

United States General Accounting Office
Washington, DC 20548

May 19, 2003

The Honorable Jo Ann Davis
Chairwoman
Subcommittee on Civil Service and Agency Organization
Committee on Government Reform
House of Representatives

Subject: *Posthearing Questions Related to Pay for Performance*

Dear Madam Chairwoman:

On April 1, I testified before your Subcommittee at a hearing on “Compensation Reform: How Should the Federal Government Pay Its Employees?”¹ This letter responds to your request that I provide answers to follow-up questions from the hearing. Your questions, along with my responses, follow.

1. What standards must an agency implement to safeguard against a pay-for-performance system that might be abused by managers playing favorites?

At the request of Representative Danny Davis, we developed an initial list of possible safeguards for Congress to consider to help ensure that pay for performance systems in the government are fair, effective, and credible. We believe that the following could provide a starting point for developing a set of statutory safeguards in connection with any additional efforts to expand pay for performance systems.

- Assure that the agency’s performance management systems (1) link to the agency’s strategic plan, related goals, and desired outcomes and (2) result in meaningful distinctions in individual employee performance. This should include consideration of critical competencies and achievement of concrete results.
- Involve employees, their representatives, and other stakeholders in the design of the system, including having employees directly involved in validating any related competencies, as appropriate.
- Assure that certain predecisional internal safeguards exist to help achieve the consistency, equity, nondiscrimination, and nonpoliticization of the performance management process (e.g., independent reasonableness reviews by Human

¹U.S. General Accounting Office, *Results-Oriented Cultures: Modern Performance Management Systems Are Needed to Effectively Support Pay for Performance*, GAO-03-612T (Washington, D.C.: Apr. 1, 2003).

Capital Offices and/or Offices of Opportunity and Inclusiveness or their equivalent in connection with the establishment and implementation of a performance appraisal system, as well as reviews of performance rating decisions, pay determinations, and promotion actions before they are finalized to ensure that they are merit-based; internal grievance processes to address employee complaints; and pay panels whose membership is predominately made up of career officials who would consider the results of the performance appraisal process and other information in connection with final pay decisions).

- Assure reasonable transparency and appropriate accountability mechanisms in connection with the results of the performance management process (e.g., publish overall results of performance management and pay decisions while protecting individual confidentiality, and report periodically on internal assessments and employee survey results).

2. I understand a large percentage of employees now under the General Schedule are rated on a simple pass/fail basis. How can meaningful distinctions in performance be made under such a system? Should the Administration rule out that kind of a system for an agency to participate in the Human Capital Performance Fund?

A pass/fail system does not provide enough meaningful information and dispersion in ratings to recognize and reward top performance, help everyone attain their maximum potential, and deal with poor performers. At your request, and at the request of Senator Voinovich, we identified the key practices leading public sector organizations both here and abroad have used for effective performance management.² Among these practices is to make meaningful distinctions in performance. We believe that this set of practices can serve as the basis for an agency to demonstrate that it has a performance management system in place that can support pay and other personnel decisions before it would be eligible to participate in the Human Capital Performance Fund.

3. If pay and performance management systems are handed over to individual agencies so they can tailor their systems to their particular needs and objectives, what role in setting compensation policy would you foresee for the Office of Personnel Management (OPM) and the Office of Management and Budget (OMB)?

We have reported that OPM leadership is critical to accomplish its mission in a decentralized human capital environment in which direct accountability for strategic human capital management continues to shift to agencies.³ In particular, as noted above, OPM should certify that an agency has in place an effective performance management system before the agency is granted the authority to better link pay to performance for broad-based employee groups. In addition, OPM should gather, assess, and disseminate leading practices from federal organizations on a full range of

²U.S. General Accounting Office, *Results-Oriented Cultures: Creating a Clear Linkage between Individual Performance and Organizational Success*, GAO-03-488 (Washington, D.C.: Mar. 14, 2003).

³U.S. General Accounting Office, *Major Management Challenges and Program Risks: Office of Personnel Management*, GAO-03-115 (Washington, D.C.: January 2003).

innovative human capital policies and procedures, such as pay for performance. Further, OPM should build on its White Paper to design and lead a broad research agenda to develop a more market-based approach to federal pay.

First and foremost, OMB can help to obtain funding for agencies to make the targeted investments that often are needed to develop and implement performance management and related human capital systems. OMB also can continue to help sustain attention on human capital management. For example, in October 2001, OMB notified agencies that they would be assessed against standards for success for each part of the President's Management Agenda, including the strategic management of human capital. The first agency assessment was made public in February 2002 as part of the President's proposed fiscal year 2003 budget. Subsequent assessments were later released on both the status and progress of agency efforts. In October 2002, OMB and OPM approved revised standards for success in the human capital area of the President's Management Agenda, reflecting language that was developed in collaboration with GAO.

4. The General Accounting Office (GAO) report discusses “line of sight” as the overarching principle for effective performance management. What is it and why is it important? Can you highlight the practices that public sector organizations used in their performance management systems to drive internal change and achieve results?

Leading public sector organizations used the key practices I referenced above to create a clear linkage—“line of sight”—between individual performance and organizational success.⁴ These organizations have found that to successfully transform themselves, they must often fundamentally change their cultures so that they are more results-oriented, customer-focused, and collaborative in nature. To transform their cultures, high-performing organizations have recognized that an effective performance management system can be a strategic tool to drive internal change and achieve desired results.

5. Things seem to move awfully slowly in the government sometimes. I understand the China Lake pay system experiment is over 20 years old and other experimental systems have also been used for years now. How many tests of pay-for-performance do we need before we decide to go for it across the entire government?

Additional testing of the concept of pay for performance at the federal level is not what is needed at this point. Our experience at GAO and the experiences of others have shown that it is possible to better link employee pay to performance. However, experience also has shown that how it is done, when it is done, and the basis on which it is done can make all the difference in whether or not such efforts are successful. In our view, one key need is to modernize performance management systems in executive agencies so that they are capable of adequately supporting more performance-based pay and other personnel decisions. Unfortunately, based on GAO's past work, most existing federal performance appraisal systems are not designed to support a meaningful performance-based pay system.

⁴GAO-03-488.

We believe that Congress should consider granting governmentwide pay banding authority in a manner that assures that appropriate performance management systems and safeguards are in place before the new authorities are implemented in any respective agency. This approach would accelerate needed human capital reform throughout the government in a manner that assures reasonable consistency on key principles within the overall civilian workforce. It also would provide agencies with reasonable flexibility while incorporating key safeguards to help maximize the chances of success and minimize the chances of abuse and failure. This approach would also help to maintain a level playing field among federal agencies in competing for talent.

6. GAO's internal pay for performance system is relatively new. How long do you think it will take before we can tell whether it is a success? How did GAO develop its competency-based performance management system? What lessons learned did GAO experience in developing, implementing, and using its new performance management system?

The most prominent change in human capital management that we implemented as a result of the GAO Personnel Act of 1980 was a broadbanded pay for performance system. It should be noted that we had over a decade of experience in the use of pay banding before we undertook our recent changes, so much of the needed organizational infrastructure was already in place. In January 2002, we implemented a new competency-based performance management system that is intended to create a clear linkage between employee performance and our strategic plan and core values.

In designing the new system, GAO involved employees at key points through a variety of channels. Senior management and a diverse cross section of staff selected from across all employee populations reviewed a preliminary competency model. Once developed, all analyst and analyst-related staff across GAO validated the model to ensure the activities and associated behaviors were indeed relevant and important for analyst work. The new policies were put on the GAO intranet for employee comments and appropriate changes were made. We see early results of GAO's implementation of its new competency-based performance management system and other changes to key human capital programs. For example, GAO has achieved greater dispersion in its performance appraisals and merit pay decisions, thus making meaningful distinctions in performance that were not always made in the past.

We realize our approach is not perfect and never will be. High-performing organizations continually review and revise their performance management systems to support their strategic goals. In that spirit, we expect to modify our banded system in the future based on our experience to date.

7. Has GAO found pay for performance efforts that failed?

Yes. Experience from the U.S. and abroad shows pay for performance does not work when modern, effective, credible, and validated performance management systems, with appropriate safeguards, are not in place to support pay decisions and

consequently, employees and managers lose confidence in the fairness of the decisions that are made. At your request, and the request of Senator Voinovich, we are reviewing OPM's personnel demonstration projects where pay for performance systems have been established to identify lessons learned from their experiences. These demonstration projects are required to prepare project designs, conduct employee feedback, and complete evaluations of their results. Of the 17 demonstration projects that have been implemented, 12 have implemented a pay for performance system. The projects have taken a variety of approaches to linking pay to performance and have also made determinations about how much of an employee's pay increase should be "at risk"—that is, the amount of the pay increase that is tied to performance as opposed to provided as an entitlement.

8. When the GAO undertook an assessment of the Federal Aviation Administration's (FAA) pay for performance policy, what was the percentage of employees interviewed by the GAO that stated that the pay system was unfair? What did the employees think was unfair about it?

In February 2003, we reported that FAA's human capital reform efforts were still in progress.⁵ Many of the FAA managers and employees we interviewed were critical of the new compensation system. Nearly two-thirds of those responding to our structured interview (110 of 176) disagreed or strongly disagreed that the new pay system is fair to all employees. While we did not attempt to evaluate the concerns raised during the interviews, we did find some evidence that helps explain these perceptions of unfairness. For example, concerns about air traffic controller pay disparities were supported by a Department of Transportation Inspector General report. FAA has since corrected its air traffic control pay policies to clarify differences in pay scales between those controllers in air traffic control facilities and those in regional or headquarters offices. In addition, according to both FAA and external stakeholders, a general perception of unfairness regarding FAA's new compensation system has led to increased unionization among both air traffic service employees as well as those in other FAA business lines.

9. In your research, what performance management system do you find more effective—an individually based reward system or a group based reward system? If rewards are given to individuals as opposed to groups, couldn't this create teamwork problems in situations where collaboration and information sharing are essential to good performance? How do you protect against that kind of behavior? Conversely, if rewards are group-based rather than individual-based, couldn't there be problems in which individuals slack off and hope to benefit from the efforts of others? How do you protect against that kind of behavior?

Leading organizations reward individuals based on their contribution to team, unit, and organizational goals. Among the key practices I referenced above is the practice to connect performance expectations to crosscutting organizational goals.⁶ That is, if individuals are to be successful in achieving results, they must work collaboratively

⁵U.S. General Accounting Office, *Human Capital Management: FAA's Reform Effort Requires a More Strategic Approach*, GAO-03-156 (Washington, D.C.: Feb. 3, 2003).

⁶GAO-03-488.

with colleagues in other organizational units. To further underscore the importance of teamwork, leading organizations also set individual performance expectations for collaboration, interaction, and teamwork. Finally, leading organizations recognize and celebrate successful teamwork. In our own case at GAO, we are implementing a new awards program to recognize high-impact work that is produced by matrixed teams formed across the organization.

For additional information on our work on federal agency transformation efforts and strategic human capital management, please contact me on 512-6806 or at mihmj@gao.gov.

Sincerely yours,

A handwritten signature in black ink, reading "J. Christopher Mihm". The signature is fluid and cursive, with the first name "J." followed by "Christopher" and "Mihm".

J. Christopher Mihm
Director, Strategic Issues

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