

A REPORT TO THE PRESIDENT AND THE
CONGRESS OF THE UNITED STATES BY
THE U.S. MERIT SYSTEMS PROTECTION BOARD

PERFORMANCE MANAGEMENT AND RECOGNITION SYSTEM: Linking Pay To Performance



A Report Concerning Significant Actions of the
Office of Personnel Management

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U.S. MERIT SYSTEMS PROTECTION BOARD
1120 Vermont Avenue, N.W.
Washington, D.C. 20419
December 30, 1987

Sirs:

In accordance with section 202(a) of the Civil Service Reform Act of 1978 (5 U.S.C. §1205(a)(3) and §1209(b)), it is my honor to submit this U.S. Merit Systems Protection Board report titled "Performance Management and Recognition System: Linking Pay to Performance."

This report addresses implementation of the Performance Management and Recognition System (PMRS), the revised pay-for-performance system that replaced the Merit Pay System established by the Civil Service Reform Act of 1978.

I think you will find this report useful as you consider issues concerning civil service pay policies and practices. It may be of particular interest for three reasons:

- It suggests two changes to title 5 of the U. S. Code that could make PMRS more effective;
- It identifies a need within agencies for more emphasis on PMRS as a tool to manage performance so that, in the end, agencies may more accurately recognize their most deserving senior managers and supervisors; and
- It documents important concerns that the Office of Personnel Management, the agencies, and employees have raised about some aspects of PMRS.

Respectfully,

Daniel R. Levinson

The President of the United States
The President of the Senate
The Speaker of the House of Representatives

Washington, DC



OVERVIEW

This report examines implementation of the Performance Management and Recognition System (PMRS). PMRS is the pay-for-performance system that replaced the Merit Pay System established by the Civil Service Reform Act of 1978 (CSRA). Under the legislation establishing PMRS, the system has a "sunset" provision; it expires on September 30, 1989, unless the Congress acts positively to extend it before that date.

PMRS is very different from the earlier Merit Pay System, and, at this relatively early stage, appears to be an improvement over it. The Office of Personnel Management (OPM) and the agencies implemented the technical changes (from Merit Pay to PMRS) well, especially considering the short time frame allowed as a result of the legislation's timing. Agencies' efforts to make affected employees aware of the changes were not as successful.

While the performance awards aspect of PMRS should be particularly valuable as a means of recognizing better-than-average performance, many agencies are concerned that funding for that component of the system is inadequate. Whether, or to what degree, underfunding is a problem is still a matter of debate. *However, this report offers evidence that high performance ratings for large percentages of employees are a major factor contributing to the problems agencies report they are experiencing in providing meaningful recognition to top performers.*

For the performance rating cycle that ended in October 1985, over two-thirds of all employees subject to PMRS received ratings that either required or encouraged performance awards. In other words, a large majority of PMRS employees received ratings indicating they exceeded "normal" expectations. Despite this, only 45.4 percent of the PMRS employees responding to an MSPB survey believed better performance was likely to lead to more pay.

Nearly half (12 of 28) of the agencies or agency components providing information for this report expressed concern over inflated or unrealistic performance ratings. Agencies fear--with apparent justification--that employees' perceptions of a "fully successful" rating are very unfavorable. Improving the perception of a "fully successful" rating is an area over which agencies should be able to exert considerable influence, particularly through efforts to ensure the conscientious application of fair and understandable performance standards and elements.

Fewer than 1 percent of PMRS employees in the 21 largest executive departments and independent agencies use the formal process established to challenge their performance ratings. Of those who challenged their performance ratings, approximately one in five succeeded in improving the rating.

Two changes in title 5 of the U.S. Code should be considered. One would eliminate a disparity in pay treatment between PMRS employees in the middle third of their pay ranges compared with their General Schedule counterparts in those ranges. Several agencies expressed particular concern that the current disparate treatment

may contribute to employees' unfavorable perceptions of "fully successful" ratings, and that it acts to discourage managers from giving such ratings to PMRS employees in the middle third of the pay range.

The second suggestion would eliminate uncertainty as to the action agencies are to take when employees with "unacceptable" performance improve their performance, but only to a limited extent. Specifically, the current law and implementing regulations are not clear as to the required agency action when an employee's performance improves, but not to the "fully successful" or higher level. OPM has informed MSPB of pending regulations that will address this problem.

Finally, OPM should assume a more active role as "information broker" for PMRS issues common among agencies. Nearly every agency would benefit from better sharing of "how to" information on topics such as ensuring accurate appraisals and encouraging reasonable distributions of ratings without violating the restriction against forced distributions.

These three areas of concern are important enough to deserve attention as early as possible. However, as a general matter, PMRS needs a period of stability to allow employees and agencies to see how it works and to better define problem areas. Such a period of stability might help prevent a complaint often raised concerning the earlier Merit Pay System--that it was changed too frequently. Additional changes to PMRS may well be appropriate if the system is continued beyond its September 30, 1989, expiration date, but for now a period of stability is very important.

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INTRODUCTION

MSPB is required by 5 U.S.C. § 1209(b) to report annually to the President and the Congress on the significant actions of OPM. The report is to include "an analysis of whether the actions of the Office of Personnel Management are in accord with the merit system principles and free from prohibited personnel practices."

This is one of a series of reports MSPB is publishing in calendar year 1987 concerning the significant actions of OPM over a period of approximately 18 months. The report reviews a pay-for-performance system, called the Performance Management and Recognition System (PMRS), which applies to white-collar managers, supervisors, and management officials in GS pay grades 13, 14, and 15. These employees are assigned to the GM pay plan. PMRS is an outgrowth of the earlier Merit Pay System created by the CSRA.

Other reports in this series address:

- The systems for hiring entry-level employees (for white-collar professional and administrative occupations, and for apprentices for blue-collar crafts and trades occupations);
- Implementation of revised reduction-in-force (RIF) regulations;
- Expanded temporary limited appointment authority; and
- Performance management.

BACKGROUND

PMRS was established by a law that was effective November 8, 1984.¹ The PMRS provisions were retroactively effective to October 1, 1984, and applied to pay periods beginning on or after that date. The law authorized PMRS for 5 years (until September 30, 1989); its continuation beyond that date will require positive legislative action.

The performance appraisal system established by PMRS is required to have five summary rating levels. The lowest level of rating--level 1--is "Unacceptable"; level 3 is "Fully Successful," and level 5 is "Two Levels Above Fully Successful." Level 2 is defined as between "Unacceptable" and "Fully Successful;" level 4 is defined as one level above "Fully Successful."

PMRS offers employees the opportunity to earn merit increases in their rates of basic pay (advancement within the ranges for their pay grades) and to earn performance awards (one-time "bonus" payments not part of basic pay). A rating of level 3 or higher entitles the employee to the full amount of any general pay increase authorized during the pay adjustment period, and to a merit increase determined by the rating and the employee's placement in the pay range.

An employee rated at level 5 must receive a performance award ranging from 2 percent to 10 percent of his or her basic pay. In exceptional cases, the head of an agency may grant a performance award not to exceed 20 percent of base pay. OPM regulations encourage agencies to grant performance awards to employees rated at level 4, and permit performance awards to employees rated at level 3.

¹ Pub. L. 98-615, Nov. 8, 1984, 98 Stat. 3214.

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By contrast, employees with ratings below level 3 are not eligible for merit increases or performance awards. Employees rated at level 2 receive only one-half of any general pay increase authorized for the pay adjustment period, and employees rated at level 1 receive no general pay increase.

Within any fiscal year, each agency's performance award budget is limited to not more than 1.5 percent of that agency's estimated total amount of basic pay for its PMRS employees.

FINDINGS

Implementation

OPM and most of the agencies that commented on PMRS implementation were satisfied with the implementation process that took place in FY 1985. OPM's assessment was that implementation "went remarkably well, given the lateness in the passage of the Act and the retroactive nature of its implementation."² OPM supported its assessment by pointing out that:³

all performance award plans had received OPM approval by mid-January 1985 for payment of awards based on the FY 1984 performance cycle[, and]

[c]omplete PMRS plans were approved by January 1986.

² Comment contained in enclosure to letter from Honorable Constance Horner, Director, Office of Personnel Management, to Honorable Daniel R. Levinson, Chairman, Merit Systems Protection Board, dated December 3, 1986. (Subsequent references to this source are identified as "OPM Response.")

³ Ibid.

OPM was generous in its compliments of agencies' efforts to implement the new system, citing "a concerted effort to get the initial pay systems designed and in place,"⁴ and "[a] high degree of cooperation between the agencies and OPM * * * as they sought answers to questions, solved problems, and worked out necessary compromises."⁵

While not uniform in their assessment of how well implementation went, most agencies (19 of the 26 that commented on this subject) were favorably disposed towards OPM's efforts to guide implementation.

Seven responses contained negative comments. One was from a component of the Department of Defense and six were from departments or independent agencies. The negative comments generally fell into these categories:

- Untimely guidance, or guidance that changed several times;
- Inadequate coordination within OPM in preparing the PMRS regulations, allowing inconsistencies and contradictions with other (especially RIF) regulations to occur; and
- The absence of final written guidance (e.g., an FPM chapter) on PMRS.

However, even the agencies making negative assessments included positive comments. They acknowledged that OPM staff were generally prompt in responding by telephone to agency inquiries, although some cited "inconsistency of position" as a problem. They also reported advisory opinions and

⁴ Ibid.

⁵ Ibid.

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clarifications of OPM guidance as further efforts by OPM to ease implementation.

In January and February 1986, MSPB distributed its 1986 Merit Principles Survey. When the survey was distributed, PMRS had been in effect for over 15 months. Employees returned the survey over a 4-month period. The responses were prepared between 15 and 18 months following PMRS implementation. During that time, agencies provided PMRS training to affected employees, carried out other implementation activity, and made their first PMRS payouts. Consequently, the survey responses are a valuable information source for employee perceptions concerning PMRS.

Among the survey questions was one that touches on the effectiveness of training given to affected employees as part of the implementation of PMRS: *"How much do you know about the changes made to the merit pay system when it became the current Performance Management and Recognition System (PMRS) for supervisors and management officials at grades 13 through 15 in your agency?"* Responses from GM employees do not provide as positive a picture as that presented by OPM and most agencies:

Knowledge of the changes made to the merit pay system when it became PMRS:⁶

	"A Great Deal"	"Some"	"Little or Nothing"
GM Supervisors	28.6%	53.6%	17.8%
Nonsupervisor	19.0%	54.1%	27.0%
GM Combined	26.7%	53.7%	19.6%

⁶ Because of rounding, the sums of the columns may not equal 100%.

When approximately one-fifth of all affected employees professed to know "little or nothing" about the PMRS at a time (Spring 1986) when all PMRS plans recently had been approved,⁷ problems are suggested. However, whether these are problems with agencies' training efforts, or whether they indicate employees' difficulties in seeing differences between the Merit Pay and PMRS systems despite reasonable training efforts, cannot be determined.

In a July 1987 report on PMRS,⁸ OPM reported on agencies' implementation activities, stating that "increased employee understanding of the system"⁹ was a significant finding. OPM relied in part on information provided by "43 Federal agencies or major components of agencies"¹⁰ in preparing its report. Without knowing the base level of understanding OPM used, MSPB cannot conclude that the Merit Principles Survey findings contradict OPM's. In fact, OPM's report also noted that "reviews by OPM and GAO of individual agency programs did not make [as positive an assessment of employees' understanding of PMRS as did agency reports] and identified a need for improved communication of PMRS requirements."¹¹ From this, it appears that the OPM and GAO reviews produced findings similar to those obtained through the Merit Principles Survey.

Given the timeframe within which OPM and the agencies had to work (from passage of the legislation to implementation of

⁷ See OPM comment earlier.

⁸ "Performance Management and Recognition System, Report to the President and the Congress, July 1987," U.S. Office of Personnel Management.

⁹ Ibid., p.7.

¹⁰ Ibid., p.2.

¹¹ Ibid., p.8.

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the new system), MSPB believes both did a creditable implementation job. If the process did not go as well as agencies and OPM might have wished, neither did it go as badly as it could have. While everything necessary is not yet done, MSPB believes the system was implemented in an overall efficient and effective manner.

Opportunity to Formally Challenge
Summary Rating

PMRS is a replacement for the Merit Pay System established by the Civil Service Reform Act. Both systems included provisions for employees to challenge their summary ratings formally. In an effort to determine how often this provision was used, and how successful the employees were, MSPB asked the agencies to provide information about disputes, or grievances, initiated by GM employees to challenge their ratings. We requested the information by fiscal year for 4 years: 1982, 1983, 1984, and 1985.

The response data do not lend themselves to display in a table or chart, but can be summarized as follows:

- Three departments (Air Force, Housing and Urban Development, and Commerce) indicated that the information was unknown or unavailable.
- Among the 19 agencies that could provide the requested information, there were proportionately very few GM employees who exercised their challenge right formally. Expressed as a percentage of all GM employees, the figure was less than 1 percent for each agency each year, with one ex-

ception--a 3.26 percent rate in the Department of the Navy in FY 1982. Barring the exception, the actual annual figures reported ranged from .0005 percent to .83 percent.

- Of the employees who exercised their challenge right, the proportion that prevailed (were successful in changing the rating) ranged from 0 to 100 percent but typically was around 20 percent.
- The actual numbers upon which the preceding two points are based were generally small, often in the range of fewer than 20 employees challenging their ratings and around 4 succeeding. The Department of the Navy was again a major exception, recording 471 challenges in FY 1982. That figure has never come close to being matched again.
- The figures provided by the agencies do not show a year-to-year pattern of increasing or decreasing numbers of challenges to summary ratings, or a pattern of proportionately more or fewer successful challenges.

These data show that a small percentage of employees do challenge their ratings. Further, they show that the process has substance, since a significant proportion of those employees prevail. The small number of challenges, however, suggest several possibilities, including: 1) raters are doing a good job and the number of instances where employees believe they have been "wronged" is very small; 2) so many employees receive high ratings that there is little need or

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incentive to challenge ratings; 3) informal avenues are used with such success that only a small percentage of dissatisfied employees find it necessary to pursue formal procedures; or 4) employees have so little confidence in the formal challenge process that very few use it.

Perceived Problems With Linking
Pay and Performance

Agency identification of PMRS problems tended to focus on two related points: 1) the dollar limitation on the amount of money available for performance awards (1.5 percent of an agency's aggregate PMRS basic pay); and 2) the difficulty agencies are encountering in getting a reasonable distribution of performance ratings. Since OPM regulations¹² require performance awards for employees rated at level 5¹³ (defined by regulation¹⁴ as "two levels above 'Fully Successful'"), encourage performance awards for employees rated at level 4 (defined as "one level above 'Fully Successful'"), and permit performance awards for employees rated at level 3 ("Fully Successful"), concern for the relationship between available funds and rating distributions is understandable.

Table 1, prepared from information furnished by OPM, helps demonstrate the extent of the problem agencies face. The table shows the number of PMRS employees (pay plan GM) in each of the 21 largest departments and independent agencies, plus OPM, who had received valid performance

ratings¹⁵ as of October 1985, and the percentages of these populations that were rated at levels 5 and 4. The agencies are ranked from high to low. At the bottom of the table there are comparable figures for all Federal agencies. Table highlights are:

- Governmentwide, 20.7 percent of all GM employees were rated 5. In the largest agencies, this figure varied from 0.8 percent (in Agriculture) to 59.9 percent (in State). Agencies are required to give performance awards to employees with this rating.
- Also Governmentwide, 48.0 percent of all GM employees were rated 4. In the largest agencies, this figure varied from 36.1 percent (Education) to 64.5 percent (National Aeronautics and Space Administration). Agencies are encouraged to give performance awards to employees with this rating.
- Overall, 68.7 percent of all Federal GM employees fell into the combined category of mandatory or encouraged performance awards. Among the largest agencies this figure varied from 48.3 percent (Treasury) to 89.9 percent (Justice).

¹² 5 CFR 540.109(d).

¹³ The requirement to give a performance award to an employee with this rating is established first in law, at 5 U.S.C. §5406(a)(1).

¹⁴ This and the following definitions are taken from 5 CFR 430.405(h).

¹⁵ OPM explained that an employee's record could also have an invalid rating, or the rating could be missing. Invalid ratings are ones that agencies submitted to OPM with a value not recognized by the OPM computer system (such as "6" on a 5-point scale). The number of invalid ratings is relatively small. The number of missing ratings varies by agency, exceeding 20 percent in some. All information in this report is based on valid ratings only.

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**Table 1
GM Employees With Valid Performance Ratings
Who Received Summary Ratings of 5 or 4, as of October 1985
(Employees in the 22 largest departments and independent agencies;
departments and independent agencies listed in descending order)**

Department or Independent Agency	Total Number of GM Employees With Valid Ratings	Percent Level 5	Percent Level 4	Percent Included in Both Ratings
Justice	2,907	48.3	41.6	89.9
State.....	232	59.9	28.9	88.8
General Services Administration..	1,907	26.5	62.0	88.5
Navy.....	14,521	25.6	51.2	76.8
Environmental Protection Agency.....	1,858	24.9	51.7	76.6
Health and Human Services	8,121	26.5	49.0	75.7
National Aeronautics and Space Administration.....	2,952	11.0	64.5	75.5
Energy.....	2,906	23.4	49.1	72.5
Veterans Administration	4,252	27.5	44.7	72.2
Interior.....	4,721	20.1	51.8	71.9
Defense (excluding Army, Air Force and Navy).....	4,137	25.3	45.3	70.6
Education	879	32.5	36.1	68.6
Commerce	3,727	23.2	43.0	66.2
Transportation	8,179	17.6	48.6	66.2
Housing and Urban Development.....	1,515	19.0	46.7	65.7
Air Force	6,813	20.0	44.0	64.0
Agriculture.....	9,098	0.8	61.5	62.3
Army.....	9,316	23.2	37.2	60.4
Small Business Administration	615	12.8	45.5	58.3
Office of Personnel Management.....	497	10.5	40.0	50.5
Labor.....	2,359	7.8	40.6	48.4
Treasury.....	7,758	6.8	41.5	48.3
ALL AGENCIES.....	103,964	20.7	48.0	68.7

Note: A level 5 summary rating is 2 levels above fully successful;
a level 4 rating is 1 level above fully successful.
These definitions are in 5 CFR 430.405(h).

Note: Because of rounding, the sums of the rows "Percent Level 5" and "Percent Level 4"
do not necessarily equal the figures for "Percent Included in Both Ratings."

Source: U.S. Office of Personnel Management.

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Faced with such figures, it is not surprising that agencies believe a 1.5 percent of base salary cap on performance awards money is too stringent. *These figures suggest, however, that unrealistically high performance ratings may be as much a problem as inadequate funding.*

Twelve of the 28 responding agencies identified inflated or unrealistic performance ratings as a problem. Several of these agencies suggested, or used language that hinted at, the need for forced distributions to make the system work better. Additionally, Air Force mentioned "some inconsistency within OPM related to rating distributions," reporting that "OPM regional offices have evaluated a large number of Air Force installations and have reported to our commanders that 'normally, 60 to 70 percent of the work force should fall within the Fully Successful range."¹⁶ The Air Force response then goes on to say "when one of our commands issues guidance to address their inflation problem, they often are not supported by the OPM when challenged by employees or congressional staff."¹⁷

Following her review of this report, OPM's Associate Director for Personnel Systems and Oversight informed MSPB that OPM had responded in writing to the "inconsistency" concern expressed by the De-

partment of the Air Force. She explained that OPM had informed the Department of the Air Force that "while agencies may not prescribe a distribution of ratings, they can use non-binding guidelines as part of their overall responsibility to manage the performance appraisal process."¹⁸ She concluded with the comment: "We believe OPM has been consistent in its position on this matter."¹⁹

OPM's Associate Director for Personnel Systems and Oversight provided MSPB with a copy of the letter OPM sent to the Department of the Air Force on this subject. The letter contains the following information that all agencies may find instructive:

[In the context of the language found in PMRS legislation and regulations,] we view an agency's articulation of normal performance expectations in general, in non-binding guidelines [to be] part of its overall management of the performance appraisal process. * * * There is, of course, no precise "ideal" or "desired" rating scheme that can be applied as a rigid quota. Nevertheless comparison with government-wide and agency-wide rating distributions, placed in proper context, is clearly appropriate. Likewise, improvement goals, when not applied as rigid quotas also are permissible. Care must be taken whenever norms or goals are used to consider whether under all existing circumstances such

¹⁶ Comment contained in attachment to memorandum dated 23 October 1986, from P.I. Schittulli, Director of Civilian Personnel, Department of the Air Force, to Claire E. Freeman, Deputy Assistant Secretary for Civilian Personnel Policy, Department of Defense. The Air Force information was forwarded to MSPB as part of a consolidated DoD response to MSPB's information requests by letter dated 5 November 1986, from Deputy Assistant Secretary Freeman to MSPB Chairman Daniel Levinson.

¹⁷ Ibid.

¹⁸ Comment contained in a letter, dated December 10, 1987, from Claudia Cooley, OPM Associate Director for Personnel Systems and Oversight, to Paul D. Mahoney, Director, Policy and Evaluation, U.S. Merit Systems Protection Board.

¹⁹ Ibid.

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comparisons are appropriate in the organization under review.²⁰

The comments above, and the explanation OPM sent to the Department of the Air Force, exemplify the difficulty in coming to grips with PMRS "rating inflation" in Federal agencies. Forced distributions are prohibited by law, and guidelines on distributions are subject to be viewed as tantamount to attempting to force distributions. However, without some form of guidelines or a change in the law, there appears to be little hope for obtaining consistent application of the performance appraisal process among agencies, or even among major components of the same agency. As long as a majority of PMRS employees remain grouped at the high end of the rating scale, the ability of the appraisal process to make meaningful performance distinctions among those employees will be severely limited.

Concerns about inflated ratings, insufficient performance award money, and arbitrary limits on ratings are serious and require attention. It may be too soon to know if the 1.5 percent of base salary dollar limit is too little money to make the system work. OPM pointed out that most agencies spend proportionately three times as much on awards for PMRS employees as on awards for General Schedule employees (1.5 percent

versus .5 percent of payroll).²¹ It is interesting that, given greater discretion on payment of awards, agencies spend proportionately less rather than more money.²²

Before the issue of funding can be determined, agencies may need to put more emphasis on the heart of this system--the "Management" of the Performance Management and Recognition System. Specifically, a strong case can be made for the need to be more realistic either: 1) in rating performance, or 2) in describing the expectations against which the ratings are made. While forced distributions are illegal, OPM should help agencies identify other ways to deal with what appears to be "rating inflation."

Employee Perceptions

In addition to the question already mentioned (concerning what employees knew about the changes made to the merit pay system when it was changed to PMRS), MSPB's 1986 Merit Principles Survey collected other information concerning performance rating and linking pay to performance. GM employees' responses to a number of questions were examined for this report.

²¹ Information contained in the letter, dated December 10, 1987, from Claudia Cooley, OPM Associate Director for Personnel Systems and Oversight, to Paul D. Mahoney, Director, Policy and Evaluation, U.S. Merit Systems Protection Board (op. cit.).

²² Regulations governing Performance Management for employees not under PMRS are less prescriptive than are those governing PMRS. Performance awards regulations (5 CFR 430.506) only require that each agency establish a program. Regulations concerning quality step increases (QSI), found in 5 CFR 531.504, say a QSI "shall not be required but may be granted only to an employee [with a level 5 (Outstanding) rating]."

²⁰ Contained in a letter dated August 28, 1987, from Barbara L. Fiss, OPM Assistant Director for Pay and Performance, to Michael I. McGuire, Chief, Performance Management, Pay and Allowances Division, Directorate of Civilian Personnel, Department of the Air Force.

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Employees receiving the survey were asked to use a rating scale to respond to the following statement: *"There is an arbitrary limit on the number of people who can get high ratings."* Ironically, while agencies are concerned about inflated or unrealistic performance ratings, GM employees' responses suggest they believe their organizations already have addressed this problem through arbitrarily controlling the distribution of ratings:

There is an arbitrary limit on the number of high performance ratings.²³

	"Strongly Agree" or "Agree"	"Disagree" or "Strongly Disagree"
GM Supervisors	69.3%	19.5%
GM Nonsupervisors	77.2%	9.4%
GM Combined	70.6%	17.5%

Respondents also had an opportunity to address the subject of inflated performance ratings directly. They were asked to indicate their agreement or disagreement with the following statement: *"My supervisor tends to inflate the ratings of the employees he/she supervises."* As perceived by their GM employees, supervisors are doing a relatively good job of avoiding rating inflation:

²³ "Neither agree nor disagree" and "No basis to judge" responses are not included, so the row figures do not equal 100%.

My supervisor tends to inflate performance ratings:²⁴

	"Strongly Agree" or "Agree"	"Disagree" or "Strongly Disagree"
GM Spvrs.	9.5%	58.6%
GM Nonspvrs.	9.3%	49.4%
GM Combined	9.5%	57.1%

Undoubtedly, rating distributions like those shown in table 1 influenced employees' responses.

Employees also responded to the statement *"There is a tendency for my supervisor to give the same performance ratings regardless of how well people perform their jobs."* GM employees indicated the following agreement and disagreement with this statement, suggesting there is still room for improvement in this area:

My supervisor tends to give the same performance ratings regardless of performance differences:²⁵

	"Strongly Agree" or "Agree"	"Disagree" or "Strongly Disagree"
GM Spvrs.	28.4%	41.7%
GM Nonspvrs.	26.9%	36.6%
GM Combined	28.0%	40.7%

The 1986 Merit Principles Survey also included the following question: *"If you perform better in your present job, how likely is it that you will receive more pay (e.g., bonus, promotion, cash award)?"* Since this is the essence of pay-for-performance, responses

²⁴ "Neither agree nor disagree" and "No basis to judge" responses are not included, so the row figures do not equal 100%.

²⁵ "Neither agree nor disagree" and "No basis to judge" responses are not included, so the row figures do not equal 100%.

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from PMRS employees are particularly important. Their responses are shown in the following tabulation:

My Likelihood of More Pay
if I Perform Better on the Job:²⁶

	GM <u>Spvrs</u>	GM <u>Nonspvrs</u>	GM <u>Combined</u>
"Very or Somewhat Likely"	45.3%	44.4%	45.4%
"Neither Likely nor Unlikely"	15.5%	17.3%	15.8%
"Somewhat or Very Unlikely"	38.8%	38.1%	38.5%

The tabulation shows that slightly more than two of every five PMRS employees (45.4 percent) believe more pay for better performance is "very" or "somewhat" likely. A somewhat smaller proportion (38.5 percent) considered more pay for better performance "somewhat" or "very" unlikely. This latter group may include persons with "5" ratings who responded in the negative because they believed their performance had already earned them the highest pay recognition possible. There are no appreciable differences between responses from supervisors and nonsupervisors.

These figures fall short of representing an employee endorsement of PMRS. They reflect a higher level of skepticism than should be present in a well-running system. In light of the information concerning the distribution of ratings that appears earlier in this report, these figures appear to make

²⁶ "Neither agree nor disagree" and "Don't know/can't judge" responses are not included, so the row figures do not equal 100%.

sense only if they are influenced by top performers concluding and responding that performing even better will not improve their pay.

Finally, the issues of fair performance standards and accurate performance elements also were examined through the eyes of employees. The following two statements were in the 1986 Merit Principles Survey:

a. *"The standards used to evaluate my performance are fair."* GM employees expressed the following agreement and disagreement:²⁷

	"Strongly Agree" or "Agree"	"Disagree" or "Strongly Disagree"
GM Spvrs.	60.3%	19.9%
GM Nonspvrs.	56.2%	20.4%
GM Combined	59.7%	20.1%

b. *"To what extent are the job elements in your performance standards an accurate statement of the work you are expected to perform in your job?"* GM employees responded:²⁸

	"Very Great" or "Considerable" <u>Extent</u>	"Some" <u>Extent</u>	"Little" or "No" <u>Extent</u>
GM Spvrs	57.0%	27.6%	13.8%
GM Nonspvrs	55.0%	29.4%	14.4%
GM Combined	56.6%	28.1%	13.9%

With approximately three-fifths of the GM employees responding favorably to both

²⁷ "Neither agree nor disagree" and "No basis to judge" responses are not included, so the row figures do not equal 100%.

²⁸ "Do not have performance standards" and "Don't know/can't judge" responses are not included, so the row figures do not equal 100%.

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statements, it appears that a majority of affected employees believe that two basic building blocks of PMRS are in place. However, since approximately one-fifth indicate their standards are not fair, and about one-tenth say the elements of their standards are not accurate, it also appears those agency efforts are not uniformly successful.

Review and Evaluation Activity

Following PMRS implementation, OPM's Office of Performance Management conducted a number of Performance Management Program Reviews. In responding to MSPB's information requests, OPM provided several comments directly relevant to the problem of evaluating performance under the PMRS pay-for-performance system. For example, OPM reported reviewing 11 agencies over a recent 18-month period and finding "[h]igh rating levels * * * at 87.5 percent of * * * agencies reviewed."²⁹

Additionally, OPM reported " * * * a great need to improve the quality of elements and standards (87.5 percent of the agencies reviewed)."³⁰ These following OPM observations, drawn from the same reviews and quoted from the same source, make even more clear the challenges agencies face in implementing effective Performance Management and Recognition Systems.³¹

[The need for] development of standards that clearly distinguish among levels of performance (50% [of the agencies reviewed]);

[The need for] improvement of employees' perceptions of a fully successful rating (50% [of the agencies reviewed]); and

* * * most of the agencies reviewed (75%) had no systematic approach to program evaluation. Whereas there was some awareness of the problems revealed through the OPM reviews, the lack of internal systematic program evaluation contributed to the agencies' inability or unwillingness to pinpoint and address the areas of concern.

Agencies painted a somewhat different picture of their internal efforts to "pinpoint and address" PMRS problems. Citing their internal personnel management evaluation programs and/or their performance standards review boards as vehicles they use to monitor PMRS activity, several agencies reported identifying quality of performance elements and standards and distribution of ratings as two problem areas with which they are particularly concerned. While OPM and the agencies may have a somewhat different view of the effectiveness of each agency's approach to evaluating PMRS activity, they generally agree on what the problems are.

MSPB ASSESSMENT OF PROBLEMS

Agencies need to eliminate the problems that their own evaluations, and OPM's PMRS program evaluations, have identified. A key first step to doing this is to make good use of the performance standards review boards required by regulation,³² if they are not already doing so. (While MSPB's questions to agencies did not spe-

²⁹ OPM Response.

³⁰ OPM Response.

³¹ OPM Response.

³² 5 CFR 430.408.

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cifically address use of these boards, five agencies commented on how their PMRS programs have benefited from the operation of their boards.) Three responding agencies reported that PMRS activity is covered thoroughly by their internal personnel management evaluation (PME) programs. To the extent they are not already doing so, other agencies could benefit from using internal review programs to pinpoint agency problems. Of course, it is up to each agency to correct problems which have been, or will be, identified and that are within its control. These include the three problem areas that OPM identified in its PMRS program reviews.

Of those three problems, perhaps the most difficult for agencies to surmount is the second: improving employees' perceptions of a fully successful rating. Several factors combine to make this particularly difficult:

1. A pay policy (discussed at length below in the Recommended Changes section of this report) which places GM employees who are in the middle third of their pay ranges at a pay disadvantage relative to their GS counterparts if rated fully successful.
2. The pay computation provisions of the earlier Merit Pay System³³ and

³³ Primarily the Merit Pay provision that based one-half of any comparability increase on performance, but also the provision that basic Merit Pay increases were linked to ratings within particular pay pools (so that employees with the same ratings but in different pools often received differing increases in basic pay), and the provision that allowed determination of award amounts without reference to a firm minimum for "Outstanding" ratings. These provisions undermined the Merit Pay system generally, and especially the fully successful rating.

the perceptions of underfunding and pay inequities that many Merit Pay employees believed were insurmountable weaknesses in that system combined to make a fully successful rating less desirable than the words imply. Until employees see that PMRS has overcome those weaknesses, their attitudes towards PMRS will be governed by memories of the Merit Pay System.

3. Until 1978, when the CSRA mandated the use of performance elements and standards in agency performance appraisal systems, those systems varied widely. Performance standards, per se, were infrequently used before the CSRA and, even then, often only ad hoc to justify recommendations for Quality Step Increases or to withhold a within grade increase. Most supervisors, especially those applying commonly used 3-level systems, simply rated employees "satisfactory," making those employees eligible for any within grade increases otherwise due them.

Governmentwide, some 3 to 4 percent of Federal employees receive Quality Step Increases each year.³⁴ In 1980, the last year before pay for performance was fully implemented (in its original Merit Pay form), the figure was 3.0 percent.³⁵ Also in 1980, 1,211 full-time permanent GS employees had their within-grade increases withheld. This represents a

³⁴ Information provided by OPM's Incentive Awards Branch.

³⁵ "Achievements 1980: A Report on the Federal Incentive Awards Program," Office of Personnel Management, Incentive Awards Branch, p.21.

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withholding rate of less than 2.3 per 1000 eligible employees.

For years the withholding rate has been far less than 1 percent of the employees eligible each year for within grade increases.³⁶ Based on these figures, it is clear that few supervisors would have had experience either in developing or using performance standards before the Merit Pay System was implemented.

4. As a corollary to the immediately preceding point, the tools necessary to measure performance objectively often were nonexistent or inadequate in the Federal work place until the advent of Merit Pay. Even now, they often are not adequate (witness OPM's finding of "a great need to improve the quality of elements and standards" in 87.5 percent of agencies reviewed, and agencies' expressions of concern for the same subject). Marginal tools and limited experience in their use are hardly a good combination for conscientious Federal managers and supervisors to use to distinguish among employees' performance, especially when pay distinctions and other personnel actions may be a direct consequence. Given the need to adapt to a series of major changes in pay for performance in the Federal government over the last several years, the problems identified by OPM probably are not unusual.

5. In a number of departments, PMRS employees coexist with employees in other systems (e.g., the Foreign Service system in State Department; the commissioned officer grade and pay system in the military departments). Many of those other systems operate under "up or out" rules. In such cases, the agencies report the PMRS employees often are viewed in the same light as persons under those other systems, in which a rating equivalent to "fully successful" may be very damaging to an employee's career.

MSPB RECOMMENDATIONS

The prevailing opinion of most agencies is that the GM pay-for-performance system has been "tinkered with" too much already. Consequently, agencies--including OPM--were sparing in their suggestions or recommendations for immediate changes to the system. OPM's Associate Director for Personnel Systems and Oversight pointed out that there will be an opportunity to address all aspects of PMRS when it is reviewed by Congress before the September 30, 1989, expiration date of the current authorizing legislation.

However, OPM or the responding agencies identified for MSPB three additional actions they considered necessary or desirable. One is needed to clarify the intent of the Congress in a particular circumstance; one is a change in pay policy several agencies recommended; the third would improve the exchange of information about PMRS activity among Federal agencies and provide agencies additional PMRS operational guidance. These are listed below.

³⁶ Information about withheld within-grade increases provided by OPM's Office of Work Force Information.

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1. Amend the legislation to eliminate an area of uncertainty when dealing with employees whose performance is rated unacceptable but then improves to a level below fully successful. OPM acknowledged this need.³⁷

Specifically, 5 U.S.C. §4302a(b)(6) (which applies to PMRS employees) provides for:

reassigning, reducing in grade, or removing any employee who continues to perform at the level which is 2 levels below the fully successful level, after such employee has been provided with written notice of such employee's rating and afforded reasonable opportunity to raise such employee's level of performance to the fully successful level or higher.

OPM's regulations implementing this provision³⁸ echo this requirement and demonstrate the problem:

If, at the conclusion of the opportunity period * * * the employee's performance is 'Unacceptable,' the agency must initiate reassignment, reduction in grade, or removal * * *. When the employee's performance improves to level 2, but not level 3, the employee, if not reassigned, shall be required to undergo an additional opportunity period in order to demonstrate performance at the 'Fully

Successful' level or higher

* * *³⁹

This provision creates a problem with what to do with employees who, after being warned in writing that they need to improve their unacceptable ("2 levels below fully successful") performance, do improve, but only to the level one level below fully successful. The law specifies a range of required actions (reassignment, reduction in grade, removal) if the person's performance continues to be unacceptable. It also speaks of affording an opportunity to raise the level of performance to fully successful or higher. What to do about improvement to the less-than-fully-successful level is not clear in the law.

OPM's regulation on this point speaks of an additional opportunity period "if the person is not reassigned," which provides some hint of what should be done. However, there is no clear statement--or indication--of what to do if the performance remains between unacceptable and fully successful.

The resulting "gray area" is a potential employee relations problem for agencies, setting the scene for diverse treatment of PMRS employees in this situation until a body of case law is developed.

OPM's Associate Director for Personnel Systems and Oversight informed MSPB that OPM "will soon issue final changes to regulations on

³⁷ OPM Response.

³⁸ 5 CFR 430.405(j)(1).

³⁹ Ibid., 430.405(j)(3).

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performance-based actions. These new regulations will clarify that employees can only be reduced-in-grade or removed based on Unacceptable performance, and will eliminate the requirement for a second opportunity period. We believe that this revision will resolve this problem."⁴⁰

2. Restructure one statutory merit increase provision to eliminate disparate treatment between some GM and GS employees.

The suggested restructuring is to correct a provision affecting GM employees rated Fully Successful and whose salaries put them in the middle third of the pay range (equivalent to GS steps 4, 5 or 6). Three departments and the National Aeronautics and Space Administration (NASA) identified this as a problem, because it results in disparate treatment for GM and GS employees in this range of their pay grades. NASA defined the problem well:

GM employees rated at the Fully Successful level in this part of the pay range receive merit increases annually equivalent to one-third of a step increase whereas their GS counterparts effectively receive one-half. Over the 6 year span between steps 4 and 7, the GM employee rated continuously at

the fully successful level would fall behind the GS employee in base salary by one full step increase. The pay for performance system may be compromised because some ratings may be determined by pay considerations rather than performance, and Fully Successful is no longer perceived as a 'good' rating.⁴¹

At the heart of this pay policy is a statutory provision⁴² that says that, if the performance of an employee subject to PMRS is rated "at the fully successful level, the rate of basic pay of the employee shall be increased by an amount equivalent to one-third of a merit increase."

This statutory provision clearly does lead to treating GS and GM employees differently. It places GM employees in the middle third of the pay range who are rated fully successful at a disadvantage compared to GS employees with similar performance ratings. If, as NASA suggests, this policy may directly affect performance ratings--and may contribute to an unfavorable perception among GM employees of the fully successful rating--then the cost of this provision may well outweigh its benefits.

PMRS is administered so that employees at the lower end of the pay

⁴⁰ Comment contained in the letter, dated December 10, 1987, from Claudia Cooley, OPM Associate Director for Personnel Systems and Oversight, to Paul D. Mahoney, Director, Policy and Evaluation, U.S. Merit Systems Protection Board (op. cit.).

⁴¹ Comment contained in enclosure to letter, dated October 27, 1986, from Carl Grant, Director, Human Resources Management, National Aeronautics and Space Administration, to Maria L. Johnson, Acting MSPB Chairman.

⁴² 5 U.S.C. §5404(c)(1)(B)(iii).

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range advance faster, for the same level of performance, than employees at the higher end of the range. This creates a parallelism to the GS "step" system, where movement upward through the steps of each grade is faster in the early years than the later ones.

MSPB takes no stand on whether this parallelism is desirable or even in strict keeping with the concept of pay for performance. However, the parallelism does exist at the two ends of the pay spectrum, only to be overturned by statute in the middle of the range. The result is "mixed signals" to PMRS employees.

Congress should revise this statutory provision to eliminate the pay disadvantage it gives to PMRS employees.

3. Establish a mechanism for the exchange of PMRS information among agencies.

Four agencies suggested that OPM should assume a more active "information broker" role, serving as a clearinghouse for information on areas of concern to agencies. For example, most agencies would appear to be in a position to use information on how to ensure accurate appraisals and how to encourage, without specific numeric goals, reasonable rating distribution patterns in a way that serves as an incentive to performance improvement. Two agencies, however, specifically suggested that additional "prescriptive" guidance from OPM was not desired.

Relative to the provision of information, two agencies also commented on the fact that there is no Federal Personnel Manual (FPM) chapter to provide guidance for agencies' PMRS activity. Through the FPM issuance system, OPM has published numerous bulletins and letters providing PMRS guidance. It has published them under the label of FPM Chapter 540, but there is no such basic chapter. Given the extensive nature of the PMRS regulations and OPM's detailed reviews of agency implementation plans, the need for FPM guidance is debatable.

In addition to assisting in the gathering and sharing of current program improvement information, OPM should continue to monitor PMRS for possible structural weaknesses (e.g., funding deficiencies or unrealistic program expectations) that may influence some of the observed agency undesirable performance appraisal practices.

METHODOLOGY

In preparing this report, MSPB relied heavily on two sources of information. The first source was information from the Office of Personnel Management and the 21 largest executive departments and independent agencies, provided in writing in response to requests from MSPB. The officials who responded to the MSPB information requests are identified in the appendix to this report.

There were actually 28 responses from the 21 responding agencies, because there were 8 replies from Department of Defense components (in addition to responses from the

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departments of the Army, Navy and Air Force, which were among the 21 agencies queried).

The material submitted by both OPM and the agencies responded to specific questions from MSPB. The answers were a mixture of facts, perceptions, and opinions. In analyzing these responses, we looked for patterns and consistency, as well as indications of how well the Performance Management Recognition System contributes to upholding the merit system principles and to the prevention of prohibited personnel practices.

The second source of information for this report was MSPB's 1986 Merit Principles Survey. This was an extensive survey sent to a stratified sample of Federal employees. More than 21,000 employees received the survey; 16,651 (approximately 77 percent) returned it during the spring of 1986. GM employees' weighted responses to seven questions in the survey were included in this report.

OPM REVIEW

OPM's Associate Director for Personnel Systems and Oversight was given an opportunity to review this report before it was published. Following her review, she provided MSPB with written comments on December 10, 1987, concerning the report. Those comments were taken into consideration in preparing the final report.

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**APPENDIX
LIST OF OFFICIALS IN DEPARTMENTS AND INDEPENDENT AGENCIES
WHO CONTRIBUTED INFORMATION TO THIS REPORT BY RESPONDING
TO MSPB'S AUGUST 1986 INFORMATION REQUESTS**

William J. Riley, Jr.
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General Services Administration

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Charles E. Thomas
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Office of the Deputy Chief of Staff
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Judith L. Hofmann
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John M. Golden
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Department of Commerce

Gerald R. Riso
Assistant Secretary for Policy, Budget
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Claire E. Freeman
Deputy Assistant Secretary for
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Department of Defense

Harry H. Flickinger
Acting Assistant Attorney General
for Administration
Department of Justice

Veronica D. Trietsch
Director, Personnel Resource
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Department of Education

William E. Brock
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