

**METRO**  
**Metropolitan Exposition-Recreation  
Commission**

***MERC'S PFP Program Implementation  
Is Not a Model For Metro***

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**October 2003**

A Report by the Office of the Auditor



**METRO**

PEOPLE PLACES  
OPEN SPACES

**Alexis Dow, CPA**  
**Metro Auditor**

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**METRO**  
**OFFICE OF THE AUDITOR**

October 31, 2003

To the Metro Council and citizens of the Metro region:

Pay for performance (PFP) is a sound management tool that has had success in both the private and public sectors. However, the PFP model as it has been implemented at MERC is not an approach Metro should apply in other parts of the organization.

The audit reveals that MERC made pay decisions inconsistent with both PFP program objectives and its own policies. It made significant pay increases that are not performance based, gave performance awards to some employees lacking the required tenure and granted substantially more vacation benefits to select employees than MERC policy allows.

The audit also found that MERC could provide no data to substantiate that its PFP program has made much difference to organizational performance. In addition, after four years, employees continue to have significant misgivings about the program.

In January 1999, MERC instituted a performance oriented compensation system, or PFP, for about 90 full time, non-represented employees. The program reflects growing governmental movement toward pay approaches that attempt to relate employee pay more directly to their performance – a very worthy goal.

Salaries for program employees totaled \$4.8 million in FY 2003.

Consistent with Metro Council President David Bragdon's inaugural promise of "transformation of this government into a more accountable and efficient organization" and our own work plan, we reviewed the program to determine if opportunities exist to improve program operations, to assess accountability mechanisms and to evaluate the program's potential applicability elsewhere within Metro.

The written response of the Metro Chief Operating Officer is at the end of the report.

Very truly yours,

Alexis Dow, CPA  
Metro Auditor

Auditor: Joe Gibbons

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## Executive Summary

In January 1999, the Metropolitan Exposition-Recreation Commission (MERC) established a Pay for Performance (PFP) program, a new compensation system for about 90 full-time, non-union employees. The program reflects growing governmental movement toward pay approaches that attempt to relate employee pay more directly to their performance. MERC management is satisfied with the way the program is working and believes employees are more accountable for their performance. However, from a public accountability standpoint, the program has a number of limitations that the MERC Commission should address and the Metro Council and Chief Operating Officer should act on as they consider a new performance-oriented pay system for the rest of Metro.

The PFP model itself is basically a sound one that has had success in both the private and public sectors. However, the PFP model, as it has been applied at MERC, is not an approach that Metro should apply. MERC has not established an articulated, well-defined compelling business reason for the program or a system to measure and report on program performance. MERC did not have or could not provide effectiveness-related data to substantiate that its PFP program has made much difference to organizational performance. Essentially, MERC has a performance-oriented compensation system that does not measure its performance. Also, in the administration of the program, MERC has made pay decisions inconsistent with the PFP program objectives. Some indicators show that the program has had little if any effect on MERC's organizational performance and may have had negative effects on the organization.

Any new program in the public sector, especially one that has high impact on organization culture and future operations, should be set up so it can be evaluated and its program performance, effectiveness and results reported. This is particularly true of a program like MERC's because it represents a significant departure from MERC's former compensation system and the usual public sector way of compensating personnel. The MERC Commission should voice a need to know about program effectiveness and provide stronger guidance and oversight to assure that this has been done. Because a program performance measurement system is not in place, MERC cannot demonstrate what the program is accomplishing and whether the organization is achieving any better results in relation to its former compensation system.

The PFP concept is basically sound when planned and implemented consistent with sound management principles. MERC's model of implementing the concept, however, is not one that Metro should embrace as it considers revising Metro's compensation system. The following section summarizes our recommendations to Metro as it considers moving toward a similar pay model.

## Recommendations

The Metro Council directed its Chief Operating Officer in August 2003 to explore a performance-based compensation system for Metro. The introduction of a new pay system is potentially one of the most disruptive changes an employer can make. If the Council and COO desire to establish a compensation system that ties pay more closely to employee performance, they need to fully consider the implementation and administration issues and outcomes of the MERC PFP program. This is particularly true if the Council and COO wish to move to a system that makes extensive and consistent use of pay-for-performance principles based on employee performance and/or organizational performance and achievement. MERC's pay program provides some ties to employee and organizational performance, but these ties are limited, and there are few clear links between the program and what MERC accomplishes organizationally as a result of the program.

We recommend that the Metro Council and COO perform the following steps in developing a new performance-based compensation system:

1. Conduct a needs assessment to clearly define why the new system is needed – that is, what specific problems and issues exist with the current system that can be specifically solved by establishing a new system? What is the compelling business need and reason for the model or approach that is selected?
2. Consider the costs of installation in relation to anticipated benefits. Compensation systems based on performance vary widely in sophistication and cost, and all require appropriate levels of resources to administer the program and help ensure program success.
3. Assure that program performance measurement and reporting systems are intrinsic to the new system. Clearly defined goals, objectives and organizational performance measures should be established and tracked to provide an objective basis for evaluating progress and reporting results.
4. Provide strong oversight and accountability to assure that the program consistently meets defined goals and objectives and make mid-course corrections as needed.

Appendix A summarizes some key issues and best practices for planning a PFP program.

## Introduction

The MERC Commission<sup>1</sup> instituted a performance-oriented compensation program (Pay for Performance or PFP) for about 90 full-time, non-represented employees in January 1999. MERC developed this program to tie pay increases to individual and organizational performance rather than to the more traditional governmental approach of making salary increases based on length of service. We reviewed the program to evaluate the program's potential applicability elsewhere within Metro, to determine if opportunities exist to improve program operations and to assess accountability mechanisms. This report focuses on the program's potential applicability elsewhere within Metro.

Under MERC's program, employee pay increases and/or bonuses can vary substantially, and are based at least in part on management's judgment of employee job performance and other factors. MERC's program bases employees' pay on three primary factors:

- the results of classification and compensation studies and salary trending studies<sup>2</sup>
- MERC facilities' performance as measured by condition, customer service, operating revenues/expenses and ending fund balance
- how well an employee is performing his or her job.

In fiscal year 2002, MERC's PFP program covered 88 employees, whose salaries ranged from \$26,400 to \$116,600, excluding the General Manager. PFP employee awards (including salaries and bonuses) totaled nearly \$4,358,000.<sup>3</sup> These amounts exclude employer-paid benefits, such as retirement contributions or health insurance contributions.

An August 2003 Metro Council resolution established performance goals and measures for Metro's Chief Operating Officer (COO) for FY 2004, including completing a compensation and classification study and implementing a performance-oriented pay program. The information in our three reports will aid the COO and Metro Council in evaluating such matters.

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<sup>1</sup> MERC is both a seven-member citizen commission and the organization that operates the facilities under the Commission's direction. MERC provides stewardship and management of the Oregon Convention Center, the Portland Center for the Performing Arts and the Portland Metropolitan Exposition Center. In this report, we use the acronym "MERC" to refer to the organization that operates the facilities and the term "Commission" to refer to the governing board.

<sup>2</sup> Trend analysis is a statistical method used to adjust salary ranges to keep pace with the local labor market, usually conducted every year. Classification and compensation studies are surveys of other employers to determine comparability of compensation paid for particular positions, usually conducted about every five years. For simplicity, we refer to these studies in this report as compensation studies.

<sup>3</sup> This figure includes the salary of the MERC General Manager. We included his salary in our figures because his and PFP employees' salary were adjusted based on the same compensation study.

## **MERC'S PFP Program Implementation Is Not a Model For Metro**

The PFP concept is basically sound and has been successfully applied within the private and public sectors. MERC's employee compensation program has three main limitations that affect its usefulness as a potential approach for performance-based compensation programs in other Metro units:

- The program does not have clear ties linking all pay decisions with how well individual performance contributes to accomplishing organizational objectives. MERC management decided not to establish a set of organizational goals that would link directly to performance goals of its PFP program. To a degree, the program's design also works against such linkage because many salary adjustments are tied to other factors, such as pay comparability and availability of funds, common elements in traditional government compensation programs, but not to performance.
- MERC did not build accountability mechanisms into the program – that is, ways to plainly demonstrate what the program was designed to accomplish and to evaluate what it is accomplishing. MERC did not distinctly define the need for the program or develop a system to measure and report program accomplishments. As a result, MERC management does not have an objective basis to report the program's effects, performance and costs, and the Commission has no basis for holding management accountable for achieving program-specific results. Also, the Metro Council and others do not have objective information to assist in determining whether the program has applicability elsewhere in Metro.
- The program has apparently had little impact on enhancing organizational performance. In the absence of accountability mechanisms, we tried to make such assessments on the basis of ad hoc measures, such as MERC's financial performance, customer satisfaction, recruitment and retention, injury accident rates and employee attitudes. The information we developed is inconclusive but shows little measurable difference in these indicators before and since the program began. Relatedly, several evaluations of employee attitudes performed by MERC's human resources consultants indicated that many employees have a high level of dissatisfaction with the program.

## Program Pay Outs Have Limited Links to Employee and Organizational Performance

PFP programs recognize the importance of linking employee performance and the long-term mission and success of the organization. In a PFP program, employees' goals and objectives are usually derived from department goals and objectives, which in turn support the mission and goals of the organization. In this way, the program allows the organization to determine how effective individual employees are in achieving specific short- and long-term objectives, and it enables oversight bodies (such as the MERC Commission or the Metro Council) to evaluate how effective the program is in achieving defined organizational goals and objectives. Establishing such links to organizational missions is also important in that it helps establish a clear purpose for the evaluation of individual performance.

MERC's PFP salary increases and bonuses have limited links to employee and organizational performance. Employees' performance is not consistently aligned with MERC goals, and some pay decisions are not tied to performance or the PFP program. Also, MERC's program is evolving into a total bonus program.

### **Employee performance is not consistently aligned with MERC's goals**

We hired a compensation program expert to review the overall adequacy of MERC's PFP program employee performance agreements for FY 2003. We reported separately on the detailed results of that work.<sup>4</sup> One of the expert's findings was that 68 percent of MERC's employee goal statements were only partially aligned with MERC's goals and strategies.

A PFP program's employee performance management system should be linked to the organization's mission and goals, and employees should understand how their individual job fits into the overall mission of the organization. PFP standards essentially state that an organization's mission and goals should be included in employee performance plans by incorporating objectives, goals, program plans, work plans, or by other similar means that account for organizational results.

### **Some pay decisions are not tied to performance or the PFP program**

The performance links in MERC's program have been compromised because individual salary increases based on recommended and adopted salary range changes have been intermingled with pay for performance increases.

**Compensation Study and PFP Program.** Conducting a compensation study is a routine practice and a sound standard procedure because it

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<sup>4</sup> *MERC Employee Performance Agreements Need Improvement*, October 2003

assists organizations to arrive at salary range decisions in part based on obtaining comparable data on an organization's jobs relative to other same or similar jobs in the labor market. In 2002, MERC hired a consultant to conduct a compensation study for positions covered by the PFP. Based upon this July 2002 study, MERC adjusted its salary ranges and provided immediate base pay adjustments for most PFP program employees. Moreover, management and the Commission decided that the salary increases would be applied retroactively in the form of immediate salary increases.

Based on the study, MERC directly increased the salaries of 49 of the 88 employees in its PFP program. The increases were made retroactively and split over a 2-year period and totaled \$165,911 for FY 2002 and \$138,474 for FY 2003, exclusive of fringe increases tied to salary (such as Social Security, retirement and medical benefits that would add about 40 percent to those dollars). For FY 2002 these PFP awards represented 37 percent of total salary increases for PFP employees.

In discussions about these salary hikes, MERC's General Manager stated that he does not consider them to be part of the PFP program, and maintained that these increases would be necessary whether MERC had its current PFP program or a system like Metro's, even though we did not find that either MERC or Metro has previously made these type of immediate salary increases.

Further, MERC's actions to make salary increases based on the compensation studies also appear inconsistent with MERC's 2002 personnel policies that state:

- All MERC full-time non-represented employees are to be compensated in accordance with the Commission's PFP program and the Commission must approve pay plans for these employees. The policy states that the PFP program is intended to compensate employees based on their job performance and contribution to MERC.
- The purpose of the classification plan is to provide an inventory of specifications for each classification. The policy also indicates that those employees earning less than the minimum for their range will receive salary adjustments to bring them to the minimum for their range.

MERC's General Manager referenced MERC's PFP program as one that is meant to be very different from what he views as a "typical government entitlement pay program." If this is the intent, then salary increases based primarily on an employee simply being in a job position

would be inappropriate. In our research we found that a primary intent of a PFP program is to change and eliminate the “entitlement” concept in pay and replace it with a focus on managing and making pay decisions based on “performance”. MERC’s actions are inconsistent with this concept.

While compensation studies in themselves are a legitimate part of many pay systems, MERC’s use of the July 2002 study to make immediate salary increases separate from PFP is troubling for several reasons:

- MERC provided no support for the justification often cited by compensation experts for including or establishing an exception that might result in some individual adjustments in pay separate from the PFP – recruitment and retention, experienced employees are leaving because they can make more money elsewhere, and potential employees are choosing not to join the organization for the same reason. Further, MERC managers told us and statistical data confirms that they were not having problems recruiting and retaining competent employees.
- The increases are fully inconsistent with other MERC and Metro compensation policies and practices wherein no other employees receive retroactive increases based on a compensation study. For example, MERC does not adjust the pay of employees in union- or association-represented positions based on compensation studies, and Metro does not directly increase the salaries of either represented or non-represented employees based on compensation studies.
- Adjusting pay based on compensation studies is not good personnel policy or PFP program cost management because it results in paying people more than is necessary to recruit or retain them. In addition, the procedure costs more because employees receive immediate salary increases that would otherwise be earned, rather than handed-out, over a period of time through performance-based pay adjustments.
- Over relying on market data to control base pay is an established reason for potential PFP program derailment.

**Metro Council concerns regarding compensation study pay decisions.** In addition to the above-cited concerns that planned salary increases were not consistent with basic PFP principles and established policy, the Metro Council raised significant concerns about other aspects of MERC making salary increases based on the July 2002 compensation study. For example, the Council noted that:

- The compensation study recommended substantially higher pay for some positions without documenting study methodology and comparabilities or the basis for revised/increased salary ranges.

- MERC unilaterally decided to make the adjustments.
- Salary increases appeared particularly questionable because MERC had previously announced financial difficulties and had laid off about 29 employees between July 2001 and February 2002.

Metro Councilors asked for an independent evaluation of the compensation study to better determine its accuracy and reasonableness. However, MERC went ahead and made the across-the-board salary increases over a two-year period.

Some similar issues and concerns raised by the Council in 2002 resurfaced one year later in late July 2003 when MERC gave additional salary increases as the second part of the compensation study implementation. In the more recent case, MERC was again in financial difficulties and in August 2003 announced a \$2.1 million financial shortfall. MERC managers stated that one way to deal with the situation would be to lay off about 20 employees, even though it had two weeks previously made retroactive salary increases to eligible PFP employees of \$138,474 (exclusive of related fringe benefits) as the second part implementation of the compensation study. PFP employees' awards, including salaries, bonuses and compensation study adjustments, have increased to \$4.9 million from \$4.2 million between 2002 and 2003. As such pay increases were made, MERC's financial situation declined by a similar degree (see Chart 2 on page 14). In summary, MERC PFP employees received immediate salary increases on two occasions over a two-year period only by virtue of their being in a PFP position. Individual and organizational performance was not relevant to the increases, even though non-PFP MERC and Metro employees are excluded from having such automatic increases.

**Other compensation decisions contrary to existing policies.** MERC made other compensation decisions that were contrary to its existing policies. These decisions included:

- making pay adjustments during probationary periods
- making salary increases higher than policy allowed
- awarding vacation allowances in excess of MERC's policies.

These are discussed in more detail in the report regarding the MERC accountability process.<sup>5</sup>

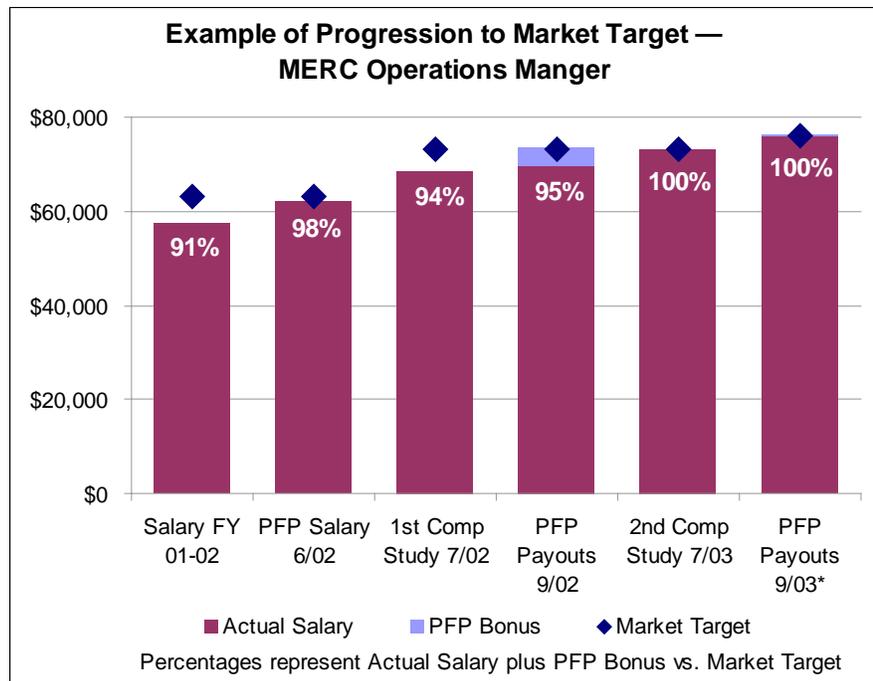
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<sup>5</sup> *MERC's Accountability Processes Need to Be Strengthened*, October 2003

**MERC's program is evolving to a total bonus program**

Another effect of the immediate compensation study salary increases over two years, coupled with the “regular” PFP increases, is the movement of about 75 percent of PFP employees to between 95 and 100 percent of their respective market targets established at the “midpoint” of the salary range. This means that MERC’s original concept of its program no longer applies. That program provided an opportunity to reward employees with a combination of base salary increases up to no more than his or her position’s market target plus a potential yearly bonus for employees earning between their market target and the end of the salary range. If the study had not been implemented in the manner previously describe, employees could have had “room to continue to grow” through performance within their position’s salary range up to the market target. Now eligible program employees’ salaries are essentially “pushed” fully against the market target, and the program has become essentially a bonus program without any or extremely limited potential for base salary adjustments. The following chart illustrates how a MERC Operations Manager progressed to 100 percent of new market target in two years.

**Chart 1**



## Accountability Processes Not Built In

Our review of literature related to PFP programs and our discussions with PFP and human resources professionals indicated that if organizations wish to move aggressively in the direction of pay for performance, they need a clear set of accountability processes, beginning with a sound business case for making the change and turning this sound business case into a set of indicators that can be used to measure the program's effect on organizational goals. MERC's system does not have these elements.

### **Program purpose not clearly defined**

PFP best practices and prudent management principles require that a compelling business reason be established before a new program, such as PFP, involving a fundamental culture shift is implemented. Modern PFP programs are radical departures from "traditional" government pay programs where salary rates are based largely on tenure and seniority. Such reengineering requires indisputable reasons for change and a management structure that clearly establishes well-articulated program goals and objectives, sound administration policies and procedures, and definitive performance measurements to assure the changes are positive and meet stated objectives. Generally, reengineering authorities claim a 60 to 70 percent failure rate among such reengineering efforts, primarily citing the lack of a very compelling business reason to exist, lack of management commitment and support, inability to obtain the "buy-in" (level of acceptance) and support of employees among the reasons for the high failure rate.

After discussions with MERC managers and review of MERC PFP documentation, we were not able to identify or determine MERC's compelling need for the program. Management provided varying and somewhat inconsistent reasons for why the program was established. MERC did not conduct a study to determine whether a new compensation system was needed to enable the organization to better achieve its mission. MERC's General Manager told us the decision to install the program was strictly a policy decision, made by MERC's senior management team and approved by the Commission, and that there was no need to base the decision on precisely defined needs of an objective study.<sup>6</sup>

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<sup>6</sup> The General Manager stated that when MERC hired a consultant to assist with creating and implementing the PFP program, he relied on the consultant's expertise and advice in determining if a PFP system was appropriate and, if so, what kind of system it should be. He further stated that, in hindsight, the consultant provided a "one size fits all" PFP program that does not seem right for MERC. In reviewing the consultant's work, we found no mention of the consultant or MERC addressing the compelling business need for the program, or that MERC had asked the consultant to make such a determination.

The General Manager stated that he and the MERC Commission wanted to institute a program that emphasized MERC's status as an entrepreneurial organization that depends on market success for at least 70 percent of its revenues. He said he and the Commission also wanted to hold MERC employees and facility managers to a higher level of accountability. While these may be commendable purposes, they do not constitute a compelling business need for the program. We found no evidence documenting either that employees were not being responsible or accountable under the former program, or that MERC would be better able to accomplish these goals through the new PFP program. It is possible that such goals could have been accomplished through a Merit/COLA pay system that put proper emphasis on supervisor-employee communication, agreements on work objectives, performance review and overall enhanced supervision.

MERC management is pleased with its PFP program and believes it provides the flexibility to reward high performers and hold employees more accountable. These reasons may be sufficient for management to justify the program to itself, but according to the literature we reviewed and the experts we interviewed they are not recognized as sufficient to require a substantially different compensation program. For example, the same purposes, such as rewarding employees and assuring more accountability, could be met under a well-managed merit pay system where meaningful supervision and evaluation are exercised. Thus, if Metro wanted to move in the direction of implementing an approach to tie or link pay to performance, it would appear important to go further than MERC has gone in building a business case and a program that communicates the need for the change and its purpose.

**System not in place to measure what the organization achieves with PFP**

A second aspect of accountability is measuring how the effort actually impacts on the organization's performance. Performance measures may address the type or level of program activities conducted (process), the direct products and services delivered by a program (outputs), and/or the results of those products and services (outcomes). Performance measurement, because of its ongoing nature, can serve as an early warning system to management and as a vehicle for improving accountability to the public. Such an evaluation, with proper baseline data, assesses the extent to which a program is operating as it was intended. It typically assesses program activities' conformance to statutory and regulatory requirements, program design and professional standards or customers' clearly defined expectations.

MERC does not have a system to measure the program's effect on organizational performance. Fundamentally, MERC has a performance-oriented compensation program that does not measure program performance. The program does not have clearly defined goals,

objectives and performance measures and a baseline against which to compare the program's results with the former system. Metro's HR Department helped develop the initial program stages and proposed some performance indicators to measure the program's impact but MERC management did not create a system to track the costs, performance and impact of the program organizationally on such indicators.<sup>7</sup>

Some of the recommended indicators are cited as employee goals within a number of employee performance agreements. However, MERC has not linked how or whether the organization has performed on such indicators to its PFP program because MERC management decided not to adopt such indicators. The General Manager said these indicators were only suggestions and that appropriate performance measures had evolved with the program. However, he did not identify what these measures are, and we found no measures of the program's organizational performance in the documents MERC provided. By way of comparison, the General Manager stated that Metro does not measure the impact of its "traditional" government compensation program, so there is no reason why MERC should measure the impact of its PFP program. These views do not consider that this was a new program within the Metro organization and that policy makers have an interest in determining whether MERC's program has applicability to other parts of Metro. Performance measures can help in this regard.

MERC's PFP program approach does not reflect a model that would meet Metro's needs for greater measurement and accountability, as reaffirmed by the Metro Council President in his inaugural speech in January 2003. Also, Metro recognizes the importance of measuring program performance and has established such measures for its various programs. For example, a recent Metro report on the results of Metro's urban growth management policies quotes Osbourne and Gaebler's *Reinventing Government* as follows:<sup>8</sup>

- If you don't measure results, you can't tell success from failure.
- If you can't see success, you can't reward it.
- If you can't see failure, you can't correct it.

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<sup>7</sup> The consultant recommended tracking such indicators of program accomplishment as increased profit per customer, decreased total subsidy as a percent of budget, cost savings at facilities, increased customer satisfaction, improved revenue to expense ratio, new revenues, improved equal employment opportunity and affirmative action.

<sup>8</sup> Excerpt from Metro's March 2003 report: *The Portland region: How are we doing?* Metro's urban growth management policies were condensed into eight fundamental values to focus the scope of performance effort and reporting. This report is a snapshot of how the Portland region is doing in relation to Metro's growth management goals.

## Program Apparently Not Resulting In Better Organizational Performance

Our analysis of available information showed that MERC's program has had little if any impact on MERC's financial performance, employee recruitment-retention, customer satisfaction or other potential indicators. In addition, the program has apparently produced considerable employee dissatisfaction.

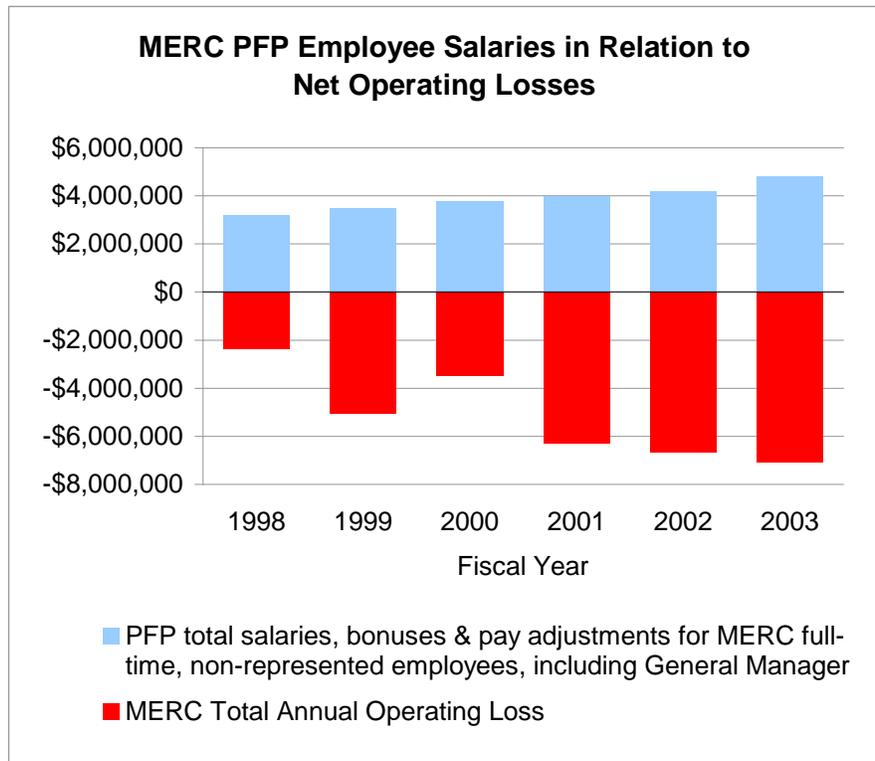
MERC's assessment of program impact found little in the way of documented positive results. In 2001, MERC hired a consultant to determine whether the program had impacted MERC's effectiveness in several areas, such as recruiting and retaining employees, lowering employee injuries, or improving MERC's financial indicators. The consultant looked at timeframes before and after the program was implemented to try to determine program impacts. We discussed this work with the consultant, who told us that there was no conclusive data to show that the program had made any difference in MERC's performance.

### **Financial and other indicators show generally negative or marginal results**

To get some idea on our own about program results, we elected to compile available information relating to some common indicators of performance, including financial performance, relative payroll costs, frequency of on-the-job injuries, turnover and retention rates, and customer satisfaction. These indicators do not show strong results. For example, the program does not appear to have resulted in better financial performance. For the three fiscal years prior to the program's installation in 1999, MERC's net operating losses varied from \$517,000 to \$2.4 million. In the years following 1999, MERC's net operating losses have been higher than in the earlier years, varying from \$3.5 to \$7.1 million. Our analysis of payroll costs, frequency of on-the-job injuries, turnover and retention rates, and customer satisfaction also did not show documented or significant improvements since the new program was installed.

The following chart shows the relationship of PFP program employee salaries, bonuses and compensation study increases to total MERC financial performance (net operating revenue) for FY 1996 through FY 2003.

**Chart 2**



**Employee recruiting and retention data shows little change**

We found a lack of clear results regarding recruitment and retention indicators, as summarized in the following table. MERC's PFP program began in mid FY 1999 and there appears to be little difference in these indicators before and after PFP inception, although resignations and terminations appear higher after PFP. Also, time needed to recruit employees has increased subsequent to the introduction of PFP. Given the poor economic environment, one would expect recruitment time to decrease exclusive of PFP.

**Table 1**

	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Resignations	8	5	9	8	10	6	8
Involuntary Terminations	0	2	0	2	7 (3 layoffs)	7 (5 layoffs)	5 (3 layoffs)
Total Recruitments	Not Avail.	Not Avail.	62	37	32	40	39
Recruitments Filled	Not Avail.	Not Avail.	57	36	28	40	34

Recruitment time (months to fill position)	Not Avail.	Not Avail.	2.3	2.17	2.6	2.5	2.7
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**Injury claims data links to PFP inconclusive**

We found a lack of clear results regarding on-the-job injuries at MERC, as summarized in the following table. Although there appears to be some difference in these indicators before and after PFP inception, we could not determine a causal relationship. For example, MERC may have intensified its safety program before, during or after PFP. MERC also may have created more awareness of safety as part of its employee performance agreement processes.

**Table 2**

	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Injury Claims for F/T, Non-Reps	2	5	3	2	3	1	1
Amount	\$552	\$1,444	\$6,101	\$908	\$424	\$525	\$540
Injury Claims for all employees	41	36	21	17	29	25	14
Amount (in 1,000s)	\$312	\$84	\$36	\$46	\$53	\$232	\$9
Total Claims	43	41	24	19	32	26	15

**Customer satisfaction data inconclusive**

We found a lack of clear results regarding customer satisfaction. We asked MERC for customer satisfaction statistics from 1996 forward. However, MERC did not start doing satisfaction ratings until 1999. MERC provided statistics that they could easily gather, but without pre-PFP baseline data there is no way to determine a potential link to the program.

**Program cost saving claims not well founded**

MERC management has on various occasions told the Commission, Metro Council, and us that its new program costs 10 to 20 percent less than would be the case under Metro's existing compensation system. If true, this could be a reason for the Metro Council to consider establishing a MERC-like PFP program throughout Metro, although PFP programs are typically not designed to save funds and may cost more. After examining available evidence, MERC's assertion is not well founded because:

- There is nothing intrinsic in MERC's or Metro's compensation approach that results in one of them costing more or less than the other. Employee compensation costs under each system are driven primarily by policy and management budget decisions related to the availability of funds and other factors.
- Saving money in compensation costs is not a recognized reason for

embarking on a PFP program. In fact, effective PFP programs anticipate that PFP costs may be higher than before in order to hire

and pay more qualified people or to reward for the desired performance.

- A Metro Financial Planning Division study that MERC management cites to support its assertion does not compare MERC's costs with Metro's system. Instead, the study compares MERC's PFP costs with a hypothetical MERC step system that is not the same as Metro's merit/COLA pay system. The author of the Metro study told us that the study could not be used as a basis to conclude that MERC's PFP program is less costly than Metro's system and that MERC's program is possibly more expensive in the long run.
- In response to our requests for data to support the assertion, MERC's Director of Administration produced two hypothetical analyses, both of which contain flawed assumptions and other weaknesses. For example, the analyses did not consider the impact of bonuses and did not consider long-term impact.
- Finally, the MERC General manager's more recent assertions contradict what he told the Commission in September 1999, nine months after program implementation. At that time, the General manager told the Commission that after comparing MERC's PFP costs to a Metro compensation plan, MERC's PFP program would be about 5 percent more expensive than Metro's plan.

MERC management's assertions regarding cost savings in relation to Metro's pay system are not well founded. Such assertions can mislead policy makers and others into believing that there is something intrinsic in MERC's program that can save money on employee compensation. We found no support that would indicate that MERC's assertion is correct.

**Program employees dissatisfied**

Employee "buy-in" in a PFP program is critical for program success. A culture of cooperation by all participants is needed because no compensation program, particularly a complex undertaking such as PFP, can work in an environment that is skeptical. PFP programs should not be used when the level of trust between employees and managers is low or marginal. However, the results of three MERC PFP employee surveys conducted since the new program was instituted in January 1999 demonstrate a high level of employee dissatisfaction with the program.<sup>9</sup> For example:

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<sup>9</sup> At the request of MERC management we did not interview PFP program employees. Management agreed that the problems noted in the three employee surveys are representative of current employee views.

- In September 1999 a MERC consultant found that 31 percent were dissatisfied or very dissatisfied with MERC's PFP program for various reasons (18 percent were satisfied or very satisfied and the rest were neutral). About 90 percent of the general comments about the program were negative.
- In August 2001 a MERC consultant found that 73 percent of participants were not satisfied with MERC's PFP program and felt that it did not provide more motivation than the previous program.
- In March 2002 a MERC consultant interviewed 85 MERC PFP program employees and found as follows: "Only 6 to 8 staff members considered the plan OK as is, and all others expressed strong criticism of several elements of the plan as currently structured". They voiced concerns that the program is unfair to middle and lower level positions, is not rewarding staff for positive performance and is producing inconsistent and unfair employee ratings and rewards.

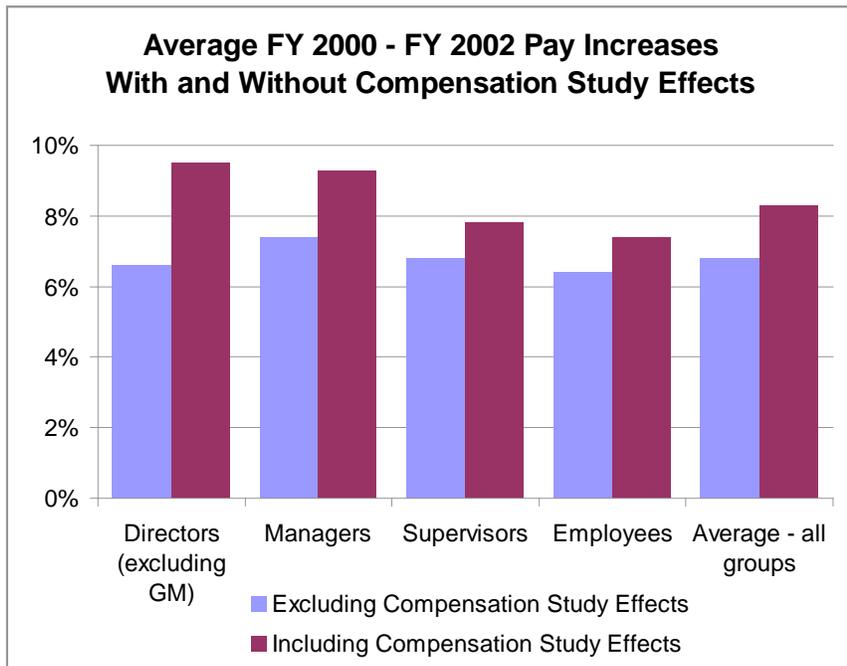
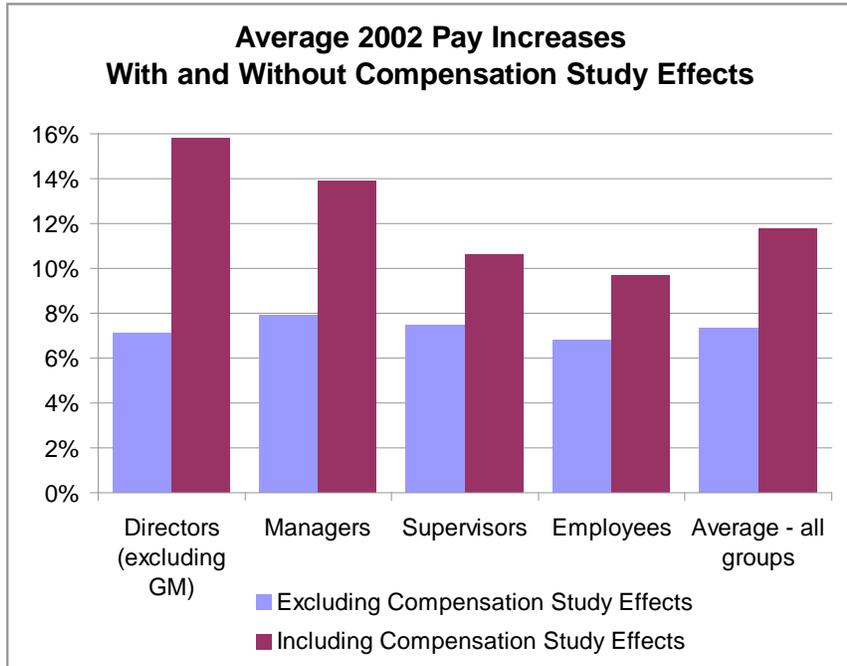
MERC management has presented a different picture to the Commission of employee acceptance and support for the program. At a MERC Commission briefing we sat in on in July 2002, MERC's HR Director and a consultant told the Commission that although some relatively minor issues existed with the program, these issues were being addressed and overall the program was well accepted and working as expected. Also, in interviews with us, three Commissioners said they thought MERC employees were generally satisfied with the program, with one estimating that at least 70 percent of the employees are well satisfied. This picture is inconsistent with the three employee surveys that evidence a high level of employee dissatisfaction.

At the MERC General Manager's request we did not personally interview MERC's program employees. However, based on the results of the three surveys, we attempted to gain some insight into one area of employee concerns that was expressed in each of the three surveys – equity of pay. To do this, we analyzed the distribution of PFP awards over the three-year period of FY 2000 through FY 2002, as summarized in Charts 3 and 4. We found that:

- Excluding adjustments based on the July 2002 compensation study, PFP awards on a percentage basis appear to be distributed about evenly between groups in the program (directors, managers, supervisors, employees).
- Including the impact of the compensation study, however, directors and managers clearly benefited in relation to supervisors and employees. We do not have a basis for concluding whether these

differences are reasonable or equitable. However, a more transparent PFP program that more fully disclosed pay decisions would help mitigate employee concerns on such matters.

**Charts 3 and 4**



Employee dissatisfaction with the program can have various effects. Of

course, dissatisfied employees can resign their positions and leave the organization. However, employee turnover can also be expensive. Another ramification is employees' taking alternative action, such as joining a labor union. This effect was realized at MERC when program issues created such dissatisfaction for MERC's security personnel that they joined the International Longshore and Warehouse Union. According to a union representative, the full-time security personnel felt demeaned under the program and had received scant PFP increases at their relatively low levels within the organization while the higher ups received what they viewed as windfalls. MERC initially offered them a 0.4 percent pay hike but under union negotiations they were able to get raises between 2.4 and 14.1 percent for the nine full-time security employees, plus shift differential and a \$750 yearly bonus. The employees' actions and subsequent results appear to be an expensive solution to issues they had with the program.

**Other potential indicators have little data**

Finally, we found little data to indicate the level of success on a variety of other potential indicators. The following table summarizes 15 indicators cited either by MERC officials or in MERC documents as to what MERC might expect from the PFP program. MERC does not have pre-PFP program baseline data to track the program's organizational performance. However, for each indicator we made a determination regarding the degree to which some objectives have been realized, based on data we gathered and analyzed.

**Table 3**

Reasons for program <sup>10</sup>	Outcome
Holding employees and managers more accountable*	Met
Establishing an intensive employee evaluation system*	Met
Increasing net revenues	Not met
Improved ability to attract/retain employees*	Not met
Tying MERC financial success to performance awards	Not met
More affordability/ability to compensate	No data to determine
Ensuring competitiveness with marketplace*	No data to determine
Better customer service*	No data to determine
Better maintenance of facilities*	No data to determine
Greater fiscal responsibility through cost effectiveness*	No data to determine
Improved ability to fulfill public mission*	No data to determine
Reversing "longevity" pay plan that was too expensive	No data to determine
Better meeting of community needs*	No data to determine

<sup>10</sup> The reasons come from sources such as the General Manager's briefings to the Metro Council and Commission prior to program implementation, Metro and MERC resolutions and MERC HR consultants.

Greater achievement of MERC goals*	No data to determine
Better employee development*	No data to determine

\* According to the HR expert we hired, this type of objective can also be attained through well-designed non-PFP compensation systems that include effective supervision and oversight.

## Background

### Summary of MERC's PFP Program

MERC manages three regional facilities – the Oregon Convention Center, the Portland Metropolitan Exposition Center and the Portland Center for the Performing Arts. Together, these three facilities and MERC's Administration Department have about 180 full-time equivalent employees, ranging from managers and events coordinators to custodial and security staffs. The Metro Council in 1997 empowered the Commission to operate these facilities in a cost-effective, independent, entrepreneurial and accountable manner. This empowerment included authority for MERC to adopt its own personnel rules, including compensation policies. Under this authority, MERC established a new compensation program for about 90 employees in January 1999. Employees covered by this program were in full-time positions that were not represented by unions or other associations. Their job titles included facility director, ticketing/parking manager, event coordinator and administrative secretary, among others.

MERC's new program differs substantially from the traditional approach used in most governmental settings, including the rest of MERC and Metro. Under the traditional approach, pay for each job carries a series of "step" increases. Employees receive a "step" or "merit" increase after completing a period of time on the job, usually one to three years, and reach the "top step" of their position after satisfactorily performing on the job for some years, depending on the organization. In this way, their pay goes up as they acquire seniority in their positions. In most years, all of the "step" levels are also adjusted upward to reflect cost-of-living (COLA) increases that are roughly equivalent to the change in the Consumer Price Index. Thus, the "traditional" Merit/COLA government approach tends to provide predictable, relatively fixed increases that are tied heavily to the length of time an employee has been in the position and continuing performance at a given level. MERC's program has neither the traditional "merit" increases nor traditional COLA increases. Under the MERC program, employee pay increases can vary substantially, and are based on management's judgment of employee job performance, facility performance and compensation studies.

#### **Evolution of MERC's program**

MERC hired an HR/PFP consultant to design the program. MERC's General Manager did not like the consultant's design because it was viewed as "one size fits all", although it is the design that was initially implemented and is to some degree still in effect. Some of the problems with the original plan were that:

- individual performance measures were too broad
- performance rankings for MERC as a whole needed to be more consistent
- more meaningful goals and objectives were needed
- more training for managers and supervisors was needed.

MERC has attempted to improve the program. According to MERC documents and our discussions with Metro and MERC HR officials, MERC has:

- streamlined the evaluation process by changing the six-month review from written to verbal
- redesigned some forms to be more user-friendly
- formed a PFP Advisory Committee comprised of representatives from all facilities and worked with the Committee to develop new performance measures for each job
- developed a comprehensive PFP Manual.

**Pay is based on three main factors**

MERC's program, which has been in effect for more than 4 years, bases employees' pay on management's judgment of three primary factors:

- **Salary ranges for comparable jobs in other organizations.** Pay systems, including MERC's, usually make these determinations through two approaches: (1) trend analyses – a statistical method used to adjust salary ranges to keep pace with the local labor market, usually conducted every one or two years; and (2) classification and compensation studies – surveys of other employers to determine comparability of compensation paid for particular positions, usually conducted about every five years. Such adjustments affect the salary ranges within which pay levels are set. MERC's policy is to have a compensation system that is fair, equitable, dependable and one that can easily be maintained through routine trending and classification and compensation studies.
- **The facility's overall performance.** This factor reflects management's judgment of how well each facility has met goals related to such factors as facility condition, customer service and financial performance.
- **How well an employee is doing his or her job.** This factor is the "bottom line" for a PFP program. Unlike "step" increases, which are fixed in amount for everyone with a particular job classification, the size of increases under this factor is determined on an individual basis. Two persons with the same job classification and experience levels might receive markedly different pay adjustments, depending

on how management views their performance. Also unlike merit increases, which are awarded at fixed intervals, these increases are typically made at the end of the fiscal year when employee performance is fully evaluated.

The factors are intertwined, in that the salary ranges established for comparable jobs can have a direct bearing on the amount and type of performance-related pay. In overview, the factors are related as follows:

- **Compensation studies establish salary ranges and a “market target” for maximum permanent pay.** Using trend analyses and compensation studies, MERC assigns each job classification a minimum and maximum salary range that MERC management adjusts, as it deems necessary, to remain competitive with the labor market. The approximate midpoint of the range is known as the “market target.” Employees are able to earn permanent increases to their base pay up to this market target. Employees whose base pay is already at the market target remain eligible for permanent increases in future years as trending and compensation adjustments move the “market target” higher. Based on compensation studies, employees are placed in the same relationship within the new salary range as in the previous range (e.g.: if an employee was at 80 percent of market target before the study, he/she would be placed at 80 percent of the revised market target). Moving employees’ compensation upward in this manner is essentially a “COLA-Plus” and quasi-Step Increase approach to compensation and contrary to true PFP because increases are not performance based.
- **Overall facility performance sets range of employees’ performance pay increases.** Facilities are rated on condition, customer service and financial success. Facilities condition is rated on a four-point scale, evaluating the general physical condition of the facilities, equipment, general maintenance, patron and tenant accommodations, safety, and other factors. MERC evaluators rate such items as parking accommodations, exterior lighting and cleanliness, condition of lobbies and restrooms, medical aid areas, and public address systems. The facility score determines the range and upper limit of PFP awards for all of the facility’s employees in a year. Each employee has a stake in the facility’s overall success because the higher the facility score, the higher the range of potential PFP awards that year.<sup>11</sup>

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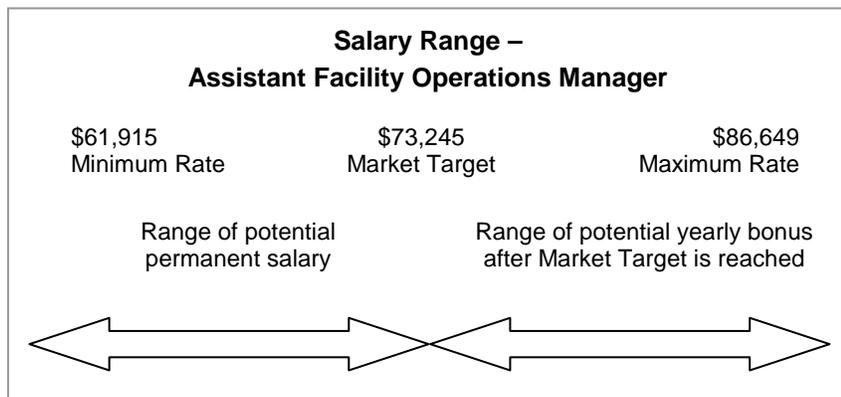
<sup>11</sup> MERC’s Administration Division has 14 PFP employees whose PFP awards are based on the combined average performance of the three facilities as well as on individual performance.

- Individual performance increases are permanent pay adjustments for employees below the “market target” of their range and bonuses for those already at the “market target.”** Once a facility’s score is determined, the size and nature of individual performance adjustments can be determined. For employees not yet at the “market target,” such adjustments can take the form of an increase to that level. Employees whose salary is at the “market target” are not eligible to receive permanent pay increases, but they are eligible for an annual bonus not to exceed 12 percent of base pay in any performance year, up to the maximum of the salary range. The yearly bonus is not added to base pay and must be re-earned each year.

**Pay program structure**

The workings of the system can perhaps be better understood through an example for a specific MERC job position. The following chart exemplifies the pay-related components of the program for a facility operations manager in 2002. In this example, the salary range minimum is \$61,915 and the “market target” (on average, the amount that the job is paid in the labor market) is \$73,245. MERC’s program does not provide base pay above the market target but it offers the potential of a lump sum bonus in an amount between market target and maximum rate.

**Chart 5**



The amount and type of the facility operations manager’s performance pay increase or performance bonus is based on the facility’s performance rating and the manager’s individual performance score. An employee’s individual score is determined by how well he or she meets the expectations established in individual performance agreements. The following table shows the minimum and maximum increases that can be earned. For example, a manager whose facility received a score a 4 (the highest) and who was rated as consistently exceeding goals and objectives would be eligible for an amount equal to 12 percent of base pay. To the extent the manager’s pay was below the “market target,” he

or she could receive this amount as a permanent pay adjustment. Any amount that would have the effect of raising permanent pay above the “market target” would be awarded as a one-time bonus.

**Table 4**  
**MERC PFP Formula**

Employee’s Performance Rating	Range of performance pay or bonus (% of base pay)
Consistently exceeds goals and objectives	8 – 12%
Meets and occasionally exceeds goals and objectives	4 – 7%
Meets some key goals and objectives but improvement is required to attain expected level of performance	2 - 3%
Consistently fails to meet goals and objectives, and improvement is required to attain expected levels of performance	0 – 1%

MERC’s program uses employee agreements to define performance expectations and foster better communications between employees and supervisors. Under these agreements, employees and supervisors jointly establish a written set of goals and objectives at the start of an appraisal period. Employee performance and progress is measured against these agreements at least twice each year – mid-year and year-end, at which time PFP decisions are made. MERC’s standards call for establishing employee goals and objectives that are clear, specific, measurable, achievable, time certain, organizationally aligned and limited in number. These agreements also serve as basic documentation for performance-based rewards. We discuss our assessment of MERC’s employee performance agreements in a separate report.<sup>12</sup>

In FY 2002, MERC’s PFP program covered 88 employees, whose salaries ranged from \$26,400 to \$116,600, excluding the General Manager. PFP awards (including salaries and bonuses) totaled nearly \$4,358,000.<sup>13</sup> These amounts do not include benefits, such as employer-paid retirement contributions or employer-paid health insurance contributions. That same year, MERC’s total budget (excluding ending fund balance and contingency) was about \$81 million. Program awards thus accounted for about 5.4 percent of MERC’s expenditures. The total pay for PFP program employees in 2002 was an increase of about 11.32 percent from the previous year, an increase that combines the results of compensation study adjustments and pay for performance increases.

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<sup>12</sup> *MERC Employee Performance Agreements Need Improvement*, October 2003

<sup>13</sup> This figure includes the salary of the MERC General Manager. We included his salary in our figures because his and PFP employees’ salary were adjusted based on the same compensation study.

**Organizational responsibilities**

The Commission designated MERC's General Manager as the administrator of the program. MERC's Human Resources Director acts for the General Manager in providing day-to-day administration of the program. MERC management also has a review committee that meets regularly to discuss PFP program issues. In addition, Metro's Human Resources Department is responsible for performing human relations-related functions for MERC, such as preparing job announcements, posting and advertising open positions, maintaining and developing salary range data, maintaining personnel files, and processing personnel action approvals (e.g. cost of living increases, classification and/or compensation actions, promotions, new hires, etc.).

## Audit Objectives, Scope and Methodology

This is one of three reports resulting from our review of MERC's performance-related compensation program. We conducted our work for several reasons. One was to determine what lessons MERC's program might have for future efforts within Metro to move to a compensation system based more heavily on performance and achievement of organizational goals. As a cutting-edge public organization, Metro continues to examine its pay system to determine if changes to a performance-based "total compensation" system would help the agency better meet its goals. Because MERC's PFP program represented the most ambitious change thus far to Metro's traditional Merit/COLA compensation system, another reason for conducting this review was to analyze the program and offer recommendations as to how MERC might be able to improve it. Finally, we reviewed the program to examine any implications for management control by the Commission and by Metro.

This report focuses on the applicability of MERC's specific approach to other potential efforts within Metro, and on potential improvements that relate specifically to that effort. The two other reports focus on:

- how MERC can improve its employee performance agreements<sup>14</sup>
- the Metro-Commission relationship and issues related to MERC's governance and accountability.<sup>15</sup>

Since the program's inception, MERC management has considered it to be a PFP program and has represented it as such. As a result, we conducted much of our work from the perspective of the PFP principles outlined in Appendix B: clear links between organizational objectives and employee performance and pay, valid measures on which to base performance assessments, and effective management control. Thus, our work included such steps as assessing:

- the links between organizational goals and the standards used to evaluate employee performance
- the business purpose set forth for the program when it was established
- the extent to which MERC established a way to gauge program effectiveness against defined measures
- the reasonableness and administration of MERC's PFP policies and procedures

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<sup>14</sup> *MERC Employee Performance Agreements Need Improvement*, October 2003

<sup>15</sup> *MERC's Accountability Processes Need to Be Strengthened*, October 2003

- the adequacy of MERC's management control system for measuring, reporting and monitoring the program's effectiveness.

In conducting our work, we obtained information from many Metro and MERC officials; reviewed pertinent plans, documents and guidance related to the program; and conducted detailed reviews of performance evaluations and pay decisions. The documents we reviewed included several studies of aspects of the program by consultants MERC had used to help establish and evaluate its program. To provide important expertise and perspective, we also hired a human resources expert with extensive experience in compensation programs, including pay for performance approaches. Our expert's work focused mainly on MERC's employee performance agreements.

The standards and criteria we used during the audit consisted primarily of the following:

- Metro and MERC resolutions, ordinances and policy statements and other standards regarding PFP, compensation and personnel management
- widely-accepted best practices relating to HR management and PFP programs
- widely-recognized elements of what constitutes a PFP program
- management control standards as developed for the Committee of Sponsoring Organizations (COSO) of the Treadway Commission and published in 1994.<sup>16</sup> The COSO Report, "Internal Control – Integrated Framework", establishes a definitive framework against which public and private organizations can assess and improve their internal control systems. COSO Report concepts have been incorporated into professional standards in the United States, including the Government Audit Standards issued by the United States General Accounting Office (GAO) that the Metro Auditor is required to abide by. In response to recent corporate fraud, the Sarbanes-Oxley Act requires publicly traded companies to have a COSO-like control framework in place.

During our review, in an attempt to work as cooperatively as possible with MERC management, we agreed to limit our work in certain ways and to structure some aspects of the work in ways that MERC's General Manager preferred. For example:

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<sup>16</sup> COSO is a voluntary private sector organization dedicated to improving the quality of financial reporting through business ethics, effective internal controls and corporate governance. COSO was originally formed in 1985 to sponsor the National Commission on Fraudulent Financial Reporting, an independent private sector initiative that studied the causal factors that can lead to fraudulent financial reporting and developed recommendations for public companies and their independent auditors, for the SEC and other regulators, and for educational institutions.

- At the General Manager's request, we did not personally interview MERC employees being evaluated under the new program to obtain their views about how the program was operating. The basis for this request was that consultants and others had already interviewed these employees, adequately covering this ground on three previous occasions. He told us that the results of those studies were still valid and we therefore elected instead to use the reports and studies compiled by the consultants and others who had done the previous interviews. We cite the findings of these reports and studies in relevant sections of this report.
- At the General Manager's request, we agreed to provide our audit questions in writing via e-mail and received written responses to them. Audit work normally involves a great deal of face-to-face interviews, often with questions supplied beforehand. The General Manager said that receiving written questions would give MERC greater opportunity to fully understand the questions and consider the answer, and written correspondence would provide better documentation of what was communicated. In hindsight, this approach proved to have significant limitations, in that MERC's written answers were often not sufficiently responsive for audit purposes, requiring considerable follow-up.

We began our in-depth work for this review in August 2002. Our expert's review of MERC's employee performance management agreements began in October 2002 and concluded in February 2003, at which time we prepared a draft report on that issue. At the request of MERC management, we agreed to postpone the completion and issuance of the report on the expert's work until drafts of the other reports had also been completed. We performed additional work on MERC's overall pay system between March and June 2003. We performed our work in accordance with generally accepted government auditing standards.

## Appendix A

### Best Practices for Planning a PFP Program

The following information may be helpful to the Council and COO in considering a move to a performance-oriented compensation system.

Governments are finding out that pay-for-performance is an idea that can break down, and implementing it requires a careful design and constant attention. The traditional system thrived on being easy and objective; performance pay relies on a web of subjective judgments about how employees are doing. Middle managers tend to dislike it because these tough decisions fall on them. Employees who are used to sure-thing raises and are not used to being numerically assessed can find it an unwelcome culture shock. One compensation expert noted that many organizations expect a miracle. They put in the time and effort to make it work, yet they don't understand that it is not as simple as making up an evaluation form, training some managers, and away you go.

There are a number of structural difficulties with performance pay that can easily make it internally disruptive. Some governments in recent years have gotten fed up with the near-constant friction PFP can produce and turned back to more traditional pay models. Meanwhile, others are starting to move away from systems that reward individual performance to less controversial ones that reward group or team efforts. Yet, many government personnel officials are satisfied with performance pay, and while they recognize its shortcomings, they say critics have not offered much in the way of alternatives. They believe it worth the trouble to have the system sending the right signal: that hard work – and good work – pays.

#### **Best practices for planning a PFP program**

Successful PFP Program planning defines a set of goals/objectives for the program and measures against them, using the following criteria:

1. Good initial design – PFP must be designed with the final, desired outcome clearly in mind. Outcomes should be monitored and reported – and answer the question: what difference does PFP make? PFP Program planning should demonstrate that:
  - The program reflects a clear statement of what is to be accomplished, i.e. establish a compelling business purpose.
  - PFP goals and objectives are measurable, realistic and support mission and values.
  - PFP effectiveness data can be readily collected and tabulated. After implementation, continual monitoring of plan progress lets

you know whether the plan is working and if it is properly designed.

- PFP rewards are consistently and equitably applied.
  - PFP's intended outcomes and expectations can be or are being realized.
2. Program measurement must justify the existence of the PFP Program and show how it contributes to organizational objectives and goals. PFP Program evaluation should:
- Be conducted annually.
  - Be simple to administer and report.
  - Contain a uniform report format to display organizational results, including between and within departments.
  - Report results to stakeholders. Possible matters to report on:
    - o Performance evaluation compliance – frequency, timeliness; completeness of evaluation.
    - o Dispute resolution effectiveness – number of disputes by type of dispute; time to resolve; number of disputes sustained.
    - o Employee performance – number of employees in the different performance categories with a breakdown of the needs improvement category.
    - o Employee commitment – results of employee experience survey; retention rate, etc.
    - o Report of awards – total dollars allocated for award; dollars awarded at each performance level.
    - o Administration cost – training, etc.
    - o Costs/benefits vs. previous program should be evaluated.
    - o Stakeholder experience – surveys of executives, managers, supervisors, and employees, measuring key aspects of their experience with the PFP Program, addressing such issues as:
      - participants understanding of the different aspects of PFP
      - perceptions of equity issues
      - trust in management
      - availability and quality of PFP training
      - adequate performance management to do the job and achieve goals

- dispute resolution effectiveness, fairness and timeliness
- likelihood of resigning employment due to performance management or PFP issues
- determining that PFP helps make the organization an employer of choice.

**Five conditions for PFP program success**

1. Clear program objectives – in order for any pay program to succeed, management must have a clear idea as to what objectives are to be attained.
2. Valid employee performance measures – must meet four technical criteria: (a) they must be job-related; (b) they must focus on significant aspects of performance; (c) they must be measurable yielding objective counts of performance; and (d) they must produce true results.
3. Controllability – employees must be able to directly bring about the desired outcome.
4. Valid appraisal system – performance appraisal is a pivotal part of merit pay, and so it is vital that the supervisor be trained to be technically competent as well as professionally responsible in fulfilling the supervisor role under PFP. (The literature on merit pay is filled with horror stories about incompetent and insecure supervisors inflicting pain on employees and using the process for personal gain.)
5. A culture of cooperation – no compensation program, particularly a complex undertaking such as PFP, can work in an environment that is distrustful.

**Factors working against PFP programs**

Pay for Performance programs should not be used when:

1. The level of trust between employees and managers is low or marginal.
2. A worker's job performance is difficult to measure.
3. Large pay rewards cannot be given to the best workers. Small pay rewards are not very powerful motivators because workers quickly get used to them.
4. Managers and supervisors are not adequately trained.
5. There is a lack of good performance appraisals and objective job evaluations.
6. There is an inability to pay (i.e., public sector organizations that do not have control over their own purse strings).

7. There is not an open pay policy – secrecy surrounds individual salaries.
8. Employees do not attach a very high value to pay.
9. Employees do not believe that good performance leads to high pay.
10. Employees do not believe that their performance evaluation reflects their efforts.

## Appendix B

### Pay for Performance Principles

Our review of literature related to PFP and discussions with PFP and human resources officials showed that true PFP programs are characterized by certain elements, including:

- **A compelling business need.** The organization needs well-reasoned and precisely defined goals in moving to PFP. There must be a credible purpose that will benefit the organization. The justification for PFP should be clearly articulated, acted upon and its performance should be measured against pre-stated standards to assure that the undeniable need is met. Among others, some matters that should be clearly defined include the business strategy, operational and employee requirements, the desired culture, the organization's ability to pay and the ability to evaluate the organizational effects of the program.
- **Clear links between an organization's objectives, employee performance and pay.** PFP programs recognize the importance of relating employees' work performance to the long-term mission of the organization. In a PFP environment, the goals and objectives on which employees are evaluated derive from their department goals and objectives, which in turn support the mission and goals of the entire organization. Employees are compensated based on how well they and the organization achieve their goals.
- **Valid individual and organizational measures of performance.** Employee performance management is the systematic process by which an organization involves its employees in improving organizational effectiveness. For performance to be evaluated meaningfully, employers and supervisors need to implement an evaluation program that include employee measures that are specific, measurable, achievable, time certain, organizationally aligned and limited in number. Similarly, organizational measures of performance, such as financial improvements and customer satisfaction levels, should be evaluated against a pre-PFP baseline to determine program effectiveness and areas needing mid-course corrections.
- **Effective management control.** Management control comprises the plans, methods, and procedures used to meet missions, goals and objectives. PFP programs are basically established to better assure that the performance and pay of individual employees is resulting in organizational objectives being achieved. An effective reporting system is needed so that management, such as the Metro Council and

MERC Commission, can have a ready means to determine if this link is present.

At the same time that PFP programs share these characteristics, they also show considerable variety. PFP can be applied to many levels within an organization, from executives to plant operators. Depending on the level of sophistication of processes and activities within the organization, different PFP approaches may be appropriate.



**METRO**

October 14, 2003

Alexis Dow, Metro Auditor  
600 NE Grand Avenue  
Portland, OR 97232

Dear Auditor Dow:

This letter is the Chief Operating Officer's response to the September 30, 2003 draft audit of the MERC Pay for Performance program. The draft audit has been published in three parts titled: 1) MERC Employee Performance Agreements Need Improvement, 2) MERC's PFP Program Implementation is not a Model For Metro and 3) MERC's Accountability Processes Need to be Strengthened. It is my understanding that the MERC Chair will comment on the first part and your expectation is that the Chief Operating Officer (COO) of Metro comment on the second and third parts as listed above.

This is the first significant audit report that this COO has commented on so let me begin by saying how important I believe the Metro Auditor is to the efficient and effective operations of Metro. Metro is a relatively new experiment in governance and to have a well functioning auditing office and a productive relationship between the Metro Auditor and the management of the agency can only lend credibility to all aspects of what we do here at Metro.

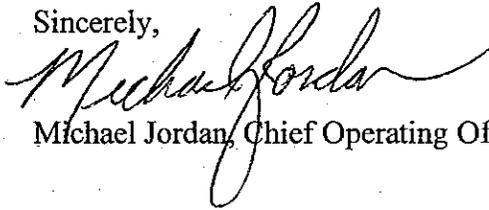
While Metro is operating under a new structure that only this year created the office of COO, it is not without a policy and legislative history that has created relationships and delegated authority in a manner that represents the desires of elected policy makers. Therefore, I feel it is inappropriate for me to comment on the properly delegated authority to the MERC and its management by the Metro Council. Further, the two parts of the audit draft that appear to be advice to the Metro Council on pay for performance are difficult for me to comment on at this time because the discussion of linking compensation to performance for Metro is in such a preliminary phase that it is impossible to determine how valuable such advice is to that discussion.

Linking compensation to performance for individuals or work groups in the public sector for general government type services is a difficult exercise, at best. I am certain that as the Metro Council proceeds with its discussion and study of this issue that it will draw on many sources for advice and comparison, including the experiences at MERC and the recommendations of your audit. Specifically, I am certain that the Council will find that

the data on Pay-for-Performance you have gathered and organized to be extremely valuable. Further, your recommendations suggest thought processes that I am sure the Council will go through when Metro considers how we will more closely link compensation to performance.

Let me reiterate my statement about how important the auditing function is here at Metro and state my commitment to work with you to enhance Metro's current reputation as a world-class organization.

Sincerely,

A handwritten signature in cursive script that reads "Michael Jordan". The signature is fluid and extends to the right.

Michael Jordan, Chief Operating Officer

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