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PERFORMANCE  
MANAGEMENT

Comments on Reauthorization  
of the Performance Management  
and Recognition System

Statement of  
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COMMENTS ON REAUTHORIZATION OF  
THE PERFORMANCE MANAGEMENT AND  
RECOGNITION SYSTEM

SUMMARY OF STATEMENT BY  
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The Performance Management and Recognition System (PMRS) was enacted in 1984 as the government's pay for performance system for grades 13 through 15 supervisors and managers. Like all performance management systems, PMRS' primary purpose is to improve individual and organizational effectiveness. Unfortunately, PMRS does not fully meet these goals.

PMRS performance ratings are used as the basis for multiple management decisions, including pay, awards, promotions, reductions in force, and removals, and are also expected to serve as a basis for providing performance feedback to employees. The result of this confusion of purpose is that supervisors inflate ratings to protect their employees against being "harmed" by the rating (e.g., not promoted). The inflated ratings are then much less useful as a tool for constructive feedback on performance, and may lead to mistrust of management if an employee receives an apparently high rating but does not receive awards or promotions. Critics also point to difficulties in distinguishing among the multiple levels of performance required in PMRS.

PMRS has also resulted in increasingly larger numbers of employees receiving performance awards. Because the pool of funds available for awards is limited to 1.5 percent of the PMRS salary base, awards are getting smaller, and many employees and supervisors believe that PMRS awards are too small to motivate.

There is consensus among the various studies of PMRS, including GAO's, that performance management systems need to be more flexible, to permit tailoring to the mission and culture of each agency. OPM's principles and features for performance management reform provide flexibility and permit agencies to design their performance management systems with participation from employees and their representatives. The thrust of OPM's reform proposals are consistent with GAO's recommendations.

Designing new performance management systems will be challenging. A starting point is the recognition that the fundamental purpose of a performance management system is to improve organizational performance. GAO encourages agencies to focus on developing a clear purpose for each element of their performance management system and to strengthen the elements of the system which are designed to communicate expectations and regularly provide realistic feedback on performance. It is also important that agencies establish, with OPM oversight, evaluation procedures which will routinely provide information and accountability for ensuring that recognition and reward systems result in fair and equitable treatment of all employees.



Madam Chair and Members of the Subcommittee:

We are pleased to be here today to assist the Subcommittee in considering the reauthorization of the government's pay-for-performance system for its grade 13 through 15 managers and supervisors--the Performance Management and Recognition System (PMRS)--which is set to expire on September 30, 1993. As requested, we are providing our views on PMRS as well as some observations on the Office of Personnel Management's (OPM's) proposals for performance management reform.

#### RESULTS IN BRIEF

Conceptually, there is strong support in both public and private sectors for performance management systems which establish a link between pay and performance. The PMRS is the latest federal government effort to create a pay for performance system for managers and supervisors. Like all performance management systems, PMRS' primary purpose is to improve individual and organizational effectiveness. Unfortunately, many observers believe that PMRS does not fully meet these goals.

In practice, PMRS performance ratings are used for multiple and sometimes conflicting management purposes, such as pay, awards, promotions, and reductions in force, as well as employee feedback and development. Our work showed that the result of this confusion of purpose was that supervisors tended to inflate

ratings to protect their employees against being "harmed" by the rating (e.g., not promoted, or RIFed). This inflation makes ratings much less useful as a tool for constructive feedback on performance, and may confuse employees or lead to mistrust of management if an employee receives an apparently high rating but does not receive an award or promotion. Critics also point to difficulties in distinguishing consistently and fairly among the multiple levels of performance currently required in PMRS.

An increasingly larger number of employees have been receiving PMRS performance awards since its implementation in 1985. Because the pool of funds available for awards is limited, awards are getting smaller, and employees and supervisors told us that PMRS awards are too small to serve a motivational purpose. Indeed, the relatively larger number of award recipients magnifies the negative impact of not receiving an award, which may in turn negatively affect the underlying objective of improving on organizational performance.

Despite these problems, supervisors and employees we talked to during our review, as well as other studies and surveys, indicated that PMRS and other performance management systems have been successful in improving expectation setting in the federal workplace. It will be important to build on that progress by incorporating more effective feedback tools in future performance management systems.

There is consensus among the various studies of PMRS, including our own, that performance management systems need to be more flexible, to permit tailoring to the mission and culture of each agency. OPM's recently circulated principles and features for performance management reform provide flexibility and permit agencies to design their own performance management systems with participation from employees and their representatives. We believe that the thrust of OPM's reform proposals are consistent with our recommendations.

Designing new performance management systems will be challenging and improvements will probably evolve over time. A starting point is the recognition that the fundamental objective of a performance management system is to improve organizational performance. We encourage agencies to focus on developing a clear purpose for each element of their performance management system, and to strengthen the elements of the system that are designed to regularly provide realistic feedback on performance such as expectation setting and regular discussion about performance. We also believe it is important that agencies establish, with OPM oversight, evaluation procedures which will routinely provide information and accountability for ensuring that recognition and reward systems result in fair and equitable treatment of all employees.

ISSUES IDENTIFIED IN  
GAO AND OTHER STUDIES

PMRS was enacted in 1984 to replace the Merit Pay System which was established under the Civil Service Reform Act of 1978. Its objective was to make improvements to the Merit Pay System and emphasize lump-sum cash awards as an important recognition and reward for exceptional performance. Since that time we have issued a series of reports and testimony on PMRS's implementation (see appendix). Our most recent report, Federal Performance Management: Agencies Need Greater Flexibility In Designing Their Systems (GAO/GGD-93-57, Feb. 24, 1993), included PMRS as part of an overall effort to examine the key elements of effective performance management systems. PMRS participants, Senior Executive Service (SES) members, and personnel officers with whom we spoke raised fundamental concerns with PMRS. Among these were the perceptions that

- multiple management decisions based on the appraisal result in inflated or unrealistic performance ratings,
- it is difficult to distinguish between five summary rating levels (level 5 being outstanding and level I being unacceptable), and
- awards are too small to motivate employees.



Others, including OPM and the Federal Managers Association, have also studied PMRS and identified similar problems. As part of the PMRS Amendments of 1991, Congress established an advisory committee, the PMRS Review Committee, to review and recommend to OPM improvements to PMRS. In addition, a provision of the Federal Employees Pay Comparability Act of 1990 established the Pay-for-Performance Labor-Management Committee to advise OPM on the design and establishment of systems for strengthening the linkage between performance and pay of General Schedule (GS) employees.

In late 1991, both committees issued reports to OPM. The PMRS Review Committee made recommendations to improve PMRS, and the Pay-for-Performance Labor-Management Committee made recommendations for strengthening the link between pay and performance for GS employees. OPM's proposals for performance management reform address many of the issues identified in our earlier work as well as many of those identified by the two committees.

APPRAISALS ARE LINKED TO  
TOO MANY MANAGEMENT DECISIONS

Generally, the purpose of performance appraisals is to assess and improve an individual's performance and thereby enhance

organizational effectiveness. Unfortunately, our work indicates that, because PMRS performance ratings are used as the basis for multiple management decisions such as pay, awards, promotions, reductions in force (RIFs), and removals, supervisors may inflate them to support or protect their employees. As I will discuss throughout my statement, such a situation can have negative implications for the organization. Among these are:

- Employees may not be given honest feedback on the need to improve.
- Employees who are given high ratings but no awards may distrust the system and view pay as not being linked to performance.
- As more people are rewarded, the size of awards diminish and may be viewed as too small to be motivating.

As cited in a 1991 National Research Council study on Pay for Performance, it is widely understood that the uses of a rating will affect the appraisal outcomes. For example, the same individual might receive different ratings and different feedback if a performance appraisal were used solely to make administrative decisions such as salary adjustments or promotions than if it were used for other purposes such as employee development. The National Research Council's report cited

several studies in which a common finding was that ratings used to make decisions regarding salary or other determinations are higher and more lenient than those used for feedback.

Personnel officials at three of the six agencies we visited during our most recent work seemed to endorse this view. They said that ratings were inflated because supervisors did not want to hurt their employees' chances of being promoted, receiving an award or pay increase, or being retained during a RIF. As a result, ratings are not accurate and therefore formal feedback and management decisions based on them may not be appropriate. Similarly, in a 1992 OPM survey, 61 percent of the employees agreed with the statement that, in general, employees receive a higher performance rating than they deserve.

OPM's most recent report to the President and Congress on the PMRS also substantiates the perception that ratings are inflated. It reported that the average performance rating for 1990 (the most recent year for which data are available) was 4.11, as compared to 4.05 in 1989, on a 5 point scale. This increase is consistent with the trend over the 5 year period beginning in 1986. The overall percentage of employees rated at level 4 or above has also steadily increased--from about 68 percent in 1986 to about 80 percent in 1990.

DIFFICULTIES IN DISTINGUISHING  
LEVELS OF PERFORMANCE

Legislation or regulation allows the flexibility of using three or more summary rating levels for SES, General Schedule (GS), and Federal Wage System (FWS) employees. However, legislation requires five summary rating levels for PMRS employees. Although the agencies that we reviewed complied with the legislation and personnel regulations, personnel officials and employees raised several problems with the performance appraisal process. One problem cited by agency officials was the lack of flexibility in the determination of the number of rating levels they may use, specifically the requirement for a five-level summary rating system for PMRS employees. (The five-level requirement for GS and FWS employees was in effect until April 1, 1992, when OPM revised its regulations to allow agencies to select three to five rating levels for these employees.)

Overall, the personnel officials (20 of 23) and supervisors (19 of 28) that we talked with believed that a five level system inadequately distinguished levels of performance. Several personnel officials and supervisors believed that it was difficult to distinguish among five levels of performance and reasoned that two or three levels would be better. They said that at five levels, the ratings tended to be inflated and that a

"fully successful" (the middle level) rating was generally viewed negatively.

A "pass/fail" rating system was suggested by officials in three of the six agencies we visited as a means for separating the performance appraisal from other management decisions and emphasizing its use for feedback and coaching. Thus, promotion and award decisions would be based on specific work accomplishments and, in the case of promotions, judgments about an employee's potential to perform in the target job.

The PMRS Review Committee recommended that appraisals for PMRS employees be simplified by using only two summary rating levels, allowing the agencies to determine the names of the two levels. However, it should be noted that employees responding to a 1989 Merit Systems Protection Board (MSPB) survey did not support a pass/fail system. Only about 25 percent of the 15,939 respondents agreed that the performance rating system should be changed to a pass/fail system.

The PMRS and other performance management systems require that standards of performance be established as the basis for appraisals and that "critical elements" be identified which employees must perform satisfactorily to keep their jobs. Some supervisors believed that they could more effectively rate employees against organizational objectives and specific

accomplishments than against critical elements. In this regard, we note that the PMRS Amendments of 1991 authorized agencies to use statements of work objectives to establish performance requirements and evaluate job performance against such requirements. These statements of work objectives may be used in lieu of, or in addition to, the critical elements and performance standards.

PMRS AWARDS ARE VIEWED

AS TOO SMALL

Conceptually, a link between pay and performance has strong support in the private as well as public sector. For example, in 1991 we surveyed the employment practices of 130 private companies with at least 25,000 employees and 10 or more employment locations with at least 100 employees. Seventy-eight of the 83 responding companies said that an individual's job performance was of great importance in determining pay. This concept also appears to be accepted by PMRS employees. In a 1989 governmentwide survey conducted by MSPB, for example, about 86 percent of the PMRS employees who responded agreed that a portion of their pay should be based on their individual performance.

Unfortunately, our work on PMRS as well as that of others has indicated that PMRS employees have questioned the success of the performance management systems in rewarding good performance.

Monetary rewards as a motivator were often looked upon as less than effective because of both the relatively low dollar amounts involved and the belief that they were not directly linked to performance. Since PMRS award funds are capped at 1.5 percent of the PMRS aggregate payroll, the more employees who are rewarded, the smaller the average award. Officials we spoke with, as well as other research, consistently pointed out that such small rewards do not motivate employees toward greater performance and can actually demotivate those who do not receive an award, resulting in a no-win situation for the agency.

In part, this problem is exacerbated by an appraisal system used for multiple decisions with the result that ratings tend to be inflated, as I have already pointed out. The increase in both the number of high performance ratings and the number of PMRS employees receiving awards has a direct impact on the value of the awards. For example, in 1986, about 22 percent of PMRS employees were rated at the highest level and received awards with an average value of 2.99 percent of basic pay. However, in 1990, 30.5 percent of PMRS employees were rated at that level and received awards with an average value of 2.60 percent of basic pay. Similarly, the average value of all PMRS awards as a percentage of the recipients' pay decreased from 2.04 percent in 1989 to 1.96 percent in 1990. Assuming a salary level of \$50,000, this would translate to a decrease in the size of a PMRS award from about \$1,101 in 1989 to about \$1,058 in 1990.

We recognize that agencies could provide larger awards by giving them to fewer employees. There is no requirement that everyone with high performance ratings receive awards. The problem can again be traced to the rating. If an individual receiving a high, positive rating does not receive an award, while others with the same apparent rating do get awards, he or she may conclude that the award system is not linked to performance and that they are being treated unfairly. In addition to demotivating the individual, it may negatively affect employees' trust in the system.

Being mindful of current budget concerns, one must note that even with the cap, current PMRS performance awards expenditures in total are substantial. In fiscal year 1990, for example, total performance awards amounted to \$110.7 million, or 1.35 percent of total PMRS basic salaries.

EXPECTATION SETTING PROCESS IS  
LOOKED UPON MORE FAVORABLY

While I have been discussing what is problematic with PMRS, it is worthwhile to note that the expectation setting part of PMRS as well as other performance management systems is an element that is viewed more positively. For example, personnel specialists responding to a 1988 MSPB survey noted that performance



management systems have helped improve supervisors' communications with employees.

Most of the personnel officials and supervisors we interviewed believed that the systems have been successful in setting employee expectations. For example, 16 of the 22 personnel officials who responded believed that expectations were adequately communicated. According to personnel officials at one agency, this communication of expectations is one of the most successful areas of performance management. Further, a May 1992 OPM survey found that 75 percent of approximately 31,000 employees surveyed indicated they believed they knew what was expected of them.

AN UNDERLYING THEME FOR  
IMPROVEMENT IS GREATER  
FLEXIBILITY

An underlying theme we found throughout our evaluation and that of others was the need for change and greater flexibility so that agencies could tailor their performance management systems, including PMRS, to their work environments and workforce. In 1989 we reported that 73 percent of the personnel directors surveyed said that PMRS did not meet or only partially met the goals their agencies wanted to achieve through a pay-for-performance system. Although the personnel directors expressed

little agreement on how PMRS should be changed, they frequently suggested that agencies be given more flexibility in designing a pay-for-performance system that fits their goals and cultures.

Our more recent work identified similar opinions by personnel and other officials and, in our February 1993 report, we recommended that Congress consider giving agencies the flexibility to better enable them to carry out their missions and manage their human resources. Areas in which greater flexibility might be appropriate are (1) the requirement to link several management decisions, such as promotions and rewards, directly to the appraisal; (2) the number of summary rating levels that agencies are required to use; and (3) the 1.5-percent ceiling on the PMRS pay pool.

The 1991 National Research Council study suggested that federal policymakers consider decentralizing the design and implementation of appraisal and merit pay programs. The study noted that many large private firms with diverse goals and workforces have moved toward decentralized management strategies. In these cases, the home office provides policy and audit functions and the local units design and implement performance evaluation and pay systems.

The PMRS Review Committee also recommended that agencies have additional flexibility in areas such as PMRS coverage and award

programs. The Pay-for-Performance Labor-Management Committee recommended that agencies be given the authority to design and administer pay-for-performance programs to satisfy their specific needs, objectives, and workforce characteristics consistent with governmentwide policies and principles.

#### OBSERVATIONS ON OPM'S PRINCIPLES

#### AND FEATURES OF PERFORMANCE

#### MANAGEMENT REFORM

At the mandate of Congress, OPM has been studying ways to improve PMRS as well as its counterpart for GS employees, the Performance Management System. As a result of this work, in May 1993 it issued a working draft entitled "Principles and Features of Performance Management Reform", in which greater flexibility is proposed for agencies to design their performance management systems to better reflect their organizational philosophies and goals. OPM also proposes to merge PMRS and PMS employees into one governmentwide, unified pay system. We believe that the thrust of OPM's reform proposals to provide agencies greater flexibility are consistent with our recommendations.

We note that OPM's proposals provide for a collaborative effort between OPM and agencies in implementing performance management reform. They also call for OPM to provide broad policy guidance and other assistance. While these principles are appropriate, it

is less clear what role OPM sees for itself in oversight of performance management reform to ensure adherence to merit system principles.

OPM's working draft on performance management reform recommends temporarily extending PMRS so that (1) the October 1993 merit increases could be paid and (2) agencies would have sufficient time to plan and revise their performance management systems. In the interest of fairness to PMRS employees, we agree that the current cycle should be completed. We are concerned, however, about ensuring that sufficient time is provided to permit agencies to design workable systems with the full participation of employees.

One of the early lessons learned from the implementation of PMRS was that insufficient lead time to prepare for implementing the system contributed to administrative and other difficulties. In our view, implementing the current performance management reform may be even more complex and time consuming since agencies may be significantly revamping entire systems and will need to closely consult with affected employees and their representatives.

Performance management reform will provide some significant challenges to agencies and OPM alike, and improvements will probably evolve over time. A key starting point, in our opinion, is the recognition that the fundamental purpose of a performance

management system is to improve organizational performance. We encourage agencies to focus on developing a clear purpose for each element of their performance management systems and to strengthen the elements of the system which are designed to communicate expectations and regularly provide realistic feedback on performance. We also believe it is important that agencies establish, with OPM oversight, evaluation procedures which will routinely provide information and accountability for ensuring that recognition and reward systems result in fair and equitable treatment of all employees.

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This concludes my prepared statement. We would be pleased to respond to your questions.

GAO PRODUCTS RELATING TO THE PERFORMANCE MANAGEMENT AND RECOGNITION SYSTEM

Pay For Performance: Implementation of the Performance Management and Recognition System (GAO/GGD-87-28, January 21, 1987).

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

Comments on Reauthorization of the Performance Management and Recognition System (GAO/T-GGD-89-36, July 18, 1989).

Pay For Performance: Agency Personnel Directors' Views (GAO/GGD-89-126FS, September 15, 1989).

Pay For Performance: State and International Public Sector Pay-For-Performance Systems (GAO/GGD-91-1, October 12, 1990).

Workforce Issues: Employment Practices in Selected Large Private Companies (GAO/GGD-91-47, March 13, 1991).

Federal Performance Management: Agencies Need Greater Flexibility in Designing Their Systems (GAO/GGD-93-57, February 24, 1993).

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