

Alternative Personnel Systems in the Federal Government

A Status Report on Demonstration Projects and Other Performance-Based Pay Systems

Working for America



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Foreword

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In December 2006, the U.S. Office of Personnel Management (OPM) published *A Status Report on Personnel Demonstration Projects in the Federal Government*, summarizing the Government's experience with demonstration projects and providing an in-depth update on their progress. Prior to that, in October 2005, OPM issued *Alternative Personnel Systems in Practice and a Guide to the Future*, covering alternative personnel systems that included a performance-based pay component. This 2007 report is an update to both of those documents.

The Federal Government's successful experience with alternative pay systems provides a clear path for improving compensation systems critical to the strategic management of our human capital. As these performance-based alternative pay systems clearly indicate, achieving a results-driven, market-based pay system Governmentwide is within reach.

The material presented here provides an updated view of all Government performance-based pay systems, which currently cover over 298,000 Federal employees. OPM is working hard to ensure the key infrastructure is put in place and operating effectively to support further transformation of Federal pay systems. As shown here, the results of these efforts are encouraging.

This material should prove useful in gaining a more in-depth appreciation of how far the Federal Government has already come in successfully using performance-based pay to create a results-oriented performance culture attractive to the next generation of Federal employees.

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Executive Summary

A Status Report on Demonstration Projects and Other Performance-based Pay Systems provides an overview of Performance-based Pay Systems (PPSs), profiles current PPS projects, and presents trends and observations regarding PPSs that currently support over 298,000 Federal employees.

This report covers three categories of PPSs. The first category is demonstration projects authorized under chapter 47 of title 5, United States Code. Under this authority, OPM establishes and evaluates demonstration projects designed to test whether certain changes in personnel management practices, such as a change to performance-based pay from a longevity-based system, would improve Federal personnel management. This category includes existing demonstration projects in the Department of the Navy, the Department of Commerce, and the Department of Defense (DOD). It also addresses projects in DOD Science and Technology Laboratories, which began as demonstration projects under OPM's purview, and which now operate under DOD's authority and oversight. The total number of employees in this category is 42,606.

The second category includes agency-specific, independent systems established under specific legislative authority. These systems include financial regulatory agencies; the Federal Aviation Administration; the Internal Revenue Service; the Government Accountability Office; the Transportation Security Administration; the Alcohol and Tobacco Tax and Trade Bureau; the Bureau of Alcohol, Tobacco, Firearms and Explosives; the Intelligence Community; the Department of Defense; and the Department of Homeland Security. These systems cover almost 247,000 employees.

The final category is Governmentwide executive pay systems, comprising the Senior Executive Service and the Senior Foreign Service, covering 8,643 executives.

Several trends and observations emerge from our experience with performance-based pay systems in all three categories:

- Performance-based pay systems continue to be successful, as evidenced by many evaluations and a stronger link between pay and performance than under longevity-based pay systems.
- Achieving success entails significant effort, but pays off by achieving a results-oriented performance culture.
- Under PPSs, managers and supervisors manage performance more effectively.
- The ability to recruit and retain a high-quality workforce increases under PPSs.
- Payroll costs are being controlled, but cost discipline must be maintained as these systems expand and mature.

Introduction

Purpose of the Report

In October 2005, OPM issued a report—*Alternative Personnel Systems in Practice and a Guide to the Future*—that focused on the Federal experience implementing performance-based pay systems. Subsequently, in December 2006, OPM published *A Status Report on Personnel Demonstration Projects in the Federal Government*, summarizing the Government’s experience with demonstration projects and providing an in-depth update on their progress. This 2007 report provides the current status of all Federal performance-based pay systems and covers the following:

- An overview of the Federal employees covered by PPSs.
- Profiles of current PPS projects.
- Trends and Observations.

“Alternative Personnel Systems” (APSs) is a commonly accepted term for the host of personnel systems generally outside of the competitive civil service designed to address longstanding issues in Federal agencies, such as strengthening performance management and updating position classification and competitive compensation. This report focuses on PPSs, the largest and oldest set of alternative personnel systems, where agencies have sought flexibilities to the General Schedule (GS) classification and pay system. Agencies seek to use PPSs to improve the strategic management of their human capital and more effectively compete for talent. Currently PPSs support over 298,000 Federal employees and fall into three categories:

- Demonstration projects: Chapter 47 of title 5, U.S. Code, authorizes OPM to establish and evaluate personnel demonstration projects, either directly or through agreement with one or more Federal agencies and other public and private organizations. Chapter 47 defines a demonstration project as “a project, conducted by OPM, or under its supervision, to determine whether a specified change in personnel management policies or procedures would result in improved Federal personnel management.”¹ The authority enables the Government to try out alternative, merit-based approaches to specific personnel management tasks and processes before making them more generally applicable.
- Independent systems: These agency-specific systems are established under independent authority granted by Congress either in a particular agency’s authorizing legislation or as a specific authority to implement a separate compensation system.
- Executive pay systems: These Governmentwide pay for performance systems make all pay increases driven by measured performance against measured objectives and achievements.

¹ Section 4701 of title 5, United States Code.

OPM's Role

The Chief Human Capital Officers Act of 2002 charges OPM with improving the strategic human capital management of the Federal Government's civilian workforce, including associated planning and evaluation efforts. OPM has a requirement and obligation to coordinate with agencies on human capital management transformation efforts, assess agency efforts in implementing new human capital systems and programs, and leverage program outcomes for future Governmentwide human capital transformation. Clearly, PPSs are a cornerstone for future civil service reform. As such, OPM has the responsibility to oversee the progress of these systems and to use the results to improve existing human capital management policies, programs, and operations.

OPM plays a critical role in developing and overseeing alternative pay systems. Since receiving Congressional authority over demonstration projects, OPM has actively supported the design, implementation, and evaluation of 18 projects. All but four of these projects have incorporated a performance-based pay component. OPM approves each project after carefully considering the proposed design for conceptual and technical soundness. Thorough evaluation plans are also required, and, over the years, information from those evaluations has been a rich source of best practices and lessons learned. For example, effective cost control, communication, and training techniques have been recognized and applied as a result of past demonstration projects.

Even where Congress has granted an agency independent authority, OPM still plays a key role. For example, under the Internal Revenue Service broadbanding authority, Congress requires OPM to issue criteria that IRS must follow in establishing its broadband pay system. Beyond that, OPM has its normal oversight and accountability responsibilities, especially when alternatives to Title 5 provisions are being used. When OPM observes or foresees difficulties in implementing a system feature, it notifies the agency and assists in making appropriate design corrections or otherwise addressing emerging issues.

OPM's leadership role is also essential to the success of alternative pay systems. Specifically, OPM provides expert guidance to help agencies design effective approaches to their management objectives. OPM's institutional expertise in alternative pay systems across the Government assures that agencies can anticipate unintended consequences, and act upon lessons learned and best practices from other agency experiences.

Scope

All current Federal PPSs are covered in this report (See Table 1). We define a pay system as "performance-based" if the system provides at least two levels of performance-based pay increases for employees rated *Fully Successful* or higher under a regular pay adjustment cycle. Not included are systems that provide the opportunity for higher base pay increases for top performers only on an irregular or *ad hoc* basis, such as the opportunity to receive quality step increases under the GS.

Table 1: Alternative Pay System Profiles

	Start Date	Total Employees	Bargaining Unit Employees	Non-Supervisory/Non-Bargaining Unit Employees	Supervisors/Managers
Demonstration Projects		42,606			
Navy "China Lake"	1980	3,757	X	X	X
Commerce – National Institute of Standards and Technology (NIST)	1988	2,676	X	X	X
Commerce – various components	1998	7,256	X	X	X
Department of Defense – Acquisition Workforce (DOD AcqDemo)	1999	3,356	X	X	X
DOD Science and Technology Laboratories (S&T Labs)		25,561			
– Air Force Research Laboratory (AFRL)*	1997	2,519	X	X	X
– Army Aviation and Missile R/D/E Center (AMRDEC)*	1997	2,592	X	X	X
– Army Research Laboratory (ARL)*	1998	1,839	X	X	X
– Army Medical Research & Materiel Command (MRMC)*	1998	1,277	X	X	X
– Naval Sea Systems Command Warfare Centers (NAVSEA) *	1998	11,183	X	X	X
– Army Engineer R/D Center (ERDC)*	1998	1,528	X	X	X
– Naval Research Laboratory (NRL)*	1999	2,351	X	X	X
– Communications Electronic Command (CECOM)*	2002	2,272		X	X
Independent Systems		246,789			
Federal Aviation Administration (FAA)	1996	37,725	X	X	X
Internal Revenue Service (IRS)	2001	8,050			X
Government Accountability Office (GAO)*	2002	2,973	X	X	X
Transportation Security Administration (TSA)*	2006	47,849		X	X
Alcohol and Tobacco Tax and Trade Bureau (TTB)	2003	131	X	X	X
Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF)	1999	268	X	X	X
Intelligence Community (IC)	2006	0	N/A	N/A	N/A
National Geospatial Intelligence Agency (NGA)*	1998	10,000**		X	X
Department of Homeland Security (DHS)	2002	0	N/A	N/A	N/A
DOD – National Security Personnel System (NSPS)	2004	125,752		X	X
Financial Regulatory Agencies		14,041			
Office of Thrift Supervision (OTS)	1989	1,017	X	X	X
Office of the Comptroller of the Currency (OCC)	1991	3,043	X	X	X
National Credit Union Administration (NCUA)	1992	908	X	X	X
Federal Deposit Insurance Corporation (FDIC)	2003	4,528	X	X	X
Farm Credit Administration (FCA)	1993	254		X	X
Federal Housing Finance Board (FHFB)	1995	130		X	X
Commodity Futures Trading Commission (CFTC)	2006	433	X	X	X
Office of Federal Housing Enterprise Oversight (OFHEO)	1992	238		X	X
Securities and Exchange Commission (SEC)	2002	3,490	X	X	X
Governmentwide Executive Pay		8,643			
Senior Executive Service (SES)	2004	7,473	N/A	N/A	N/A
Senior Foreign Service (SFS)*	2004	1,170	N/A	N/A	N/A
Grand Total		298,038			

Source: OPM Analysis—Data was obtained primarily from OPM's Central Personnel Data File;

* Employee counts were obtained from the agencies.

** Approximate number

Although each of these alternative pay systems is unique in some respects, all systems share common design features. Among these are:

- Open ranges of pay rates, rather than fixed steps, are used;
- Pay increases are usually contingent on an assessment of fully successful employee performance;
- Pay increases that move employees through their pay ranges are directly - and differentially - linked to performance assessments, rather than the passage of time;
- Position classification is streamlined; and
- Pay ranges cover more broadly defined levels of work than the narrow GS grades.

Overall, these PPSs emphasize and reward employees' performance and contribution to mission. Employees receive an annual pay increase commensurate with their level of performance – the higher the level of performance, the higher level of annual pay increase. Annual pay increases range from 0 percent for low performers to as much as 20 percent for top performers. At China Lake, the first demonstration project, there was a 40 percent difference in pay between the average and high performers after 20 years.

We note that other alternative pay systems apply to specialized groups of Federal employees (e.g., Department of Veterans Affairs Title 38 pay system and DOD Dependent Schools). These systems are not included in this table because they do not meet our definition of “performance-based.”

Alternative Personnel Systems Profiles

The Federal Government has experienced PPSs for almost 30 years with positive results for the more than 298,000 employees covered (see Table 1). This section provides a current view of existing systems using data provided by agencies, unless otherwise noted.

Demonstration Projects

Since 1980, OPM has approved 18 demonstration projects (demos): Four were completed, three were made permanent based on successful evaluation results, and the Commerce Demo, AcqDemo and eight Lab Demos are currently active.² In addition, a final *Federal Register* notice was recently approved for a new demonstration project at the Department of Energy, National Nuclear Security Administration.

Completed Demonstration Projects

- Federal Aviation Administration (FAA) Airway Science Curriculum: The FAA Airway Science Curriculum Demo ended in March 1991.
- Federal Bureau of Investigation (FBI) New York Office:³ The FBI Demo expired in October 1993.
- Pacer Share: The Pacer Share Demo expired in February 1993.
- Federal Aviation Administration: The FAA Demo expired in June 1994.

Former Demonstration Projects Converted to Permanent Systems

- Navy China Lake: In 1994, the expiration date for the Navy China Lake Demo was removed by section 342 of Public Law (P.L.) 103-337.
- Commerce - National Institute of Standards and Technology (NIST): In 1996, the NIST Demo was extended indefinitely by section 10 of P.L. 104-113.
- U.S. Department of Agriculture: In 1998, section 749 of P.L. 105-277 permitted the Agriculture Demo to continue indefinitely.

The permanent systems are managed independently by their respective agencies. Therefore, they no longer count toward the ten-project limit for demos managed by OPM. The agencies involved are no longer required to conduct evaluations, but they must obtain OPM approval for modifications.

² “Completed” refers to demonstration projects that have ended. “Permanent” projects are ongoing and have been permanently implemented as a result of legislation. “Active” projects are ongoing but have not been permanently implemented.

³ The FBI Demo was not a chapter 47 demonstration project but was authorized by the Intelligence Authorization Act for Fiscal Year 1988 (P.L. 100-178). This legislation required FBI and OPM to “conduct a study to ascertain the effect on recruitment, retention, and operations of employees of the New York Field Division of the FBI caused by the unusual living expenses associated with such employment.”

Commerce National Institute of Standards and Technology (NIST)

All NIST employees, with the exception of the SES and Wage Grade community, are covered under this demonstration project. The appraisal period lasts 12 months, and employees must be employed at NIST for at least 120 days before an appraisal rating can be given. NIST uses 6 rating levels: *Exceptional Contributor, Superior Contributor, Significant Contributor, Contributor, Marginal Contributor, and Unsatisfactory*. These changes were made in 2005. Prior to this, different types of rating systems have been used over the years.

NIST monitors employees' performance plans to ensure they are aligned with organizational goals. In 2006, NIST sampled 140 performance plans and found that they were all in compliance with the requirement to cascade organizational goals to individual critical elements.⁴ Federal Human Capital Survey data demonstrate the degree to which NIST employees experience and understand this alignment and shows, even in a mature demo project, that employee alignment improves continuously over time.

Table 2: NIST FHCS Results

FHCS Question	% Positive *	% Neither agree or disagree	% Negative	% Do not know
<i>Item #19: I know how my work relates to the agency's goals and priorities.</i>				
2006 Results	84.7	9.5	5.6	0.2
2004 Results	80.6	12.3	6.5	0.7
<i>Item #39: Managers communicate the goals and priorities of the organization</i>				
2006 Results	61.9	23.0	14.3	0.9
2004 Results	56.2	23.9	18.1	1.7

Active Demonstration Projects

- Commerce Demonstration Project.
- DOD AcqDemo Project .
- DOD S&T Lab Demo Program - In October 2000, the Secretary of Defense was given sole responsibility for approving and conducting the Lab Demos⁵, which encompass eight separate projects.⁶ Like the permanent demos, the Lab Demos do not count toward OPM's ten-project limit.

⁴ OPM's Performance Appraisal Assessment Tool (PAAT) – Commerce, 2006

* % Positive = Strongly Agree + Agree

⁵ Section 1114 of the Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001 (P.L. 106-398) removed OPM's responsibility for approving and conducting S&T Lab Demonstration Projects and transferred it to the Secretary of Defense.

⁶OPM approved eight of the S&T Lab Demo projects, two of which were later merged to form one project. Since October 2000, DOD has approved one project.

Department of Commerce

In March 1998, the Department of Commerce implemented a five-year personnel demonstration project covering its Technology Administration, Bureau of Economic Analysis, Institute for Telecommunication Sciences, and National Oceanic and Atmospheric Administration (NOAA). Largely based on the original NIST Demonstration Project,⁷ this demo was designed to test whether the NIST Project interventions can be implemented successfully in specified occupations across Commerce Department environments with different missions and organizational hierarchies.

In 2002, Commerce requested OPM approval to extend the deadline of its demo expiration and expand the number of participants covered. OPM granted the request and extended the Commerce Demo for an additional 5 years, allowing Commerce time to complete validation of the large number of interventions implemented and to test and evaluate underused interventions, especially in the staffing area. OPM also permitted the Commerce Demo to expand coverage to additional organizations and to increase the number of participants up to the legal maximum of 5,000. Based on this expansion authority, Commerce added six components of its Office of the Chief Financial Officer/Assistant Secretary for Administration and additional NOAA components.⁸

In 2005, the Commerce Demo received authority for an additional expansion through Title II of the Department of Commerce and Related Agencies Appropriations Act of 2006 (P.L. 109-108). This law permits the Commerce Demo to add up to 3,500 additional NOAA employees, increasing the total number of NOAA employees to 6,925, as well as additional NOAA organizations and locations. In August 2006, OPM published a *Federal Register* notice announcing the expansion, which allows the Commerce Demo to include up to 8,500 employees.⁹ The extension for the Commerce Demo ends in March 2008.

DOD AcqDemo

Section 4308 of the National Defense Authorization Act for Fiscal Year 1996 (P.L. 104-106), as amended by section 845 of the National Defense Authorization Act for Fiscal Year 1998 (P.L. 105-85), permits DOD, with the approval of OPM, to conduct a personnel demonstration project covering the Department's civilian acquisition workforce and supporting personnel. In September 1996, the Secretary of Defense delegated authority to direct this program to the Under Secretary of Defense for Acquisition and Technology, working in coordination with the Under Secretary of Defense for Personnel and Readiness. The final demonstration project plan was announced in the *Federal Register* on January 8, 1999, and phased implementation of the

⁷ *Federal Register* Vol. 62, No. 247, 67440 (December 24, 1997).

⁸ *Federal Register* Vol. 68, No. 180, 54506 (September 17, 2003) and Vol. 70, No. 127, 38732 (July 5, 2005).

⁹ *Federal Register* Vol. 71, No. 166, 50950 (August 28, 2006).

Demo began in February 1999.¹⁰ It was designed to provide managers the authority, control, and flexibility needed to better manage the workforce, with the immediate goal of enhancing workforce quality and professionalism, and the ultimate goal of providing the best acquisition systems for DOD.

AcqDemo is a wide-ranging personnel demonstration project that includes employees from the Office of the Secretary of Defense and its agencies, as well as the Departments of the Army, the Navy, and the Air Force. It is subject to most requirements of chapter 47 of Title 5; however, a few exceptions have been allowed, including a 95,000 limit on the number of participants.

On December 2, 2002, the deadline for AcqDemo was extended to September 30, 2012, by section 813 of the Bob Stump National Defense Authorization Act for Fiscal Year 2003 (P.L. 107-314). As of November 2006, the project covered 11,450 employees, but migration to the DOD National Security Personnel System (NSPS) has caused the number to decrease to 3,356 in 2007. Once NSPS began implementation, AcqDemo employees became eligible for coverage under the new pay system. OPM recently approved an amendment to the demonstration project plan to facilitate the transition of AcqDemo employees to NSPS. This amendment, announced in the *Federal Register* on October 4, 2006, provides authorization for an out-of-cycle payout under the project's Contribution-based Compensation and Appraisal System (CCAS) prior to transition to NSPS. It also addresses procedures for conversion of employees from this demonstration project to NSPS.¹¹

The AcqDemo Evaluation Plan, approved in July 1999 by the OPM, addressed how each AcqDemo intervention would be comprehensively evaluated after the first five years of the demonstration project. The final report—"DOD Civilian Acquisition Workforce Personnel Demonstration Project Summative Evaluation Report" issued in June 2006—provided insight into the results and, unless otherwise noted, is the source of the information that follows.

The 2006 summative evaluation results indicated:

- AcqDemo had a positive impact on overall workforce quality by enabling managers to compete with the private sector for the best talent available and make job offers to potential employees through streamlined processes that were easy to administer.
- AcqDemo achieved higher retention rates of high contributors and higher separation rates of low contributors without damaging employees' overall sense of fairness.
- AcqDemo achieved high levels of customer satisfaction. Both employees and supervisors realized the benefits of the flexibilities offered by AcqDemo interventions in responding to customer requirements quickly.

¹⁰ "DOD Civilian Acquisition Workforce Personnel Demonstration Project Baseline/Implementation Report", August 2000, A-2-3.

¹¹ *Federal Register* Vol. 71, No. 192, 58638 (October 4, 2006).

- A variety of data indicate that there was a positive shift in workforce satisfaction with the AcqDemo personnel management system.

Survey results show a statistically significant increase in positive perceptions of new hire quality in AcqDemo versus a comparison group. On a composite of survey questions related to satisfaction with new hire competence, favorable responses from AcqDemo employees and managers grew from 62% in 1998 to 73% by 2003. In the comparison group, the favorable response rate remained at 66% throughout the period.

Survey respondents increasingly agreed that high contributors tended to stay with the organization, while low contributors tended to leave. This perception was borne out by objective data (loss rates by contribution zone) from CCAS that showed an increase in the retention rates of high contributors while the retention rates of low contributors decreased.

AcqDemo employees also had a higher perception of the linkage between pay and performance as shown by the following table.

Table 3: AcqDemo Employee perception of link between pay and performance compared to control group

In this organization, my pay raises depend on my contribution to the organization's mission.					
	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
1998 AcqDemo Baseline	22.2%	31.9%	26.3%	15.0%	4.7%
1998 Comparison	34.4%	32.9%	20.7%	10.0%	1.9%
2001 AcqDemo	16.0%	17.9%	15.1%	37.5%	13.6%
2001 Comparison	27.3%	33.6%	18.0%	18.8%	2.3%
2003 AcqDemo	13.6%	14.4%	12.8%	42.4%	16.8%
2003 Comparison	21.1%	39.3%	21.8%	13.8%	4.0%

One of the expected project outcomes was “Increased Workforce Satisfaction with the Personnel Management System”; and one aspect of the outcome is employee perception of fairness. Based on the survey responses shown below, AcqDemo participants’ views of fairness on a variety of dimensions improved in the project’s early stages.

Table 4: DOD AcqDemo Perceived Fairness Questions, AcqDemo Participants' Positive Responses

Survey Question	1998	2003
I am satisfied with my chances for advancement	31%	45%
CCAS is administered without regard to gender, ethnic origin, or age	52%	62%
Supervisors are fair in recognizing individual contributions	46%	50%
Supervisors are fair in recognizing team contributions	41%	51%
Pay pools are fair in recognizing individual contributions	25%	37%
Promotion opportunity-best qualified applicant is chosen	27%	35%
Competition for jobs is fair and open	27%	41%
Gender, race, national origin, age, cultural background, or disability do not affect advancement opportunities	64%	67%

This report also documented lessons learned from AcqDemo Project implementation, including the need for senior leader knowledge/involvement, clarifying stakeholder roles and responsibilities, using an iterative/integrated training approach, improving the pay pool process, and delegating human resources authorities. DOD is in the process of migrating AcqDemo participants to NSPS. Currently, of the approximately 3,000 employees who participate in AcqDemo, approximately 1,800 are covered by collective bargaining agreements and cannot convert to NSPS. AcqDemo will continue for at least one more year, while the AcqDemo Program office works on a new collective bargaining contract.

Until all participants are migrated out of AcqDemo, the Project Office will maintain centrally provided services for participating organizations, including operation and maintenance of automated employee appraisal and pay systems and interface with the Defense Civilian Personnel Data System; technical support of pay pools and pay pool managers; policy and procedure interpretation and assistance; and assistance to Component personnel on use of automated appraisal and pay system software. In addition, the Project Office will coordinate with and assist the NSPS Program Executive Office in the transition process.

DOD Science and Technology Laboratories Demonstration Projects (Lab Demos)

The DOD Lab Demo Program was authorized by section 342 of the National Defense Authorization Act for Fiscal Year 1995 (P.L. 103-337). This legislation enabled DOD, with the approval of OPM, to conduct personnel demonstration projects “generally similar in nature to the China Lake Demonstration Project” at DOD S&T reinvention laboratories. These projects follow most of the requirements of chapter 47 of Title 5, United States Code, but section 342 of P.L. 103-337 removed any mandatory expiration date, removed the limitation on the number of employees covered, and removed the limitation on the number of lab demo projects that can be in effect at one time. Although

there is no mandatory expiration date, DOD committed to evaluating the Lab Demos after the first 5 years of implementation.

The Lab Demos and their implementation dates are:

- Air Force Research Laboratory (AFRL) – 1997.
- Aviation and Missile Research, Development and Engineering Center (AMRDEC) – 1997.
- Army Research Laboratory (ARL) – 1998.
- Army Medical Research and Materiel Command (MRMC) – 1998.
- Naval Sea Systems Command Surface Warfare Center (NAVSEA) – 1998.
- Army Engineer Research & Development Center (ERDC) – 1998.
- Naval Research Laboratory (NRL) – 1999.
- Communications Electronic Command (CECOM) – 2002.

The Lab Demos' purpose is to improve DOD laboratories' effectiveness through a more flexible and responsive personnel system. The demonstration program was part of DOD's Laboratory Quality Improvement Program.

As a result of legislation passed in October 2000 (section 1114 of the Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001, P.L. 106-398), the Secretary of Defense is solely responsible for approving and conducting these projects. Although DOD plans to convert many of its civilian employees to NSPS, DOD Lab Demo employees are excluded from coverage until October 1, 2008. After that date, they will be converted to NSPS only if the Secretary of Defense determines that the flexibilities provided under NSPS are greater than those provided under the Lab Demos.¹²

OPM continues to monitor the Lab Demos' results as they mature, in order to gather important lessons about the operation and effectiveness of large-scale PPSs. In 2006, the Assessment Services Branch of OPM's Division for HR Products and Services conducted analyses of the Lab Demos. Using OPM's Central Personnel Data File (CPDF) and the FHCS, OPM merged data with the existing longitudinal database to provide a comprehensive picture of the demos' impact. This analysis showed:

- Overall support for the project has increased gradually in all but one of the Lab Demos.
- Implementation of PPSs increased job satisfaction in most of the Lab Demos, and was impact-neutral in the rest.
- Increases in individual effort and motivation were found.
- The flexibility to pay higher starting salaries and reward high performers has been helpful in attracting and retaining talent.
- Lab Demo employees seem to have a better understanding of the appraisal process, but less understanding of pay decisions.

¹² 5 U.S.C. 9902(c).

- Agreement increased between supervisors and employees on what “good performance” means.
- There has been no overall negative impact on perceived fairness of pay administration.
- Perceived accuracy and fairness of ratings tended to drop following implementation, but has gradually risen.
- Perception that managers addressed poor performers effectively increased.
- Pay satisfaction increased for all of the Lab Demos.
- There has been no negative impact on employee perception of internal pay equity, but positive agreement on external pay equity has decreased.

New Demonstration Projects

In February 2007, OPM issued a *Federal Register* notice (FRN)¹³ announcing preliminary plans for a demonstration project at the Department of Energy, National Nuclear Security Administration (NNSA). The project will modify the GS classification and pay system by establishing broad pay bands and providing for annual pay adjustments based on performance. A public hearing held in early April gathered comments and questions. The final FRN was published on December 21, 2007¹⁴.

OPM also approved a preliminary FRN for a pay for performance demonstration project at the Department of Education’s Office of Federal Student Aid (FSA)¹⁵. The notice was published on December 14, 2007. The Education/FSA demo will cover 105 employees, and the NNSA demo will cover 1,936 employees.

Other agencies continue to express interest in conducting demonstration projects that feature robust pay for performance systems. OPM will work with agencies to ensure consistency with standards for the Results-Oriented Performance Culture System—part of the Human Capital Accountability and Assessment Framework (HCAAF) established pursuant to the Chief Human Capital Officers Act of 2002 (codified at 5 U.S.C. 1103(c)). Such projects also align group, team, and individual goals with agency strategic goals and make meaningful distinctions among levels of employee performance. As these projects feature pay for performance elements, they must also meet criteria set forth in section 1126 of the National Defense Authorization Act for Fiscal Year 2004 (P.L. 108-136).

Independent Systems

Agency-specific systems are established under independent authority granted by Congress either in a particular agency’s authorizing legislation or as a specific authority

¹³ *Federal Register* Vol. 72, No. 39, 9037 (February 28, 2007).

¹⁴ *Federal Register*, Vol. 72, No. 245, Page 72776 (December 21, 2007).

¹⁵ *Federal Register* Vol. 72, No. 240, 71168 (December 14, 2007).

to implement a separate compensation system. As of September 2007, there were more than 246,000 Federal employees covered by independent PPSs.

Federal Aviation Administration (FAA)

The FAA began its pay-for-performance system in 1996, and added its largest employee group, Air Traffic Controllers, to the system in September 2006. The FAA uses its Performance Management System (PMS) to set performance goals and track results. The employee’s performance results are recorded in a narrative summary, which determines whether the employee has met expectations and is eligible to be considered for increases. There is no numeric performance rating.

FAA also implemented flexibility in starting salaries, which can fall anywhere in the pay band. This is one factor that helps FAA attract the talent they need. Current employee job and pay satisfaction trends continue to be positive. (See below)

Recently, the FAA has received negative press about employee support of its PPS, coinciding with the determination of its 2008 pay raise for employees. However, the 2006 Employee Attitude Survey (EAS) showed that while pay satisfaction had decreased from 2003 (65.1% to 63.5%), job satisfaction has continued to increase since 1997. (See Table 5)

Table 5: FAA – Employee Attitude Survey Results

Year	Satisfied or Very Satisfied
Employee job satisfaction levels:	
2006	72.1%
2003	70.5%
2000	68.0%
1997	69.8%
Employee pay satisfaction levels:	
2006	63.5%
2003	65.1%
2001	63.5%
1998	63.0%

The Air Traffic Controllers were FAA’s largest group of union employees to be brought under the system. Negotiations to bring a few remaining unions into the pay plan are ongoing. As represented employees have joined the pay plan, FAA has experienced an increase in union attempts to negotiate changes in the pay plan.

Internal Revenue Service (IRS)

The IRS performance management system has been in place for executives and managers since December 1999, and a PPS has been in place for senior (SM) and second-level

(DM) managers since March 2001. The first two evaluation cycles produced pay and ratings distributions suggestive that the system had raised the bar for executives and managers and successfully linked pay with individual and organizational performance.¹⁶

In September 2005, all other managers (front-line) were brought into the system, and in March 2006, the original PPS was redesigned. January 2007 was the first service-wide performance-based increase for front-line managers and the first increase for SM and DM under the new design.

IRS used a phased approach to implementing new performance measures, starting at the top. To effectively change employee perceptions and the broader IRS culture, leaders and managers had to “walk the talk” in balancing their performance objectives. In addition to establishing new individual goals and measures, the project added performance-based pay to the equation. The new performance management system assesses executives and managers on three critical performance expectations. Everyone is evaluated against the standard of fair and equitable treatment of taxpayers; executives and managers are also evaluated on what they accomplish and how they meet their responsibilities.¹⁷ Rating distributions have improved numerically over time, as shown in the following table.

Table 6: IRS ratings distributions from 1999 - 2002¹⁸

	Rating Cycle	Outstanding	Exceeded	Met
New system	2006	13%	58%	28%
	2002	28%	50%	22%
	2001	31%	49%	20%
Old System	2000	42%	55%	3%
	1999	36%	59%	4%

The positive correlation of performance ratings to pay increases is strong. The IRS’s service-wide performance increases are differentiated by performance rating, and all covered employees with the same performance rating received the same percentage increase. The January 2007 pay increases by performance rating were:

- Outstanding = 6.5%
- Exceeded = 3.6%
- Met = 1.7%
- Less than Met = 0%

¹⁶ Case Study, *IRS: Performance Management Drives Change in Agency Culture*, Partnership, April, 2005, page 7.

¹⁷ Case Study, *IRS: Performance Management Drives Change in Agency Culture*, Partnership, April, 2005, page 4.

¹⁸ Ibid, page 9.

The average increase was 3.2%. All IRS employees receive the locality pay applicable to the GS. Annually, the formula for the performance-based pay increase factors in the performance ratings distribution and the pay pool funds; and then IRS adjusts the percentages for the service-wide performance-based increases to stay budget neutral.

Government Accountability Office (GAO)

All GAO employees are covered by a market-sensitive pay-banding compensation system introduced in 2002. Positions have been placed into pay bands based on job content. GAO developed competitive pay rates based on the market and applied them to each band; the pay rates may be adjusted as market forces change. The annual amount of funding available for performance-based compensation increases is calculated as a percentage of the salaries within each pay band. The comptroller general determines the pay increases and applies those increases accordingly to remain within budget.¹⁹

GAO uses a five-level performance rating system, based on employee competencies, to evaluate individual employee performance. GAO does not use pay pools or review boards to validate ratings across different units, nor does the agency require ratings consistency across units.

During FY 2007, an employee-initiated decision to form a union was largely perceived to be due to employee dissatisfaction with the deployment of pay banding. On May 22, 2007, David M. Walker, Comptroller General of the United States testified on the status of GAO's human capital transformation efforts²⁰ and stated that GAO had taken steps to address the issues and would also submit legislation that will seek to enhance the pay and pension provisions applicable to its employees.

GAO conducts its own yearly employee survey and includes items that cover employee perception of the link between performance and reward, and employee perception of the fairness of performance ratings.

Transportation Security Administration (TSA)

In December 2006, TSA unveiled the new Performance Accountability and Standards System (PASS) compensation packages for the 2007 Fiscal Year. The PASS program is a key element in the long-term professional development of the Transportation Security Officer (TSO) workforce.

According to TSA, PASS was introduced as a business decision as well as a security decision. PASS acknowledges that the security of the U.S. air transportation system depends on smart, motivated, highly-trained and professional security employees. TSA's plan includes significant compensation to reward the challenge and seriousness of the

¹⁹ Thompson, James R., *Designing and Implementing Performance-Oriented Payband Systems*, Washington, DC, IBM Center for the Business of Government, 2007

²⁰ GAO-07-872T "Status of GAO's Human Capital Transformational Efforts" – May 22, 2007

mission as well as the quality of the work that goes with it. In 2007, TSA had 13 broad, overlapping pay bands.

PASS has three ratings that reward Security Officers for exceptional work:

- **Achieves Standards** – TSO hit a high standard and merits a \$1,000 bonus.
- **Exceeds Standards** – TSO excelled. Merits a \$2,000 bonus and a 3% pay raise.
- **Role Model of Excellence** – Awarded to approximately 3% of the workforce. Merits a bonus of \$3,000 and a 5% pay raise.

Alcohol and Tobacco Tax and Trade Bureau (TTB)

The U.S. Department of the Treasury implemented a Civilian Personnel Demonstration Project at the Bureau of Alcohol, Tobacco, and Firearms (ATF) in March 1999. In January 2003, ATF was split into two bureaus, including the new Alcohol and Tobacco Tax and Trade Bureau (TTB).

Data from the TTB 2006 Pay Demo Project Evaluation show that the majority of TTB employees understand the link between performance and pay. As shown below, 76% of employees understand the performance appraisal system and close to 59% understand the link between productivity and pay.

Table 7: TTB - Job Performance and Pay/Awards Related Survey Questions

Question	Non-supervisor agree/disagree	Supervisor agree/disagree	Total agree/disagree
Item 29 I understand the current performance appraisal system	71%/22%	96%/4%	76%/18%
Item 32 My performance rating is a fair and accurate picture of my actual performance	64%/15%	78%/4%	67%/13%
Item 33 My performance appraisal takes into account the most important parts of my job	67%/12%	83%/13%	71%/12%
Item 34 My supervisor and I agree on what “good performance” on my job means	66%/13%	78%/9%	69%/12%
Item 39 I understand how pay raises are given	60%/22%	87%/9%	66%/19%
Item 43 Pay raises depend on how well employees perform	52%/22%	83%/4%	59%/18%
Item 46 My supervisor gives me adequate feedback	59%/17%	74%/9%	63%/15%

As shown in Table 8, performance-based pay and flexible pay setting on promotion have a strong positive influence on employees' "intent to stay."

Table 8: TTB Turnover Related Survey Questions

Question	Non-supervisor agree/disagree	Supervisor agree/disagree	Total agree/disagree
Item 50 Performance-based pay makes me want to stay in my organization	72%/9%	78%/9%	73%/9%
Item 53 Flexible pay upon promotion makes me want to stay in my organization	72%/11%	70%/13%	71%/11%
Item 56 I will probably look for a new job outside this organization this year	28%/44%	17%/52%	26%/46%
Item 57 High-performers tend to stay with this organization	37%/22%	57%/4%	41%/18%
Item 58 Low-performers tend to leave this organization	15%/38%	30%/17%	18%/33%
Item 59 Current retention efforts have produced a high quality, high-performing workforce	40%/21%	68%/0%	46%/16%

The items presented in the figure below were answered only by supervisors who had experience recruiting and hiring employees (N=16). The respondents unanimously agreed their most recent hire was a good match for the job, and 83% agreed the organization is able to attract high quality candidates.

Table 9: TTB Hiring Related Survey Questions (Supervisors Only)²¹

Question	Total agree/disagree
Item 113 Skill and abilities of the most recent hire were a good match for the job	100%/0%
Item 121 This organization is able to attract high-quality candidates	83%/12%

Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF)

In Fiscal Year 1999 appropriations legislation, Congress granted ATF, the Customs Service and the Secret Service three-year authority to launch a pay and performance management system for 950 scientific, technical, engineering, intelligence analysis, language translation and medical jobs. ATF implemented a PPS in 1999 that allowed employees to advance on the pay scale according to performance and skill. The policy emphasized accountability to organizational goals and meeting critical job elements and performance standards. At ATF, there is a direct equation between performance ratings

²¹ *Pay Demonstration Project Evaluation*. TTB, May 2006, page 25.

and percentage increases in base pay, and outstanding work makes employees eligible for bonuses.

The PPS also included other incentives:

- ATF employees enrolled in the PPS may be eligible for paid sabbaticals and self-directed studies.
- Qualified employees could accelerate up through GS-15 without moving into management positions.

In 2000, ATF expanded its PPS by incorporating a pay-banding system to help boost its efforts to recruit and retain high-caliber information technology employees. The system combined the GS pay structure into four broader salary ranges: entry and developmental, full performance level, senior level, and expert and manager level. Adjustments to pay bands are the same amount as General Schedule pay adjustments. Enrollment in the project was optional for ATF's 260 eligible employees; when implemented, more than 80 percent chose to join.

Intelligence Community (IC)

The United States Intelligence Community (IC) has begun its Pay Modernization project to convert the 17 IC Components from the GS to an alternative pay system. This initiative is now a key part of the Director of National Intelligence's 500 Day Plan, captured in Enabling Initiative 1F. The IC has launched this effort to allow leadership to reward employees based on observed performance against established competency criteria and completion of work objectives, rather than on longevity of service. Moreover, the project seeks to make the IC compensation system more responsive to the needs and expectations of future generations of intelligence analysts.

Both the Weapons of Mass Destruction Commission and the Intelligence Reform and Terrorism Protection Act of 2004 recommended the Director of National Intelligence (DNI) pursue pay modernization. They observed that pay modernization offers a powerful tool by which the IC could engineer a transformation of its many diverse cultures into a unified and collaborative culture.

IC leadership anticipates the new compensation system will help to promote competitive salaries for critical skills, eliminate pay disparities among IC Components, and help avoid intra-community competition for experienced analysts. Further, leadership anticipates that common compensation practices will help to facilitate and encourage joint duty assignments and promote personnel interoperability. Expanding joint duty is a critical step in the process of changing the IC from 17 unique, stove-piped organizations into a more unified and seamless intelligence enterprise.

The project began in February 2006, when the Principal Deputy Director for National Intelligence launched a Pay Modernization Feasibility Study. A program office led by the National Security Agency (NSA) conducted the study to examine the IC and other

Federal pay modernization efforts, and to identify “lessons learned.” The study concluded that the IC should proceed as a community to modernize its pay system by creating a common compensation “architecture” for the entire IC workforce. The study was endorsed by the IC Leadership Committee and the Joint Intelligence Community Council’s Deputies Committee.

The DNI launched the planning phase in September 2006. The Detailed Design and Implementation Plan (Plan) was developed in coordination with the IC Components and was overseen by the IC’s Leadership Development Executive Council. The design was led by NSA and the National Geospatial Intelligence Agency (NGA), and was based on the NGA model and its experience. (NGA converted to a pay for performance management system in 1998 – see below) The design was informed by GAO and OPM reports, input from employees via surveys and focus groups, and lessons learned from past efforts at pay modernization.

The IC Executive Committee approved the design on October 23, 2007. The IC Pay Modernization Project Office will be managed out of the Office of the Chief Human Capital Officer, which is a Directorate within the Office of the Director of National Intelligence. Because the IC is made up of 17 different components, spread over six departments with six different personnel systems, each IC Component will establish its own Program Management Office (PMO) to manage the local transformation. Furthermore, a few of the smaller IC Components will require additional legislative authorities to implement the new PPS. IC leadership has already engaged in discussions with external stakeholders (Congress, OMB, OPM, etc.) to develop a legislative proposal that would address the needed special pay authorities.

Because the existing set of special pay authorities derives from past legislation (U.S.C. Title 5, 10, 28, 50, etc.), the IC Pay for Performance Management System will be a “system of systems.” The essence of this system will be captured in six Intelligence Community Directives, which are currently going through a formal coordination process. The IC Pay Modernization Office is preparing to launch an intensive employee communications program. The IC Components are finalizing their implementation plans and schedules.

The costs of IC conversion and implementation have been budgeted in the FY 2008-2013 National Intelligence Program, augmented by Defense Department funds budgeted in the FY 2008-2013 Military Intelligence Program. An IC Pay Advisory Council will be formed to oversee the implementation and conversion, and to coordinate community pay decisions in a collaborative manner.

National Geospatial Intelligence Agency (NGA)

The NGA began its PPS in November of 1998 with a pay-banding conversion. On September 30, 2007, NGA completed its eighth rating period, and evaluations for this cycle were completed on November 1. For the previous rating period ending September

30, 2006, the modal performance rating was *Excellent* on a 5-point scale (*Unsatisfactory-Marginal-Successful-Excellent-Superior*).

NGA utilizes an “Occupational Advancement” process that allows “career-ladder”-like salary increases within and across bands when developing analysts meet the expected levels of performance and proficiency. This provides a safety net of salary increases while the employee is developing and may not yet attain high performance ratings. NGA also uses Individual Development Plans to enable employees to establish plans on training, assignments, and career paths with their supervisors.

NGA surveys employees annually and uses the survey results and interviews with managers, panel members, supervisors, and employees to address challenges.

NGA has not conducted a formal study comparing hiring salaries within its PPS; however, the broadband pay scale provides NGA greater flexibility to make competitive salary offers. According to NGA, turnover has been very low for several years – typically less than 6 percent – even when retirements are included. A more rigorous exit survey is being established to capture a better picture of the reasons for leaving.

Department of Homeland Security (DHS)

In May 2007, OPM published a report that assessed the status of the DHS APS. Entitled *Creating a Foundation for the 21st Century Federal Workforce – An Assessment of the Implementation of the Department of Homeland Security Alternative Personnel System* the report identified the six components of the APS: performance management, classification, pay, adverse actions, labor relations, and appeals systems. At that time, the performance management system was implemented for almost 10,000 DHS employees, but as Table 1 shows, there are no DHS employees yet covered by the new pay system.

A new name has emerged for the entire APS – Human Resources Management System (HRMS) – and work continues on implementation. DHS has defined an occupational structure to cover GS positions, which includes occupational clusters and broad pay bands. Additionally, draft pay administration and classification procedures have been developed. Due to appropriation issues, DHS has no plans to convert employees to a new pay system.

Department of Defense National Security Personnel System (DOD NSPS)

As with DHS, in May 2007, OPM published a report that assessed the status of the DOD NSPS entitled *Creating a Foundation for the 21st Century Federal Workforce – An Assessment of the Implementation of the Department of Defense National Security Personnel System*. At that time, the DOD Program Executive Office (PEO) was just completing conversion of employees (approx. 34,000) in Spiral 1.3 of its phased implementation and was planning for Spirals 2.1 and 2.2. In October 2007, DOD published new projected numbers for the spirals (see Table 8 below).

Table 10: Phased Implementation of DOD NSPS

Spiral	Army	DoN	Air Force	4th Estate*	Total	Conversion	End of Rating Cycle
1.1	2,322	4,294	3,098	1,244	10,958	April 2006	October 2006
1.2	13,702	8,404	34,596	7,402	64,104	Oct 2006 - Feb 2007	October 2007
1.3	25,006	7,442	1,203	320	33,971	March-April 2007	October 2007
2.1	9,167	8,842	0	148	18,157	Nov 2007 – Dec 2007	October 2008
2.2	18,139	23,029	173	15,628	56,969	Jan 2008 – March 2008	October 2008
Total					184,159		

* Every organization, collectively, under the purview of the Department of Defense that is not part of the Department of the Army, Department of the Navy, Department of the Air Force, or the Office of the Inspector General of the Department of Defense. It does not include the Defense Intelligence Agency or the National Security Agency/Central Security Service.

Several articles have been written about the progress of DOD NSPS, and its web site is continually updated. It is worth noting that

- 97 percent of employees working under the first round of conversion (Spiral 1.1) to NSPS will receive performance-based payouts in 2007.
- The 11,000 employees working under the NSPS Spiral 1.1 conversion were given a performance rating on a scale from one to five. The bulk of those employees – 64 percent – received a rating of three, defining them as "valued performers."
- Employees were awarded "shares" based on their ratings and merit factors in several categories. An average rating of five earned five to six shares, a four rating earned three to four shares, a three rating earned one to two shares and a two or one rating did not earn any shares.
- The largest portion of employees in the first round – 41.7 percent – received two shares, while only 3.7 percent received either five or six shares.
- Employees with performance ratings of two and higher received the equivalent of the January 2007 overall average GS pay increase of 2.2 percent; employees receiving an "unacceptable" rating of one did not receive the annual adjustment
- The first appraisal cycle for employees working under Spiral 1.2 and 1.3 ended September 30, 2007, and those employees can expect to receive their ratings and payouts resulting from those appraisals in early January 2008, along with Spiral 1.1 employees in their second cycle.

DOD is also making changes to the program plan based on employee feedback. The NSPS PEO made changes²² in May 2007 that:

- Changed the launch date: Instead of being given a single date to transfer employees, agencies are now given a window that can last several months.
- Provided better training:
 - An online training tool called “Success” was created to help employees write their own job objectives and assess their own performance.
 - General training for managers and employees was expanded to include more information on performance management and the pay pool process.
- Improved the performance appraisal system – Version 2.0 of the automated Performance Appraisal System was designed to incorporate:
 - Easier-to-understand buttons, links and terms.
 - Simpler screen layouts.
 - Improved report printing and more space to write out assessments.

Spiral 2.1 of DOD NSPS has just been implemented and Spiral 2.2 will follow during FY2008. Next year’s spiral incorporates non-bargaining unit employees.

Financial Regulatory Agencies

SEC, OFHEO, and CFTC FDIC have independent pay authority for their performance-based pay systems. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) granted other Federal financial regulatory agencies – OTS, OCC, NCUA, FDIC, FCA, and FHFB – the flexibility to establish their own compensation systems. FIRREA agencies are also required to consult for the purpose of keeping their compensation in line with others. The FIRREA agencies link employee performance objectives to organizational goals and the overall strategic direction of their organizations. Overall, FIRREA agencies have pay systems that enable them to offer higher pay increases to employees whose performance is rated highest. Two financial regulatory agencies that offered across-the-board increases in the past (SEC and CFTC) are planning to remove those increases in future ratings cycles. Unless otherwise noted, the information in this section is from the June 2007 GAO Report: GAO-07-678 – “Financial Regulators: Agencies Have Implemented Key Performance Management Practices, but Opportunities for Improvement Exist.”

Office of Thrift Supervision (OTS)

The PPS for OTS was implemented in 1991. OTS has reinforced alignment to mission goals by developing a standard performance element – “Leadership Skills” – for managers and senior managers. Under the element, managers are assessed on accomplishing the agency’s goals and objectives, taking initiative and incorporating organizational objectives into the organization, and scheduling work assignments. In

²² M. Z. Hemingway. “Most employees under Pentagon’s performance pay system earned raises plus bonuses” Federal Times, May 3, 2007.

addition, senior managers have a supplemental performance element that holds them responsible for supporting the achievement of OTS's strategic plan.

At OTS, employees receive a performance rating on a 5-level scale. OTS gives managers the flexibility to determine the specific pay amount each employee will receive within the range of possible pay increases corresponding to that performance. Employees who receive a rating of 1 or 2 did not receive any pay increase in the last rating cycle.

Office of the Comptroller of the Currency (OCC)

The OCC PPS was implemented initially in 1981. The current performance management system was deployed in 2001 and continues to be modified. The OCC performance management system is designed to align employee performance expectations with organizational objectives and priorities. OCC has reinforced the linkage between individuals' performance expectations and organizational goals by including the corresponding organizational goals directly on individual performance plan forms. This helps make clear the line of sight between the employee's work and agency goals.

OCC has established ranges of potential pay increases that correspond to different performance rating levels and gives managers the flexibility to decide on the exact amount of pay increase that each individual will receive within the range that corresponds to that employee's rating level.

Each year, OCC adopts a merit pay matrix that defines a range of allowable percentage increases that may be paid for performance rating levels 3 and 4 (the two highest rating categories). The rating official recommends the percentage of merit pay for each employee with a summary rating of 3 or 4. Managers attempt to ensure consistency among employees with similar levels of performance and often consult with other managers or human resources staff for advice when making these pay increase decisions.

National Credit Union Administration (NCUA)

The NCUA PPS was implemented in 1991. NCUA uses a pay matrix tied to employees' performance rating scores (which can range from 0 to 300) to calculate pay increase percentages. All employees in the same pay pool who received the same performance rating received the same pay increase percentage. Employees who received a performance rating score below a specified number fall within the "unsatisfactory" or "minimally successful" performance rating ranges and would not receive any pay increases. In 2004, NCUA employees voted to have the National Treasury Employees Union (NTEU) represent them. A collective-bargaining agreement, which took almost three years to negotiate, was recently announced. Under the agreement, employees will be eligible for merit pay increases each year during the three-year contract. The top 25 percent of high-performing employees will receive pay increases of 8.25 percent; the middle 50 percent will get a 4.5 percent pay increase, and those in the lower 25 percent will receive a 2.5 percent increase.²³

²³ Stephen Barr. "Contract Provides Raises at NCUA" [Washington Post](#), December 14, 2007.

Federal Deposit Insurance Corporation (FDIC)

The FDIC PPS began in 1998. FDIC has essentially two pay and performance management systems; one applies to senior managers, and one applies to bargaining unit and non-bargaining unit employees. Currently, all non-bargaining unit employees are under the same plan, but the FDIC Board has the option to make changes annually as it proactively decides what performance management and performance-based pay standards will apply to this population.

A key objective of FDIC's performance management program as stated in a policy directive is to "establish fair and equitable performance expectations and goals for individuals that are tied to accomplishing the organization's mission and objectives." The directive further states that employees at FDIC are assessed against performance criteria, which are defined as "the major goals, objectives, and/or primary responsibilities of a position which contribute toward accomplishing overall organizational goals and objectives" (as found in FDIC's strategic plan and annual performance plan).

FDIC's system bases merit pay increases for individuals at least partly on corporate contributions (defined as contributions to corporate, division, or unit-level goals). Non-executive/non-management employees must first earn a "meets expectations" rating to be eligible for performance-based pay increases. In a subsequent process called the "Pay for Performance" system, those same employees are placed into one of four pay groups, based on an assessment of total performance and corporate contributions as compared with other employees in the same pay pool. The pay-for-performance program is essentially comparative, so the contributions and performance of each employee are evaluated and rewarded on a relative basis with the peers in his or her pay pool.

Farm Credit Administration (FCA)

The FCA introduced a market-sensitive, performance-based pay banding system in 1993, and has made some revisions since its inception. The FCA performance management system emphasizes rating individual employees against their performance standards, not against other employees. FCA wants employees to focus on their individual ratings and performance.

The percentage pay increase an employee may receive depends on a pay/performance matrix. The matrix considers an employee's existing salary position within the relevant pay band (with position defined in terms of one of five possible quintiles), as well as the employee's performance rating, and determines the percentage pay increase corresponding to those factors. When employees receive the same performance rating, an employee whose salary was considered to be below market rate at the bottom of the pay band would receive a larger percentage pay increase than an employee whose salary was considered to be at or above market rate. FCA provides pay increases only to employees who performed above a minimally successful rating level.

To help bridge the gap between FCA's pay and compensation in other financial organizations, FCA uses the average market rate paid by other financial regulators as a benchmark to keep them competitive in the labor market.

Federal Housing Finance Board (FHFB)

The FHFB PPS was implemented in the mid 1990s; the system has been slightly revised since its inception. FHFB created a handbook and a guide for their performance management systems containing several references to alignment of individual expectations to organizational goals. FHFB has reinforced alignment in standardized performance elements for several occupational groups. Standardized elements for executives, managers/supervisors, staff attorneys, and professional positions contain references to aligning with or contributing to organizational goals. The first page of the performance plan form includes the statement of agency mission and office mission to which an employee is contributing.

Commodity Futures Trading Commission (CFTC)

In October 2006, CFTC introduced a new performance management system directive for performance planning and appraisal processes. CFTC's revised performance management system is a five-level system that includes descriptions of all five performance levels, an improvement over the previous system where only the successful rating level was described. The new system was developed by an agency committee with employee and union (the American Federation of Government Employees) input.

Beginning on July 1, 2007, the performance-based pay portion of the new performance management system was linked to performance ratings. A minimum threshold performance rating is required for an employee to be eligible for a pay increase. Previously, the agency operated under a performance management system in which some performance bonuses were the only increases directly linked to performance ratings. CFTC does not require that all employees' performance plans include a standardized performance element related to mission alignment. However, to achieve the highest summary performance rating, an employee must "achieve element objectives with extensive impact on organizational mission." This standard reinforces the line of sight between individual performance and organizational results. All employees at CFTC must make visible contributions to organizational goals in order to achieve the highest possible performance rating. Alignment is further reinforced for managerial employees, who are assessed on the standardized performance element of "Effective Leadership." This element requires them to accomplish the work unit's mission and organizational goals, and communicate organizational goals to subordinates.

Office of Federal Housing Enterprise Oversight (OFHEO)

OFHEO has had a PPS since the agency's inception in 1992. Employees are rated on a five-level rating scale for each of the performance elements included in their performance plans. These performance standards define the middle level of performance (fully

successful), and include what the rater should look at to determine how an employee is performing against this benchmark. An employee's performance for each element is assessed and a total score is determined. OFHEO further distinguishes between "high" and "low" levels within rating categories. Merit increases are determined directly by employees' performance ratings, so employees can ascertain the merit increases they will receive for given performance ratings. For example, an employee rated "high" commendable receives a higher merit pay increase than one who is rated "low" commendable.

Securities and Exchange Commission (SEC)

The SEC implemented its PPS in 2002 covering all employees. Currently, SEC and its union negotiated implementation of a new Compensation and Benefits Agreement, under which employees rated as unacceptable would not receive annual pay adjustments. SEC officials acknowledge that a negative perception occurs when employees who are not performing satisfactorily receive a pay increase.

For its non-executive employees, SEC uses a two-level rating system in which individuals' performance is rated as acceptable or unacceptable. SEC follows the definitions under title 5 that are used by the rest of the Government for differentiating between acceptable and unacceptable performance. To determine performance-based pay increase amounts for non-executive employees, SEC developed a second phase process that involves making distinctions in contributions for those individuals who receive a summary performance rating of acceptable.

As part of the second phase, employees and their supervisors submit contribution statements summarizing the employees' accomplishments during the appraisal cycle. Using the summary statements and the supervisors' own assessments, supervisors place employees into one of four categories:

- Made contributions of the highest quality.
- Made contributions of high quality.
- Made contributions of quality.
- Made no significant contribution beyond an acceptable level of performance.

Next, a compensation committee within each office or division evaluates the contribution statements and the supervisors' placements. For each employee, the committee recommends a merit pay increase percent corresponding to "steps" 0 to 3 to inform the final determination of the employee's merit increase.

Government Executive Pay

Senior Executive Service (SES)

OPM implemented the requirements for a Governmentwide SES PPS in 2004. Agencies have been required to obtain OPM certification, with OMB concurrence, of their SES performance appraisal systems based on OPM's requirements before adjusting pay above Executive level III, up to level II. Pay adjustments are based on performance. Stronger distinctions in performance are being made; the "outstanding" description truly carries the connotation of "stands out as an exception." Base pay increases are being awarded in higher amounts and greater proportions to higher-performing executives.

OPM's certification guidance for calendar year 2007 included new requirements; the features and results of agency SES performance management systems are communicated to executives, and appropriate training is provided to those responsible for operating the system. Agencies have generally done a good job of meeting these requirements, which will continue to play a significant role in future determinations regarding both full and provisional certification. In addition, agencies now are required to develop SES performance plans that credit measurable results as at least 60 percent of the performance rating. Agencies have been successful in instituting the required adjustments to summary rating derivation formulas and the design of performance plans.

An important enhancement to the certification process is being introduced in calendar year (CY) 2008. Agencies receiving full certification of their SES appraisal systems in 2007 will be able to request a renewal of full certification by using OPM's SES Performance Appraisal Assessment Tool (SES-PAAT). This tool is designed to function as an important component of agencies' internal human capital accountability systems and to promote increased efficiencies in the certification process. The SES-PAAT must be completed every 2-years, consistent with the 2 year full certification cycle, and submitted to OPM no later than 6 months prior to the expiration of certification.

The results of the SES PPS are directly aligned with the certification requirements:

- Pay adjustments and awards are based on performance.
- Agencies are holding executives accountable for achieving results that are clearly tied to organizational goals.
- Agencies are assessing organizational unit performance, communicating that performance to rating officials, and ensuring their rating distribution reflects the unit's performance.
- Agencies are making distinctions in levels of performance.
- Agencies are holding executives accountable for the performance management of subordinates.
- Agencies are establishing oversight and accountability systems for their SES performance based-pay system.

Through the certification process and continuing technical support and guidance, OPM has seen marked improvements in agency systems compliance. In October 2005, OPM reported one agency – GSA – with full certification. Currently, eight large agency systems and eight small agency systems have received full certification.

Table 11: Agency SES Performance Management System Certification Status

Agency	Certification Status Through 2008	SES Rated FY 2006
Agriculture	Provisional	350
Commerce	Full	282
Defense	Full	1,173
DHS	Provisional	294
Education	Full	79
Energy	Provisional	398
EPA	Full	289
HHS	Provisional	392
GSA	Provisional	86
HUD	Full	90
Interior	Pending	239
Justice	Provisional	612
Labor	Full (<i>through 2007</i>)	170
NASA	Full	397
OMB	Provisional	66
OPM	Provisional	42
SBA	Provisional	38
SSA	Full	149
State	Provisional	147
Transportation	Full	196
Treasury	Full	394
USAID	Provisional	19
VA	Provisional	278
All Others*		626
Total		6,806

* Other Small Agencies

Prior to 2004, several agencies were still using Pass/Fail and three-level systems for performance management. Since then, agencies have improved their ability to make distinctions in performance (See Table 12).

Table 12: SES Performance Ratings²⁴

Agency	2001 Percent at Highest Rating Level	2004 Percent at Highest Rating Level	2006 Percent at Highest Rating Level	Difference 2006 2004
AGRICULTURE	36%	44%	45%	1%
COMMERCE	80%	49%	43%	-6%
DEFENSE	99%*	99%	32%	-67%
EDUCATION	100%*	99%	38%	-61%
ENERGY	99%*	44%	35%	-9%
EPA	85%	61%	38%	-23%
GSA	92%	28%	22%	-6%
HHS	91%*	52%	61%	9%
HOMELAND SECURITY	n/a	85%	55%	-30%
HUD	99%*	45%	53%	8%
INTERIOR	100%*	22%	22%	0%
JUSTICE	91%	62%	65%	3%
LABOR	61%	45%	46%	1%
NASA	76%	76%	56%	-20%
NRC	100%*	9%	9%	0%
OMB	20%	33%	8%	-25%
OPM	37%	47%	31%	-16%
SBA	82%	70%	29%	-41%
SSA	100%*	56%	64%	8%
STATE	99%	86%	71%	-15%
TRANSPORTATION	100%*	33%	31%	-2%
TREASURY	63%	44%	46%	2%
USAID	79%	53%	53%	0%
VA	56%	64%	58%	-6%
ALL OTHERS	83%	61%	51%	-10%
GOVERNMENTWIDE	84%	62%	45%	-17%

* Most, if not all, of the Agency was under a Pass/Fail System

Senior Foreign Service (SFS)

In January 2004, Executive Order 12293 covering the SFS was amended to align SFS pay with the PPS being adopted for the SES. Overseen by the State Department, the SFS plan currently affects SFS-designated employees at USDA, Commerce, and USAID, as well as at State. Together, these agencies developed policies covering promotions, pay and cash bonuses. Although SFS pay was not covered by OPM's SES pay for performance regulations, at the Department of State's request, OPM reviewed the SFS appraisal and pay system and determined the SFS system generally meets OPM's certification criteria.

²⁴ Report on Senior Executive Service Pay for Performance for Fiscal Year 2006. OPM, June, 2007.

Trends and Observations

Federal agencies initiate APSs to establish high-performing, results-oriented cultures that can achieve a variety of goals, including the ability to:

- More closely tie reward to achievement and provide the largest rewards for the highest-performing employees.
- Strengthen performance management.
- Enable organizations to attract and retain engaged employees, particularly in markets where the Government faces extreme competition for specialized skills.

The following observations show there are continuing positive results, yet there are some areas requiring thoughtful planning and implementation.

Performance-based pay systems continue to be successful

As shown by the profiles, PPSs have been tested in various environments across agencies. DOD has the most experience, and its projects have been extensively evaluated and documented. OPM has conducted longitudinal studies on the Lab Demos since they began, and the data show that in most cases the projects have had positive results and impact. Other project evaluations tell the same story.

It is important to note that under an alternative pay system, the money distributed as salary increases is comparable to what would have been distributed under the GS. The important difference lies in the basis used to make pay determinations and the value that basis represents. For the GS, time is the overwhelming basis for distributing increases, so the message to employees is, “Longevity is what matters.” In the PPSs tested in the Departments of Defense and Commerce and implemented in other independent systems, pay increases differ based on distinctions in performance and appraisal outcomes. The message to employees is shifting to, “Performance is what matters.” In the war for talent, establishing the right value proposition – performance is what we value and what makes a difference – can be critical. The positive results and trends across these systems are clear; they work based on a range of widely accepted effectiveness benchmarks. There also is increasing recognition that PPSs can significantly benefit employees and organizations when they are implemented properly.

In designing and implementing systems for strategic management of human capital, agencies are taking a two-pronged approach: results-oriented performance culture through performance-based systems; and recruiting and retention that is market-sensitive. Many of the agencies’ performance management systems lay the foundation for creating stronger links between pay and performance.

Achieving success entails significant culture change

Culture change takes time. OPM studies of PPSs have shown it takes at least five years for the majority of employees to be supportive of the change – but the support inevitably emerges. Implementing a PPS requires commitment, communication, training, and follow through, and agencies have proven willing to make the investment. Most of the demonstration projects, including Commerce and AcqDemo, reached the 50% benchmark of employee support within five years.²⁵ Measures of support for the demonstration projects are in some instances as high as 80 percent. Even where the explicit support is more temperate, the largest proportion of employees is undecided rather than opposed. In those settings where employees are still uncertain, other data suggest that agencies need to monitor and focus more closely on their implementation efforts.²⁶

The Federal Government’s new performance-based culture is outlined in OPM’s Human Capital Accountability and Assessment Framework (HCAAF) (established pursuant to requirements of the Chief Human Capital Officers Act of 2002 and codified at 5 U.S.C. 1104(c)), in the Results-Oriented Performance Culture System (ROPC). The ROPC standard is defined as follows: “The agency has a diverse, results-oriented, high-performing workforce and a performance management system that differentiates between high and low levels of performance and links individual/team/unit performance to organizational goals and desired results effectively.” As shown in this report’s profiles, all of the PPSs align employee performance objectives with agency goals and use distinctions in performance to drive pay decisions.

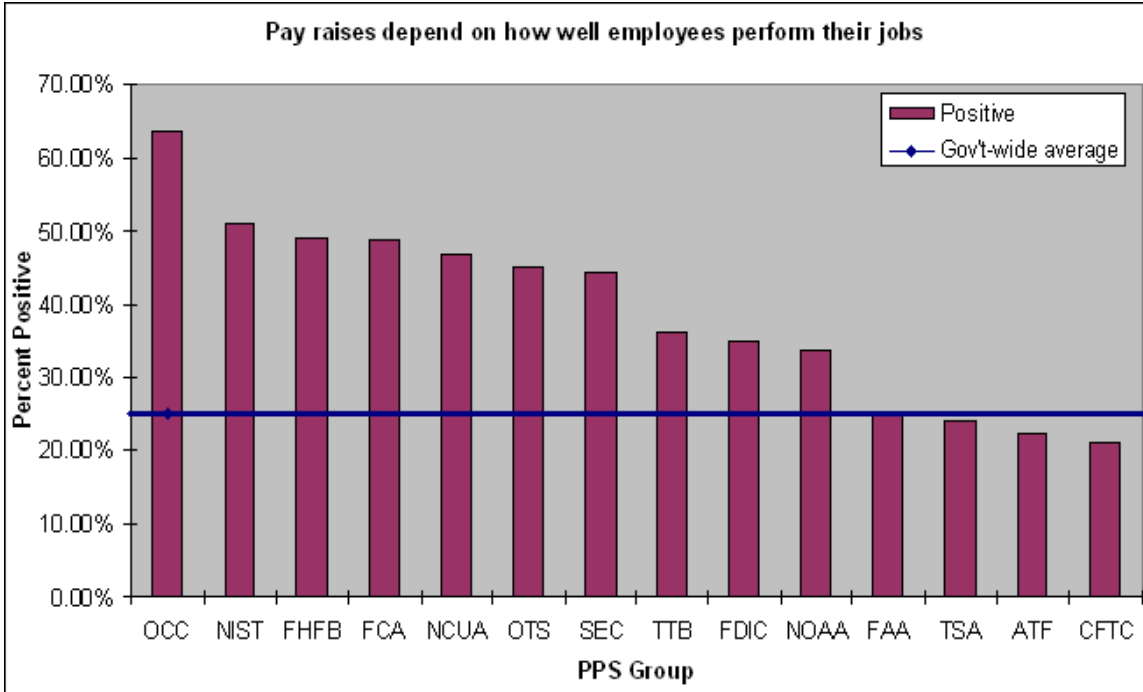
Other indicators of culture change include employee perception of satisfaction with pay, fairness of pay administration, and the link between pay and performance. In most cases, PPS employees respond more positively to seeing a direct link between their performance and their pay than the Governmentwide average (see Figure 1). In the Lab Demos, that link was reported by two out of three employees, compared with only one out of three employees in control sites under the General Schedule.²⁷

²⁵ U.S. Office of Personnel Management. *Demonstration Project Benchmarking Report*. OPM, December, 2006.

²⁶ *Ibid.*

²⁷ *DOD Science and Technology (S&T) Reinvention Laboratory Demonstration Program: Summative Evaluation 2002*. OPM, August 2002.

Figure 1: 2006 FHCS Results – Pay link to performance



As one example, TTB supervisors perceive the pay system provides the ability to raise the pay of good performers, thus encouraging higher individual performance. Employees perceive that TTB is more effective now in accomplishing its objectives than at the beginning of the Demonstration Project. Furthermore, compared to the General Schedule (GS) system, employees perceive that the Demonstration Project provides a better incentive structure for encouraging improved employee performance.²⁸

Acq Demo provides another example where the agency placed great importance on employee perception of fairness as a desired outcome. Based on the survey responses shown below, AcqDemo participants' views of fairness on a variety of dimensions remained the same or increased over the first 5 years of AcqDemo.

Table 13: Perceived Fairness Questions, AcqDemo Participants' Positive Responses

Survey Question	1998	2003
I am satisfied with my chances for advancement	31%	45%
CCAS is administered without regard to gender, ethnic origin, or age	52%*	62%
Supervisors are fair in recognizing individual contributions	46%	50%
Supervisors are fair in recognizing team contributions	41%	51%

²⁸ *Alcohol and Tobacco Tax and Trade Bureau (TTB) Pay Demonstration Project Evaluation*. SRA International, May 2006, page 48.

Pay pools are fair in recognizing individual contributions	25%*	37%
Promotion opportunity-best qualified applicant is chosen	27%	35%
Competition for jobs is fair and open	27%	41%
Gender, race, national origin, age, cultural background, or disability do not affect advancement opportunities	64%	67%

* 2001 Survey

In the IRS, the introduction of balanced measures promoted an understanding within the organization that the Service’s performance is assessed on multiple dimensions, not just tax dollars collected. The organization as a whole has experienced a subtle but discernible change. Executives and managers now focus on achieving results by managing and leading people, and a culture of employee involvement and engagement is evolving.²⁹

Managers and supervisors are trained to manage performance more effectively

Taking the time to make sure managers understand the new systems and how to use them effectively and transparently is critical to achieving acceptance and support. PPS success requires that managers be held accountable for effective performance management and for making meaningful distinctions across levels of performance. Techniques like calibration discussions help ensure that meaningful distinctions among levels of performance are made across organizational units. Rating reconsideration processes are built into these systems to ensure procedural justice.

The procedures governing appraisal and pay decisions – particularly those that give employees a chance to seek reconsideration or redress -- are crucial. Lab Demo employees report that they understand how their appraisal systems work (72 to 89 percent agreement) and how pay decisions are made (58 to 70 percent agreement). Further, they generally agree adequate reconsideration procedures are available. Such results are key components to achieving an overall perception of fairness and transparency.

The trust that leads to success can be earned through good communication and fair administration. PPSs show improvements in communication from management and across organizational units. In turn, the already high correlations between communication and procedural justice, as well as between communication and trust, remain strong.

As shown in Figures 2 and 3, PPS employees are generally equally or more positive than the Governmentwide average in applicable areas of the 2006 FHCS.

²⁹ Case Study, *IRS: Performance Management Drives Change in Agency Culture*, Washington, DC, Partnership, April, 2005, page 9

Figure 2: 2006 FHCS Results – Performance Discussions

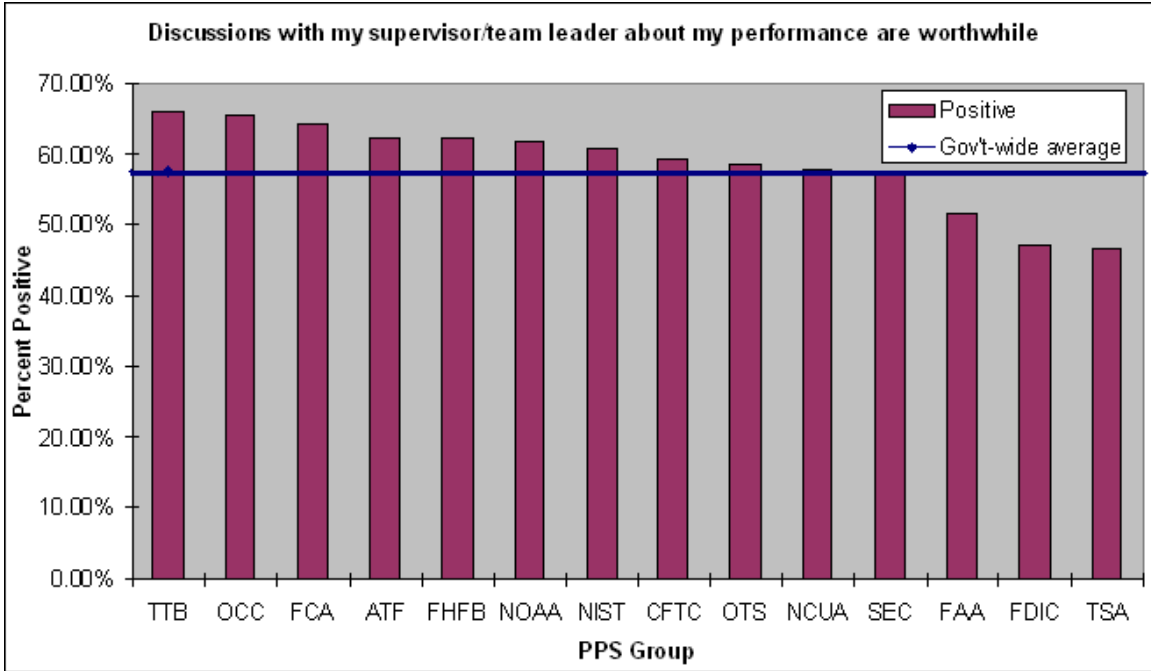
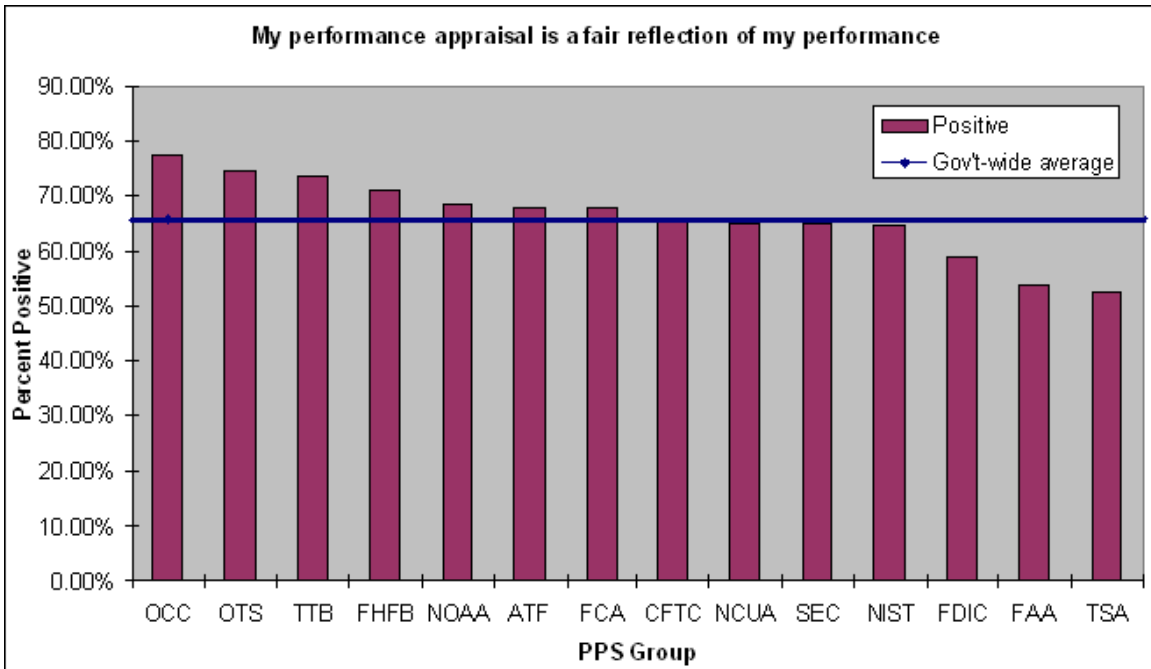


Figure 3: 2006 FHCS Results – Appraisal Fairness

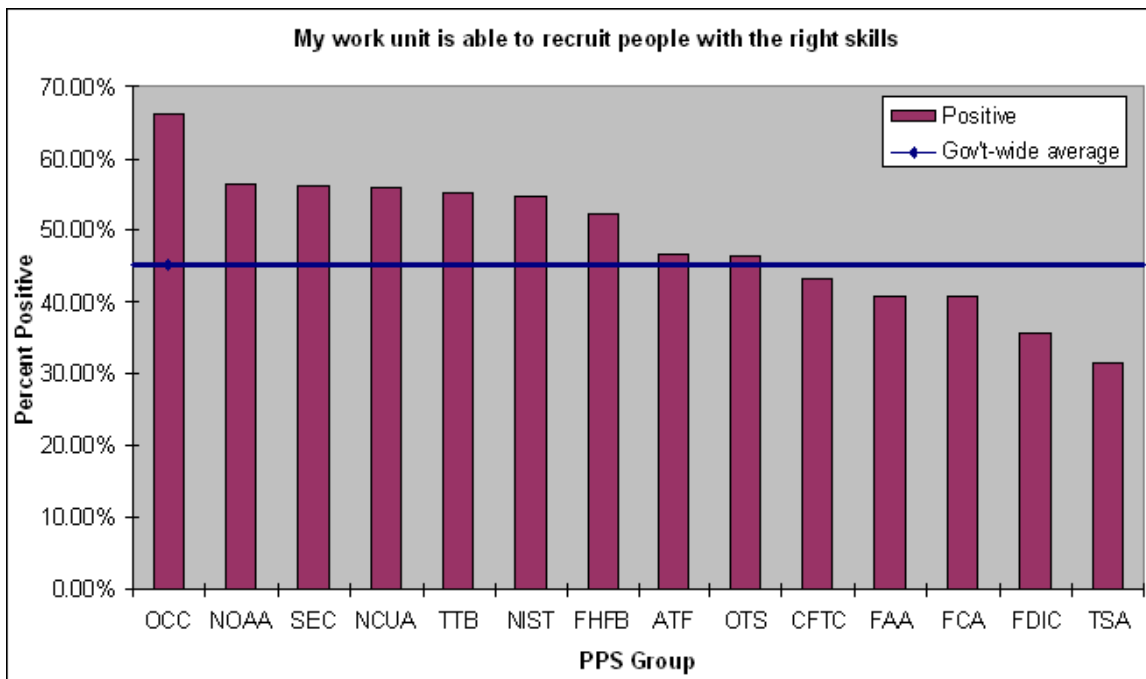


The ability to recruit and retain a high quality workforce increases

Turnover among the better performers has been shown to significantly reduce the ability to recruit talent. Among employees rated Outstanding in four DOD Lab Demos, where this measure was tracked most carefully, the annual turnover rates were reduced by 64 percent, 51 percent, 48 percent, and even 11 percent in a lab where external competition was particularly pronounced.

TTB supervisors and non-supervisors perceived the Demonstration Project was effective in motivating employees and allowed TTB to attract better employees. Additionally, 83% of TTB employees agree the organization is able to attract high quality candidates. Supervisors and non-supervisors also perceived that the Demonstration Project allowed TTB to bring in higher quality employees and increase the overall quality of the workforce. Supervisors also perceived that the hiring process had improved since the beginning of the project. Objective data indicate that TTB is able to offer higher pay to new hires than the comparison group.³⁰

Figure 4:2006 FHCS Results – Recruitment



³⁰ *Alcohol and Tobacco Tax and Trade Bureau (TTB) Pay Demonstration Project Evaluation*. SRA International, May 2006, page 48.

Payroll costs are being controlled, but cost discipline must be maintained as systems expand and mature

Previous OPM reports have shown payroll costs can be controlled. That remains true in many of the PPS systems currently underway. What is not known is when large systems (such as NSPS) expand and mature; will payroll cost discipline be maintained?

The NSPS statute (chapter 9901 title 5 U.S. Code) requires that between 2004 and 2008, to the maximum extent practicable, the amounts allocated for compensation of employees covered by NSPS cannot decrease below what it would have been if NSPS had not been implemented. After 2008, to the maximum extent practicable, NSPS regulations must provide for calculating the overall amount to be allocated for compensation of employees covered by NSPS in a way that ensures, in the aggregate, employees are not disadvantaged. There is an assumption of fiscal responsibility and cost discipline, which requires control processes to be deployed, managers and supervisors to be trained, and infrastructure to be in place. The level of complexity of managing costs may rise exponentially once NSPS is completely implemented, and payroll costs may rise beyond expectations. OPM will be working with DOD and monitoring payroll cost issues to facilitate NSPS regulation.

OPM's experience with AcqDemo sheds light on this area. The AcqDemo Summative Evaluation Report states "AcqDemo base pay growth was driven by two factors: the general pay increase (GPI), which was determined by law (applied equally to title 5 and AcqDemo); and the contribution rating increase (CRI), which was set by each pay pool. By *Federal Register*, CRI had to be at least 2.0 percent (2.4 percent first year in demo). CRI replaced Within Grade Increases and within-band promotions, which OPM estimated at about 1.7 percent per year for DOD's current GS employees. Therefore, by design, AcqDemo could not be cost-neutral; it had to cost more than title 5."

OPM analysis of AcqDemo data agreed annual spending on pay increases was between 0.5 and 1 percent more than it would have been in the GS. However, estimations over the long term showed spending 0.5 to 1 percent of basic payroll more each year would result in total payroll costs being 8 to 16 percent higher than they would otherwise have been. OPM recommended DOD decision makers consider long-term salary cost projections in determining the size of pay pools and analyzing whether mission-related benefits justify the estimated costs. Also, cost projections and their analysis/justification should be documented to ensure accountability.

From a Governmentwide perspective, comparison to the GS is currently being used as a cost control mechanism. If there comes a time when the GS is replaced by PPSs, OPM should play a central leadership role to establish core classification and pay systems. There are at least two reasons core systems should be considered. First, common pay structures and pay rules support cost discipline and ensure fairness, credibility and transparency. Second, the basic principle of leveraging to achieve efficiency makes it

more sensible to assign the task and resources necessary to set up, adjust, and maintain market-sensitive pay schedules to one lead agency with well-established expertise.

Examples of where agencies are controlling costs include:

NGA controls costs using three different strategies:

- Salary and bonus budgets are determined centrally as a percentage of base pay.
- By allocating funds to pay pools via performance pay spreadsheets. (Note: Higher-level organizations can shift funding among their pay pools to meet tactical and strategic goals.)
- Pay pools cannot exceed the limits posted on the spreadsheets.

That is evident by the results of NGA's last cycle in which the pay increase was 2.4%, not including the General Pay Increase (GPI). They awarded the GPI to all employees who demonstrate satisfactory performance or higher. GPI is awarded in early January, and TPC salary increases are awarded in early February. The actual average was 2.4%, as planned and budgeted. Bonus levels were also controlled. The budget was 1.55% of base salary and the actual average was 1.55%, as planned and budgeted.

The **FAA** uses cost-controlling methods by using the same dollars as under the GS system (general increase, within-grade increases and quality step increases) for base pay increases. However, these dollars are spent differently for the Organization Success Increases (OSI) and the Superior Contribution Increases (SCI). Under this system, no increases are automatic, but are based on performance and other eligibility criteria.

The **IRS** uses a Performance Review Board (PRB) to review ratings and point distribution. Each division manages the pay for pay-banded positions through a PRB comprised of executives and senior managers. The PRB reviews ratings to ensure there is consistent application of performance standards within all operating units. The PRB also compares unit to organizational performance, considering the overall "point budget," and can require additional justification if necessary. The PRB forwards the reviews to the Division Commissioner who reviews, approves, reallocates points within the Division when necessary, and requests additional points from the Deputy Commissioner. The Deputy Commissioner may authorize additional points if necessary.³¹

Many agencies including NIST, DOC, DOD, and AFRL utilize "pay pools" to limit the growth of salaries. A percentage of the total annual salaries of employees in a pay pool (typically representing 75-200 employees) is used as the pool of money that can be allocated as salary increases. The pay pool manager is responsible for limiting the total increases.³²

³¹ *Case Study, IRS: Performance Management Drive Change in Agency Culture*, Partnership for Public Service, 2005, pages 7 - 8

³² Thompson, James R., *Designing and Implementing Performance-Oriented Payband Systems*, IBM Center for the Business of Government, 2007, page 19

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