

**METRO**

**Metropolitan Exposition-Recreation Commission**

***MERC Employee Performance Agreements  
Need Improvement***

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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:

In January 1999, MERC instituted a performance oriented compensation system (Pay for Performance 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 its operations, to assess accountability mechanisms and to evaluate the program's potential applicability elsewhere within Metro.

This report focuses on MERC's employee performance agreements - the pivotal tool for any PFP program.

Audit findings show that the employee agreements do not adequately meet MERC's own criteria, such as being easily understood, to the point and within the employees' control.

Training from a professional with successful PFP experience can help improve employee agreements. However, the training needs to go further to address employee misgivings about the program. MERC's previous reviews by outside consultants found that most MERC employees have significant misgivings about the PFP program.

The written response of MERC is at the end of the report.

Very truly yours,

A handwritten signature in black ink, appearing to read "Alexis Dow". The signature is fluid and cursive, written over a light grey rectangular background.

Alexis Dow, CPA  
Metro Auditor

Auditor: Joe Gibbons

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## Executive Summary

The Metropolitan Exposition-Recreation Commission (MERC) 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 MERC's employee performance agreements.

Employee performance agreements are the pivotal tool for any PFP program. Performance agreements spell out the criteria under which employees will be evaluated and upon which they will receive any performance-based adjustment to their pay. MERC's standards call for these criteria to be clear, specific, measurable, achievable, time certain, organizationally aligned and limited in number. Because these agreements are considered to be the "heart" of the program and because this aspect of PFP may be of interest to Metro as it considers moving toward a performance-based compensation system, we hired a human resources expert with extensive expertise in establishing and evaluating compensation systems to assess MERC's employee performance agreements.

Our expert's assessment showed that MERC's employee agreements are unnecessarily complex, confusing and generally did not adequately meet MERC's own criteria, in that:

- 68% were not directly aligned to MERC's goals and strategies

- 81% were not easily understood and linked with a finite result(s)
- 68% were not to the point
- 70% contained multiple criteria or vague outcomes
- 50% did not seem to be within control of employees
- 71% did not include timeframes or referred to uncertain timeframes.

All agreements listed the desired number (3 to 5) of goal statements.

Three key factors contribute to the unnecessary complexity and resulting confusion:

- The program evaluates individuals on goals that are not specific and clear.
- The program uses four levels of performance for evaluating each of the goals, rather than a simpler approach of measuring each goal against a 4-point generic scale.
- The program identifies and measures behaviors that are not central to the evaluation process.

Previous reviews by consultants hired by MERC have found that that most MERC employees have significant misgivings about the program. The findings of these other consultants are relevant because positive attitudes are key to improving performance agreements. Moreover, successful PFP programs cannot work in an environment that is distrustful. Training can help improve MERC's employee performance agreements, but the training needs to go further to address employee misgivings about the system.

Our conclusions and recommendations for improving these aspects of the program follow.

## Conclusions and Recommendations

Elements of a performance-based compensation program, such as employee performance agreements, must be easily understood and transparent to ensure program integrity, credibility and long-term acceptance. MERC's employee performance agreements do not meet these criteria. The deficiencies our expert noted, together with the available evidence of employee dissatisfaction, indicate that changes are needed.

To their credit, MERC managers realize that its four-year old PFP program has some problems and they have tried to make improvements along the way. For example, the MERC Human Resources (HR) Director has established a PFP working group of about five managers and supervisors who meet about every two weeks to discuss PFP-related issues. However, the results of our work indicate that more significant improvements are needed if the overall employee performance management program is to be an effective part of MERC's performance-oriented employee compensation program.

We recommend that MERC make its employee performance agreements more consistent with its criteria by making the program simpler for managers and employees to understand and use. We recommend three steps:

1. **Simplify and focus employee performance agreement goal statements.** Continue to use 4 (or even 3) goal statements and limit them to 35 words or less. Use several behavioral factors (e.g. customer service, initiative, flexibility, planning) to rate performance against a three or four-point generic scale. For example, set a standard, such as:

*90 percent of all final and complete event settlements are submitted to Sales & Event Manager with zero errors within three days post event.*

Then rate performance (of work products and behaviors) in accordance with the four point criteria currently in place by simply asking: Does the employee's performance:

- consistently exceed this standard (demonstrated performance exceeds MERC's high standard and targets on a consistent basis throughout the year)?
- fully meet this standard (demonstrated performance consistently meets and occasionally exceeds MERC's high standards at target or expected levels)?
- somewhat meet this standard (demonstrated performance meets minimum requirements though may require occasional coaching and/or assistance to develop the skills required to perform at expected levels)?
- not meet this standard (does he/she not meet the minimum level of MERC standards and expectations)?

2. **Establish further training on employee performance agreements.** Training should emphasize why performance appraisals are a critical aspect of MERC success and how they are to be prepared. Performance management training for managers, supervisors and employees should be different because:
  - Managers need to focus on meeting organizational goals within the context of their respective business units and on how to coach supervisors toward achievement of goals.
  - Supervisors need to concentrate on a combination of processes (timing, forms), translating organizational needs

into components of individual jobs and interacting with employees (coaching on process and performance).

- Employees need to concentrate on how their individual job performance fits into the goals for their work group and how the work group fits into meeting the performance of their division and the objectives of MERC overall. Employee training could be structured to include a segment with supervisors and result in the completion of draft agreements.

Training for each group should be done in conjunction with further emphasizing and communicating organizational goals for the upcoming year and stating how those translate to each work group within MERC. Doing this would increase the probability for improved understanding of employee performance management throughout MERC.

3. **Have an independent HR consultant review employee performance agreements at the beginning of the next evaluation cycle.** Require that the consultant be well versed on MERC's standards that agreements need to be specific, measurable, etc. To enhance program credibility and lessen potential for employee/supervisor misunderstanding, have the consultant look for and resolve issues where agreements are not consistent with the criteria.

## Introduction

The Metropolitan Exposition-Recreation Commission (MERC),<sup>1</sup> a unit of Metro, 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 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 MERC's employee performance agreements.<sup>2</sup>

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 plus other

factors. MERC's program bases employee pay on three primary factors:

- The results of classification and compensation studies and salary trending studies.<sup>3</sup> These studies determine the salary range and amount of increase, if any, for which an employee may be eligible.
- MERC facilities' performance as measured by condition, customer service, operating revenues/expenses and ending fund balance.
- How well an employee is performing in his or her job.

In fiscal year 2002, MERC's PFP program covered 88 employees, whose salaries ranged from \$26,400 to \$116,600, not including the General Manager's salary. PFP employee payouts (including salaries and bonuses) totaled nearly \$4,358,000<sup>4</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. The total pay for PFP program employees was an increase of about 11.32 percent from the previous year.

<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> MERC refers to these documents as "Goals/Objectives/Expected Results" forms. As part of its PFP program, MERC requires that all PFP employees have performance goals and objectives that are documented on this form in which the goals and objectives are developed jointly by the supervisor/manager and employee. For simplicity, we refer to these documents as "Employee Performance Agreements" in this report.

<sup>3</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>4</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 employee compensation program is described more fully in the section titled "Overview of MERC's Compensation Program".

### **Role of employee performance agreements**

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. These agreements also serve as basic documentation for performance-based rewards. MERC's standards call for establishing employee goals and objectives that are: clear, specific, measurable, achievable, time certain, organizationally aligned and limited in number.

Employee performance agreements are one part of an employee performance management system, which in turn is a key element of a credible performance-based employee compensation program. Employee performance management has five interrelated elements, as follows:

- Planning work and setting expectations – creating performance agreements that set performance expectations and goals to channel employee efforts toward achieving organizational objectives.
- Continually monitoring performance – using performance agreements to consistently measure performance and provide ongoing feedback to employees on their progress toward reaching their goals.
- Developing the capacity to perform – increasing the skill level to execute through training, giving assignments that introduce

new skills or higher levels of responsibility, improving work processes, or other methods.

- Periodically rating performance – evaluating employee performance against the elements and standards in an employee's performance agreement and assigning a summary rating of record.
- Rewarding good performance – recognizing employees, individually and as members of groups, for their performance and acknowledging their contributions to the agency's mission, goals and objectives.

## Employee Agreements Can Be Improved

Under a PFP program, the employee performance agreement is a vital tool for making the performance management system work effectively. Our expert's assessment showed that many MERC employee performance agreements did not adequately meet the standards MERC established for them. MERC's standards call for agreements to be clear, specific, measurable, achievable, time certain, organizationally aligned and limited in number. Our expert, after evaluating performance agreements for 84 employees in the program, found that the agreements were generally not easily understood, not measurable, or otherwise not consistent with the standards, as follows:

- **Organizational Alignment** – 68% were not directly aligned to MERC's goals and strategies.
- **Clear** – 81% of the performance agreements were not easily understood and linked with a finite result(s).
- **Specific** – 68% were not to the point.
- **Measurable** – 70% contained multiple criteria or vague outcomes.
- **Achievable** – 50% did not seem to be within control of employees.
- **Time certain** – 71% did not include timeframes or referred to uncertain timeframes.
- **Limited** – All agreements listed the desired number (3 to 5) of goal statements.

The following pages present a more detailed description of our expert's assessment of how MERC's employee performance agreements measure against MERC's employee performance management criteria and describe opportunities for MERC to improve its employee performance management program. The

assessment covers each of the seven MERC standards listed in the bullets above. Under each, specific examples are provided about the types of improvements that can be made.

The deficiencies discussed here are a reflection of current program implementation, not the capability or intent of the employees and supervisors trying to implement the program. They are an indication that the program needs to be simpler, clearer and better understood if it is to more effectively meet MERC objectives. An independent HR consultant can help remedy many of these shortcomings through enhanced training, more emphasis on precise agreements, and additional review and consultation with added emphasis and expertise in developing such agreements.

### Assessment regarding alignment of agreements with MERC’s goals

Sixty-eight percent of employee performance agreements were not directly aligned to MERC’s goals and strategies. As an example, one of MERC’s strategic goals is to “Maintain its facilities in premier condition.” One aspect of this is delineated in a facility’s goals as “Complete and successfully open the expanded center”. It logically follows that whatever is needed to open the expansion would be related to the overall goal. So the following example appears to be credible and related to MERC’s mission, although its intent seems to go awry. This provides an example from a MERC employee performance agreement, explains why it is not consistent with MERC’s standards and suggests an improved approach.

MERC Performance Statement and Measure	Problem With MERC Statement	Consultant’s Approach
<p><b>Goal:</b> Organization Skills: Accurately files and organizes construction documents, drawings and assignments that allows for quick references and can be found by others. Organizes calendar to meet all deadlines and attends required appointments.</p> <p><b>Consistently Exceeds:</b> Maintains personal calendar so as to meet all deadlines and attend all required appointments. Develops procedures for, organizes, and maintains filing systems for drawings, construction documents, electronic photos, etc. so that others can retrieve a required item 100% of the time.</p> <p><b>Fully Meets:</b> Maintains personal calendar so as to meet most deadlines the first time, and attend required appointments at least 95% of the time. Develops procedures for, organizes, and maintains filing systems for drawings, construction documents, electronic photos, etc. so that others can retrieve a required item 95% of the time.</p> <p><b>Somewhat Meets:</b> Maintains personal calendar so as to meet most deadlines the first time, and attend required appointments at least 90% of the time. Develops procedures for, organizes, and maintains filing systems for drawings, construction documents, electronic photos, etc. so that others can retrieve a required item 90% of the time, but which must be improved for the betterment of the Team.</p> <p><b>Fails to Meet:</b> Does not track or organize issues.</p>	<p>The personal organization skills of this employee are not directly related to the strategic goal of the organization. Rather, the standard should focus on how well the employee accomplishes the MERC objective of completing the expansion project.</p>	<p>A better way to simply state the desired outcome of work would be:</p> <p><i>Ensures that abc are retrievable by (date) so that xyz can be accomplished in order to meet (xyz) organizational goal</i></p> <p>Our intent here is to write a standard that reflects that the employee meets deadlines and that the items he/she is responsible for organizing are organized in a way that has a measurable and meaningful outcome that is directly linked to MERC’s strategic plan.</p>

As noted above, one of MERC’s strategic goals is to “Maintain its facilities in premier condition.” One aspect of maintaining facilities in premier condition is assuring that property grounds are in good condition. Accordingly, a grounds maintenance program would likely be a mechanism to systematically manage and ensure premier condition. The following example seems credible and related to MERC’s mission, but its goal statement is not related to a facility goal.

<b>MERC Performance Statement and Measure</b>	<b>Problem With MERC Statement</b>	<b>Consultant’s Approach</b>
<p><b>Goal 4:</b> Develop grounds maintenance program and appropriate checklists to monitor work &amp; results. Acquire a Pesticide Applicators License.</p> <p><b>Consistently Exceeds:</b> Grounds maintenance program developed &amp; checklist implemented, report consisting of status, projects done &amp; pending projects turned in weekly to Ops Mgr., acquired pesticide applicators license.</p> <p><b>Fully Meets:</b> Grounds maintenance program developed &amp; checklist implemented and weekly report s turned in to Ops Mgr effective 7/1/02, classes attended as needed to acquire pesticide applicators license.</p> <p><b>Somewhat Meets:</b> Grounds maintenance program developed &amp; checklist finished and work has started on grounds maintenance, steps taken to acquire pesticide applicators license.</p> <p><b>Fails to Meet:</b> Does not develop grounds maintenance program and does not show efforts to acquire a pesticide applicators license.</p>	<p>The goal is tangential to MERC’s goals and strategies on at least two levels. First, the condition of the facility, specifically the ground, is not directly related to the goals of this facility. Therefore, there is not a clear link between facility and employee objectives. Second, the goals &amp; standards are not necessarily or directly supportive of the primary objective of maintaining facilities in premier condition. Making checklists and submitting reports does not fully define a ‘grounds maintenance program’. Similarly, a pesticide applicator’s license allows a person to apply specific pesticides but it does not ensure that the facilities are maintained in a premier condition.</p> <p>Most of MERC’s non-supervisory employees have goals that relate to their facilities, rather than overall MERC goals. However, this facility does not have a goal about maintaining the facility. Rather, the facility’s goals are marketing, financial stability, construction and community awareness. Like many employees, this one has no big-picture of what the overall MERC goals are, what they mean at the ‘corporate’ level or how he can impact the corporate bottom line. Our intent is simply to note that this facility does not have a stated goal that the employee’s performance is being tied to. Tying employees to stated strategic goals is a more consistent and meaningful way to establish employee agreements.</p>	<p>A more focused, specific <i>and time-certain</i> goal statement that also tracks with the strategic plan may read as follows:</p> <p><i>Submits weekly reports no later than xyz to the Ops Manager. Reports outline the status of planned projects, enumerate problems encountered/resolved and describe accomplishments and unusual situations encountered.</i></p>

## Assessment regarding clarity of agreements and linkage with results

Eighty-one percent of performance agreements were not easily understood or linked with defined results. When relationships are good and funds for performance pay readily available, broadly written agreements may pass for good performance criteria. However when either the relationship or availability of cash incentives wears thin, such statements may not be clear enough to provide the support needed to either withhold pay or address challenges. Employee performance agreements need to be written and clearly understood by all parties that one’s pay increase is directly and unambiguously related to the amount and quality of work being performed above the baseline job. Without such clarity, MERC’s employee performance agreements may be viewed as subjective and potentially biased. The following provides an example from a MERC employee performance agreement, explains why it is not consistent with MERC’s standards and suggests an improved approach.

MERC performance statement and measures	Problem with MERC statement	Consultant’s approach
<p><b>Goal:</b> To reliably coordinate event set-ups and custodial needs.</p> <ul style="list-style-type: none"> <li>• <b>Consistently Exceeds:</b> Shows initiative to actively research, facilitate and implement approved suggestions within budget and on time.</li> <li>• <b>Fully Meets:</b> Event critiques contain less than two valid complaints about event set-ups and coverage per quarter; Scheduling is always responsive to the budgetary concerns of the department and covers event special needs; Scheduled set-ups completed at least two hours prior to the event with attention to detail; Participate in weekly meeting with supervisor and provide feedback to improve efficiency of department.</li> <li>• <b>Somewhat Meets:</b> 75% of the above performance standards are met; No major safety or security problems noted; Scheduled set-ups usually completed prior to an event.</li> <li>• <b>Fails to Meet:</b> Less than 75% of above performance standards are met; significant valid complaints, oversights and schedule problems.</li> </ul>	<p>The criteria regarding initiative to “actively research, facilitate and implement approved suggestions” are unclear. An employee would not know what “actively research or facilitate a suggestion” means and, more importantly, how it can be measured. Unanswered questions:</p> <ol style="list-style-type: none"> <li>1. What measures “reliably”?</li> <li>2. How does “initiative” relate to number of complaints, scheduling or safety deficiencies?</li> <li>3. How would MERC prove or disprove employee performance with these vague criteria?</li> </ol> <p>It would be difficult to provide clear answers to these questions and without clear answers there is excess room for interpretation and differences of opinion at rating time.</p>	<p>Clearer agreements facilitate better communication between employees and supervisors, provide better focus on performance, enhance the understanding of the performance evaluation process and improve long-term acceptance of PFP. This goal statement would be improved by stating:</p> <p><b>Goal:</b> <i>Reliably coordinate event set-ups and custodial needs by:</i></p> <ol style="list-style-type: none"> <li>1. <i>Completing event set-ups in accordance with event plan standards, at least two hours before scheduled start for each event</i></li> <li>2. <i>Satisfying custodial needs (defined) before, during and after event</i></li> <li>3. <i>Assuring that event critiques reveal variation from these standards no more than two occasions per quarter.</i></li> </ol>

### Assessment regarding specificity of employee performance agreements

Sixty-eight percent of agreements were not to the point. The training materials prepared by MERC’s Buck Consultants in November 1998 state “complex measurement systems only confuse and alienate people”. This is an HR truism of employee performance management. Cumbersome goal statements result in decreased understanding of performance targets and confuse the relationship between employee accomplishments and organizational success. Decreased understanding invariably leads to ambiguities and raises the likelihood of employees questioning links between performance and pay. The following provides an example from a MERC employee performance agreement, explains why it is not consistent with MERC’s standards and suggests an improved approach.

MERC Performance Statement and Measures	Problem With MERC Statement	Consultant’s Approach
<p><b>Goal:</b> To create a new community marketing and public relations position for enhanced exposure in community.</p> <p><b>Consistently Exceeds:</b> (1) Create a database of local community public relations organizations, community groups, and local business by April 15, 2003. (2) Create a calendar of local community events to enhance our presence at by May 1, 2003. (3) Create and implement a minimum of 4 marketing/public relations projects with local community groups to enhance visibility. (4) Begin to network with local/regional media to develop relationships for positive stories on OCC.</p> <p><b>Fully Meets:</b> Auditor note: these statements were essentially the same as above; the primary difference involved later deadlines for the work.</p> <p><b>Somewhat Meets and Fails to Meet:</b> Auditor note: these statements were essentially the same as above, but the primary difference involved later deadlines for the work.</p>	<p>The relevant criteria for satisfying the goal of “a new community marketing and public relations position for enhanced exposure in the community” seems to be implementing public relations projects and networking with the media. However the statement’s focus and specificity is tied to internal administrative activities (database and calendar creation) that are not measurable and meaningful outcomes that satisfy the goal of enhancing MERC’s exposure in the community.</p>	<p>All levels of measurement need to be direct and meaningful. A clearer, more focused statement for the “fully meets” level of performance might be:</p> <ul style="list-style-type: none"> <li>• <i>Create and implement a minimum of 3 marketing/public relations projects by May 30, 2003 to enhance visibility of OCC within local community groups</i></li> <li>• <i>Develop (number of) relationships for positive stories on OCC.</i></li> </ul> <p>This suggestion focuses the desired work performance on the goal of creating a new community marketing and public relations position for enhanced exposure in the community and it is outcome-specific. It also decreases emphasis on internal and administrative work activities.</p>

## Assessment regarding measurability of agreements' criteria and outcomes

Seventy percent of agreements contained multiple criteria or vague outcomes. When performance measures relate to an unexplained scale, they send the mixed message to an employee that x has to be done, but when or how well is not as important. This can lead to employee cynicism and dissatisfaction with the performance management program. Moreover, adding multiple criteria to different levels of performance further complicates the measure and a supervisor/manager's ability to precisely evaluate performance. This in turn can lead to confusion on the part of managers, supervisors and employees. The following provides an example from a MERC employee performance agreement, explains why it is not consistent with MERC's standards and suggests an improved approach.

MERC Performance Statement and Measure	Problem With MERC Statement	Consultant's Approach
<p><b>Goal:</b> Training/Development  <b>Consistently Exceeds:</b> (1) Items developed and operational during evaluation period. (2) Develop training program to incorporate People Soft. (3) Develop procedure for paperless Event Documents. (3) Complete cross training with Sales and Events Departments.  <b>Fully Meets:</b> (1) Some headway on items listed/program still being defined. (2) Develop training program to incorporate People Soft. (3) Develop procedure for paperless Event Documents. (4) Cross training begun but not complete/only complete with one of the disciplines.  <b>Somewhat Meets:</b> (1) Programs not defined. (2) Develop training program to incorporate People Soft. (3) Develop procedure for paperless Event Documents. (4) Cross training begun but not complete/not complete with either discipline.  <b>Fails to Meet:</b> (1) Item seriously worked on. (2) Develop training program to incorporate People Soft. (3) Develop procedure for paperless Event Documents. (4) No cross training takes place.</p>	<p>One way to assess employee performance agreements is to put yourself in the role of a newly-promoted supervisor coming into the process at year-end and trying to evaluate an employee's performance, after his/her original supervisor moved to another position. Are the statements clear enough to define outcomes that can be measured? We doubt that a new supervisor could answer the following important questions on this example:</p> <ul style="list-style-type: none"> <li>• What items are to be developed and operational?</li> <li>• Cross training of whom or what disciplines?</li> <li>• How do I tell if one or more items have been seriously worked on?</li> <li>• If no programs are defined, is the goal of training/development met?</li> <li>• What is 'some headway' (fully meets criteria)?</li> </ul>	<p>A statement that would better meet the training and development goal would be:</p> <ul style="list-style-type: none"> <li>• <i>Develop &amp; implement a training program no later than July 1, 2003 that ensures (unit name) employees are:</i> <ul style="list-style-type: none"> <li>○ <i>Cross trained in x and y</i></li> <li>○ <i>Able to use the paperless Event Document process</i></li> <li>○ <i>Able to (do xyz) with PeopleSoft.</i></li> </ul> </li> </ul>

Another example of a lack of precise measurability is found in performance agreements where the standards state arbitrary “breaking points” between the definitions of success and failure. This is also referred to as ‘sliding measures’ wherein employees use sliding scale dates (task accomplished by x month consistently exceeds standard, x-1 month fully meets standard, etc) or percentages (performance consistently exceed standard when x% is achieved; performance fully meets standard when x-1% is achieved, etc). The following provides an example from a MERC employee performance agreement, explains why it is not consistent with MERC’s standards and suggests an improved approach.

<b>MERC Performance Statement and Measure</b>	<b>Problem With MERC Statement</b>	<b>Consultant’s Approach</b>
<p><b>Goal:</b> Produce accurate and timely event settlements</p> <p><b>Consistently Exceeds:</b> (1) 100% Event settlements are submitted to Event Manager within two working days post event. (2) 100% Event settlements are complete with zero errors. (3) 100% of the time all clients are provided with written cost estimates for events (without being asked). (4) 100% of the time the Event Manager is notified of and approves of any write-offs.</p> <p><b>Fully Meets:</b> Same as above, but with scale of 90%, 90%, 90% and 95% respectively.</p> <p><b>Somewhat Meets:</b> Same as above, but with scale of 80%, 80%, 80% and 85% respectively.</p> <p><b>Fails to Meet:</b> Same as above, but with scale of less than 70%, less than 70%, less than 70%, and less than 75% respectively.</p>	<p>Such agreements do not address important questions, such as:</p> <ul style="list-style-type: none"> <li>• What is the level of performance necessary for organizational success?</li> <li>• Is performance consistently better if the date or percentage is faster or higher than that needed?</li> <li>• If organizational performance is indeed enhanced, how much is it enhanced and is that amount consistent with the amount of money provided the employee for exceeding the required performance level?</li> </ul> <p>The MERC example contains 4 different performance measures, such as:</p> <ul style="list-style-type: none"> <li>• <i>Event settlements are submitted to Event Manager within two working days post event.</i></li> <li>• <i>Event settlements are complete with zero errors.</i></li> </ul> <p>With varying levels of performance:</p> <ul style="list-style-type: none"> <li>• <i>100% performance - Consistently Meets</i></li> <li>• <i>90% performance - Fully Meets</i></li> <li>• <i>80% performance – Somewhat Meets</i></li> <li>• <i>70% performance – Fails to Meet</i></li> </ul> <p>Such statements can confuse employees. Determining overall performance on this goal would be difficult because there are too many measures. The standard becomes further diluted when one of the criteria is not met at a particular level. For example, what would the employee’s final evaluation be if the outcomes are 100% on submitting event settlements (consistently exceeds), 80% on zero errors (somewhat meets), less than 70% on providing written cost estimates (fails to meet) and 90% on obtaining Event Manager approval of write-offs? The evaluation becomes the hazy and subjective judgment of the supervisor/manager since outcomes do not meet any of the exact measures for any one level of performance.</p>	<p>An example of a more precise and meaningful performance standard for the goal of “produce accurate and timely event settlements” might be:</p> <p><i>Accurate and timely event settlements are achieved when event settlements are submitted, without errors, to the Event Manager within two days post event.</i></p> <p>If performance were then evaluated in the context of the original, simpler format using a four-point scale, the measure and the rating would be clearer, more meaningful and measurable.</p>

## Assessment regarding ability to achieve agreement goals

About half of the employees’ performance agreements cited certain goals that did not seem to be within the control of employees. To be achievable, the goal must involve work and accomplishments that the employee can directly control. Generally this requires that the employee be proficient within the activity and that task completion not be dependent upon work, review, approval or implementation of another employee or customer. The following provides an example from a MERC employee performance agreement, explains why it is not consistent with MERC’s standards and suggests an improved approach.

MERC Performance Statement and Measure	Problem With MERC Statement	Consultant’s Approach
<p><b>Goal 1:</b> Increase ratio of operating revenue to operating expense (relevant goals/strategies).</p> <p><b>Goal 2:</b> Develop long-term (financial stability).</p> <p><b>Consistently Exceeds:</b> Ratio is 145% or more.</p> <p><b>Fully Meets:</b> Ratio is 140%.</p> <p><b>Somewhat Meets:</b> Ratio is 135%.</p> <p><b>Fails to Meet:</b> Ratio is 130%.</p>	<p>Managers often stumble on what seem like solid performance goals by using desired bottom-line goals as personal ones. One would think that the manager would have all the competency and authority needed to achieve desired bottom line results. The fallacy is that in an organization of any complexity, one person generally does not single-handedly increase revenue and decrease expense to the point of affecting significant change in financial stability metrics. The question really is: what does this employee actually do that will impact the bottom line?</p>	<p>For management, the course of action planned and executed is important so that the responsibility and recognition is properly placed for either achieving or missing the mark on a desired result. This allows the reviewing manager to meaningfully engage in activities performed to realize a desired result and for both parties to know whether the goal was reached because of, or in spite of, the employee’s effort. A better performance goal for the “increase the ratio of operating revenue to operating expense to 140% or better” statement in this example would be:</p> <p><i>Increase year-end operating revenue to operating expense by (doing xyz) to increase revenue and (xyz) to decrease expense.</i></p>

A significant difference between the statements is that our expert’s approach engages management and commits to participation.

Another common shortfall in this regard is that employees must rely upon the results of customer service surveys as the measure for meeting the goal of internal and external customer service. Some MERC employees’ performance agreements indicated that their performance depended upon receiving no complaints from others or the approval of their supervisor. Such surveys or lack of negative feedback can be good measures of organizational accomplishments but less so of individual accomplishments. In these instances employees give authority or control over their achievements to others as individual customer ratings may or not be an accurate reflection of a particular work product and the ratings (individually or in aggregate) reflect the product of a work group in many cases, not just the employee. This has the effect of displacing individual employee responsibility and accountability for work outcomes. Customer service survey ratings are typically better used as measures for group performance and group incentives rather than for determining the amount of reward for individual contribution.

### Assessment regarding timeframe certainty

Seventy-one percent of performance standards do not refer to a specific timeline. Time-specific goals are important because they bring certitude and clear understanding to an agreement. Unstated or vague timeframes to achieve specific accomplishments greatly diminish an important aspect of employee performance management. The following provides an example from a MERC employee performance agreement, explains why it is not consistent with MERC’s standards and suggests an improved approach.

<b>MERC Performance Statement and Measure</b>	<b>Problem With MERC Statement</b>	<b>Consultant’s Approach</b>
<p><b>Goal:</b> Maintain equipment and report all equipment and bldg. problems.</p> <p><b>Consistently Exceeds:</b> No damage to equipment &amp; bldgs. Repair needs reported to Operations Manager in a timely manner.</p> <p><b>Fully Meets:</b> No damage to equipment or buildings and no more than 3 unreported damages found.</p> <p><b>Somewhat Meets:</b> No damage to equipment or buildings and no more than 4 unreported damages found.</p> <p><b>Fails to Meet:</b> More than 4 unreported damages to equipment or buildings.</p>	<p>Without time certainty, there may be an open question as to when an action item is to be completed. Also, as referenced in the above assessment of measurability, other agreements also reflect sliding measures. This is seen when employees use sliding scale dates, such as task accomplished by x month consistently exceeds standard, x-1 month fully meets standard, and so forth.</p>	<p>Establishing time-certainty could enhance this agreement. For example:</p> <p><i>Repair needs are evaluated on the first Monday of every month and reported to Operations Manager no later than the following Wednesday.</i></p> <p>Also, if performance were then evaluated in the context of the simpler format using a four-point scale, the measure and the rating would be clearer, more meaningful and measurable. For example, when this standard is met:</p> <p><i>100% of the time, the employee consistently meets expectations; 90% of the time, the employee fully meets expectations and so on.</i></p>

The issue of time certainty and relevance also relates to employee performance agreements needing to define why certain dates are more critical than others. The following table cites an example MERC employee performance agreement excerpt, noting why it is not consistent with MERC’s standards on time-related issues and a suggested improved approach.

<b>MERC Performance Statement and Measure</b>	<b>Problem With MERC Statement</b>	<b>Consultant’s Approach</b>
<p><b>Goal:</b> In order to insure the security and operating performance of MERC's IT systems, a site security policy to prevent unauthorized access to MERC's IT system is required. Insure the security and operating performance of MERC's IT systems by establishing standards for IT resource protection (password, access authorization) providing basic rules and guidelines.</p> <p><b>Consistently Exceeds:</b> Develop policy, procedures and rules by the end of January.</p> <p><b>Fully Meets:</b> Develop policy, procedures and rules by the end of February.</p> <p><b>Somewhat Meets:</b> Develop policy, procedures and rules by the end of March.</p> <p><b>Fails to Meet:</b> Policy, procedures and rules are not developed by the end of March.</p>	<p>What is the standard necessary for MERC success? The answer to this question should be the standard to which the employee is held accountable at the ‘fully meets standard’ level of performance. For example, if a policy needs to be implemented by February in order to meet an organizational objective, then later implementation would not meet the standard. However, we should note that earlier implementation may or may not be relevant to achievement of MERC objectives and may be an unnecessary expectation level.</p>	<p>A tighter standard of performance would make clear when the work needs to be done for organizational success and how performance would be measured at that time. In essence the standard would be written around the quality of the work rather than sliding timelines. For example, the ‘fully meets standard’ could be:</p> <p><i>By the end of February 2003:</i></p> <ul style="list-style-type: none"> <li>• <i>An IT security policy that addressed abc standards to prevent unauthorized access to MERC's IT system is developed</i></li> <li>• <i>Standards for IT resource protection (password, access authorization) is established</i></li> <li>• <i>Implementing rules/guidelines issued.</i></li> </ul> <p>The “consistently exceeds” measure could add elements (e.g. briefing those impacted by the policy/guidelines) and the “somewhat meets” measure could relate to drafting policy/guidelines rather than completing the work.</p>

### **Assessment regarding number of performance goals**

All 84 agreements listed four performance goals, in accordance with the desired number of 3 to 5 statements. MERC's performance-based compensation program specifies that employee performance agreements should be 3 to 5 performance goals for each employee. The number of goals is reasonable in that it allows for a range of individual targets but not too many so as to be overwhelming. Considering the relatively low complexity of MERC's basic mission, four or perhaps three goal statements are sufficient.

## Employee Concerns About Performance Management

At the request of MERC management, our expert's work did not include discussing the performance agreement program first-hand with MERC employees. However, three MERC-initiated employee surveys about its program show that most employees do not like or have little faith in MERC's PFP processes, including the relevance and accuracy of employee performance agreements. This point is relevant because attitudes are an important part of the ability to improve overall performance management. Moreover, successful PFP programs cannot work in an environment that is distrustful. For this reason, we need to briefly discuss this issue here.

### Participants express dissatisfaction with the performance agreement process

Most MERC employees in the PFP program expressed significant misgivings about the program. Starting when the program was about one year old and in following years, MERC consultants polled managers, supervisors and employees on three occasions to gauge how program participants viewed and accepted the program. The results of these surveys were generally disappointing as the majority of participants question various aspects of the program.

Essentially, the program had about a 28 percent acceptance level among participants. For example, a May 2001 survey found that for non-supervisory employees:

- only 27% were satisfied with the PFP program
- only 26% believed they are more motivated under the new program
- only 24% felt their performance had increased under the new program.

The survey also showed that supervisors/managers had similar concerns:

- none of the MERC supervisors believed their employees are satisfied with the PFP program
- only 20% felt that employee training on the program is effective
- most felt that their employees do not understand the program
- 73% felt that the program had not improved employee performance.

Comments made by program participants reflect a wide range of concerns related to the program's acceptance. For example, the following quotes by managers/supervisors are illustrative:

- "There are still questions about rating... Inconsistency throughout the organization causes dissatisfaction. The employees I supervise have not had the training or the training was inadequate. They do not participate in goal setting. Some have unreasonable expectations; believe that everything they do is a 4."
- "I feel that training on the mechanics of the PFP program was adequate. There is other training that is needed in how to deal with employees that have a problem with the PFP: Training on coaching, how to guide staff through change and teamwork."

The following quotes are from employees:

- "Performance evaluations are too subjective to the manager's opinion. Past feelings can prevent fair assessment of an employee's true performance."
- "The performance program is interpreted differently by departments and appears unfair... Criterion established is

arbitrary and at times has not reflected the responsibility of my position. I do not control items I have been judged on.”

- “It’s too biased...”

Another manager/employee survey about the program in March 2002 found that of over 85 interviews only about 6 to 8 participants considered the program suitable as is; all others expressed strong criticism of several elements of the program. One of the specific issues raised during the survey was that the program was producing inconsistent and unfair employee ratings and rewards.

We discussed the results of these surveys with the MERC consultants who performed them. We also discussed the matter with our HR expert, but did so only after work on our contract had been completed so as not to bias the results of the expert’s work. All three consultants felt that participants should have accepted MERC’s new program to a much higher degree, especially considering the time that it had been implemented. The common thread in their views on this related to the need for MERC to establish and implement a regular training program on pay-for-performance issues that are directly aligned with organizational goals.

Constant and consistent PFP training is an essential element for program success. However, MERC’s PFP-related training appeared to have been limited in that only two training sessions had been held since program implementation in January 1999. The first training session was in January 2001 where a MERC HR consultant worked with managers and supervisors to address issues raised in the consultant’s previous survey about attitudes and problems related to PFP implementation. The second training session was in October 2001 where a MERC HR consultant held a

similar session with managers and supervisors to address issues raised in a consultant’s survey about PFP implementation issues.

## Background

### Audit objective, 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. Another reason for conducting this review was to analyze the program and offer recommendations for MERC to improve it. MERC's PFP program represented the most ambitious change thus far to Metro's traditional Merit/COLA compensation system. Finally, we reviewed the program to examine any implications for management control by the Commission and by Metro.

This report focuses on how MERC can improve employee performance agreements. The two other reports focus on:

- the applicability of MERC's performance-oriented program to Metro's compensation program efforts<sup>5</sup>
- the Metro-Commission relationship and issues related to MERC's governance and accountability.<sup>6</sup>

This report's findings and recommendations apply to MERC's current program, but they also offer a framework for Metro to consider in planning and implementing any compensation program using employee agreements. In this regard, an August 2003 Metro resolution established performance goals and measures for Metro's Chief Operating Officer (COO) for FY 2004. The COO's goals included completing a compensation and classification study and implementing a performance-oriented pay program. The information in our three reports addresses these issues and will aid the COO and Metro Council in evaluating such matters.

Much of the evaluation for this report was done with the help and expertise of a human resources expert with extensive experience in developing and analyzing employee performance agreements. The expert, from HROhana Corp., has over 20 years of human resources management experience with expertise in compensation, organizational design, change facilitation, performance management and systems design. The expert, currently the compensation manager for King County, Washington, also served as compensation manager for the City of Portland and Ventura County, California, among others. We contracted with the expert to do the following with regard to MERC's performance agreements:

- Review MERC's employee performance agreements prepared for its full-time, non-represented employees to determine employees responsibilities.
- Determine the extent to which the employee performance agreements met the standards MERC established for these agreements – namely, that the agreements contain employee goals and objectives that are clear, specific, measurable, achievable, time certain, organizationally aligned and limited in number.

<sup>5</sup> *MERC'S PFP Program Implementation Is Not a Model For Metro*, October 2003

<sup>6</sup> *MERC's Accountability Processes Need to Be Strengthened*, October 2003

- Evaluate MERC's employee performance management program to determine how well performance agreements fit with MERC's new performance-based culture.
- Submit findings in writing so they could be incorporated into a report.

Our expert's work included the following:

- Reviewing MERC's Strategic Plan to gauge MERC's direction and environment.
- Reviewing MERC's compensation program policy statements, program guidelines and training materials to determine MERC's criteria for employee performance management issues.
- Assessing 84<sup>7</sup> employee performance agreements that documented individual employee goals/objectives, evaluating clarity, completeness and conformance with program guidelines and consistency with MERC's criteria.
- Reviewing and assessing best practices information on PFP programs in the public sector and the use of employee performance criteria in employee performance management programs.
- Evaluating current implementation of the employee performance management aspect of MERC's compensation program. Our expert did this by assessing MERC's employee performance agreements with MERC's criteria, HR best practices and the expert's prior experience in creating and managing employee performance management programs.

- Developing relevant recommendations for employee performance management improvement based on professional opinion of current program implementation as compared to MERC and related human resources standards.

MERC's Strategic Plan provides a reference for understanding MERC mission, goals and objectives (strategies) as well as the major elements of organizational performance for MERC and each of its facilities. The strategic plan's goal and objective statements were often cited in especially broad terms. Our expert used MERC's strategic plan to evaluate whether individual employee agreements are directly aligned with organizational goals.

At the request of MERC management, we did not interview PFP program employees. However, MERC management agreed that the results of three surveys they had used consultants to conduct accurately reflected the views of program participants. Accordingly, we relied on these surveys to assess participant views and discussed the results of these surveys with the MERC HR consultants who performed them. We also discussed the survey results and participant views with our HR expert, but did so only after our expert had completed her work for us so as not to bias the results of her work.

We began our in-depth work for the three reviews 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

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<sup>7</sup> The Auditor's Office originally estimated that the expert's review would include 88 employees that MERC reported as being in the PFP Program as of July 2002. However, 84 agreements were reviewed because of confusion between the original paper copies and electronic copies of forms submitted later. The difference in planned (88) vs. actual (84) sample size does not impact the outcome of the review for individual or overall quality.

accordance with generally accepted government auditing standards.

## **Overview of MERC's compensation 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 a 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 comparability 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

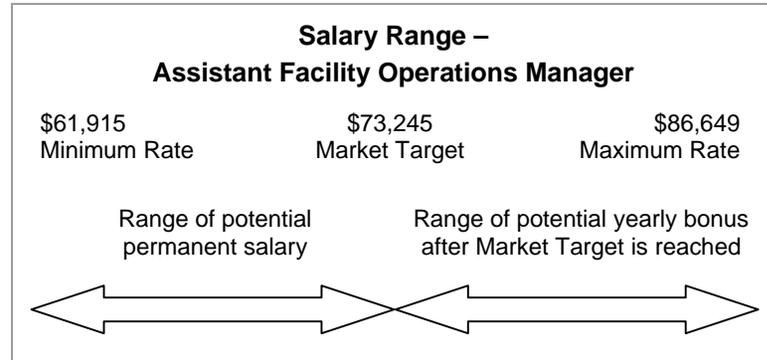
facility score determines the range and upper limit of PFP awards for all of the facility’s employees in a year. Each employee has a stake in the facility’s overall success because the higher the facility score, the higher the range of potential PFP awards that year.<sup>8</sup>

- **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. Figure 1 exemplifies the pay-related components of the program for a facility operations manager in 2002. In this example, the salary range minimum is \$56,286 and the “market target” (on average, the amount that the job is paid in the labor market) is \$66,586. 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.

**Figure 1**



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.

<sup>8</sup> MERC’s Administration Division has 14 PFP employees whose PFP awards are based the combined average performance of the three facilities as well as on individual performance.

**Table 5  
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.

In FY 2002, MERC's PFP program covered 88 employees, whose salaries ranged from \$26,400 to \$116,600, excluding the General Manager. PFP payouts (including salaries and bonuses) totaled nearly \$4,358,000.<sup>9</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 payouts 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 adjustments and pay for performance increases.

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.).

<sup>9</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.

## **Response to the Report**

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**MERC Response**

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### ***Auditor comments on use of Audit Response forms***

We are pleased to introduce the use of *Audit Response* forms.

These forms allow readers to focus more easily on the recommended actions. This benefit contributes to their use as a widely accepted standard practice.

In addition, Metro Code 2.15.070 states in part, “The response must specify agreement with the audit findings and recommendations, or reasons for disagreement, as well as proposed plans for implementing solutions to identified problems and a proposed timetable to complete such activities.”

We provided MERC with an *Audit Response* form for each audit recommendation addressing these items to facilitate its response and to improve the process for monitoring progress.

The formal narrative response from MERC follows the *Audit Response* forms.

*Audit Response* forms will continue to be used on future audits.

**Audit: MERC Employee Performance Agreements Need Improvement**

**Date: October 2003**

## AUDIT RESPONSE

### Recommendation 1

Simplify and focus employee performance agreement goal statements. Continue to use 4 (or even 3) goal statements and limit them to 35 words or less. Use several behavioral factors (e.g. customer service, initiative, flexibility, planning) to rate performance against a three or four-point generic scale.

### Agree

Yes

### What action will be taken (if any)?

A great deal of training has been conducted since the program was implemented just four years ago. As we gain experience, we have recognized that ongoing training is needed, especially on developing and measuring employee goals and objectives. We also recognize that training needs are different for managers, supervisors, and general employees.

We have made a commitment to review goals for each of MERC's 68 job classifications and develop model goals and measurements that can be adapted for individuals in accordance with facility needs. This is a two-year project led by MERC's Human Resources Director in conjunction with its Employee Review Committee, which assists management in improving the program. Another issue being addressed is identifying positions that would be better served by "position standards" rather than the goals and objectives.

### Who will take action?

MERC's Human Resources Director in conjunction with its Employee Review Committee

### When will action be accomplished?

We agree with this recommendation and are already implementing it.

We have made a commitment to review goals for each of MERC's 68 job classifications and develop model goals and measurements that can be adapted for individuals in accordance with facility needs. This is a two-year project led by MERC's Human Resources Director in conjunction with its Employee Review Committee, which assists management in improving the program.

### Follow-up necessary to correct or prevent reoccurrence.

Not addressed

**Audit: MERC Employee Performance Agreements Need Improvement**

**Date: October 2003**

## **AUDIT RESPONSE**

### **Recommendation 2**

Establish further training on employee performance agreements. Performance management training for managers, supervisors and employees should be different. Training for each group should be done in conjunction with further emphasizing and communicating organizational goals for the upcoming year and stating how those translate to each work group within MERC.

### **Agree**

Yes

No  (specify reasons for disagreement)

We agree in part with this recommendation. We agree employee goals should be simple and focused.

We disagree that we must use a limit of 3 or 4 goal statements. That is a management decision dictated by our strategic plan and business needs.

### **What** action will be taken (if any)?

We agree employee goals should be simple and focused. This is a major emphasis of our ongoing enhancements to the program. This will be achieved by creating the "model goals" referred to earlier, as well as by continued training. We already use the four-point scale that is recommended.

### **Who** will take action?

Not addressed

### **When** will action be accomplished?

Not addressed

### **Follow-up** necessary to correct or prevent reoccurrence.

Not addressed

**Audit: MERC Employee Performance Agreements Need Improvement**

**Date: October 2003**

## **AUDIT RESPONSE**

**Recommendation 3**

Have an independent human resources consultant review employee performance agreements at the beginning of the next evaluation cycle. Require that the consultant be well versed on the MERC's standards that agreements need to be specific, measurable, etc. To enhance program credibility and lessen potential for employee/supervisor misunderstanding, have the consultant look for and resolve issues where agreements are not consistent with the criteria.

**Agree**

Yes

No  (specify reasons for disagreement)

We disagree with this recommendation, which has been made without a cost-benefit assessment. Based on our experience using consultants, we believe the cost would be very high and outweigh any potential benefits. We believe Metro and MERC have sufficient internal expertise to accomplish these tasks. We now have more experience in managing this type of program than outside consultants, who typically are in the business of helping to create them. Moreover, this recommendation would serve to undermine one of the fundamental tenets of PFP and its application, which is the trust and accountability built between supervisor and employee that results from collaborative goal setting and regular performance reviews.

**What** action will be taken (if any)?

Not addressed

**Who** will take action?

Not addressed

**When** will action be accomplished?

Not addressed

**Follow-up** necessary to correct or prevent reoccurrence.

Not addressed

## ***Auditor comments on MERC response***

Four years ago, MERC embarked upon an innovative and entrepreneurial approach to employee compensation when it introduced its Pay for Performance (PFP) program.

In keeping with my responsibility to protect the interests of the citizens of the Metro region, my staff and I recently studied MERC's PFP program to gauge its effectiveness, identify areas for improvement, and determine if it could be applied to other areas of Metro.

The Office of the Auditor shares the Metro Council's goal of efficiency and accountability in government. Consequently, we were disappointed by the response to our reports provided by the MERC Commission.

The response does not address many of the reports' substantive issues, such as the need for accountability processes and adherence to established policies. In addition, the Commission's response contains inaccuracies, including incorrect statements about the reports' contents or conclusions, that distract from the reports' primary findings. For example:

- Contrary to MERC's position, the Metro Auditor does have the authority to question management decisions, particularly when those decisions result in actions in direct violation of MERC's own policies.
- Contrary to MERC's assertion, MERC could not prove its pay program had made any difference to organizational performance. Further, after three years, as many as 9 out of 10 employees continue to have significant misgivings about the PFP program, as implemented by MERC management.
- Contrary to MERC's position, the Auditor's benchmarks for the PFP program are clear and reasonable. Simply put, the fact that the PFP program is a good idea is not enough. To realize its potential benefit for MERC employees, managers and the taxpayers, the PFP program must be properly implemented and able to show objective, measurable results.
- Contrary to MERC's statement, PFP is not less costly over time than traditional "step" based compensation programs. Any projection to decide which program is less costly is *based on assumptions, many of which are policy driven*. In fact, then-MERC Chair Rice concurred with this conclusion during an April 2003 meeting with the Auditor.
- Contrary to MERC's presentation, the Auditor pursued a cooperative and constructive approach to MERC's response to the audit by meeting with MERC Commission Chair Conkling two weeks before issuing the draft audit reports, followed by a telephone consultation a few days later.
- Contrary to MERC's contention, the human resources consultant utilized by the Auditor is an acknowledged expert, with more than 20 years experience designing, implementing, and/or analyzing public- and private-sector compensation programs. In fact, a Metro human resources professional called this consultant "one of the best."

MERC can better realize the potential benefits offered by a PFP program by making the recommended improvements outlined in the audit reports.

In addition, by measuring the accomplishments of its own performance program, MERC can better manage its PFP program and provide the fairness and accountability it owes to its employees and the taxpayers.



arts. sports. conventions. shows.

METROPOLITAN EXPOSITION-RECREATION COMMISSION

October 14, 2003

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

Dear Auditor Dow:

This is MERC's response to the September 30, 2003 draft audit of our Pay for Performance program.<sup>1</sup>

Executive Summary

MERC's Pay for Performance (PFP) system is an innovative approach to public employee compensation that links pay to measurable performance. Traditional public employee compensation systems typically have no annual goals, no meaningful evaluations, and salary increases based on seniority. The public has grown concerned about the gulf between public and private sector approaches to compensation and wants government to be more accountable for levels of service, cost efficiency and productivity.

We sought to change that four years ago, with a commissioner-led initiative to strengthen the entrepreneurial culture of our staff in line with our mission of professionally managing publicly owned exposition and spectator facilities. We are proud of the results. At the highest level, it shows that we are serious about being accountable for public service standards by tying compensation to measurable performance. Employees and managers meet regularly, enhancing communication. Managers have a mechanism to allocate resources to the best performers rather than giving the same pay increases to everyone.

PFP is a fiscally responsible business management process. Even if it cost the same as a "civil service" program, the message that "performance matters" would still have value. However, it costs *less over time than* "civil service" programs because payouts are not automatic: lower payouts result when performance goals are not achieved. *Average salaries at MERC have increased less than salaries in traditional "step" programs—even when market based adjustments are included.*

The recommendations in the first section of the audit on "performance agreements" are largely helpful. We have already implemented many of them. The remainder of the audit, however, tends toward sweeping judgments, often based on inaccurate conclusions. Equally troubling is the inclusion of extraneous commentary that at best tangentially touches on the PFP program. These errors and inaccurate conclusions, along with the adversarial tone and content of the audit, detract from a useful and professional discussion. Here is a quick summary of some of the more egregious errors and inaccurate conclusions in the audit:

- The audit consistently mixes up the impacts of MERC's PFP system with the implementation of a compensation market study that was conducted. No compensation system exists in a vacuum from market conditions. That's why Metro is undertaking a similar compensation market study for its pay

<sup>1</sup> Due to the length and complexity of this audit and concerns about its methodology, Commissioner Sheryl Manning, a Certified Public Accountant with auditing experience, and Commissioner Judy Rice, a former corporate human resources director, have co-authored this response. We note that we were asked to respond only to the audit recommendations, using a form supplied by the Auditor's Office. To do so would imply that we accept the conclusions made about the program—many of which we consider ill-founded, subjective, or inaccurate. The Metro Code does not require this form and no previous audit has employed it.



system. Differentiating the impacts of separate undertakings is essential to a constructive evaluation of the PFP system.

- Overall salary increase statistics cited in the reports fail to take into account the addition of new employees at the expanded Oregon Convention Center. Failing to exclude new employee salaries skews the statistics to make the program look more costly.
- Program costs are actually very reasonable. The average plan salary increased by only approximately 5% annually during the audit study period—including all salary, bonus, and compensation market study adjustments.<sup>2</sup> Over the same time frame, several Metro departments had higher average annual salary increases under a traditional “step” plan. Average annual salaries of MERC staff under the PFP program also are lower than in many Metro departments.
- The analysis (especially the bar charts “MERC PFP Employee Salaries and Net Operating Losses”) lumps together all MERC facilities, though our system is tied to specific facility performance. Each facility has different kinds of operations and community missions therefore different performance targets. The audit also does not recognize planned business losses at the Oregon Convention Center during expansion construction. Failure to analyze the facilities separately and take into account OCC construction distorts the conclusions.
- The reports assert that newly recruited MERC personnel were hired with terms that violate MERC and Metro employment policies. This isn’t true. Not one employee’s salary has been set above the mid-point range. Once hired, they became subject to the PFP system and were treated like all other employees.
- The audit claims that Metro was unaware of key MERC compensation decisions. That’s not true. In the case of the compensation market study implementation, there was close communication between MERC commissioners and Metro officials, resulting in a decision to phase-in pay raises.
- The audit asserts that commissioners were uninformed about the program and concludes that MERC staff misrepresented program performance. That’s not true. The commission assigned Commissioner Judy Rice as its liaison to MERC staff for both the PFP program and the compensation study. Commissioner Rice and MERC staff kept us well informed.
- The audit inappropriately uses a single hired consultant’s views on “best practices” to criticize MERC’s system. Many of these conclusions are simply disagreements with the consultants MERC retained. Conflicting consultant opinions are an inadequate basis for audit findings.
- Many audit conclusions are based on supposition, rather than objective evidence.
- The audit states that trying something new such as Pay for Performance must be supported by an analysis approaching mathematical certainty. We disagree. Choosing performance over seniority is a *policy* decision. Further, this requirement would only discourage innovation.
- The audit inaccurately represents MERC as having inadequate or inconsistent PFP policies.
- The audit’s intemperate language, misleading statistics, and personal attacks on MERC staff are not constructive. The overall approach lacks the objectivity and impartiality required by government auditing standards.

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<sup>2</sup> While we reject mixing up PFP with compensation study adjustments, we do so here in response to the audit’s erroneous insistence on this approach, and to illustrate the overall economy of our compensation strategy.

## **I. Faulty Process, Timelines and Methodology**

### **A. Faulty Process and Timelines**

This audit began 18 months ago, in March, 2002, when the PFP program was only 2 1/2 years old. The audit contains nearly 100 pages of recommendations and discussion. The Auditor's office has always given Metro and MERC staff advance copies of audits for review and discussion well in advance of release of the "final draft," which triggers the formal response deadline. Here, no advance notice was given. The MERC Chair's request for additional time to respond was denied. MERC Chair Conkling and Commissioner Manning also tried to identify problems with the audit and requested a more constructive approach in a meeting with the Auditor, before submitting this response.

It is unfair and unwise to require a response to an 18-month audit project in such a short time frame, especially when volunteer commissioners are involved in the response. The public interest is best served by an audit report that has been vetted to meet the highest standards of accuracy. This unprecedented approach contributes to the audit's errors.

### **B. Inappropriate and Invalid Methodology**

#### *(1) Differences of Opinion Among Consultants are an Invalid Basis for Audit Findings*

The most valuable audit findings are based on objective evidence—not mere differences of opinion. Much of the audit is an essay detailing differences of opinion between the human resource consultant hired by the Auditor's office and those that were employed by MERC. This difference of opinion between "dueling consultants" is not a legitimate basis for audit findings.

#### *(2) Conclusions Should be Based On Real Evidence, Not Supposition*

The audit makes many unjustified suppositions. For example, the audit concludes the MERC PFP program is not working very well. After this conclusion was reached, several unnamed MERC Commissioners were interviewed, who apparently stated their opinions that the program was working well. Based on that evidence, the audit concludes that MERC staff misrepresented the program's effectiveness—without any evidence of misrepresentation. Suppositions of this sort are unfair to our staff and inappropriate.

#### *(3) Disincentive for Innovation and Use of Inappropriate Standards*

A major theme is that MERC should have made a series of findings approaching mathematical certainty prior to adopting a PFP system. However, no similar justification is required for continuing traditional systems. This is not a legitimate basis for audit findings. First, the decision to link employee compensation to performance instead of seniority is a *policy* decision not subject to audit review. Second, requiring this sort of empirical justification *only for innovation* would create a powerful disincentive at Metro for change of any kind—a climate we doubt the public or the Metro Council would endorse.

The audit compares MERC's PFP program to a theoretically perfect PFP program based on the concept of "best practices." "Best practices" analysis can be a legitimate benchmark for analyzing programs, *but only where such standards are generally accepted and agreed upon*. Pay for performance is an innovative program and increasingly popular compensation choice, but there is no standard design—each workplace application is developed based on the specific business objectives. The "best practices" presented in the audit are merely the subjective opinions of the auditor's consultant, not a universal comparison for audit findings.

#### *(4) Failure to Interview Appropriate Staff*

MERC repeatedly requested during the 18 months of the audit that the individual assigned by Metro's Human Resource Department to work with MERC on both PFP and the compensation study be interviewed. Despite these many requests, this individual was not contacted until after the Auditor's office informed the Metro Council that the audit had already been written. This failure has contributed to the many factual errors in the audit.

### **C. Violations of Government Auditing Standards**

Government Accounting Standards (references are to Government Auditing Standards – 2003 Revision) require auditors to be “objective and free of conflicts of interest.” Additionally, auditors must be “impartial, intellectually honest,” and free of relationships “that may in fact or appearance impair [an] auditor's objectivity in performing the audit...” (Section 1.24).

The “accountability” and “not a model” parts of the audit violate the requirement that auditors be objective, impartial, and free of conflicts. The use of intemperate language, erroneous statistics, supposition, and personal attacks on MERC staff shows an unprofessional level of personal involvement inconsistent with objectivity and impartiality.

Sections 3.03, 3.04, and 3.05 of Government Auditing Standards require auditors to be free in both fact and appearance from any personal impairments to “independence.” (Section 3.03). This means that auditors should “avoid situations that could lead reasonable third parties with knowledge of the relevant facts and circumstances to conclude that the auditors are not able to maintain independence and, thus, are not capable of exercising objective and impartial judgment on all issues associated with conducting and reporting on the work.” (Section 3.04).

No knowledgeable third party could read the inflammatory language and unwarranted suppositions in this audit and conclude that the auditor is “exercising objective and impartial judgment on all issues associated with conducting and reporting on the work.” In this situation, applicable standards require that an auditor either decline the work, or report those personal impairments in the scope section of the audit. By failing to do either, the audit violates these important requirements.

## **II. Serious Errors of Fact**

The audit contains many factual errors. That may be partially due to the insufficient time that has been allowed for MERC to point out problems prior to issuance of the final draft. Another factor may have been the Auditor's use of a consultant with little in the way of experience with PFP programs. We will attempt to point out these errors as we respond.

## **III. “Performance Agreement” Recommendations**

A major section of the audit deals with recommendations for improving what are termed “Performance Agreements,” a term MERC does not use in its PFP program. We will assume that it applies to the “Goals and Objectives” used as the basis for setting performance expectations with MERC staff.

### **Recommendation Number 1:**

*“Establish further training on employee performance agreements. Performance management training for managers, supervisors and employees should be different. Training for each group should be done in conjunction with further emphasizing and communicating organizational goals for the upcoming year and stating how those translate to each work group within MERC.”*

### Response to Recommendation Number 1:

We agree with this recommendation and are already implementing it. A great deal of training has been conducted since the program was implemented just four years ago. As we gain experience, we have recognized that ongoing training is needed, especially on developing and measuring employee goals and objectives. We also recognize that training needs are different for managers, supervisors, and general employees.

We have made a commitment to review goals for each of MERC's 68 job classifications and develop model goals and measurements that can be adapted for individuals in accordance with facility needs. This is a two-year project led by MERC's Human Resources Director in conjunction with its Employee Review Committee, which assists management in improving the program. Another issue being addressed is identifying positions that would be better served by "position standards" rather than the goals and objectives.

### Recommendation Number 2:

*"Simplify and focus employee performance agreements' goal statements. Continue to use 4 (or even 3) goal statements and limit them to 35 words or less. Use several behavioral factors (e.g. customer service, initiative, flexibility, planning) to rate performance against a three or four-point generic scale."*

### Response to Recommendation Number 2:

We agree in part with this recommendation. We agree employee goals should be simple and focused. This is a major emphasis of our ongoing enhancements to the program. This will be achieved by creating the "model goals" referred to earlier, as well as by continued training. We already use the four-point scale that is recommended.

We disagree that we must use a limit of 3 or 4 goal statements. That is a management decision dictated by our strategic plan and business needs.

### Recommendation Number 3:

*"Have an independent human resources consultant review employee performance agreements at the beginning of the next evaluation cycle. Require that the consultant be well versed on the MERC's widely accepted standards that agreements need to be specific, measurable, etc. To enhance program credibility and lessen potential for employee/supervisor misunderstanding, have the consultant look for and resolve issues where agreements are not consistent with the criteria."*

### Response to Recommendation Number 3:

We disagree with this recommendation, which has been made without a cost-benefit assessment. Based on our experience using consultants, we believe the cost would be very high and outweigh any potential benefits. We believe Metro and MERC have sufficient internal expertise to accomplish these tasks. We now have more experience in *managing* this type of program than outside consultants, who typically are in the business of helping to *create* them. Moreover, this recommendation would serve to undermine one of the fundamental tenets of PFP and its application, which is the trust and accountability built between supervisor and employee that results from collaborative goal setting and regular performance reviews.

#### IV. “Accountability” Recommendations

##### Introduction

The “accountability” section of the audit is not really an “audit” in any generally accepted use of that term. In essence, it is an essay of the auditor’s personal views.

##### Inappropriate “Audit Objective, Scope, and Methodology”

This section of the audit purports to set forth the “Audit Objective, Scope, and Methodology.” However, there is no defined objective, no governing scope, and no discernable methodology. This section of the audit begins with a conclusion and follows with an essay seeking to justify that conclusion. This does not conform to generally accepted governmental auditing standards.

##### **Response to Executive Summary**

The audit inaccurately claims that salaries for program employees increased by 14% over two budget years. This is not true. The summary uses an inaccurate and misleading basis for assessing the rate of increase in MERC’s personal service costs, in part by including the cost of adding additional staff for the expanded Oregon Convention Center. The result falsely implies these increases are due to MERC’s PFP program and skews the entire result.

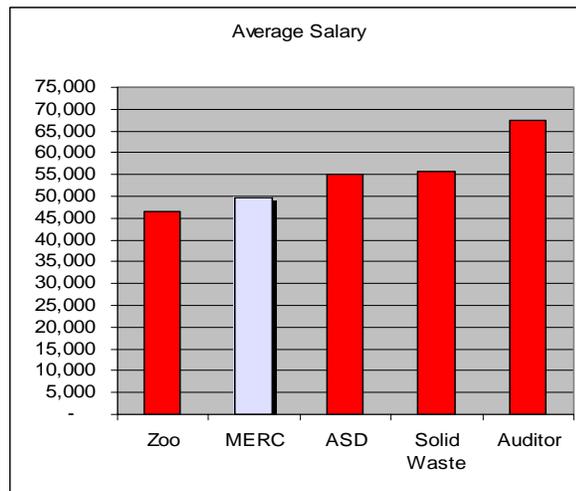
On the contrary, the costs of the program are actually quite reasonable. During the four-year period from 2000-2003 (the time period analyzed by the audit), the average salary paid to an employee in our PFP program has increased from \$43,844 to \$49,569. This amounts to an average annual increase of approximately 5%, *including all base salary increases, all bonuses, and all compensation study adjustments.*<sup>3</sup>

By contrast, during the same time period, traditional civil service type plans resulted in slightly larger increases in salaries at Metro. For example, the average pay of Oregon Zoo employees increased from \$39,671 to \$46,426, an annual increase of 5.4%. Solid Waste salaries increased from \$47,580 to \$55,812, an average of 5.5%. In Metro’s Administrative Services Division, the average salary increased 6.4% annually, from \$45,707 to \$55,120. The following chart illustrates the situation:



<sup>3</sup> Our analysis compares actual annual percentage changes in average salaries for MERC employees in the PFP plan with budgeted salaries for full-time regular Metro employees. Again, while we reject combining PFP with compensation study adjustments, we do so here in response to the audit’s erroneous insistence on this approach.

Moreover, the average salary for MERC employees in the PFP program was low by comparison, at \$49,569. Metro's Administrative Services Department's average salary was \$55,120, Solid Waste was at \$55,812, and the Office of the Auditor was highest of this group at \$67,518. These comparisons are illustrated graphically below:



There is no legitimate basis for concluding that MERC's PFP program is overly generous.

The summary also repeats and emphasizes two flaws common to the entire audit:

(1) It fails to distinguish between MERC's implementation of a compensation study to address inequities with the market place and the PFP program. Like most organizations, MERC and Metro periodically perform compensation studies in order to test their salary ranges against the marketplace. Compensation studies are *necessary regardless of what kind of compensation system an organization has*. In fact, periodic market reviews are even more critical under a performance-based compensation program. When salaries are not automatically adjusted for inflation (as under a standard COLA), the risk of deviation from the market is even greater. The audit's erroneous insistence that MERC's compensation study undermined the PFP program has led to serious mistakes and faulty conclusions.

(2) The audit falsely claims that decisions about pay and benefits have run counter to unspecified "MERC or Metro policies." In its rush to judgment, the audit takes three entirely appropriate recruiting decisions and jumps to the unjustified conclusion that this makes the entire PFP program invalid. On three separate occasions over four years, MERC hiring managers found it necessary to negotiate first-year compensation with potential employees. This is a common practice in both the public and private sectors. None of these employees received base salary above the mid-point and, once hired, they became subject to the PFP plan and were treated like all other staff. There is nothing improper about these decisions.

Given these serious analytical problems, the specific recommendations that follow are of marginal value.

Recommendation Number 1:

*"The MERC Commission should strengthen its oversight of MERC's compensation program by directing MERC management to establish and report on specific program goals and performance measures."*

### Response to Recommendation Number 1:

The commission has been kept well informed on the PFP program involved in decisions about continuous improvements to the program. MERC Commissioner Judy Rice was appointed as liaison to management on the PFP program. Commissioner Rice has extensive private sector experience in human resource systems, including PFP. Commissioner Rice worked directly with MERC's Human Resources Director and senior staff, monitoring the program and overseeing proposed changes and improvements.

Continuous program improvement is an ongoing activity. We commissioned an employee survey to determine areas where the program could be strengthened. Subsequently, an employee review committee was created to advise management and the commission on possible areas of improvement. The committee has been capably staffed by human resources managers from MERC and Metro. The review committee worked with a qualified human resources consultant to recommend changes in the program.

### Recommendation Number 2:

*"The MERC Commission should strengthen its oversight of MERC's compensation program by assuring that compensation policies are prudent, equitable, transparent and consistently applied."*

### Response to Recommendation Number 2:

MERC's compensation policies are prudent, equitable, transparent, and consistently applied.

The audit recommends that MERC not perform further compensation comparability studies and adjust employee wages in response to labor market standards. The audit purports that where an employer has a performance-based compensation system, no salary changes should be implemented as result of a market comparability study. This is an invalid theory that does not reflect standard practice. There is no data nor any generally accepted "best practice" that justifies this recommendation.

Market competitiveness is essential to a successful PFP program. If it is ignored, the plan will fail. Implementing market-based adjustments to salaries on a periodic basis is also critical. The intent from the beginning was to move people through the salary range to the market based mid-point based on their performance. If the market based mid-point doesn't reflect the changes in the market it would make the entire program suspect. Individual employees become discouraged when they feel they are losing ground while market rates increase even if they are getting frequent pay increases<sup>4</sup>.

All responsible employers periodically test their compensation systems against the market and make adjustments. MERC's policies require a study at least every five years. MERC retained a qualified compensation consultant who worked closely with its management staff, the employee review committee, and Metro Human Resources to compare MERC's salary ranges to the relevant market, including Metro. The results called for adjustments in specified ranges and recommended implementing all of those changes effective July 1, 2002.

Noteworthy, the commission elected not to implement this recommendation fully. In order to mitigate personnel wage adjustments, the commission decided to phase in full implementation of the study over a two-year period. Staff followed that direction and budgeted accordingly. The budget was approved in public hearings by the MERC budget committee, the full commission, the Metro Council, and the Tax Supervising and Conservation Commission.

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<sup>4</sup> Metro is currently considering a similar system.

The remainder of this section of the audit is difficult to understand. It includes a recommendation to develop policies “as needed” and modify supposedly “unclear” policies, but does not identify any policies that are missing or unclear. It also recommends MERC create an operating manual, which it already has in place.

Recommendation Number 3:

*“The MERC Commission should strengthen its oversight of MERC’s compensation program by directing MERC management to establish clear linkage between employee pay and MERC’s operational and financial performance.”*

Response to Recommendation Number 3:

The PFP program has a demonstrably clear linkage between employee pay and MERC’s operational and financial performance, especially when compared with traditional plans.

Each MERC facility has four goals that reflect MERC’s business and strategic plan objectives and together determine the facility’s PFP score. No one goal is determinative—they are all calculated together as a weighted average. Employees’ goals, in turn, contribute to the attainment of one or more of the overall facility goals. The facility goals include:

1. The ratio of operating revenues to operating expenditures.
2. Customer service.
3. Building condition.
4. A variable goal chosen by agreement between the General Manger and the facility director.

This section of the audit causes us several concerns regarding accuracy, inappropriate recommendations, and misleading statistics.

**First**, the audit declares that tying employee compensation to a factor such as increasing the ratio of operating revenues to operating expenditures is inappropriate. We disagree. We believe our facility management staff is responsible for exactly that type of accomplishment. That is a management decision as to what we believe the job is, not a subject for audit review.

**Second**, after concluding that employee compensation should not reflect net operating revenues, the audit then criticizes our program because it supposedly lacks a direct link between financial performance and PFP. This is illogical at best. It also misconstrues the program, which never has been based solely on financial performance, but includes other important factors such as building maintenance and customer service. PFP was designed to place our pay program in alignment with MERC’s organizational objectives. We are confident that we have done just that, but organizational performance is impacted by many factors that are more significant than the PFP program.

The statistics used to attempt to prove this point are misleading. The audit employs a chart that purports to show the relationship between PFP payouts and MERC operating results. This chart suffers from several serious flaws:

- It falsely characterizes the entire annual salaries of all employees in the PFP program as “PFP Payout,” when the actual amount is far smaller.
- It compares PFP payouts exclusively to financial performance, which never has been the sole and exclusive goal of the program.
- It inaccurately includes one time only compensation study implementation costs as “PFP Payouts.”

- It includes years in which the Oregon Convention Center was under construction, with expected and planned decreases in operating revenues.
- It lumps all MERC facilities together, even though each facility has a different mission, subsidy level, and operating results.

*Third*, the audit errs when it discusses supposed failures in communication between MERC management staff, the commission, and the Metro Council. For example, a member of the Metro Human Resources staff was assigned to work with the employee review committee and relayed this information back to the Metro Human Resources Director. MERC staff also made sure MERC's PFP liaison commissioner had full knowledge of all issues concerning the plan.

The auditor mistakenly criticized MERC's communication with the Metro Council about the compensation study and its implementation. When the consultant's recommendations were presented, the MERC and Metro Council leadership discussed the study's implementation plan and reached consensus that it should be phased in during a two-year time period. The phase-in was adopted by the commission, a reflection that advice from the Metro Council was considered and acted upon positively.

*Finally*, the audit claims that the Metro Council requested that MERC retain a second consultant to review its compensation study implementation and that MERC refused to do so. That is incorrect. The former Metro Executive Officer assigned the Metro Budget Coordinator to perform this task. She determined that MERC's system actually cost less than a traditional "step" program. After these results were obtained, the Executive saw no need for retaining additional consultants. The audit dismisses the analysis done by Metro's Budget Coordinator. Additionally, MERC staff provided the Auditor's office with several alternative financial evaluations that all yielded similar results, which the Auditor's office also dismissed.

## V. Conclusion

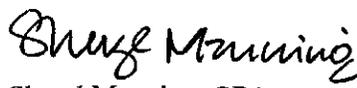
Part of the "accountability" section and the entire "not a model" report are directed to the Metro Council and Chief Operating Officer as opposed to MERC. We will not presume to respond on their behalf. We do note that these sections suffer from the same faulty analysis and factual errors detailed above. These reports are essentially essays of the Auditor's personal opinions, not audits.

We have not yet sent copies of this response to the Metro Council, as is our usual practice. It is our hope that further dialogue with the Auditor's office could produce a more mutually beneficial and constructive approach. Please feel free to contact us or our staff if you believe this would be productive.

Sincerely,



Gary Conkling  
MERC Chair



Sheryl Manning, CPA  
MERC Commissioner



Judy Rice  
MERC Commissioner



METRO

# Metro Auditor Report Evaluation Form

Audit Report: *MERC Employee Performance  
Agreements Need Improvement*

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Our mission at the Office of the Metro Auditor is to assist and advise Metro in achieving honest, efficient management and full accountability to the public. We strive to provide Metro with accurate information, unbiased analysis and objective recommendations on how best to use public resources in support of the region's well-being.

Your feedback helps us do a better job. If you would please take a few minutes to fill out the following information for us, it will help us assess and improve our work.

Please rate the following elements of this report by checking the appropriate box.

	<b>Too Little</b>	<b>Just Right</b>	<b>Too Much</b>
Background Information	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Details	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Length of Report	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Clarity of Writing	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Potential Impact	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Suggestions for our report format: \_\_\_\_\_  
\_\_\_\_\_

Suggestions for future studies: \_\_\_\_\_  
\_\_\_\_\_

Other comments, ideas, thoughts: \_\_\_\_\_  
\_\_\_\_\_

Name (optional): \_\_\_\_\_

**Thanks for taking the time to help us.  
Sincerely, Alexis Dow, CPA, Metro Auditor**

600 NE Grand Avenue, Portland, OR 97232-2736 ♦ Phone: 503.797.1891 ♦ Fax: 503.797.1831 ♦ Email: [dowa@metro.dst.or.us](mailto:dowa@metro.dst.or.us)

**Suggestion Hotline:** 503.230.0600 ♦ [MetroAuditor@metro.dst.or.us](mailto:MetroAuditor@metro.dst.or.us)

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