job.

It is important that agencies reemphasize the need for supervisors and subordinates to jointly establish performance standards that (1) include measures of quantity, quality, and timeliness to the maximum extent feasible; (2) are consistent in difficulty; (3) accurately reflect employee duties; and (4) distinguish between performance levels. Without this emphasis, standards may not be fair and accurate criteria by which to judge performance.

Requiring a review of performance standards at the beginning of each appraisal period by pool managers or their delegates may improve the consistency and quality of standards and may also ensure that employees receive them at the beginning of each appraisal period.

RECOMMENDATIONS TO THE DIRECTOR, OPM

We recommend that the Director, OPM, improve performance standards and the standard-setting process, to the extent that it is legally permissible, by requiring pool managers or their delegates to review standards at the beginning of each appraisal period. This review should ensure that, to the maximum extent feasible, standards contain the desired characteristics of objectivity and measurability and that they are of comparable difficulty for similar jobs.

The Director, OPM, should also require that, to the extent that it is legally permissible,

--employees be given the opportunity to consult with their supervisors in setting their performance standards and

--performance standards be communicated to the employee within a specified time after the beginning of the appraisal period.

AGENCY COMMENTS

In its comments on our draft, OPM suggested that as written, the proposed recommendation requiring employee participation in standard setting could be interpreted as infringing upon management's right to assign work. Therefore, we revised the recommendation to ensure that it not be misinterpreted.

OPM stated that its October 25, 1983, proposed regulations would require review and approval of standards, elements, and ratings by a supervisor or manager at a higher level than the appraising official. OPM noted that employee participation in setting standards is fundamental to the success of the performance appraisal system and that its October regulations stated that the agencies "shall encourage" this participation. OPM also said that these regulations would require that performance plans be provided to employees at the beginning of each appraisal period. OPM expects that its oversight activities will ensure that this requirement is met.

HUD and DOD agreed with the findings, conclusions, and recommendations in this chapter. Agriculture had no comments on this chapter.

CHAPTER 4

MORE EVALUATION AND GUIDANCE

NEEDED FOR MERIT PAY SYSTEMS

OPM is responsible for establishing, evaluating, and monitoring merit pay systems governmentwide. CSRA requires OPM to analyze the cost and effectiveness of the merit pay system and cash awards program and to annually publish the results. OPM's past efforts to evaluate various agency merit pay systems were limited in scope and have not met the CSRA requirement. OPM now plans more emphasis on merit pay evaluation. OPM has not ensured that all agencies emphasize and use the cash award program as an integral part of merit pay as intended by the CSRA. Agencies we reviewed have evaluated and made changes to their merit pay systems.

OPM EVALUATIONS HAVE BEEN OF LIMITED SCOPE

Since merit pay was first implemented in October 1980, OPM's reviews and evaluations have focused on statistical analyses of ratings and pay increases and on reviews of agencies' compliance with regulations. It has not succeeded in measuring whether the merit pay system is accomplishing the goals of the CSRA, nor has it determined the cost to implement or operate merit pay governmentwide.

A September 1981 OPM report, Merit Pay: First Year Experiences in Eight Federal Agencies, described merit pay formulas of different agencies and statistically analyzed ratings and pay. A May 1982 OPM pamphlet, Merit Pay in 1980: Lessons Learned, summarized data from nine other studies.[1] Both studies were based on the experiences of the eight agencies that implemented merit pay in 1980 and that employed about 2,200 merit pay employees--about 2 percent of the current merit pay population.

A January 1983 OPM report, Merit Pay, Fiscal Year 1982 Program Report, statistically analyzed rating and pay data from the October 1981 pay cycle. Its findings were based on appraisal data from 19,000 merit pay employees--16 percent of the merit pay population. According to OPM, because the data were limited and varied from agency to agency, "it is not possible to make valid generalizations to the Federal work force as a whole."

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[1]These studies were conducted by OPM, other government agencies, universities, and the National Academy of Public Administration.

The report makes no attempt to assess the success of merit pay in meeting its goals, nor does it analyze the cost and effectiveness of the merit pay system and the cash award program.

In August 1983, OPM published a pamphlet entitled Significant Progress in Pay for Performance 1980-1982. This pamphlet concluded that

> "the Federal government's new performance appraisal system is functioning very well less than two years after its establishment. And, pay-for-performance . . . has been effective in providing greater rewards for above average performers, while achieving a high degree of acceptance among employees."

These conclusions were based upon (1) an experiment in 1980 involving eight agencies employing a total of 2,200 merit pay employees; (2) data gathered by the Federal Employee Attitude Survey in early 1980, about 7 months before merit pay was fully implemented; (3) OPM's own experience with merit pay; (4) informal employee and agency comments; and (5) incomplete submissions of rating and payout data from all the agencies operating merit pay systems. At the request of Senator Bingaman, we evaluated and reported on this OPM study[2] and generally disagreed with OPM's conclusions.

OPM also funded university research studies of merit pay. One paper analyzed merit pay in five agencies[3] and concluded that

> "as perceived by affected employees, the new performance appraisal system does not effectively measure performance and therefore does not serve the purpose of the merit pay program to link pay to performance."

Following the first merit pay cycle, Case Western Reserve University published a study[4] for OPM, which assessed the effect of various parts of the CSRA on employees at five federal installations in two agencies. The study commented on the need for fairness in determining raises and bonuses and the importance of fairness in influencing acceptance of merit pay as a

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2Analysis of OPM's Report on Pay for Performance in the Federal Government 1980-1982, GAO/GGD-84-22, October 21, 1983.

3Federal Merit Pay: An Appraisal, James Perry and Jone Pearce, 1982.

4Organizational Assessments of the Effects of Civil Service Reform, Case Western Reserve University, Fall 1982.

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system. It also noted that poorer employee attitudes toward merit pay result when pool managers change ratings.

In a January 1983 paper,[5] Case Western researchers concluded that

> ". . . merit pay is not working in our two agencies or in most of the other agencies in which evaluations are taking place. By not working we mean that it is not widely accepted, it is not seen as an improvement, it is not rewarding deserving people fairly with significant raises, and it is not contributing to agency effectiveness."

The paper also noted that

> ". . . performance standards and performance appraisal may be working to improve the way in which employees are able to plan and accomplish their work goals. This is . . . an encouraging accomplishment for the CSRA and for the prospects for work effectiveness improving in the federal government."

OPM HAS NOT CONDUCTED OR PUBLISHED REQUIRED ANALYSES OF MERIT PAY SYSTEM AND CASH AWARD PROGRAM

The CSRA requires OPM to analyze the cost and effectiveness of the merit pay system and the cash award program and to annually publish the results.[6] Although OPM has stated that this reporting requirement was eliminated by the Congressional Reports Elimination Act of 1980,[7] the statute requiring it remains in full force and effect. While OPM has not analyzed and reported on the cost and effectiveness of these systems, it did attempt to determine implementation costs from October 1978 to October 1981. However, its estimate of implementation cost was not based on accurate submission of data from all the agencies operating merit pay systems.

In late August 1981, OPM's Interagency Advisory Group (IAG) asked agencies to voluntarily provide first-year cost data on the development, training, and implementation of merit pay. As

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[5] Performance Appraisal: The Federal Experience, Karen N. Gaertner and Gregory H. Gaertner, Case Western Reserve University, January 1983.

[6] 5 U.S.C. § 5404(1).

[7] Public Law 96-470, October 19, 1980, 94 Stat. 2241.

a result, in its January 1983, Merit Pay, Fiscal Year 1982 Program Report, OPM estimated the cost governmentwide for developing, training, and implementing merit pay and performance appraisal systems from October 1978 to October 1981 to be $43.6 million.

We have some concern with the accuracy of this cost estimate. First, as OPM noted, 53 of 89 agencies or components with a separate merit pay plan submitted cost data. For agencies not submitting data, OPM estimated their costs using figures provided by agencies of comparable size. Second, the agencies received the IAG request in August 1981 long after they had begun designing and implementing their systems. This required them to reconstruct and estimate costs incurred since 1978. Third, agencies were asked not to include either the time employees and supervisors spent setting standards and preparing ratings or the salaries of employees in merit pay training. Finally, OPM estimated Navy's contractor costs to develop the performance appraisal and merit pay systems at $6.6 million, understating the actual costs reported by Navy by $3.4 million.

EMPLOYEE COSTS TO CARRY OUT PERFORMANCE APPRAISAL FUNCTIONS MAY HAVE DECREASED IN THE SECOND YEAR

Our questionnaire to Navy, HUD, and Agriculture merit pay employees asked them to estimate the time they spent setting standards, preparing ratings, and counseling staff in fiscal years 1980, 1981, and 1982. Using their responses and the average salaries of merit pay employees in each agency, we estimated employee costs to perform these functions, as shown below.

Table 1

Estimated Costs of Performance Appraisal Functions for Fiscal Years 1980 through 1982

	Navy	HUD	Agriculture
	(millions)		
Fiscal year 1980[a]	$ 6.1	$1.1	$3.7
Fiscal year 1981	11.7	1.2	5.8
Fiscal year 1982	9.5	.9	4.2

[a]Employees estimated time spent on performance appraisals in 1980, the year before merit pay was implemented, about 15 months after the end of the fiscal year. They made estimates for 1981 and 1982 about 3 months after the end of each of these years. (See app. X for details on these estimates.)

The chart shows that estimated employee costs increased 92 percent in Navy and more than 50 percent in Agriculture the first year of merit pay (1981). In HUD and Agriculture, these costs decreased to at or below fiscal year 1980 levels (when the comparability increases are factored out). A possible reason for the reduced costs from 1981 to 1982 is that, in 1981, the process of standard-setting was new, while, in the second year, employees were more comfortable with the system and, thus, required less time. Only in the Navy do fiscal year 1982 cost estimates greatly exceed the pre-merit pay level (1980). A Navy personnel official suggested that these costs did not decrease to pre-merit pay levels because, in the Navy, the standard-setting process has been made an integral part of the overall Navy planning process and requires a great deal of time.

NEW OPM EVALUATION STRATEGY EMPHASIZES MERIT PAY EVALUATION

To help carry out its responsibilities for evaluating the merit pay system and the cash award program, OPM has established an Office of Performance Management, which will, among other things, evaluate performance management in federal agencies. The evaluations and special studies of the merit pay system will be performed by the Analysis and Evaluation Division of OPM.

One responsibility of the division is "evaluating the implementation and administration of performance management programs in Federal departments and agencies for effectiveness and compliance." The Evaluation Branch of the division has been reduced to six employees, who will receive some support from OPM's regional offices to carry out their planned reviews. OPM officials said that any further decrease in evaluation staff would greatly impair its ability to complete its evaluations. The branch initiated two major studies in 1983. The first examined the effect of various factors--such as pay pool size, composition, and management; location of pool members; and the quality of performance standards and elements--on merit pay system operations. Other topics the study was to address were

--the extent and impact of rating changes during higher level reviews;

--the link between performance appraisal and organizational effectiveness;

--the effect of merit pay on individual motivation and performance;

--employee and manager perceptions and acceptance of merit pay; and

--the actual distinction in merit pay amounts, cash awards, and total pay rates and their relation to ratings.

This study, to be completed by February 1984, is a nationwide project involving 35 installations at 18 agencies. In the second planned study, agency performance appraisal and incentive awards programs will be reviewed for compliance with the law and regulations and for quality and effectiveness. This study is to involve on-site agency evaluations of at least 34 installations. However, OPM must also analyze the cost associated with the merit pay system and the cash award program and publish the results annually as required by statute[8].

OPM NEEDS TO ENSURE THAT CASH AWARDS ARE USED AS AN INTEGRAL PART OF MERIT PAY SYSTEM

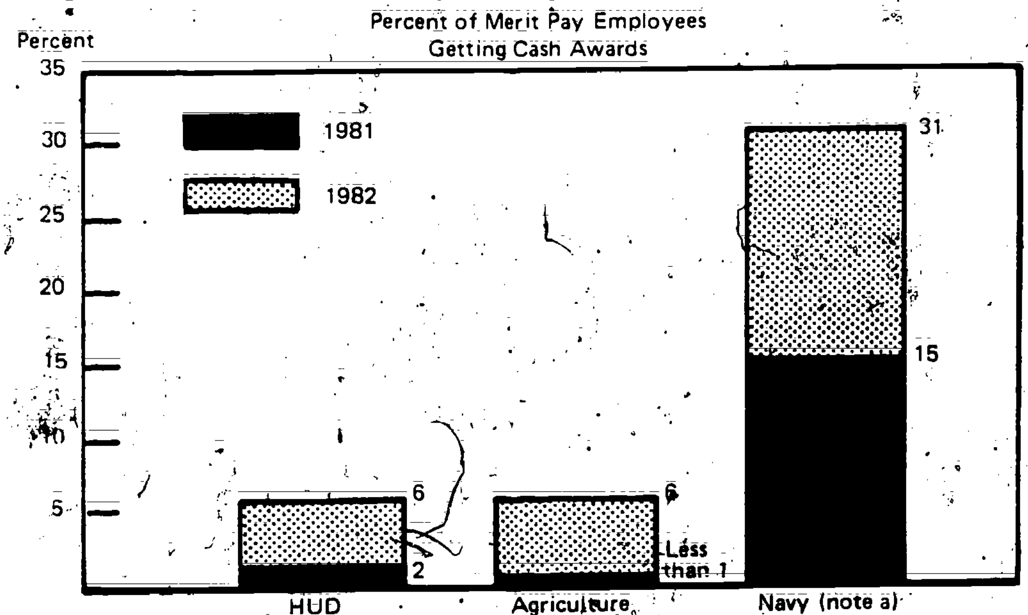
Under the CSRA, cash awards are supposed to be an integral part of the merit pay system. They can be used to reward employees for outstanding performance and to reward those whose top performance is not reflected in their merit pay because they were at the top of the salary range or were newly promoted and not under merit pay long enough to be appraised. Cash awards require little additional paperwork since they are supposed to be based on performance, and performance is documented by the employee's annual appraisal. However, OPM has not ensured that all agencies are using their cash award programs as an integral part of merit pay.

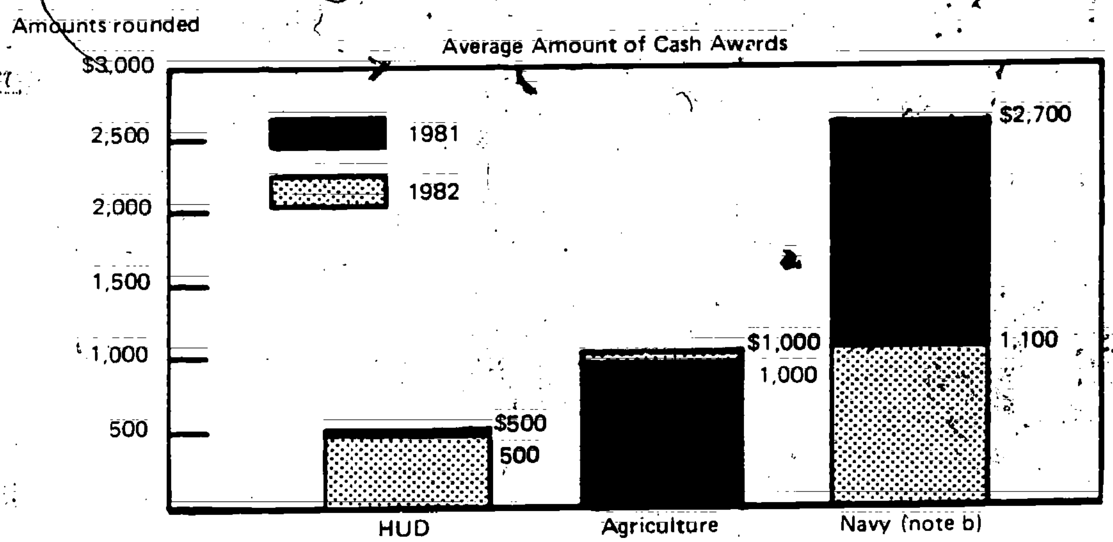
As a result, the three Departments established cash awards programs and supported them with varying degrees of emphasis. Navy emphasized its cash awards program in both years; Agriculture and HUD did not. Therefore, Navy granted larger cash awards to a larger percentage of its merit pay employees in both years. According to personnel officials, one reason for the variance among the Departments was budget restrictions in Agriculture and in HUD. The differences in the dollar amount and percentage of awards made in the three Departments in 1981 and 1982 are shown on the following page.

8 5 U.S.C. § 5404(1).

SUMMARY OF CASH AWARDS:

PERCENT OF MERIT PAY EMPLOYEES GETTING CASH AWARDS AND AVERAGE AWARD AMOUNT





a/ Navy policy on cash awards changed from 1981 to 1982. In 1981, the number of awards at each activity was limited to 15 percent of its merit pay employees. In 1982, the percentage was not limited, but the dollar amount was restricted to 1 percent of base salaries of merit pay employees in the unit.

b/ The average award amount for the entire merit pay population was not available for 1981. The amount shown for 1981 is the average for the units visited in the Washington, D.C. area.

AGENCIES HAVE IDENTIFIED AND CORRECTED SOME FIRST-YEAR PROBLEMS

All three Departments have evaluated their merit pay systems and gathered attitudinal data from employees or supervisors about merit pay. Each Department made changes to its system based on these evaluations.

The HUD evaluation identified several areas needing improvement, including more consistent standards, better justification of ratings, and rules for assigning overall ratings. To remedy these problems, HUD

--recommended an upper-level review of standards at the beginning of the appraisal period;

--developed "model managerial elements and standards" and a "performance appraisal package" containing examples of well-documented ratings;

--required written justification for all ratings other than Fully Satisfactory; and

--implemented "decision rules" to use in determining an overall rating when individual elements receive a different rating score.

Agriculture's evaluation task force identified several merit pay issues needing attention. First, it noted that quality and consistency of standards within its organizational units needed to be improved and recommended that Agriculture establish a library of performance standards and act as a center of expertise to assist these units. Second, it noted problems with documenting employee job accomplishments and reaffirmed that they must be documented. Third, it concluded that the formula used in 1981 did not adequately reward above average performers. Therefore, it recommended changing its merit pay formula to increase the difference in pay between different performance levels. The revised formula adopted by Agriculture made a 5.0 (Outstanding) rating worth three times more than a 3.0 (Fully Successful) rating for employees in the same grade and position in the salary range.

Agriculture also surveyed its merit pay employees in 1981 on their attitudes toward merit pay and concluded that a great benefit of the new performance appraisal system was the increased communication between supervisors and employees. It also noted several causes for employee negativism toward merit pay, including

--small differences in pay, despite fairly large differences in ratings;

--the time and effort required to implement and administer the new system; and

--the fact that many Fully Satisfactory employees received less than they would have under the old system.

Navy has conducted several evaluations of its merit pay system and also used our questionnaire results to better understand employee concerns. Following the 1981 pay cycle, Navy evaluations found that

--pool managers believed the merit pay system was too time-consuming, with excessive paperwork, and provided disappointing pay;

--the most significant problems pool managers cited were setting meaningful and measurable objectives and the time to administer the system;

--standards were, in some cases, overly quantitative;

--ratings were changed during the review process with no justification provided;

--ratings were high for higher graded employees; and

--strong points of the system, according to pool managers, were pay for performance, increased interaction between supervisor and subordinate, comparison of command (organization) goals to individual goals, and differentiation of good performers from bad.

The Navy changed its system for the appraisal period starting July 1982 because of the problems discovered. Among these changes, the Navy

--required that changes to ratings be justified on the rating form and communicated to the employee within 90 days of the end of the appraisal period;

--required fewer performance reviews during the year;

--simplified its appraisal forms;

--made second-level supervisory reviews of standards optional but encouraged an up-front review of them by review boards appointed by the pool manager to ensure equity among pool members' standards and the timely establishment of standards;

--informed raters that higher level merit pay employees already are compensated for their broader authority and responsibility by a grade adjustment factor and, therefore, do not need their ratings raised for this reason; and

--made it acceptable to use more subjective approaches to measuring performance, thereby reducing the emphasis on quantity as a measure of performance.

Following the 1982 pay cycle, Navy sent a questionnaire to pool managers and members of boards designated to review standards and ratings for the pools. Some results were favorable toward performance appraisals. For instance, these pool managers believed

--the system helped focus managers' and supervisors' attention on organizational goals (83 percent),

--they were able to adequately reward their high performers with pay increases and cash awards (54 percent),

--communication within their merit pay unit increased (55 percent), and

--the 1982 performance evaluations accurately reflected the worth of employee contributions to their organization (66 percent).

CONCLUSIONS

OPM efforts to evaluate merit pay have been limited. It has not accurately determined the cost of implementing and operating merit pay systems. It also has not analyzed the cost and effectiveness of the merit pay system and cash award program and published the results as required by law.

OPM has established a new organization (Office of Performance Management) which will evaluate merit pay in the future, including its effectiveness and impact on employee motivation and performance. Its new emphasis on evaluation appears promising. However, the number of staff assigned to carry out the strategy is limited and may experience difficulty in conducting the reviews as planned if the size of the staff is decreased. OPM has not ensured that all agencies are using the cash award program as an integral part of merit pay.

The three Departments reviewed have evaluated their merit pay systems and made changes based on their evaluations. These actions were steps in the right direction.

RECOMMENDATIONS TO THE DIRECTOR, OPM

In order to improve the evaluation and administration of the merit pay system and the cash award program, we recommend that the Director, OPM, to the extent that it is legally permissible,

--provide adequate resources to maintain planned merit pay evaluation efforts;

--publish annual reports which analyze the cost and effectiveness of the merit pay system and the cash award program; and

--clarify the intended role of the cash award program for merit pay employees and provide guidance and oversight that will ensure that it is used as an integral part of merit pay.

AGENCY COMMENTS

OPM concurred that it should provide adequate resources to maintain their evaluation efforts and pointed out the establishment of the Office of Performance Management and its plans for future evaluation. OPM believes that it is responding to our "cost and effectiveness" recommendation. OPM stated that it is currently performing studies which will address how effectively the merit pay program is achieving CSRA objectives. OPM does not believe it is necessary to report on the costs of the merit pay system because the total payouts under merit pay are the same as they would have been under the General Schedule. However, the law requires that an annual report on cost and effectiveness be published. OPM has not kept track of the costs required to implement or operate these programs and the time spent for performance appraisal functions--the administrative costs of actually making the payouts could be substantial.

OPM stated that its October 1983 proposed regulations would require that performance awards become a mandatory part of merit pay and that agencies submit to OPM for approval a plan specifying how these awards are to be distributed and the amount to be funded by the agency for such purposes.

DOD and HUD agreed with the findings, conclusions, and recommendations in this chapter. Agriculture had no comment on this chapter.

CHAPTER 5

EMPLOYEES RETAIN NEGATIVE

PERCEPTIONS OF MERIT PAY SYSTEM

Employees' perceptions of their merit pay systems will play a large role in determining whether merit pay succeeds. While in the second year employees believed there were some improved aspects of merit pay, such as the system taking less time to operate, in the three Departments we reviewed, employees' overall perceptions about merit pay remained negative.

Most employees, including top performers[1] who received the largest merit pay increases, believed the system had not been successful. We did find slight improvements in Navy respondents' perceptions after the 1982 merit pay cycle. However, most respondents in all three agencies at the end of both years believed that the system had not increased (1) motivation or (2) performance/productivity. Merit pay pool officials also held the same negative attitudes expressed by surveyed employees.

While between 37 and 46 percent of the employees in each Department in both years supported the concept of merit pay, less than 10 percent favored retaining the current merit pay system in their Department. Many believed the current system had not been administered fairly and that performance ratings under merit pay were more subjective than before.

EMPLOYEES SKEPTICAL ABOUT THE MERIT PAY SYSTEM'S INTENDED BENEFITS

After the 1981 and 1982 pay cycles, many respondents did not believe that the objectives of merit pay were being met. Respondents felt that motivation, productivity, and performance had not increased under merit pay. In addition, in both 1981 and 1982, about 80 percent of each Department's surveyed employees did not believe the benefits of the merit pay system justified the additional time required to operate it. After the 1982 cycle, however, respondents who believed the benefits of merit pay justified the effort it required increased from 7 percent to 11 percent in Navy, from 11 percent to 13 percent in HUD, and from 8 percent to 9 percent in Agriculture. Only the increase in Navy, however, was statistically significant.

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[1]"Top performers" are defined in this report as those who in Agriculture, were rated at 4.5 or higher (out of 5.0); in HUD, were rated Outstanding or; in Navy, were rated Level 1 (highest rating).

Respondents believed that productivity did not increase under merit pay. About 80 percent of the respondents in both years reported that they were no more productive under merit pay. Further, after the 1982 pay cycle, less than a quarter of each Department's top performers reported increased productivity under merit pay. Over the 1981 and 1982 period, of the respondents who supervised merit pay employees, approximately 75 percent believed their merit pay subordinates were no more productive as a result of the merit pay system. While the percentage of supervisors who believed this remained fairly constant in both years at Navy and HUD, the percentage increased in Agriculture from 62 to 84 percent from 1981 to 1982.

Surveyed employees were more satisfied with the amount of their merit increases after the 1982 pay cycle. After the 1982 cycle, when more merit pay funds were available because of the increased within-grade contributions mentioned earlier (see pp. 7 and 8), more respondents in each Department felt the amount of merit increase they had received accurately reflected their performance. The percentage of employees who believed this increased from 15 percent to 27 percent in Navy, from 10 percent to 26 percent in HUD, and from 8 percent to 25 percent in Agriculture. Among the top 1982 performers in each Department, about 50 percent felt their merit pay accurately reflected their performance, 40 percent said it did not, and 10 percent were not sure.

Over the 2-year period, about 80 percent of Navy, HUD, and Agriculture respondents said that the merit pay system had not increased the pressure on them to fulfill their job duties and responsibilities. This percentage remained virtually unchanged for both years.

EMPLOYEES EXPRESS SUPPORT FOR MERIT PAY CONCEPT, BUT WANT CURRENT APPLICATION OF SYSTEM REVISED OR DROPPED

According to a recently published OPM survey,[2] almost half of all senior-level supervisors believed that, in principle, merit pay was a good idea. Many employees we surveyed also supported the concept of merit pay (see question 10, app. III).

On the other hand, less than 10 percent of the respondents in each Department wanted to retain the merit pay sytem as currently implemented, and even among the top performers who responded, less than 15 percent favored retaining the system "as is." Between 31 and 39 percent of both years' respondents in

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[2] _Federal Employee Attitudes_, OPM, 1983.

each Department favored retaining merit pay but wanted the system revised. Almost half the top performers in HUD and Navy and about a third at Agriculture shared this opinion. Approximately half of all surveyed employees wanted to return to the General Schedule for pay increases. The percentage of employees who wanted to return to the old system decreased from 49 to 44 percent in Navy, from 55 to 50 percent in HUD, and from 56 to 53 percent in Agriculture, after the 1982 pay cycle. The decrease in Navy was statistically significant, the decreases in HUD and Agriculture were not.

Employee feelings about the performance appraisal system were more positive than toward the merit pay system. For both years, the percentage of surveyed employees who wanted to keep their agency's appraisal system ranged from 27 percent in Navy to 43 percent in HUD. Further, between 34 and 49 percent of each Department's top performers favored retaining their performance appraisal system even if it were not linked to merit pay.

Respondent comments showing their concern for the way the merit pay system was implemented included:

--"The concept of merit pay was good in its initial . . . stages. However it has been inequitably administered and as such has not produced the benefits that were supposed to accrue from it."

--"The intentions of merit pay are good, equitable implementation is impossible."

EMPLOYEES QUESTION FAIRNESS OF MERIT PAY SYSTEM

A 1983 University of California study,[3] funded by OPM, states that the link between merit pay and performance appraisals--specifically their accuracy and fairness--is critical to the system's general effectiveness. Although the CSRA calls for objective performance ratings to the maximum extent feasible, after two appraisal and merit pay cycles, 40 percent or more of our survey respondents in each Department believed that the appraisal process was influenced by favoritism.

After the 1982 pay increases, between 28 and 48 percent of each Department's surveyed employees reported that ratings had become more subjective since merit pay was implemented, even

[3] Federal Merit Pay: A Longitudinal Analysis, Jone Pearce and James Perry, Graduate School of Management, University of California, Irvine, 1983.

though appraisals under the new system were to be based on objective criteria to the extent feasible. The percentage of top performers who shared this view ranged from 22 percent in Navy to 36 percent in Agriculture. Between 68 percent and 74 percent of all respondents reported that subjective ratings were at least somewhat of a problem in their pool.

The following comments reflect employee concern about subjectivity and favoritism in the ratings:

--"The Merit Pay System . . . fosters favoritism. People performing similar jobs with essentially identical outputs get extremely varied ratings . . . . The system is not handled objectively as intended."

--"The appearance of fairness and equity is important in any pay system. In my agency, the credibility of the merit pay system has been undermined by the significant differences between ratings given in the various merit pay pools."

--"The system requires too much subjectivity on the part of reviewers, and tends to foster unfair preferential treatment."

--"I am concerned over favoritism, bias, and cronyism in ratings."

After completing two appraisal and pay cycles, employees doubted the system's overall fairness. Sixty-three percent of HUD respondents, 44 percent in Navy, and 43 percent in Agriculture thought merit pay and performance appraisal systems were unfair in fiscal year 1982. Between 27 and 43 percent of those employees who said they earned more merit pay than they would have under the old system characterized the overall system as unfair. On the other hand, among Agriculture, HUD, and Navy, top performers, 47, 54, and 61 percent, respectively, believed the merit pay system was fair.

MOTIVATING IMPACT OF THE MERIT PAY SYSTEM IS QUESTIONED

A basic assumption of the merit pay system is that the possibility of increased pay motivates employees to improve their performance. Respondent comments, discussions with merit pay pool officials, and an independent study of merit pay indicate that the amount of merit increases has not motivated merit pay employees.

An OPM-funded University of California study[4] based on the first-year merit pay cycle concluded that

> ". . . a diverse sample of Federal managers do not appear to be more highly motivated under merit pay than under the previous time-in-grade compensation policies. . . . These managers report that effort is less likely to lead to a good performance rating, [and that] merit pay does not encourage them to do their jobs well or contribute to their agency's effectiveness."

Our questionnaire results showed that in both years, between 78 and 86 percent of the respondents in the three Departments believed that merit pay had not motivated them to perform better. Among the top performers in each Department, in 1981 between 70 and 79 percent thought that merit pay had not motivated them to better performance. In 1982, between 61 and 75 percent of the top performers shared this view. Only in Navy was there a statistically significant increase in the percentage of 1982 respondents who believed that merit pay motivated them--9 percent in 1981 to 13 percent in 1982. Further, in all three Departments, less than 2 percent of the respondents in 1982 said they were motivated to a great or very great extent by the merit increases awarded to top performers in their pay pool.

Employee and pool official responses raised questions on the degree to which money is a motivator for merit pay employees. When asked to what extent money helped motivate them to improved job performance, about 20 percent in each Department responded that it helped to a great or very great extent, another 60 percent said money motivated them to some extent or a little, and about 20 percent said money did not motivate them at all. In another survey question, we asked employees what percentage increase to their salary would have motivated them to better performance, and about 45 percent in each Department answered that money did not motivate them to better performance. Even among the top performers responding to this question, between 35 percent and 45 percent in each Department gave the same response.

Some of the narrative comments submitted by respondents in the Departments following the 1982 pay cycle include the following:

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[4]Federal Merit Pay: A Longitudinal Analysis, Jone Pearce and James Perry; Graduate School of Management, University of California, Irvine, 1983.

--"The primary motivation on my part was the feeling of doing a good job and the approval of my peers."

--"Money does not really motivate me in the performance of my job . . . . However, in terms of my personal job satisfaction, I would like to believe that my performance is being fairly rewarded . . . ."

--"While money is not a motivator to some, perceived unfairness in the distribution of merit pay definitely is a de-motivator."

--"Professional personnel don't need merit pay to motivate."

Three pool officials cited factors other than money as motivators, including responsibility, status, and recognition, as primary motivators.

--"Merit Pay can motivate people, in theory, but only at the lower levels where you can define jobs/productivity easier."

--"Merit Pay has not motivated people to better performance. At GM level, people are motivated to do well on their own."

--"Motivation, especially in relation to higher graded employees, is more a function of status and recognition than money."

MOST MERIT PAY POOL OFFICIALS HAVE NEGATIVE PERCEPTIONS OF MERIT PAY

Comments received from pool officials during both surveys generally echoed the perceptions of merit pay employees about the effects of the merit pay system. Some officials, however, did believe that merit pay was producing some positive results.

Sixty-four percent of the 141 pool officials interviewed in both years said that merit pay had no effect on employee productivity. Seventeen pool officials in 1981 and 13 in 1982 thought some of their employees were more productive, while 6 in 1981 and 5 in 1982 felt the system was counterproductive because of the time required to operate the system which left less time for employees to perform their normal duties.

Fifty-three percent of the officials in the second survey indicated that merit pay had no effect on employee motivation. Forty-four percent, however, said that merit pay has the potential--if administered properly--to motivate employees to improved performance and productivity. Most said, however, that under current funding levels, there is insufficient money in the system to motivate employees.

Sixty-three percent of the pool officials interviewed in 1981 and 73 percent in 1982 said that one effect of merit pay was a decrease in employee morale. Reasons cited included (1) subjective appraisals which resulted in unfair distributions of pay and (2) small pay differentials which did not recognize or properly reward varying levels of performance.

CHANGES TO MERIT PAY HAVE BEEN PROPOSED

The negative employee reactions discussed above and many of the merit pay problems discussed in chapters 2, 3, and 4 have been recognized by employee unions, private researchers, members of the Congress, and other government agencies. As a result, many espouse basic changes to the merit pay system. For example, OPM has proposed regulations[5] and bills have been proposed that would, in different ways, alter the scope of the merit pay system.

OPM's proposed regulations scheduled to go into effect on November 25, 1983, would have, among other things,

--guaranteed the annual comparability adjustment and an average annualized equivalent of a within-grade increase to everyone rated Fully Successful or above;

--specified a minimum funding level to be used for performance awards;

--guaranteed a minimum differential in total performance pay of those rated Outstanding over those rated Fully Successful;

--required agencies to have five summary rating levels;

--prohibited forced distribution of ratings; and

--required agencies to provide higher level management review of the performance appraisal process in the interest of employee equity and in order to reflect organizational performance.

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[5] Federal Register, Vol. 48, No. 207, October 25, 1983, pp. 49472-49491.

The regulations also covered other non-merit pay subjects such as reductions-in-force and performance appraisals. On November 12, 1983, the Congress enacted legislation to block their implementation. OPM, however, believed this legislation barred funding of the regulations but did not invalidate the regulations themselves. On December 30, 1983, the U.S. District Court declared null and void and enjoined OPM from directly or indirectly taking any action on the regulations. This court decision was rendered in response to a suit brought against OPM by the National Treasury Employees Union, which sought to have the regulations set aside and declared null and void.[6]

The proposed legislation, the Merit Pay Reform Act of 1983,[7] would prohibit OPM and agencies from forcing the distribution of ratings, guarantee the annual comparability adjustment and within-grade increases to merit pay employees rated Fully Successful or above, require five rating levels, and establish a performance award (bonus) program for merit pay employees.

CONCLUSIONS

A key factor in the eventual success of the merit pay system is how it is accepted and judged by those employees participating in it. After completing two appraisal and pay cycles, employee acceptance shows slight improvement; however, wider acceptance is needed to increase merit pay's chances for success. The improvements in attitudes--should they continue--may indicate a greater employee willingness to accept the system if they perceive it as accurately and objectively linking ratings and pay to performance. However, we agree with OPM and congressional leaders that some changes are needed in the current merit pay system to ensure that nonperformance factors do not adversely affect merit pay increases.

If OPM and the Departments take steps to ensure greater equity in ratings and pay, merit pay is more likely to gain wider employee support and acceptance. This, in turn, will enhance its chances of success.

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[6] National Treasury Employees Union v. Donald J. Devine, Civil Action No. 83-3322.

[7] Senate Bill S. 958, 98th Congress, First Session, March 24, 1983; and House Bill H.R. 1841, 98th Congress, First Session, March 2, 1983.

NINETY-SEVENTH CONGRESS

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U.S. House of Representatives

COMMITTEE ON POST OFFICE AND CIVIL SERVICE
SUBCOMMITTEE ON COMPENSATION AND EMPLOYEE BENEFITS
608 HOUSE OFFICE BUILDING ANNEX 1
Washington, D.C. 20515

TELEPHONE (202) 225-6831

December 9, 1981

The Honorable Charles A. Bowsher
Comptroller General
General Accounting Office
Washington, D. C. 20548

Dear Mr. Bowsher,

As required by the Civil Service Reform Act of 1978, most Federal agencies implemented their performance appraisal and merit pay system for the first time in October 1981. These systems, which cover between 120,00 and 150,000 GS-13 through GS-15 employees, are designed to link pay with performance.

In light of problems with merit pay system implementation already, and because of our continued interest in the success of the merit pay program, we would like the General Accounting Office to review the status of merit pay implementation in certain agencies, and provide a report of agency activity. We would like the report to include case studies of the merit pay program at two or three major Federal agencies which implemented their systems in October 1981.

We appreciate the work your office has done on this issue in the past and believe there is a need to continually monitor agency efforts to successfully implement this program. Your assistance will be greatly appreciated.

Sincerely,

Mary Rose Oakar

Mary Rose Oakar
Chair
Subcommittee on Compensation
and Employee Benefits

MAIL SURVEY OF MERIT PAY EMPLOYEES

We surveyed Agriculture, HUD, and Navy merit pay employees to assess their attitudes toward the system and their experiences with merit pay. We sent a questionnaire to employees in February 1982 about the fiscal year 1981 implementation of merit pay. In January 1983, we sent another questionnaire asking about merit pay in its second year.

INITIAL SURVEY PROCEDURE (FISCAL YEAR 1981)

The questionnaire used in the first mail survey assessed employee attitudes, experiences, and beliefs related to the following aspects of merit pay:

--Time devoted to performance appraisal duties and functions.

--Adequacy of training in performance appraisal functions.

--Extent to which performance standards were linked to employees' jobs and to organizational goals.

--Whether performance appraisal was implemented according to mandated procedures.

--Fairness of standards and the merit pay system.

--Degree to which ratings and merit pay increases reflected performance.

--Perceived benefits of merit pay, including general organizational benefits and effect on employees' motivation, productivity, earnings, etc.

--Desire to retain merit pay and the performance appraisal system.

Mail survey procedures and sample designs varied for each of the three agencies. In HUD and Agriculture, our questionnaire was attached to agency questionnaires on merit pay. The questionnaires were sent to all merit pay employees in the two agencies. HUD and Agriculture did not use followup questionnaires or contacts.

The initial survey of Navy merit pay employees was made by GAO independent of any agency effort and was sent to a random sample of merit pay employees. The initial sample size and the method used to draw the sample were both designed to allow for a high level of precision and confidence in projecting the findings to the universe. A second mailout was used in the Navy survey to increase the response rate. Standard instructions, which explained the purpose and use of our questionnaire and procedures for answering, were included in all three surveys.

SECOND YEAR SURVEY (FISCAL YEAR 1982)

The second-year survey questionnaire contained items used in the initial survey except for questions about the adequacy of training. In addition, the questionnaire was expanded to include items on problems with merit pay and performance appraisal that had been mentioned in written comments in the first-year survey.

In the second-year survey, procedures and sample designs in all three agencies essentially replicated those used in the initial Navy survey. In each agency, the questionnaire was sent by us to a random sample of employees and one followup mailing was used. The samples were drawn according to the same method as the initial Navy survey and, thus, were designed to be of sufficient size to project with high confidence to the populations.

Although the samples in the second-year survey were not designed to include the same people as the initial survey, some overlap between respondents in the two surveys occurred. In Navy, about 18 percent of the second-year survey respondents said that they had also participated in the initial survey. Overlap in the Navy samples occurred as a function of the same people being drawn at random in the 2 years. Because our initial questionnaire was sent to all merit pay employees in HUD and Agriculture, it is not surprising that over one-half of our followup survey respondents in those two agencies (52 percent and 58 percent, respectively) reported having participated in the initial survey.

RESPONSE RATES FOR BOTH QUESTIONNAIRES

Questionnaire statistics related to response rates are presented in the table below. As the table indicates, relatively lower response rates were obtained in the first-year HUD and Agriculture surveys. The possible effect of nonresponse bias, which would exist if nonrespondents in the two agencies differed from respondents on our questions, requires caution in projecting our initial survey findings to the universe of merit pay employees in the two agencies. Statistical tests were made to determine whether HUD and Agriculture respondents differed from all merit pay employees in the two agencies on grade level, age, and most recent performance rating--three variables possibly related to attitudes toward and experiences with merit pay.

Basic Questionnaire Statistics

Agency	Size of universe[a]	Number sampled	Undeliverable questionnaires	Number responding[b]	Response rate[c]
First-year survey					(percent)
HUD	2,198	2,198	-[d]	1,364	62.1
Agriculture	9,667	9,667	387[e]	5,541	59.7
Navy	16,095	624	41	549	94.2
Second-year survey					
HUD	2,174	643	18	564	90.2
Agriculture	9,536	586	35	491	89.1
Navy	15,963	580	26	499	90.4

[a]Universe and sample sizes refer to merit pay employees only.

[b]For HUD and Agriculture, number responding equals number of usable responses. That is, number giving at least one answer to the GAO sections of the survey.

[c]Response rate equals number responding divided by number sampled less number of undeliverable questionnaires.

[d]Since questionnaires were distributed by local personnel officers according to up-to-date records, we assumed that all questionnaires were deliverable (i.e., all employees could be located).

[e]Pro rata estimate based upon 450 undeliverables in a total mailout of 10,746 (including 9,667 merit pay employees and 1,079 General Schedule employees grades 13 through 15).

Neither HUD nor Agriculture respondents differed by a statistically significant margin from all merit pay employees on grade level. Significant differences, however, were found on performance ratings and age. A somewhat greater percentage of respondents in both agencies reported higher performance ratings than would have been expected based on the ratings of all merit pay employees. The Agriculture sample also tended to be younger than the universe of Agriculture merit pay employees. HUD respondents were similar to their population group in terms of age. Further analyses revealed, however, that these differences would not bias our findings or bias them by only about 1 to 3 percentage points toward more positive evaluations of merit pay. Thus, while the possible effect of nonresponse bias requires caution in projecting our initial findings to the population, especially in HUD, the comparability between respondents and the universe found in most of our tests and the sizable number of respondents in the initial surveys gives us confidence in making inferences and conclusions, based on our data, about the first year of merit pay.

Nonresponse bias in the first-year survey also introduces possible error in making inferences about changes from the first to the second year of merit pay. In order to minimize the possible effects of nonresponse bias in HUD and Agriculture, only the second-year data from respondents who reported participating in the first survey were used to analyze differences between our initial and subsequent findings.

CONFIDENCE INTERVALS

The results from a statistical sample are always subject to some sampling error because only a portion of the universe has been selected for analysis. The sampling error consists of two parts: confidence level and confidence interval or sampling error. The confidence level indicates the degree of confidence that can be placed in estimates derived from the sample. The sampling error or confidence interval is the range in which the actual universe results are located with a certain probability.

The sampling errors presented below show the confidence intervals at the 95-percent confidence level for both surveys in the three Departments.

Sampling Errors at 95 Percent Confidence Level			
	Observed percent		
Agency	10 or 90	20 or 80	50
First-year survey			
HUD	±1.0	±1.3	±1.6
Agriculture	±0.5	±0.7	±1.0
Navy	±2.3	±3.1	±3.8
Second-year survey			
HUD	±2.1	±2.8	±3.6
Agriculture	±2.6	±3.4	±4.8
Navy	±2.6	±3.4	±4.3

Confidence intervals for other reported percentages can be interpolated. This assumes that our respondents represent the entire group from which they were selected. For example, if 10 percent of Navy employees who answered our second-year questionnaire preferred to retain the merit pay system as it is, then we can say that we are 95-percent sure that between 7.4 percent and 12.6percent of all Navy merit pay employees wish to retain merit pay.

The confidence intervals reported above are for findings regarding all merit pay employees in each Department. Findings concerning subgroups of merit pay employees may be associated with different levels of precision and possibly wider confidence intervals than those for all merit pay employees depending on the size of the subgroup universe and the number of respondents in the subgroup.

EMPLOYEE RESPONSES TO GAO QUESTIONNAIRES

IN 1981 AND 1982

Below are questions taken from our second-year (1982) questionnaire, and employee responses to both the first-and second-year questionnaires. When these questions refer to a period of time, such as fiscal year 1982, you may assume that the 1981 questionnaire referred to a comparable period, but a year earlier. Questions 2 and 5 were answered only by those who supervised merit pay employees, the others were supposed to be answered by all respondents. Questions 1, 2, and 3 referred to the most recently completed fiscal year, while questions 4, 5, and 6 referred to one year earlier. For example, those employees responding to questions 4, 5, and 6 in 1981 were referring to fiscal year 1980. Some questions were asked in 1982 and not in 1981 and vice versa. These have been identified in the text.

INTRODUCTION

The U.S. General Accounting Office (GAO) is an agency of the Congress responsible for evaluating federal programs. At the request of a congressional Subcommittee, we are currently examining the merit pay system in its second year and would like you to respond to the following questions. This survey is a followup to the study we conducted last year of your agency's merit pay system. Your answers are vitally important, as we will use them and last year's findings to inform the Congress about employee opinions on merit pay implementation in the first 2 years. Please give your frank and honest opinions. Also, please be sure to answer all of the questions. The questionnaire should require no more than 20 minutes of your time.

Please check the box which best answers each question. Space has been provided after the last question for making narrative comments on any merit pay subject. Any comments are appreciated. Thank you.

1. The first questions refer to your supervision, if any, of merit pay employees. Supervisory functions under merit pay involve setting performance standards for the subordinates you directly supervise, rating them, and counseling them. How many merit pay employees (GM-13's, GM-14's, GM-15's), if any, did you supervise in FY 1982, the second year of merit pay? Please count every GM employee directly supervised in FY 1982 (i.e., October 1, 1981, to September 30, 1982).

	Agriculture		HUD		Navy	
	1981	1982	1981	1982	1981	1982
	(percent)					
None (Go to question 3)	66	70	64	67	69	68
1-3 employees	18	15	19	18	21	19
4-6 employees	9	9	9	11	6	10
7-9 employees	3	2	3	3	2	2
10 or more employees	3	3	4	1	2	1

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2. In FY 1982, approximately how many hours, if any, did you spend performing supervisory functions related to standard setting, performance appraisal, and counseling on the average per merit pay employee you directly supervised?

	Agriculture 1981	Agriculture 1982	HUD 1981	HUD 1982	Navy 1981	Navy 1982
	(percent)					
None	23	0	5	1	1	11
1-8 hours, or 1 day or less per employee	18	29	20	31	9	15
9-16 hours, or 1 to 2 days per employee	19	47	21	40	28	37
17-24 hours, or 2 to 3 days per employee	13	18	14	18	29	24
25 hours or more, or more than 3 days per employee	27	7	41	11	34	14

3. In FY 1982, about how many hours, if any, did you spend developing performance standards for your position and being counseled by your supervisor concerning your performance?

	Agriculture 1981	Agriculture 1982	HUD 1981	HUD 1982	Navy 1981	Navy 1982
	(percent)					
None	6	5	16	16	2	2
1 to 8 hours	45	59	58	67	22	38
9 to 16 hours	25	22	16	11	29	30
17 to 24 hours	11	9	5	2	19	15
25 hours or more	14	6	5	3	28	15

4. Now, think about your supervisory responsibilities in FY 1981, the first year of merit pay (i.e., October 1, 1980, to September 30, 1981). How many merit pay employees, if any, did you directly supervise in fiscal year 1981?

	Agriculture		HUD		Navy	
	1981	1982	1981	1982	1981	1982
	(percent)					
None (Go to question 6)	71	72	56	68	70	70
1-3 employees	16	15	24	18	21	18
4-6 employees	8	9	12	10	6	19
7-9 employees	3	2	4	3	1	1
10 or more employees	2	2	4	2	2	2

5. In FY 1981, about how many hours, if any, did you spend performing supervisory functions related to standard setting, performance appraisal, and counseling on the average per merit pay employee?

	Agriculture		HUD		Navy	
	1981	1982	1981	1982	1981	1982
	(percent)					
None	28	1	8	1	0	16
1-8 hours, or 1 day or less per employee	42	32	40	38	61	15
9-16 hours, or from 1 to 2 days per employee	16	32	30	40	23	30
17-24 hours, or about 2 to 3 days per employee	6	22	9	14	9	[illegible]
25 hours or more, or more than 3 days per employee	8	12	14	7	7	21

6. In FY 1981, how much time, if any, did you spend in developing your performance standards and being counseled by your supervisor concerning your performance?

	Agriculture 1981	Agriculture 1982	HUD 1981	HUD 1982	Navy 1981	Navy 1982
	(percent)					
None	16	5	22	16	20	7
1 to 8 hours	69	50	62	65	54	29
9 to 16 hours	9	25	9	13	10	23
17 to 24 hours	3	11	3	4	5	17
25 hours or more	3	9	4	2	11	23

7. What was your most recent performance rating (that is, the one upon which your October 1982 merit pay determination was based)?

Agriculture 1981		Agriculture 1982	
(percent)			
4.6 - 5.0	11	4.5 - 5.0	12
4.0 - 4.5	39	4.0 - 4.4	40
3.6 - 4.0	31	3.5 - 3.9	39
3.0 - 3.5	19	3.0 - 3.4	8
Less than 3.0	[illegible]	Below 3.0	0

	HUD 1981	HUD 1982		Navy 1981	Navy 1982
	(percent)			(percent)	
Outstanding	14	12	Level 1	10	13
Highly satisfactory	53	43	Level 2	34	34
Fully satisfactory	31	44	Level 3	41	37
Marginal	2	1	Level 4	13	11
Unsatisfactory	0	0	Level 5 or 6	2	[illegible]
			Level 7	-	4
			Level 8	-	0

8. The following questions ask your opinion concerning various aspects of the merit pay system and your experiences with the system. For each question, please indicate your opinion by checking the one box, either "Definitely yes," "Probably yes," "Don't know/Not sure," "Probably not," "Definitely not," which best answers the question.

a. Did you spend too much time setting standards, preparing ratings, and counseling merit pay employees?

	Agriculture		HUD		Navy	
	1981	1982	1981	1982	1981	1982
	(percent)					
Definitely yes	23	16	15	7	33	23
Probably yes	16	15	17	11	23	21
Don't know/Not sure	11	8	7	5	[illegible]	7
Probably not	26	34	34	30	18	29
Definitely not	24	27	28	46	20	21

b. Has merit pay motivated you to better performance?

	Agriculture		HUD		Navy	
	1981	1982	1981	1982	1981	1982
	(percent)					
Definitely yes	2	2	2	3	2	3
Probably yes	10	11	12	12	7	10
Don't know/Not sure	8	3	7	6	6	3
Probably not	32	35	35	29	28	28
Definitely not	48	48	45	49	58	56

c. Have you become more productive as a result of merit pay?

	Agriculture		HUD		Navy	
	1981	1982	1981	1982	1981	1982
	(percent)					
Definitely yes	1	2	1	2	2	1
Probably yes	6	7	8	7	5	9
Don't know/Not sure	9	6	8	[illegible]	[illegible]	7
Probably not	34	36	35	33	29	25
Definitely not	50	49	48	50	59	58

d. Can your productivity be accurately measured?

	Agriculture		HUD		Navy	
	1981	1982	1981	1982	1981	1982
	(percent)					
Definitely yes	11	12	13	15	13	11
Probably yes	28	25	33	29	17	24
Don't know/Not sure	10	8	9	6	9	8
Probably not	35	39	32	36	38	34
Definitely not	15	16	14	14	23	23

e. Do the general benefits, if any, of the merit pay program in your pay pool (or unit) justify the additional time and effort, if any, of the program over what it replaced?

	Agriculture		HUD		Navy	
	1981	1982	1981	198	1981	1982
	(percent)					
Definitely yes	2	2	2	2	3	2
Probably yes	6	7	9	11	4	9
Don't know/Not sure	9	10	11	14	5	8
Probably not	25	27	29	26	19	26
Definitely not	59	55	49	47	69	55

f. Did the amount of merit pay you earned for your performance in fiscal year 1982 accurately reflect the quality of your performance?

	Agriculture 1981	Agriculture 1982	HUD 1981	HUD 1982	Navy 1981	Navy 1982
	(percent)					
Definitely yes	1	3	1	5	3	5
Probably yes	7	22	9	21	12	22
Don't know/Not sure	13	15	7	6	9	11
Probably not	22	22	20	21	17	20
Definitely not	58	38	64	47	59	43

g. Did your most recent performance rating (i.e., the one upon which your October 1982 merit pay determination was based) accurately reflect the quality of your performance during the rating period?

	Agriculture 1981	Agriculture 1982	HUD 1981	HUD 1982	Navy 1981	Navy 1982
	(percent)					
Definitely yes	11	9	15	13	14	17
Probably yes	40	41	40	39	36	37
Don't know/Not sure	12	11	4	4	8	5
Probably not	18	18	13	[illegible]	18	16
Definitely not	19	21	28	35	25	25

h. Were your performance standards and elements for fiscal year 1982 tailored to your particular job?

	Agriculture 1981	Agriculture 1982	HUD 1981	HUD 1982	Navy 1981	Navy 1982
	(percent)					
Definitely yes	32	33	25	26	40	42
Probably yes	44	45	43	34	38	38
Don't know/not sure	5	4	4	5	4	[illegible]
Probably not	10	8	13	16	9	[illegible]
Definitely not	9	10	15	20	9	8

i. Were your performance standards and elements consistent with the goals and/or mission of your organization?

	Agriculture 1981	Agriculture 1982	HUD 1981	HUD 1982	Navy 1981	Navy 1982
	(percent)					
Definitely yes	32	37	29	29	37	43
Probably yes	46	47	48	44	42	42
Don't know/Not sure	11	8	7	7	9	6
Probably not	7	5	9	11	7	4
Definitely not	5	3	7	8	5	5

j. Were your (FY 1982) performance standards changed after your supervisor had prepared the rating that was based on those standards?

	Agriculture 1981	Agriculture 1982	HUD 1981	HUD 1982	Navy 1981	Navy 1982
	(percent)					
Definitely yes	8	11	9	8	11	9
Probably yes	3	2	2	5	3	5
Don't know/Not sure	11	10	12	11	12	8
Probably not	15	13	11	10	8	11
Definitely not	64	64	67	66	67	66

k. Were your performance standards too easy?

	Agriculture 1981	Agriculture 1982	HUD 1981	HUD 1982	Navy 1981	Navy 1982
	(percent)					
Definitely yes	1	1	1	1	2	1
Probably yes	6	3	6	3	6	5
Don't know/Not sure	14	9	11	7	8	8
Probably not	45	42	41	39	[illegible]	40
Definitely not	34	45	42	50	43	47

l. Did your supervisor take your views into account when setting your standards for fiscal year 1982?

	Agriculture		HUD		Navy	
	1981	1982	1981	1982	1981	1982
	(percent)					
Definitely yes	38	38	[illegible]	21	48	50
Probably yes	34	32	29	25	28	26
Don't know/Not sure	9	9	10	9	6	5
Probably not	9	6	13	15	9	7
Definitely not	10	15	23	31	9	12

m. Were your standards for fiscal year 1982 fair?

	Agriculture		HUD		Navy	
	1981	1982	1981	1982	1981	1982
	(percent)					
Definitely yes	20	24	18	17	28	27
Pro[illegible]	49	[illegible]	47	46	42	46
Don[illegible]Not sure	14	12	11	9	14	10
Probably not	11	7	13	16	10	10
Definitely not	7	7	11	12	7	7

n. Was the rating your supervisor gave you for your FY 1982 performance later lowered by higher management?

	Agriculture		HUD		Navy	
	1981	1982	1981	1982	1981	1982
	(percent)					
Definitely yes	8	9	14	12	14	13
Probably yes	3	2	3	5	4	3
Don't know/Not sure	16	14	12	13	13	12
Probably not	14	10	8	6	7	8
Definitely not	60	64	63	63	62	63

o. Were any changes in your ratings documented or explained to you? (If there were no changes to the rating your supervisor gave you, please check Don't Know/Not sure.)

	Agriculture 1981	Agriculture 1982	HUD 1981	HUD 1982	Navy 1981	Navy 1982
	(percent)					
Definitely yes	6	6	7	7	11	10
Probably yes	4	2	3	2	5	3
Don't know/Not sure	79	78	73	72	69	[illegible]
Probably not	3	2	2	1	2	3
Definitely not	9	12	15	18	13	12

p. Should the performance appraisal system instituted under merit pay be retained, even if it is not tied to merit pay?

	Agriculture 1981	Agriculture 1982	HUD 1981	HUD 1982	Navy 1981	Navy 1982
	(percent)					
Definitely yes	11	13	13	8	7	8
Probably yes	26	29	30	32	20	24
Don't know/Not sure	15	9	[illegible]	13	11	9
Probably not	16	18	14	13	19	16
Definitely not	32	31	29	34	43	43

q. Under merit pay, do you feel more pressure to fulfill the duties and responsibilities of your job than you did prior to merit pay?

	Agriculture 1981	Agriculture 1982	HUD 1981	HUD 1982	Navy 1981	Navy 1982
	(percent)					
Definitely yes	5	4	6	6	6	7
Probably yes	13	11	10	14	11	9
Don't know/Not sure	6	3	5	5	5	4
Probably not	29	29	27	24	20	19
Definitely not	46	52	53	52	59	60

r. Thinking about your earnings last year in FY 1982 (October 1, 1981, to September 30, 1982), did you earn less under merit pay than you would have under the old GS schedule, including any within-grade increases you were scheduled to receive under the old system?

	Agriculture 1981	Agriculture 1982	HUD 1981	HUD 1982	Navy 1981	Navy 1982
	(percent)					
Definitely yes	32	30	41	39	28	31
Probably yes	17	12	19	13	19	10
Don't know/Not sure	19	17	16	13	21	14
Probably not	19	22	12	15	17	16
Definitely not	13	18	12	20	15	29

s. Again, thinking about your total earnings last year (i.e., in fiscal year 1982), did you earn more than you would have under the old GS schedule?

	Agriculture 1981	Agriculture 1982	HUD 1981	HUD 1982	Navy 1981	Navy 1982
	(percent)					
Definitely yes	9	[illegible]	5	12	9	21
Probably yes	13	16	7	9	12	14
Don't know/Not sure	21	19	16	13	20	14
Probably not	24	17	23	17	25	13
Definitely not	34	34	49	49	34	37

t. Have your merit pay subordinates become more productive as a result of merit pay? (Only answer this questions if you supervised merit pay employees (GM-13's, GM-14's, GM-15's) in fiscal year 1982.)

	Agriculture		HUD		Navy	
	1981	1982	1981	1982	1981	1982
	(percent)					
Definitely yes	3	0	2	2	2	2
Probably yes	13	16	11	9	9	12
Don't know/Not sure	22	11	13	13	7	7
Probably not	35	42	41	36	38	34
Definitely not	27	42	33	40	44	45

9. Has merit pay increased, decreased, or had no effect on teamwork and cooperation within your pool?

	Agriculture		HUD		Navy	
	1981	1982	1981	1982	1981	1982
	(percent)					
Increased teamwork/cooperation a great deal	Not asked	1	Not asked	1	Not asked	[illegible]
Increased teamwork/cooperation somewhat	Not asked	4	Not asked	3	Not asked	6
No effect, teamwork/cooperation about the same as before merit pay	Not asked	73	Not asked	69	Not asked	62
Decreased teamwork/cooperation somewhat	Not asked	17	Not asked	16	Not asked	20
Decreased teamwork/cooperation a great deal	Not asked	6	Not asked	10	Not asked	12

 APPENDIX III

10. Which of the following would you most prefer? (Check only one.)

	Agriculture 1981	Agriculture 1982	HUD 1981	HUD 1982	Navy 1981	Navy 1982
	(percent)					
Retain merit pay system as it is	7	6	6	5	4	7
Retain pay based on merit but revise the system from what it is now	31	31	33	38	36	39
Return to the old GS schedule to determine pay	56	53	55	50	49	44
Other (Please describe)	6	9	6	7	12	10

Questions 11 through 29 were asked in 1982 only.

11. In general, how fair was the performance appraisal/merit pay system last year (FY 1982)?

	Agriculture	HUD	Navy
	(percent)		
Very fair	4	3	
Fair	27	19	26
Neither fair nor unfair	26	15	23
Unfair	28	38	31
Very unfair	15	25	13

12. Was your FY 1982 annual salary equal to or greater than the federal pay cap?

	Agriculture	HUD	Navy
	(percent)		
Yes	11	15	11
No	78	78	84
Not sure	11	[illegible]	5

13. Was your FY 1982 salary at the top of your grade level's pay scale?

	Agriculture	HUD	Navy
	(percent)		
Yes	7	11	11
No	90	86	86
Not sure	3	4	3

14. Including the 2-percent federal pay comparability increase and any merit pay increase you may have received for FY 1983, by what percent of your FY 1982 salary has your pay increased for FY 1983?

	Agriculture	HUD	Navy
	(percent)		
2 percent to 4 percent	20	31	22
4.1 percent to 6 percent	42	27	44
6.1 percent to 8 percent	23	17	22
8.1 percent to 10 percent	5	10	3
10.1 percent or more	1	3	1
Don't know/Not sure	9	12	8

15. Thinking about the cumulative effect of your pay increases in the first 2 years of merit pay, will you earn more, less, or about the same in FY 1983 as you would have under the old GS schedule, including any within-grade increases you were scheduled to receive in those 2 years? (If you are a capped employee, please consider your earnings on paper.)

	Agriculture	HUD	Navy
	(percent)		
More	17	20	23
Less	38	44	37
About the same	28	19	28
Don't know/Not sure	14	16	10
Not applicable	2	1	2

16. Including comparability and merit pay, what was the minimal pay increase over your FY 1982 salary, if any, that would have motivated you to better performance this year?

	Agriculture	HUD	Navy
	(percent)		
4 percent or less	1	3	2
4.1 percent to 6 percent	3	4	2
6.1 percent to 8 percent	9	10	8
8.1 percent to 10 percent	15	14	15
More than 10 percent	14	11	17
Don't know/Not sure	12	14	11
Money does not motivate me to better performance	46	44	44

17. The following are possible characteristics of the performance appraisal/merit pay systems as they operated in your pay pool and agency. Please indicate to what extent, if any, each occurred by checking "To a very great extent," "To a great extent," "To some extent," "To a little extent," "Not at all," or "Don't know/Not sure."

a. [illegible] nt did the systems operate [illegible] according to established [illegible]

	To a very great extent	To a great extent	To some extent	To a little or no extent	Not at all	Don't know/not sure
	percent					
Agriculture	15	25	19	9	4	28
HUD	5	16	21	14	9	35
Navy	13	29	22	11	4	21

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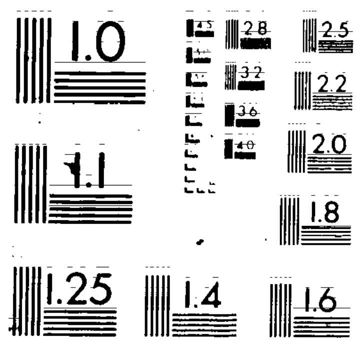


MICROCOPY RESOLUTION TEST CHART
NATIONAL BUREAU OF STANDARDS
STANDARD REFERENCE MATERIAL 1010a
(ANSI and ISO TEST CHART No. 2)

		To a very great extent	To a great extent	To some extent	To little or no extent	Not at all	Don't know/not sure
b. Within your pay pool, to what extent, if any, were standards set and ratings and payouts made without favoritism?		-percent-					
	Agriculture	10	18	17	14	9	33
	HUD	4	13	16	18	14	34
	Navy	11	22	16	15	11	26
c. To what extent, if any, were your performance standards reasonable and capable of being exceeded by outstanding performance?							
	Agriculture	4	19	37	18	11	10
	HUD	3	17	29	21	21	8
	Navy	6	32	35	14	7	4
d. In your office/division, to what extent, if any, were merit pay employees treated equitably relative to nonmerit pay employees?							
	Agriculture	8	26	14	9	10	33
	HUD	5	18	18	14	18	26
	Navy	12	27	12	7	10	32

18. Below are some additional aspects of the performance appraisal/merit pay systems in your pay pool. Please indicate the degree to which each has or has not been a problem for you either as a merit pay employee or as a supervisor of other merit pay employees. Check "A very great problem," "A great problem," "A moderate problem," "Somewhat of a problem," "Little or no problem," "Did not happen to me," or "Don't know/Not sure," whichever best describes your experience.

a. Pay pool managers being in the same pools they administer or supervisors being in the same pay pool as subordinates.

	A very great problem	A great problem	A moderate problem	Somewhat of a problem	Little or no problem	Did not happen to me	Don't know/not sure
	percent						
Agriculture	10	7	9	6	23	20	25
HUD	12	8	9	8	21	11	30
Navy	14	10	8	7	28	12	20

b. Differences in the difficulty of elements and standards for the same or similar jobs.

Agriculture	7	12	17	9	24	12	18
HUD	8	11	11	10	31	12	16
Navy	17	15	14	9	21	10	14

c. Lack of written justifications for your performance rating.

Agriculture	7	8	12	11	38	22	3
HUD	13	12	9	8	33	20	5
Navy	8	9	10	10	39	19	5

d. Ratings changes by reviewers higher than first level manager.

Agriculture	8	3	5	5	17	49	14
HUD	19	8	6	4	13	35	14
Navy	13	7	8	6	18	36	11

ERIC

APPENDIX III

	A very great problem	A great problem	A moderate problem	Somewhat of a problem	Little or no problem	Did not happen to me	Don't know/not sure
	----------percent----------						
e. Inconsistencies in how raters within the same pool judge performance.							
Agriculture	24	19	12	9	10	8	18
HUD	30	29	10	8	7	7	19
Navy	27	16	11	10	10	7	18
f. Subjectivity in ratings.							
Agriculture	21	18	15	14	14	4	12
HUD	29	20	15	10	10	4	11
Navy	23	20	13	12	14	5	12
g. Lack of a decision rule or guidelines for combining ratings on separate elements into one overall rating.							
Agriculture	6	6	9	10	33	17	19
HUD	9	8	16	10	30	10	17
Navy	10	12	14	11	27	10	16
h. Amount of money available for merit pay increases.							
Agriculture	23	13	12	10	17	3	23
HUD	20	16	11	8	19	2	23
Navy	30	17	12	7	14	2	18

19. For each of the following questions, please indicate the extent of your feelings by checking "To a very great extent," "To a great extent," "To some extent," "To a little extent," "Not at all," or "Don't know/Not sure."

		To a very great extent	To a great extent	To some extent	To little or no extent	Not at all	Don't know/not sure
		------	------	percent	------	------	------
a. To what extent, if any, were you satisfied with the amount of input you had in setting your FY 1982 performance standards?	Agriculture	14	37	24	11	12	1
	HUD	7	22	27	14	28	3
	Navy	16	36	26	8	13	1
b. Realizing that you may be motivated by a number of factors, such as type of work, personal goals, etc., to what extent, if any, does money help to motivate your job performance?	Agriculture	6	14	37	24	17	1
	HUD	9	14	38	20	18	1
	Navy	8	15	37	22	16	1
c. To what extent, if any, did the amount of merit pay given this year to your pay pool's top performers help to motivate you to outstanding performance?	Agriculture	0	3	9	14	65	8
	HUD	1	2	9	16	68	4
	Navy	1	3	10	17	65	3

20. Since the merit pay/performance appraisal systems were instituted, have performance ratings become more subjective, less subjective, or remained at the same level of subjectivity as before?

	Agriculture	HUD	Navy
	(percent)		
A great deal more subjective	9	22	12
Somewhat more subjective	19	26	21
Remained at the same level of subjectivity	50	37	46
Somewhat less subjective	16	10	16
A great deal less subjective	6	4	4

21. Has communication between you and your supervisor gotten better, worse, or remained about the same since the performance appraisal/merit pay systems were instituted?

	Agriculture	HUD	Navy
	(percent)		
A lot better	2	1	4
Somewhat better	8	8	13
Remained the same	79	73	70
Somewhat worse	6	11	8
A lot worse	5	6	5

22. These next questions ask about some additional aspects of the performance appraisal/merit pay systems. Please check the one box which best answers each question.

		Definitely yes	Probably yes	Don't know/not sure	Probably not	Definitely not
		-----------percent------				
a. As you understand the definition of management official and supervisor, do you believe you should be under the merit pay system?						
	Agriculture	35	28	7	15	16
	HUD	45	25	5	12	13
	Navy	38	25	5	13	20
b. In general, can the productivity of jobs like yours be accurately measured?						
	Agriculture	11	30	7	40	12
	HUD	12	36	7	33	12
	Navy	6	25	8	40	21
c. Did management employ a forced distribution or quota system in developing the ratings for your pool in FY 1982?						
	Agriculture	14	16	48	8	13
	HUD	36	23	31	7	4
	Navy	24	19	40	6	11
d. Was the immediate supervisor who gave you your recommended performance rating in the same merit pay pool as you?						
	Agriculture	43	8	9	4	36
	HUD	56	13	13	2	16
	Navy	63	6	6	1	24
e. Was merit pay fairer in FY 1982 than in FY 1981?						
	Agriculture	5	15	38	22	19
	HUD	4	17	26	24	30
	Navy	7	15	36	23	18

23. Did you fill out a GAO questionnaire on the merit pay system last year? (It may have been part of a survey conducted by your agency.)

	Agriculture	HUD	Navy
	(percent)		
Yes	58	52	18
No	24	28	65
Not sure	19	19	17

24. Please make any narrative comments you wish to concerning the performance appraisal/merit pay systems in your agency. Your comments are anonymous.

	Agriculture	HUD	Navy
	(percent)		
No comments	29	36	28
Comments	71	64	72

The following questions were asked in 1981 only.

Did you get enough training in each of the following areas to allow you to accurately and fairly perform the function?

		Definitely yes	Probably yes	Don't know/not sure	Probably not	Definitely not
		(percent)				
a. set performance standards?						
	Navy	24	47	7	11	12
	Agriculture	23	48	8	14	8
	HUD	15	43	8	18	17
b. prepare performance ratings?						
	Navy	23	45	11	11	10
	Agriculture	22	48	9	13	8
	HUD	16	45	8	17	15

c. counsel subordinates?	Definitely yes	Probably yes	Don't know/not sure	Probably not	Definitely not
	---------percent------				
Navy	19	39	16	14	12
Agriculture	18	43	15	15	10
HUD	15	43	9	18	15

What was your grade (i.e., GM level) on October 4, 1981?

	Navy	Agriculture	HUD
	-------(percent)-------		
GM-13	58	58	43
GM-14	29	29	31
GM-15	13	13	26

TOP PERFORMERS' RESPONSES TO 1982 QUESTIONNAIRE

The following shows how top-rated performers in each Department answered selected questions from the 1982 GAO questionnaire. Top-rated performers are those in our respondent group who received a Level 1 rating in Navy, an Outstanding rating in HUD, or 4.5 or better in Agriculture for fiscal year 1982.

QUESTION		Definitely yes	Probably yes	Don't know/not sure	Probably not	Definitely not
		---------	----	percent	----	---------
Has merit pay motivated you to better performance?	Agriculture	3	20	2	34	41
	HUD	6	24	9	32	29
	Navy	8	27	3	20	42
Have you become more productive as a result of merit pay?	Agriculture	5	7	10	36	42
	HUD	5	8	11	42	35
	Navy	5	18	12	21	44
Did the amount of merit pay you earned for your performance in 1982 accurately reflect the quality of your performance?	Agriculture	7	29	16	12	36
	HUD	23	33	8	13	23
	Navy	18	30	9	9	33
Should the performance appraisal system instituted under merit pay be retained even if it is not tied to merit pay?	Agriculture	14	35	11	16	25
	HUD	5	42	14	17	23
	Navy	8	26	14	15	37
Under merit pay, do you feel more pressure to fulfill the duties and responsibilities of your job than you did prior to merit pay?	Agriculture	0	14	7	25	54
	HUD	5	24	6	18	47
	Navy	9	18	9	18	45

	Agriculture	HUD	Navy
	---------percent---------		
Which of the following would you most prefer? (check one)			
Retain merit pay system as it is	9	14	13
Retain pay based on merit but revise system from what it is now	36	47	42
Return to the old GS system to determine pay	42	28	34
Other	13	11	11
In general, how fair was the performance appraisal/merit pay system last year? (FY 1982)			
Very fair	8	13	24
Fair	39	41	37
Neither fair nor unfair	19	14	18
Unfair	24	22	15
Very unfair	10	10	6
Including comparability and merit pay, what was the minimal pay increase over your FY 1982 salary, if any, that would have motivated you to better performance this year?			
4 percent or less	0	0	0
4.1 to 6 percent	3	5	3
6.1 to 8 percent	5	8	11
8.1 to 10 percent	14	9	10
More than 10 percent	19	19	29
Don't know/not sure	15	14	11
Money does not motivate me to better performance	44	45	35

	Agriculture	HUD	Navy
	----------percent----------		
Since the merit pay/performance appraisal systems were instituted, have performance ratings become more subjective, less subjective, or remained at the same level of subjectivity as before?			
A great deal more subjective	10	13	11
Somewhat more subjective	26	22	11
Remained at the same level of subjectivity	45	41	46
Somewhat less subjective	10	19	19
A great deal less subjective	9	6	13

POOLS AND RATINGS REVIEWED

The following table shows the number of pools we reviewed in 1981 and 1982, the number of pools and merit pay employees in the three Departments, and the number of employees included in the pools we reviewed.

Summary of Merit Pay Pools and Ratings Reviewed for Both Reviews

	Navy		HUD		Agriculture		Total	
	1981	1982	1981	1982	1981	1982	1981	1982
Total merit pay pools in Departments	500	565	21	20	333	351	854	936
Total pools reviewed	28	24	19	11	37	22	84	57
Headquarters	12	13	9	9	30	15	51	37
Field	16	11	10	2	7	7	33	20
Total approximate number of employees under merit pay	16,100	16,000	2,200	2,200	9,600	9,500	27,900	27,700
Total number of employees covered, in pools reviewed	2,219	2,085	1,973	888	1,360	848	5,552	3,821
Total number of ratings reviewed	149	149	163	163	163	163	475	475

For the second-year review our Boston Regional Office staff reviewed six pools not studied the first year. Also, to expedite our work, in the second year we deleted several pools in each Department that we reviewed the first year. The result was that, of the 57 pools reviewed in the second year, 50 (88 percent) were also reviewed in the first year.

CONTENT ANALYSIS OF PERFORMANCE

APPRAISALS AND STANDARDS

Content analysis is a procedure for collecting and organizing information in a standardized format which allows analysts to make inferences about the characteristics and meaning of written material. The objective of our content analysis was to assess the quality of performance standards during fiscal years 1981 and 1982 in the pools we examined at the Departments of Agriculture, HUD, and Navy.

In assessing the quality of performance standards, we used OPM's characteristics of good performance standards. For each standard, we determined whether it

--contained quality measures--identified how good or how accurate performance must be;

--contained quantity measures--stated how much work or how many items are required;

--contained timeliness measures--indicated how soon or when tasks should be completed;

--distinguished performance levels--differentiated between Outstanding and Highly Satisfactory (or next lowest level), Satisfactory from Marginally Satisfactory (or next lowest level), etc.;

--contained measures below the highest level that could be exceeded--had measures below Outstanding that could be surpassed rather than being set at the level of perfection; and

--identified unacceptable performance--had measures that clearly and realistically described unacceptable performance.

We limited our analysis to standards from employees in pay pools reviewed in each agency in our second-year evaluation. (See app. V.) Within each pool, we randomly selected a sample of employees who were in the pool in both fiscal years 1981 and 1982, and we analyzed their performance standards from both years. The selection procedure and sample sizes were designed to allow for a high level of precision and confidence in projecting our findings to all performance standards in the pools we examined and in comparing results from the 2 fiscal years. The number and size of the pools from which our samples were selected and sample sizes are presented in the table below.

Universe and Sample Sizes

Agency	Number of pools[a]	Universe: Employees[a+b]	Universe: Standards[c]	Sample: Employees[d]	Sample: Standards
HUD					
FY 81	11	795	5,000	161	1,079
FY 82			12,000	155	2,387
Agriculture					
FY 81	18	618	9,000	163	2,286
FY 82			12,000	162	3,039
Navy					
FY 81	19	1,377	16,000	137	1,576
FY 82			16,000	138	1,662

[a]Number of pools is the same for fiscal years 1981 and 1982

[b]Universe size is the total number of employees in the pools we examined who were in the same pool in fiscal years 1981 and 1982. In most cases, size was estimated from total pool size in the 2 fiscal years.

[c]Universe of standards is an estimate of total number of standards in the pools examined. It equals (the number of standards in the sample divided by number of employees in the sample) multiplied by total number of employees who were in the pools in both fiscal years (i.e., universe size).

[d]Sample sizes vary between years because of incomplete data on some employees

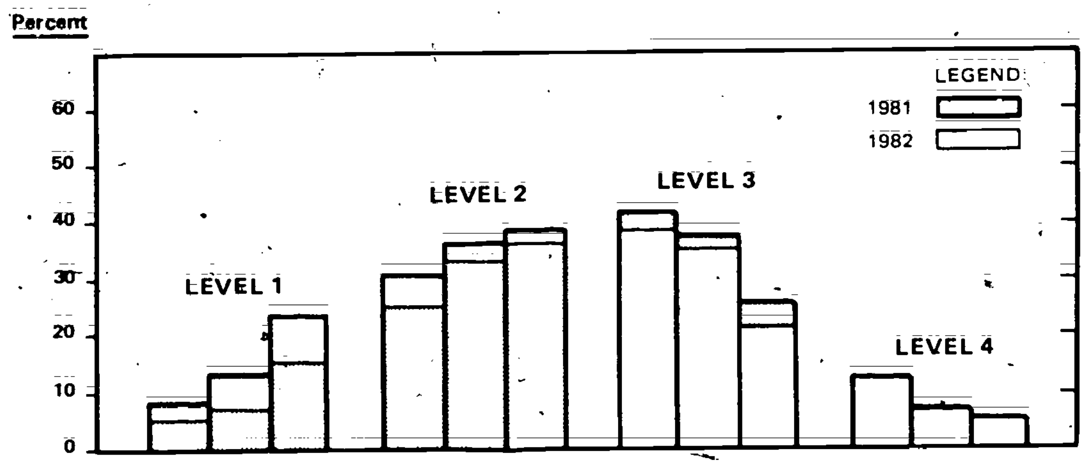
Content analyses require that one person initially analyze the standards and that a second person repeat the analysis, independent from the first person, on at least a subset of standards. This will determine the reliability of the initial analysis. Reliability can be expressed as the agreement between the two independent analysts on at least 80 percent or more of the standards. On a 10-percent random sample of all standards analyzed, the two raters agreed on from 83 percent to 90 percent of their judgments on each of the six dimensions outlined above.

The 95-percent confidence level for fiscal years 1981 and 1982 performance standards in the pools examined in each of the three Departments was ±5 percentage points at most.

Assuming our sample of employees represents their fellow merit pay pool members, the confidence intervals indicated the precision with which our findings reflect what would have been obtained had we analyzed all performance standards in the pools examined. For example, if 50 percent of the Agriculture 1981 performance standards analyzed contained quality measures, then we can say that we are 95-percent sure that between 45 percent and 55 percent of all 1981 standards in the Agriculture pools sampled contain a quality measure.

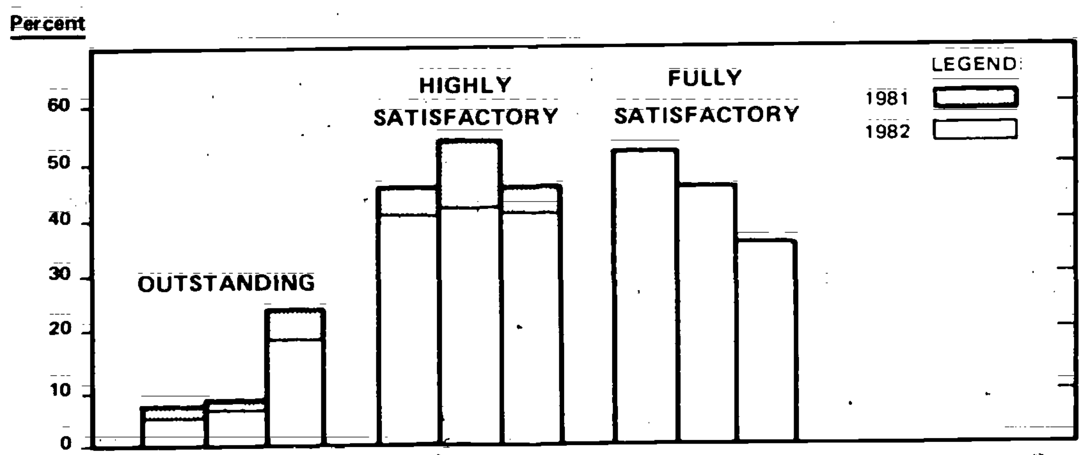
PERCENTAGE DISTRIBUTION OF RATINGS BY GRADE

NAVY



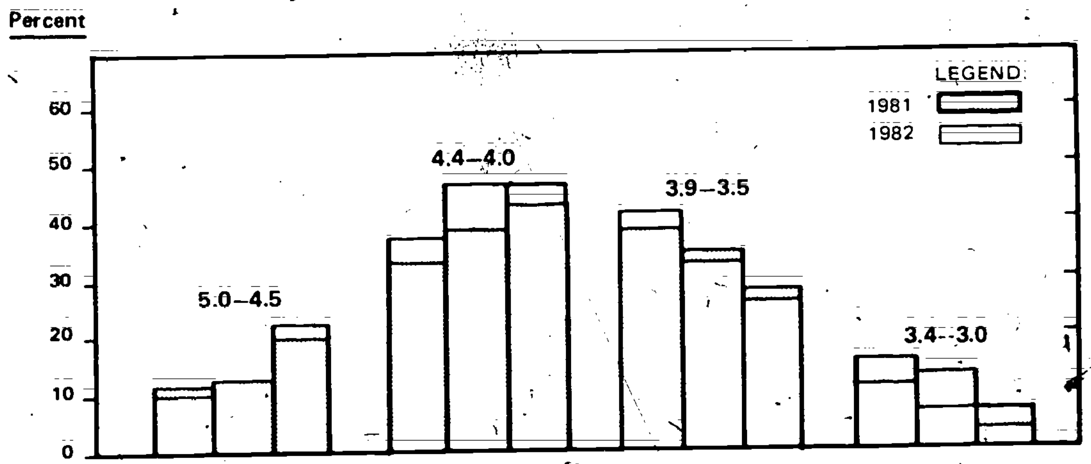
Grade		13	14	15	13	14	15	13	14	15	13	14	15
Percent of ratings in each category	1981	5	8	15	25	33	35	42	38	29			
	1982	9	14	23	31	36	38	39	36	25	13	8	5

HUD



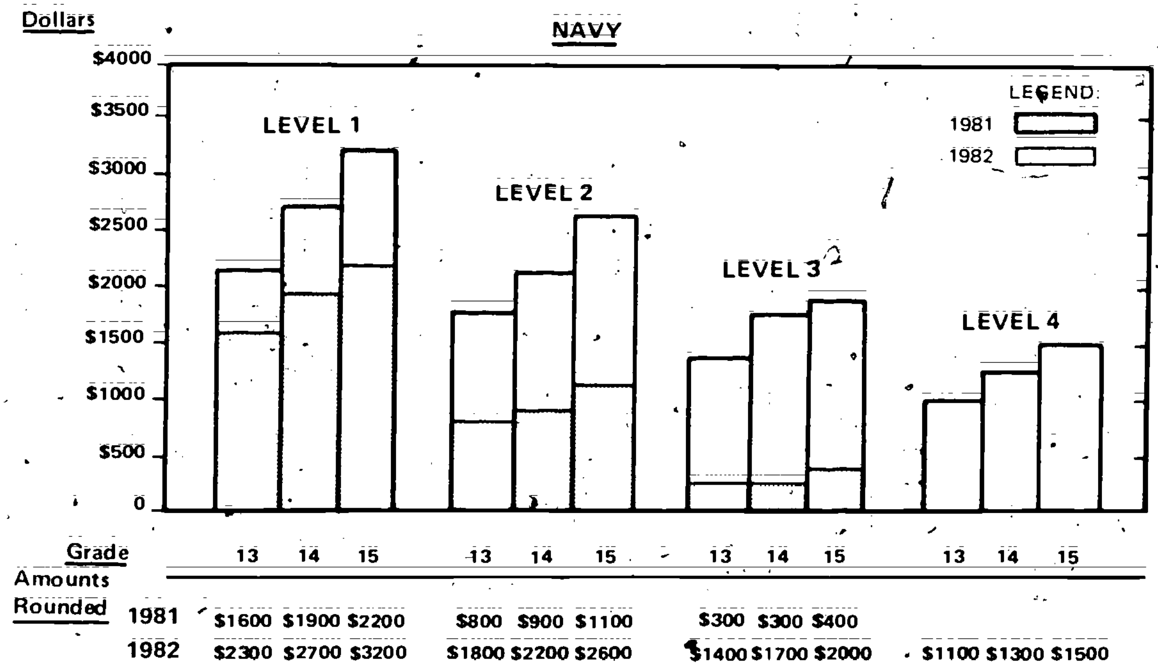
Grade		13	14	15	13	14	15	13	14	15
Percent of ratings in each category	1981	8	9	24	46	54	46			
	1982	5	8	19	41	42	42	52	47	37

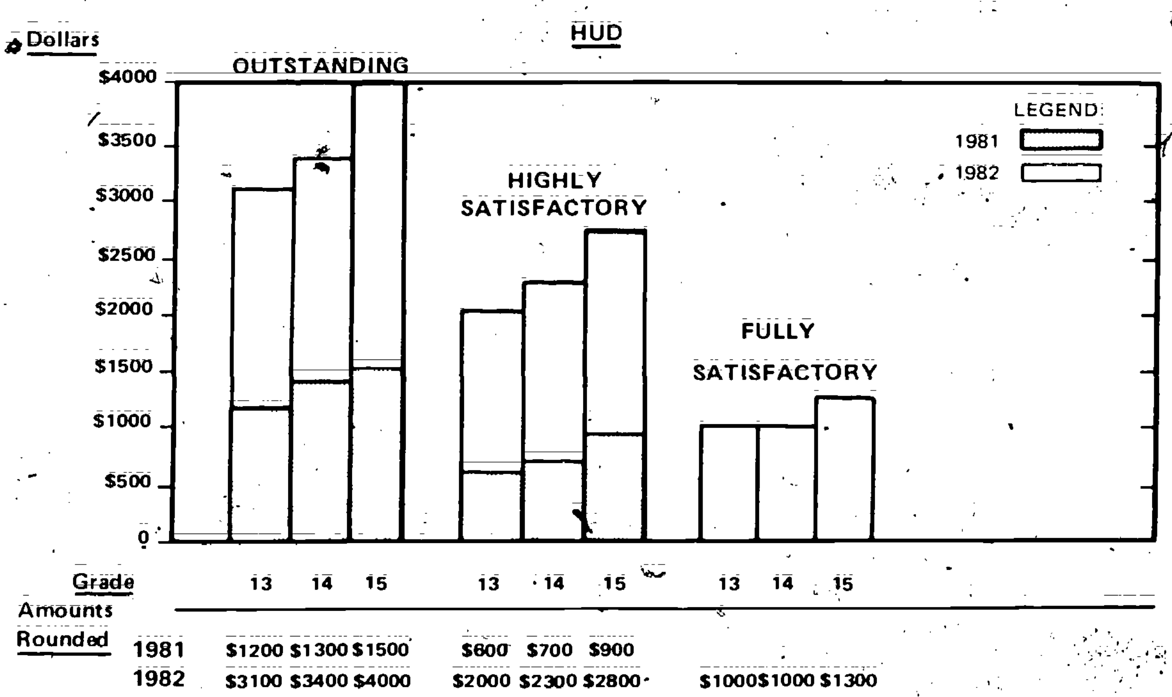
AGRICULTURE

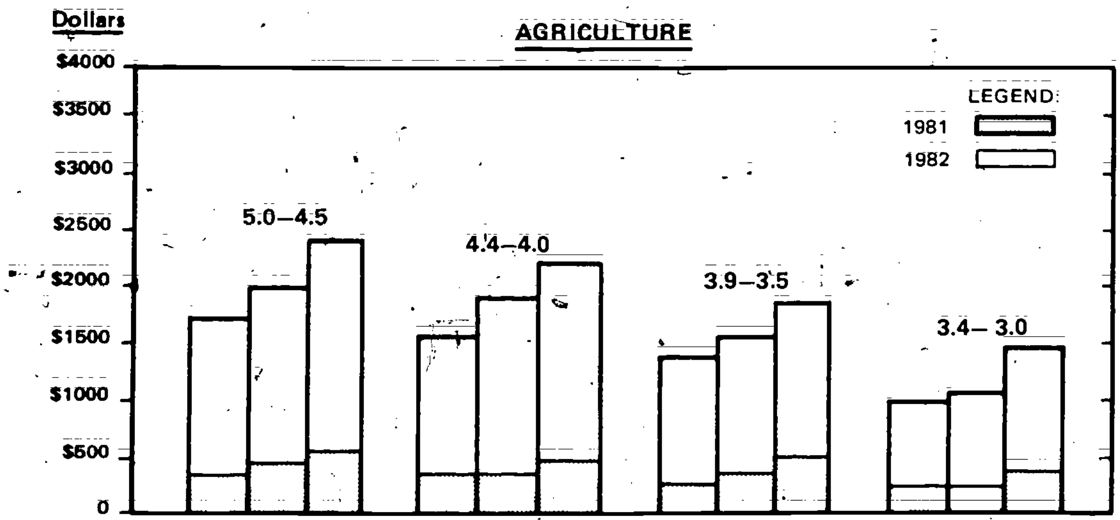


Grade		13	14	15	13	14	15	13	14	15	13	14	15
Percent of ratings in each category	1981	11	13	20	33	39	43	38	35	29	17	12	7
	1982	10	13	22	38	46	46	41	33	27	11	7	4

AVERAGE MERIT PAY INCREASES BY PERFORMANCE LEVEL AND GRADE







Grade	13	14	15	13	14	15	13	14	15	13	14	15
Amounts Rounded												
1981	$400	$500	$600	$400	$400	$500	$300	$400	$500	$300	$300	$400
1982	$1700	$2000	$2400	$1600	$1900	$2200	$1400	$1600	$1900	$1000	$1100	$1500

AN EXAMPLE OF MERIT PAY CALCULATIONS

DETERMINING MONEY AVAILABLE FOR MERIT INCREASES

The following step-by-step example of how merit pay is determined is based on the Navy's procedures. Calculating merit pay in another agency with a different formula could be very different from the example here, as discussed in chapter 2. However, this example does show two steps required in any calculation: determining the money available to make merit increases and the individual merit increases.

Agency officials allocate funds to the pool's merit pay fund using figures and procedures provided by OPM. Step 1: The percentage of all pool members' salaries available for distribution as merit pay increases is calculated. This percentage is the sum of one-half the comparability increase to be granted in the year plus the percentage of salaries normally available for within-grade increases and quality step increases for the year. (For this example, the comparability increase is 4.8 percent. Half of this is 2.4 percent. We are also using a within-grade and quality step figure of 1.2 percent for everyone in the pool, although this figure normally varies, depending on a person's location in the salary range.) The resultant sum is: .024 + .012 = .036%. Step 2: For each grade, the salary of each position in the grade is multiplied by the percentage found in step 1. These figures are then multiplied by the number of pool members in each position in the grade. (For this example, an average salary has been used for each grade.) Finally, the totals for each grade are added together. This number is the pool's merit pay fund.

The merit pay fund for a hypothetical employee, Jane Doe, was determined using the following data. The pool has the following grade distribution.

Grade	Number
GM-13	16
GM-14	11
GM-15	3

The average salary for each grade in the pool is:

Grade	Average salary
GM-13	$32,312
GM-14	38,184
GM-15	44,915

The merit pay fund for Jane's pool is calculated to be $38,584, using the table shown below.

Grade	Average salary	X	Sum of comparability increase and annualized step and QSI	X	Number in grade	=	Total
13	$32,312		.036		16		$18,612
14	38,184		.036		11		15,121
15	44,915		.036		3		4,851
					Total merit pay fund		$38,584

DETERMINING INDIVIDUAL MERIT INCREASES

Using the allocated funds, a reviewing official calculates individual merit pay according to the following procedures:

--Assign merit pay points for individual performance.

--Determine total grade-adjusted merit pay points.

--Determine dollar value of each merit pay point.

--Calculate individual salary increases.

Assigning merit pay points for individual performance

Merit pay points are assigned to each pool member according to his or her rating. Assuming that this 30-member pool has a normal distribution of ratings, the people in each performance category, and the points assigned to their ratings would be as follows:

Performance category		Number in category	Point value
Level 1:	Substantially exceeded all objectives	2	2.1
Level 2:	Substantially above target--most significant objectives	3	1.7
Level 3:	Above target--most significant objectives	6	1.3
Level 4:	On target--all significant objectives	17	1.0
Level 5:	On target--some objectives	1	0.7
Level 6:	Below target--one or more critical elements	1	0

Jane Doe, whose performance category is Level 2, receives 1.7 points.

Determining grade-adjusted merit pay points

Next, the pool's total merit pay points are calculated. At this point, the level of job responsibility reflected in the employee's grade level enters the merit pay calculation. Individual merit pay points are now adjusted by a salary differential. The following salary differentials are used in this example:

Grade	Salary differential
GM-13	1.00
GM-14	1.18
GM-15	1.39

For each grade, the total merit pay points are multiplied by a salary differential. These totals are added to calculate the total grade-adjusted merit pay points earned by the pool members.

Jane's pool has 16 GM-13's, who are distributed among the 6 performance categories, as shown on the following chart. By multiplying the number of GM-13's in each performance category by the associated merit pay points, the total points earned by

GM-13's in the pool are calculated. (Jane's performance category is asterisked.)

Performance category	Number of GM-13's		Point value		GM-13 points
Substantially exceeded all objectives	1	X	2.1	=	2.1
Substantially above target--most significant objectives**	1	X	1.7	=	1.7
Above target--most significant objectives	3	X	1.3	=	3.9
On target--all significant objectives	9	X	1.0	=	9.0
On target--some objectives	1	X	.7	=	.7
Below target--one or more critical elements	1	X	0	=	0.0
	Total GM-13 points			=	17.4

To find the GM-13 grade-adjusted points, the total GM-13 points (17.4) are multiplied by the salary differential (1.0).

The total grade-adjusted GM-14 and GM-15 points are calculated in the same manner. By adding the three grade-adjusted totals, the total grade-adjusted points earned by the members of the pool is as follows:

Grade-adjusted GM-13 points	=	17.4
Grade-adjusted GM-14 points	=	15.34
Grade-adjusted GM-15 points	=	6.12
Total grade-adjusted points	=	38.86

Determining dollar value of each merit pay point

Jane Doe's pool earned 38.86 points. The amount of money in the pool's merit pay fund, $38,584, is divided by 38.86 to determine the dollar value of a point. The dollar value of a point in Jane's pool is $993.

Calculating individual salary increase

Knowing the dollar value of a point, as well as the number of points earned by each pool member, the individual salary increases of each member in the pool are calculated. This is done using the following formulas:

--For GM-13: Points earned x 1.0 (salary differential) x dollar value of a point = merit pay increase.

--GM-14: Points earned x 1.18 (salary differential) x dollar value of a point = merit pay increase.

--For GM-15: Points earned x 1.39 (salary differential) x dollar value of a point = merit pay increase.

Jane Doe, whose performance category is "substantially above target--most significant objectives" earned 1.7 points. Since she is a GM-13, her salary differential factor is 1.0. Jane's merit pay increase is calculated in the following manner:

Points earned..	1.7
x Salary differential..................................	x 1.0
x Dollar value of point................................	x 993
Merit pay increase.....................................	$1,688

To calculate Jane's total salary increase, one must add the other half of comparability, 2.4 percent of salary in this example, to her merit pay increase. Thus, Jane's total salary increase can be computed as follows:

APPENDIX IX

	Jane's current salary..........................	$33,291
x	Percentage comparability increase..............	x .024
	Comparability increase.........................	$ 799
	Comparability increase.........................	$ 799
+	Merit pay increase.............................	+1,688
	Jane's total salary increase...................	$ 2,487

CALCULATIONS OF PERFORMANCE APPRAISAL FUNCTIONS COSTS IN FISCAL YEARS 1980, 1981, AND 1982

Estimates of fiscal years 1980-82 costs for performance appraisal functions in HUD, Agriculture, and the Navy were based on questionnaire responses concerning time spent on supervision and on developing performance standards. In our first-year questionnaire, supervisory employees indicated the average number of hours spent in setting subordinates' performance standards, completing the rating, and counseling the merit pay employees they directly supervised in fiscal year 1981--the first year of merit pay. Respondents who supervised GM-13, GM-14, or GM-15 employees in fiscal year 1980 also indicated the average hours spent on performing the same supervisory functions in fiscal year 1980--the year before merit pay began. The questionnaire also asked all employees to estimate the number of hours spent developing their own performance standards and being counseled about their performance in fiscal years 1980 and 1981.

In the second-year questionnaire, merit pay employees indicated average hours spent on supervisory functions, setting their own standards, and being counselled in fiscal years 1981 and 1982. For all questions of time, respondents indicated their answers by checking one of the following response categories: none; 1 to 8 hours; 9 to 16 hours; 17 to 24 hours; or 25 hours or more.

To estimate costs, it was necessary to assign numerical values to respondents' answers which (1) would approximate the number of hours indicated by their answers and (2) could be subjected meaningfully to arithmetic operations. The responses were assigned the midpoint of the category in which they fell, as follows:

Category		Assigned value
None	=	0 hours
1 to 8 hours	=	4.5 hours
9 to 16 hours	=	12.5 hours
17 to 24 hours	=	20.5 hours
25 or more hours	=	28.5 hours

This conversion of data assumes that, in each category, the actual number of hours respondents spent are evenly distributed so that their average is the category's midpoint.

The following basic formula was used to calculate the costs of performance appraisal functions in each agency for each fiscal year:

$$\text{Costs} = ((\bar{X}\ \text{super} + \bar{X}\ \text{own}) \times \text{wage})\ N$$

where

$\bar{X}$ super = the average number of hours spent on supervisory functions per merit pay employee as indicated by the supervisors sampled

$\bar{X}$ own = the average number of hours per employee spent on developing own standards and being counseled by supervisors

wage = in each agency, the average hourly salary of GS-13 through GS-15 employees in fiscal year 1980

N = population size (i.e., total merit pay employees for fiscal years 1981 and 1982; for fiscal year 1980, the number of GS-13's through GS-15's converted to merit pay in fiscal year 1981 which is equal to the number of merit pay employees in fiscal year 1981)

Fiscal year 1980 and 1981 costs were estimated based on data from our first questionnaire, and costs in fiscal year 1982 were calculated using data from our second questionnaire. Data from both questionnaires was available for use in estimating fiscal year 1981 costs. Data obtained in the first year was collected closer in time to fiscal year 1981 than in the second year (i.e., 3 months after the close of the fiscal year as opposed to 1 year and 3 months). Findings from our first questionnaire were thought to be more valid measures of time spent in fiscal year 1981 and, therefore, were used to estimate fiscal year 1981 costs.

Because of the timing of our questionnaires and our decision to base fiscal year 1981 estimates on first-year data, fiscal year 1981 and 1982 cost estimates are based on data collected only 3 months after the end of the respective fiscal years while fiscal year 1980 estimates are based on data collected about 1 year and 3 months after the fiscal year's close. This latter estimate, therefore, may be more prone to the types of recall errors that occur with the passage of time than the fiscal year 1981 and 1982 estimates. Also, since errors of omission and telescoping would lead to more and more underestimation as time passed, comparisons between fiscal year 1980 and the other years might indicate greater increases in costs than actually occurred.

To eliminate the possible effects of the extended recall period on our fiscal year 1980 estimates and on comparisons between years, findings from both years on time spent in fiscal year 1981 were used to estimate the increase in recall errors occurring with the addition of a year to the recall period. Our estimate of time spent in fiscal year 1980 was then adjusted by this estimated increase in recall error. As expected, fiscal year 1981 time estimates from the second-year's questionnaire were lower than the initial survey estimates in all three Departments. In the followup questionnaire, employees' reports of time spent on performance appraisal functions in fiscal year 1981 were 16, 33, and 22 percent below the time estimates 1 year earlier in Navy, HUD, and Agriculture, respectively. Fiscal year 1980 time estimates were adjusted upwards by the respective percentage in each agency to compensate for the estimated increase in recall error.[1] The formula used to estimate fiscal year 1980 costs, therefore, was as follows:

$$\text{Costs (FY 1980)} = [(\overline{X}\text{ super} + \overline{X}\text{ own}) + E\ (\overline{X}\text{ super} + \overline{X}\text{ own}) \times \text{wage}]\ N$$

where

E = the average fiscal year 1981 time reported in the initial survey minus the average fiscal year 1981 time reported in the second questionnaire as a percentage of the initial survey's average time

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[1]Adjusting our estimates by the total percentage assumes that differences between the initial and followup findings for fiscal year 1981 occurred solely as a function of recall error as opposed to recall error in combination with other factors, such as random sample variation or differences between the two.

APPENDIX XI

DEPARTMENT OF AGRICULTURE
OFFICE OF ASSISTANT SECRETARY FOR ADMINISTRATION
WASHINGTON D C 20250

SUBJECT: GAO Draft Report Entitled "A 2-Year Appraisal of Merit Pay in Three Agencies"

TO: J. Dexter Peach, Director
Resources, Community, and Economic
Development Division, GAO

The following comment is provided on the subject report. The charts which appear in Appendix VIII (pages 94 and 95) depict average merit pay increases by performance level and grade. Average merit increases are shown in dollar amounts.

While these charts are technically correct, they create the false impression that unfair benefits are accruing to those at the higher grades. In fact, because higher graded individuals have higher base salaries, they contribute proportionately more to the pay pool and receive greater increases. To present an unbiased view of merit increases across grade levels, the percentage of increase over base salary must be used. An essentially level distribution is achieved when the Agriculture chart on page 95 is converted to percentage increases.

John J. Franke, Jr.

JOHN J. FRANKE, JR.
Assistant Secretary for
Administration

GAO note: Page references have been changed to correspond with pagination in the final report.

ERIC

MANPOWER
RESERVE AFFAIRS
AND LOGISTICS

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON D C 20301

Mr. Frank C. Conahan
Director, National Security and
Intergovernmental Affairs Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense response to your Draft Report, "A 2-year Appraisal of Merit Pay in Three Agencies," dated October 6, 1983 (GAO Case No. 966130; OSD Case No. 6374).

The Department considers the draft to be an excellent report. The recommendations proposed are ones with which this Department concurs. The specific findings and recommendations contained in the draft report are addressed in the attachment.

The opportunity to review and comment on the draft report is appreciated.

Sincerely,

Jerry L. Calhoun
Principal Deputy Assistant [illegible]
(Manpower, Reserve [illegible])

Attachment

GAO note: Page references have been changed to correspond with pagination in the final report.

DoD Response on GAO Draft Report, "A 2-year Appraisal of Merit Pay In Three Agencies," dated October 6, 1983, GAO Case No. 966130; OSD Case No. 6374

FINDINGS

FINDING A: Several Factors Other Than Performance Have Affected Merit Pay. GAO found that several other factors, independent of performance, have affected the size of merit pay increases at Agriculture, HUD and Navy. These included (1) the accuracy of the performance standards and ratings, (2) distribution of ratings within a merit pay pool, (3) composition of a merit pay pool, and (4) agency formulas for computing merit pay increases. GAO further found that when headquarters and field or noncareer and career employees are included in the same pool, employees may feel they are competing in an unfair environment and that their merit pay increases may not reflect performance. For example, in HUD and Navy, a headquarters merit pay employee was more likely to receive the highest rating than an employee in the region/field. GAO concluded that, because of employee concerns over the equity of merit pay, Office of Personnel Management (OPM) and the agencies should strive to reduce the effect of nonperformance factors on pay in order to boost employee acceptance of the merit pay system. GAO further concluded that OPM can help accomplish increased acceptance by reemphasizing the need for Schedule C and career employees to be placed in separate pools and by enforcing OPM regulations which prohibit the forced distribution of ratings. GAO finally concluded that the agencies can help reduce the effect of nonperformance factors by considering such factors as pool size and employee grade and responsibilities in establishing merit pay pools. (pp. 6-24, GAO Report)

The Department of Defense concurs with this finding.

FINDING B: Performance Standards Are Better, But They Still Need Improving. GAO found that, although the quality of performance standards had improved slightly, Agriculture, HUD and Navy managers were still having problems establishing standards which were measurable in terms of quality, quantity and timeliness and that distinguished between performance levels. GAO noted that most of Navy's standards were distinguishable. GAO further found that employees that it surveyed were generally satisfied with several aspects of their performance standards, i.e., they generally felt their standards were fair, tailored to their job, and consistent with organizational goals. GAO concluded that the Director, OPM, should direct agencies to take appropriate action that will result in performance standards that contain quality, quantity and timeliness measures and distinguish between performance levels. GAO further concluded that it is important that agencies reemphasize the need for supervisors and subordinates to jointly establish performance standards that contain (1) measures of quantity, quality, and timeliness, (2) are consistent in difficulty, (3) accurately reflect employee duties and (4) distinguish between performance levels. GAO generally concluded that without such emphasis, standards will be less likely to be fair and accurate criteria by which to judge performance. (pp. 25, 26, 30, 35, GAO Report)

The Department of Defense concurs with this finding.

FINDING C: Agencies Need To Improve Standard-Setting Procedures. GAO found that, although CSRA requires agencies to encourage employee participation during the standard-setting process, to communicate performance standards to employees at the beginning of each appraisal period, to take care to assure employees are treated fairly when standards for employees with similar jobs are established and to have standards that reflect individual job requirements, at the three agencies reviewed, these procedures were not always followed. GAO further found that many employees from Navy and HUD were not satisfied with the amount of involvement they had in establishing their standards, although most employees at Navy (79 percent) believed their supervisors considered their views when setting standards. GAO concluded that the Director, OPM should direct agencies to take appropriate action that will result in requiring, rather than encouraging, employees to participate in the development of performance standards, and to receive them to the extent practicable at the beginning of the appraisal period. GAO further concluded that communication of standards early in the appraisal period can reduce the likelihood of disagreement and requiring a review of performance standards at the beginning of each appraisal period by pool managers or their delegates can improve the consistency and quality of standads. (pp. 31, 35, GAO Report)

The Department of Defense concurs with this finding.

FINDING D: More Evaluation And Guidance Is Needed For Merit Pay System. GAO found that OPM's efforts to evaluate various agency merit pay systems were limited and sporadic. GAO also found OPM had not analyzed the cost and effectiveness of the merit pay system and cash award program nor published the results as required by law. GAO further found that OPM guidance has not ensured that all agencies are using the cash award program as an integral part of merit pay. GAO concluded that OPM efforts to evaluate merit pay have been limited and not in compliance with the law. GAO further concluded that the new organization's (Office of Performance Management) evaluation strategy is promising; however, because the staff assigned to carry out the strategy is limited, it may experience difficulty in conducting the planned reviews. (pp. 37, 39, 40, 41, 46, GAO Report)

The Department of Defense concurs with this finding.

FINDING E: Agencies Have Identified and Corrected Some First Year Problems. GAO found that all three departments it reviewed had evaluted their merit pay systems, gathered attitudinal data from employees or supervisors about merit pay, and made changes to their systems based on these evaluations. GAO further found that Navy changed its system for the appraisal period starting July 1982, because of problems it discovered--i.e., simplified its appraisal forms and required fewer performance reviews during the year. GAO concluded that the three departments have made changes based on their evaluations of their merit pay systems and these actions were steps in the right direction. (pp. 44, 47, GAO Report)

The Department of Defense concurs with this finding, but recommends that an additional change made by the Department of the Navy be included in page 45 of the report. This additional change should be added to the list of Navy's changes and should be worded as follows:

> "--Encouraged an up-front review of standards by Performance Review Boards to ensure equity among merit pay members' standards and that the establishment of standards be timely."

FINDING F: Employees Retain Negative Perceptions of Merit Pay System. GAO found that in the three departments reviewed, employees' overall perceptions about merit pay remained negative--with most employees, including top performers, believing the system had not been successful, although slight improvements in Navy respondents' perceptions were noted after the 1982 merit pay cycle. GAO further found that generally employees were skeptical about the merit pay system's intended benefits and believed that performance/productivity and motivation had not increased under merit pay, nor did the benefits justify the additional time to operate it. Further that while about one-third of the employees supported the concept of merit pay, less than 10 percent of the respondents in each Department wanted to retain the merit pay system as currently implemented. GAO concluded that after implementing two appraisal and pay cycles, employee acceptance has shown slight improvement and that such improvements in attitude (should they continue) may indicate a greater employee willingness to accept the system if they perceive it as accurately and objectively linking ratings and pay to performance. (pp. 48-52 and 55, GAO Report)

The Department of Defense concurs with this finding.

<u>RECOMMENDATION 1</u>. GAO recommended that the Director, OPM, assess the impact of pool composition and agency formulas on merit pay increases and develop criteria that will minimize their possible adverse effect. (p. 23, GAO Report)

The Department of Defense concurs with this recommendation.

<u>RECOMMENDATION 2</u>. GAO recommended that the Director, OPM — reemphasize the need for agencies to establish separate merit pay pools for its career and noncareer (Schedule C) employees, so that Schedule C employees do not receive larger merit increases at the expense of career emloyees. (p. 23, GAO Report)

The Department of Defense concurs with this recommendation.

<u>RECOMMENDATION 3</u>. GAO recommended that the Director, OPM enforce the regulations which prohibit forced distribution of ratings. (p. 23, GAO Report)

The Department of Defense concurs with this recommendation.

<u>RECOMMENDATION 4</u>. GAO recommended that the Director, OPM take action to improve performance standards and the standard-setting process by requiring pool managers or their delegates to review standards at the beginning of each appraisal period. This review should assure that, to the maximum extent feasible, standards contain the desired characteristics of objectivity and measurability, and that they are of comparable difficulty for similar jobs. (p. 36, GAO Report)

The Department of Defense concurs with this recommendation.

RECOMMENDATION 5. GAO recommended that the Director, OPM, should require that performance elements and standards be jointly established by supervisors and subordinates and be communicated to the employees within a specified time from the beginning of the appraisal period. (p. 36, GAO Report)

The Department of Defense concurs with this recommendation.

RECOMMENDATION 6. GAO recommended that the Director OPM, in order to improve the evaluation of the merit pay system and the administration of the cash award program, should (1) provide adequate resources to maintain planned merit pay evaluation efforts, (2) publish annual reports which analyze the cost and effectiveness of the merit pay system and cash award program, and (3) clarify the intended role of the cash award program for merit pay employees and provide guidance and oversight that will ensure that it is used as an integral part of merit pay. (p. 47, GAO Report)

The Department of Defense concurs with this recommendation.

United States
Office of Personnel Management
Washington, D.C. 20415

In Reply Refer To Your Reference

Honorable Charles W. Bowsher
Comptroller General of the United States
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Bowsher:

This is in response to your October draft report to the Subcommittee on Compensation and Employee Benefits, House Committee on Post Office and Civil Service, entitled "A 2-Year Appraisal of Merit Pay in Three Agencies." We have reviewed the report and would like to take this opportunity to commend GAO on the thorough and comprehensive manner in which the review was conducted.

The report recognizes that developing and implementing an effective merit pay system cannot be done in a few years. Further, the report notes that compensation experts have stated that it may take 5 to 10 years for a merit pay system to operate as intended. OPM agrees with the report's findings that there are a number of problems within the existing Federal merit pay system. OPM is aware of these problems and has initiated actions to correct them.

First, OPM has established a new Office of Performance Management which brings together under one director the previously separate programs of performance appraisal, merit pay, and performance awards, including an analysis and evaluation responsibility. The improvement of performance standards and the more effective use of performance-based incentive systems in agencies is the major work of the Office of Performance Management. The Office is responsible for overseeing the operation of performance appraisal and merit pay and awards programs in agencies, for developing policies to improve performance appraisal and merit pay in the Federal Government, and for directing agencies to make changes in their systems to bring them into compliance with OPM policies. The Office provides assistance to agencies in developing and operating their systems, reviews and approves performance appraisal and merit pay plans, and conducts reviews of agency systems. In addition, the Office develops formal policy (regulations and FPM material) and advisory or guidance documents such as model standards.

On October 25, 1983, OPM published in the Federal Register a comprehensive set of regulations dealing with performance appraisal, merit pay, awards, and a Performance Based Incentive System (PBIS). Those regulations clarify and provide greater precision to policies regarding critical elements, performance standards, summary ratings, and the use of appraisal results in setting pay and rewarding employees. The revisions in the merit pay regulations enhance compatibility between the Merit Pay and General Schedule pay systems, and further promote the linkage between the performance appraisal process, personnel decisions, and management planning and decision-making.

The new merit pay regulations provide "parity" for merit pay employees. "Parity" means that all merit pay employees rated fully successful or better will receive the equivalent of the General Schedule within-grade increase as well as the full general (comparability) increase. In addition, the regulations make performance awards a mandatory part of the merit pay concept. With "parity" being granted to all merit pay employees, there will be only a relatively small amount left in the Merit Pay Fund for distribution based on better than fully successful performance. In order to maintain a meaningful pay-for-performance system, performance awards must be used on a regular basis to supplement increases to base pay as a reward for a high level of performance. These changes should reduce substantially the perceived inequities now associated with the Merit Pay System.

Our comments on specific conclusions and recommendations of the report are set forth below.

The report concludes that OPM should "assess the impact of pool composition and agency formulas on merit pay increases and develop criteria that will minimize their adverse effects." Since the implementation of the Merit Pay System in the Federal Government in 1980, OPM has continually reviewed and analyzed agency merit payout results. We are also aware of the concerns expressed by some employees about the variation in merit increases due to the composition of the pool in which the person is employed and the kind of formula or matrix that the agency has determined is appropriate for its pay-for performance philosophy. Although the statutory requirement for separate agency merit pay funds prevents the complete elimination of variability in merit increases among agencies, OPM has already taken several steps to address this problem within an agency. In April of 1982, we issued a memorandum through the Interagency Advisory Group (IAG) suggesting that agencies transfer funds from one merit pay unit to another to correct inequities in merit pay pools that are not warranted by performance. As a follow-on to the IAG memorandum, this concept is further developed in our recently issued regulations on Performance Management. In accordance with these regulations, agencies would be authorized to make adjustments in the method used to determine the funds available to each pool within the agency in order to (1) recognize organizational accomplishment, (2) adapt for unusual distributions of performance ratings, or (3) accommodate asterisked rate requirements. This change will enable agencies to grant more uniform and appropriately sized merit pay increases than at present. We intend to continue to evaluate the impact which pool composition and agency formulas have on merit pay increases and to develop whatever additional guidance is necessary to assist agencies in improving their merit pay systems.

The report recommends OPM "reemphasize the need for agencies to establish separate merit pay pools for their career and non-career (Schedule C) merit pay employees, so that Schedule C employees do not receive larger merit increases." OPM policy authorizes agencies to define the employee composition of their merit pay pools. We recognize the problem agencies can experience in the distribution of their merit pay funds when they have a number of non-career (Schedule C) employees in a merit pay pool with career personnel. In providing consultation to agencies on this matter OPM has recommended, and will continue to recommend that, whenever feasible, career and non-career employees not be included in the same merit pay pools. However, there are circumstances when it is not appropriate to have separate pools, as when there is only one or two non-career merit pay employees in the agency. Therefore, we will continue to emphasize in our technical assistance to agencies that they carefully consider the employee composition of their merit pay pool, particularly as it relates to inclusion of career and non-career employees in the same merit pay pool.

The report also recommends that OPM should "enforce the regulation which prohibits forced distribution of ratings." OPM recognizes the importance of this rule and believes the prohibition of preestablished rating distributions helps to ensure that employees are accurately appraised against the standards for their positions. Our regulations reinforce the prohibition of preestablished performance distributions but would require that agencies provide for higher level management of the performance appraisal process in the interest of employee equity and in order to reflect organizational performance. Through that process, managers would be able to change inaccurate appraisals, but would not be permitted to require a specific distribution that was established in advance. Additionally, through its agency assistance, evaluation, and monitoring activities, OPM will work diligently to see that this requirement is accomplished.

The report concludes that the Director of OPM "require that merit pay pool managers review performance standards at the beginning of the appraisal period to assure that, to the maximum extent feasible, they contain the desired characteristics of objectivity and measurability and that they are of comparable difficulty for similar jobs." Our new regulations require that critical elements, non-critical elements, and performance standards shall be in writing and shall be reviewed and approved by a supervisor or manager at a higher level than the appraising official. This requirement will provide for a stronger role for higher level managers and supervisors (including merit pay pool managers) in the appraisal process, specifically including the review of performance standards at the beginning of the period, not only for the reasons stated but to ensure also that they accurately reflect the goals and missions of the organization. Our regulations will also require that a supervisor or manager at a higher level than the appraising official review and approve ratings before they are made final and communicated to employees. We agree that the importance of the performance appraisal process demands an active role for all levels of management.

With respect to the recommendation that OPM should "require that performance standards be jointly established by supervisors and subordinates," we strongly believe that employee involvement is fundamental to the success of the performance appraisal system. Making it a requirement that there be direct supervisor-employee communication during the standards-setting process is an excellent idea. Our new regulations state, "an agency shall encourage employee participation in establishing performance standards." (emphasis added) However, we are concerned that the recommendation, as written, could be interpreted to mean that agencies would be required to jointly negotiate standards with employees and that management and employees must reach agreement on their content. It is our position that establishing performance standards is an integral part of management's right to assign work. We suggest, therefore, that this recommendation be changed to read, "require that agencies encourage employee participation in establishing performance standards."

With respect to the recommendation that OPM should "require that standards be communicated to employees within a reasonable and specified time from the beginning of the appraisal period", such a requirement already exists in nearly all agency plans and implementing procedures, and our newly published regulations also require that agencies provide written Performance Plans to employees at the beginning of each appraisal period. We fully expect that OPM's oversight and monitoring activities will help to ensure that this requirement is met.

The report recommends that OPM "provide adequate resources to maintain its planned merit pay evaluation efforts." We concur with this recommendation and also with GAO's comments on the necessity of having a comprehensive evaluation program. As stated earlier, the Office of Performance Management was established to improve upon performance standards and to promote effective utilization of performance-based incentive philosophies in the agencies. In accomplishing this mission, this office relies heavily upon an analysis and evaluation function to conduct program evaluation as it leads and directs the Government-wide areas of the performance award and merit pay programs. This functional responsibility rests with the Analysis and Evaluation Division of the Office of Performance Management.

Our Evaluation efforts were initiated during fiscal year 1983 and have been in place for less than twelve months. Studies accomplished by the Analysis and Evaluation Division during the past year, while comprehensive, were limited to a small start up effort and a small number of agencies. We concur with GAO's recommendations that additional efforts must be expanded toward the analysis and evaluation of performance management programs if future improvements in these programs are to be expected. To that end we intend to significantly increase our program evaluation efforts in the review of Government-wide performance management program operation and effectiveness. With the help and cooperation of OPM's Agency Compliance and Evaluation Group, (ACE) our analytical and evaluative efforts planned for FY-1984 will focus on: (1) a systematic review for effectiveness of performance management programs being implemented and administered in the agencies via specific agency on-site as well as Government-wide reviews. Some of this effort will be handled by the nationwide network of ACE in concert with the Office of Performance Management; (2) using available information sources including this year's program results, identifying areas where Government-wide improvements of Performance Management Systems are needed and initiating special program studies. Some of these studies will be narrow in scope and address specific problems in selected agencies. Others will be more comprehensive, Government-wide, and focus on problems that may have policy impact; and (3) intensifying our efforts to improve the accuracy and timeliness of existing data bases such as the Merit Pay Management Information System to provide an analytical and evaluative information source from which OPM can identify operational problems and provide a solid basis upon which corrective courses of action in agencies can be initiated.

Additionally, efforts will be started to lay the ground work for the agency development of self assessment procedures for performance management programs while stressing the relationship of performance management programs to the total personnel management process. While the performance appraisal system is the basis upon which merit pay decisions are made, agencies are also required to utilize the results of the performance appraisal system in the other areas of the personnel management process. The methods by which the performance appraisal results can be linked to the training, promoting, rewarding, reassigning, reducing-in-grade, retaining and removing of employees have not been emphasized in the past by OPM and almost totally left to the discretion of the individual agencies. The Analysis and Evaluation Division of the Office of Performance Management will accomplish an in-depth Government-wide study to determine to what extent the integration of performance management and personnel management programs has occurred and assess the overall thoroughness and effectiveness of existing linkages. This effort will involve a sampling of agencies and cover the agency headquarters as well as regional installations.

The report recommends that OPM "clarify the intended role of the cash award program for merit pay employees and provide guidance to ensure that it is used as an integral part of merit pay." In developing our revised regulations, OPM determined that performance awards should become a mandatory part of the Merit Pay System. The regulations provide that agencies must include in their Performance Management Plan, for approval by OPM, the way in which performance award funds will be distributed and the amount to be funded by the agency for such purposes. OPM will specify the minimum funding level for merit pay performance awards.

In response to the recommendation in the report that OPM "publish annual reports which analyze the cost and effectiveness of the Merit Pay System and Cash Award program," we would like to make the following comments:

a) OPM consistently runs an approval process and continually monitors payouts in order to ensure that neither more nor less money is spent in the Merit Pay Program for GM employees than would have been spent under the General Schedule. We have pay data resident in our Merit Pay Management Information System (MPMIS) to track this. Also, since the amount that would have been paid merit pay employees for within-grade increases, quality-step increases, and the non-automatic portions of comparability increases are put into a pool for distribution, the total amount distributed is the same as it would have been under a GS system, although the specific amounts paid to each employee vary by performance rating. Our Merit Pay Statistical Report shows how agencies actually do their payouts and also contains selected data on how the Merit Pay Program is working, but there is no need to address total cost of the payouts since it is keyed to the total costs that would have occurred under the General Schedule.

APPENDIX XIII

b) Both OPM Central and Regional offices are currently involved in performing the following studies to determine how effectively the Merit Pay Program is achieving the objectives of the Civil Service Reform Act:

- The Merit Pay Statistical Report, 1983, explores the relationship of pay and performance awards to performance ratings; it also serves jointly as a reporting mechanism to central management agencies and also as a source of feedback for operating agencies.

- There are three other studies being performed by our Program Evaluation Branch, which include surveys and document searches performed nationwide by OPM Central and Regional office personnel, and are due to produce results by the end of the calendar year.

We believe that OPM is responding to this "cost and effectiveness" recommendation. We have plans for several other more directed studies to determine how well Merit Pay and Performance Appraisal programs have been working since the passage of the Civil Service Reform Act.

Thank you for this opportunity to respond to and comment on the proposed report. We believe that our new regulatory initiatives relative to performance management will result in better management of the Federal Government's work force.

Sincerely yours,

Donald J. Devine
Director

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