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**DECISION**



**THE COMPTROLLER GENERAL  
OF THE UNITED STATES**  
WASHINGTON, D.C. 20548



**FILE:** B-203022

**DATE:** September 8, 1981

**MATTER OF:** Office of Personnel Management's Implementation of Merit Pay

- DIGEST:**
1. The merit pay provisions of the Civil Service Reform Act (5 U.S.C. § 5401 et seq.) require that the merit pay system cost no more than the pre-merit pay system. Merit pay system is only meant to redistribute funds which would otherwise have been spent on certain salary increases under pre-merit pay system. Accordingly, OPM should revise its merit pay calculations for within-grade step increase and quality step increase components of merit pay pool according to what agencies would have otherwise spent on these types of salary increases under the merit pay system.
  2. OPM should not add "capped" funds, which would have been paid to certain merit pay employees if not for the salary ceiling, to the fund to be used for merit pay awards. The ceiling imposed on salaries pursuant to certain appropriations restrictions is a limitation on the merit pay system in that funds which could not have been paid under the pre-merit pay system are not to be included in the merit pay pool.

During the course of an audit of the implementation by the Office of Personnel Management (OPM) of the Merit Pay System under the Civil Service Reform Act (CSRA), we have found that the method used by OPM to calculate amounts available for merit pay payouts by agencies does not conform to the requirements of the Act.

Under provisions contained in 5 U.S.C. § 5402(b)(4) OPM is required to determine the amount of funds available for the merit pay program of each Executive agency and department prior to the beginning of each fiscal year. OPM construes this provision of the merit pay statute differently than does this Office. These differences center upon the extent of the discretion granted OPM by this statute to calculate the amount available to each agency and department for merit pay. This statute reads as follow:

"(4) The funds available for the purpose of this subsection to the head of any agency for any fiscal year shall be determined before the beginning of the fiscal year by the Office [of Personnel Management] on the basis of the amount estimated by the Office to be necessary to reflect--

"(A) within-step increases and quality step increases which would have been paid under subchapter III [General

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Schedule Pay Rates] of chapter 53 [Pay Rates and Systems] of this title during the fiscal year to the employees of the agency covered by the merit pay system if the employees were not so covered; and

"(B) adjustments under section 5305 [annual pay reports and adjustments] of this title which would have been paid under such subchapter during the fiscal year to such employees if the employees were not so covered, less an amount reflecting the adjustment under subsection (c)(1) of this section in rates of basic pay payable to the employees for the fiscal year." [Subsection (c)(1) allows OPM to reduce annual cost of living increases for merit pay participants by as much as 50 percent.] (Emphasis added.) 5 U.S.C. § 5402(b)(4).x

It is OPM's position, in essence, that the statutory authorization to OPM to estimate the amount necessary to reflect salary increases which would have been received by merit pay participants under the pre-merit pay system was intentionally drafted to give OPM the broadest possible discretion in determining the merit pay pool. OPM also relies on its statutory responsibilities under the Civil Service Reform Act as a whole to devise an equitable merit pay system which will be accepted as such by merit pay participants. Thus, OPM believes it is authorized to add funds to the merit pay pool in excess of what actually would have been spent had merit pay not been implemented, to satisfy certain objectives such as ensuring that no employee be penalized due to the implementation of merit pay and ensuring that the average annual salary rate of all employees subject to merit pay be equivalent to what their average annual salary rate would have been under the pre-merit pay system.

Our Office's position, on the other hand, is that the quoted provision limits OPM to estimates of the amounts which would have been paid for within-grade, quality step, and comparability increases if merit pay employees were still under the old system.<sup>1/</sup> Further, this

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<sup>1/</sup> In this regard this Office does not object to regulations promulgated by OPM at 5 CFR 540.103(d) which permit agencies to expend an amount no less than 95 percent and no greater than 105 percent of the merit pay figure provided annually by OPM. OPM's formula is based on estimates of events which would not be susceptible to precise determination before the fact even in the absence of the merit pay situation. In view of the imprecise nature of the estimates, we believe that OPM has properly incorporated a degree of flexibility into the system.

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provision's legislative history convincingly demonstrates that Congress intended for the merit pay system to cost no more than the amount expended under the pre-merit pay system. It was the intent of the Congress that the implementation of the merit pay system would only redistribute an amount essentially equal to the amount expended under the pre-merit pay system.

This intent is clearly expressed in statements made by President Carter, by the Chairman and Deputy Executive Director of the Civil Service Commission (currently OPM), and by statements contained in the Senate and House Committee Reports. President Carter, in a message to the Congress, stated that the merit pay system " \* \* \* would not increase payroll costs \* \* \* ." (Weekly Compilation of Presidential Documents, March 2, 1978). This position was reiterated by The Honorable Alan K. Campbell, Chairman, U.S. Civil Service Commission when he stated: "The net effect of these changes [the merit pay system] is that employees as a group will receive neither more nor less than they presently do, but those individuals performing in a superior fashion will receive higher salary increases." (Civil Service Reform Act of 1978 and Reorganization Plan No. 2 of 1978: Hearings on S. 2640, S. 2707, and S. 2830 before the Committee on Governmental Affairs United States Senate, 95th Cong., 2d Sess. 36 (1978)). Also, Mr. George J. McQuoid, Deputy Executive Director, U.S. Civil Service Commission, in responding to questions from the staff of the Senate Committee on Governmental Affairs in the above cited hearings stated:

*54 USC Code 1101 note*

*Part 2783*

"There will be no impact, either plus or minus, on overall payroll and benefit costs as a result of the introduction of the merit pay program. Under the program, funds which, under the present system, would be expended automatically would be redistributed based upon meritorious performance rather than time in grade."

Moreover, in a section-by-section analysis of S. 2640, The Civil Service Reform Act, by the Senate Governmental Affairs Committee, it is stated:

"The merit pay system would not require additional expenditure of money. The money saved from not awarding full across-the-board comparability increases and automatic step increases would be used to reward those employees who deserve pay raises or bonuses." S. Rep. No. 95-969, 95th Cong., 2d Sess. 88 (1978).

Finally, both the Senate and House Committee Reports contain cost estimates from the Congressional Budget Office stating that the implementation of the merit pay system would have no effect on the total amount of funds expended for personnel compensation. S. Rep. No. 95-969,

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95th Cong., 2d Sess. 123 (1978); H.R. Rep. No. 95-1403, 95th Cong., 2d Sess. 94 (1978).

The fundamental issue, as we see it, centers around proper determination of the size of the "appropriation" Congress has made available for merit pay purposes. In our opinion, the terms of § 5402(b)(4), quoted above, coupled with the completely consistent legislative history, clearly demonstrate that the Act was only meant to redistribute funds and not to provide additional funds for salary increases. OPM's development of the merit pay formula must comply with this restriction. In our view, it is not permissible under the CSRA for OPM to calculate funds available for agency merit pay programs which would result in more money being expended under the merit pay system than would have been spent under the pre-merit pay system. Calculations by our audit staff demonstrate, however, that the amounts allowed by OPM's formula for pre-merit pay within-grade and quality step increases overstates by \$58 to \$74 million dollars the amounts which would have been paid to merit pay employees if they were still under the previous system. Furthermore, OPM's formula includes amounts for within-grade, quality step, and comparability increases which would be due merit pay employees who are at or above the statutory pay cap of \$50,112.50 if the cap did not exist or were lifted. This has the potential of permitting these funds, none of which would have been spent under the pre-merit pay system, to be used for merit pay awards to employees whose salaries are not limited by the pay cap.

Our analysis of how OPM's computation of these three facets of the merit pay formula will result in additional money being spent on merit pay is as follows:

Within-grade Step Increases

When determining the within-grade step increase component of merit pay, OPM assumes that each employee eligible for merit pay would have received a within-grade step increase under the prior program on October 1, the beginning of the fiscal year. By computing the within-grade increase component of the merit pay pool as if it were due at the beginning of the fiscal year, OPM is establishing a formula which overstates the amount of money which would have been expended on within-grade increases but for merit pay. This is because eligible employees under the pre-merit pay system would have received within-grade increases on their particular anniversary dates, which dates fall throughout the fiscal year. OPM believes that this is necessary because only by using this formula can it assure that the group of employees who would have received within-grade increases during the period October 5, 1981 to April 5, 1982, if not for the implementation

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of merit pay will not be penalized. OPM also maintains that use of the October 1 date is necessary for it to ensure that the average annual salary rate of all employees subject to merit pay will be equivalent to what the average annual salary rates of these employees would have been under the pre-merit pay system.

In our opinion, the computing of the within-grade increase component of the merit pay pool in this manner does not conform to the mandates of the CSRA. To ensure compliance with the CSRA, this component of the formula should reflect as precisely as possible what otherwise would have been actually spent on within-grade increases. Thus, OPM should compute the percentage agencies would have actually allocated from their payrolls for the awarding of within-grade increases but for merit pay in a given year and this figure should be used as part of the determination of the funds available for merit pay increases. While OPM's method of calculating within-grade increases apparently will assure that the average annual salary rate of employees under merit pay will be equivalent to what it would have been under the pre-merit pay system, this is not required by the CSRA. Similarly, the CSRA does not authorize OPM to adjust the merit pay formula to assure that employees who would have been due within-grade increases during the first half of fiscal 1982 will receive under merit pay what they would have otherwise received under the pre-merit pay system. Moreover, this seems contrary to the CSRA's basic concept of rewarding meritorious performance rather than longevity of service.

#### Quality Step Increases

When calculating the quality step increase component of the merit pay pool, OPM includes what it believes agencies should have spent on this type of salary increase in the past rather than the amount agencies have historically spent. It is true that the CSRA does not mandate that in calculating the quality step increase or within-grade increase component of the merit pay pool, OPM compute these components to reflect what agencies have historically spent on these two types of salary increases. Instead, the Act only requires OPM to estimate what would have been paid to employees during the fiscal year if they were not covered by merit pay. This can most logically, in our view, be achieved by referring to historical data. However, there may be other ways to satisfy this requirement and it is in OPM's discretion to determine the best possible method to meet this requirement for the various components of the pool. Thus, although agencies have historically only spent .1 percent of their payrolls on quality step increases, OPM would be authorized to use the .4 percent of payroll costs for this component it is proposing to use if OPM can show that a change in historical practice would have resulted in .4 percent of payroll costs being paid as

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quality step increases in fiscal year 1982. However, if agencies will continue to spend only .1 percent of their total payroll costs on quality step increases for non-merit pay employees in fiscal year 1982, in our view, OPM in computing this portion of the pool should only use .1 percent of total payroll costs even if OPM maintains that this will effectively result in the continued underutilization of quality step increases. In other words, unless OPM takes positive steps to assure that non-merit pay quality step increases total .4 percent of salaries Government-wide, we can see no justification for using such a percentage for merit pay pool purposes.

#### Increments Above the Statutory Pay Ceiling

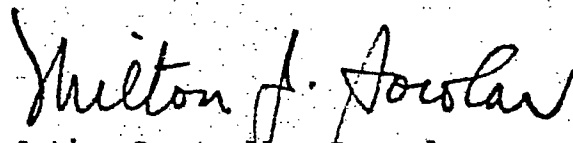
OPM includes, as part of its merit pay pool computations, amounts for within-grade step increases, quality step increases, and comparability increases which would have been paid to employees under the pre-merit pay system if it were not for the statutory cap imposed on salaries, currently fixed at \$50,112.50. OPM's procedures require that employees whose salaries exceed the cap receive accounting or "paper" increases in order that their proper pay rate will be established if the cap is ever lifted. This Office agrees that these employees must receive "paper" increases. We do not believe, however, these increases may be included in the merit pay pool if the possibility exists that these capped funds might be distributed to employees eligible for merit pay who have not reached this ceiling. A distribution of this sort will result in additional funds in the merit pay pool because these funds would not have been expended under the pre-merit pay system, given the continued existence of the pay cap. In our view, this is not permitted by the CSRA. In this regard, we would not object, in principle, to the use of "paper" salary increases which would otherwise be due capped employees for purposes of calculating how much money would be in the merit pay pool for capped and non-capped employees if the cap did not exist. However, we can see no justification for distribution to non-capped merit pay employees of any of these "paper" increases because none of these funds would be payable under the pre-merit pay system.

#### Conclusion

As indicated above, our audit staff has determined that the above-described OPM calculations of the various components of merit pay will make available to all executive agencies, collectively, approximately \$58 - \$74 million dollars more every year for merit pay expenditures than would have been expended under the pre-merit pay system. In our opinion, the computation of the merit pay pool in a

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manner which leads to this result is contrary to the language and intent of the CSRA. Accordingly, OPM should take immediate action to revise its merit pay implementation plan to bring it into compliance with this restriction.



Acting Comptroller General  
of the United States