




**U.S. SMALL BUSINESS ADMINISTRATION  
OFFICE OF INSPECTOR GENERAL  
WASHINGTON, D.C. 20416**

**Management Advisory**  
Report Number: 17-16

**DATE:** August 15, 2017

**TO:** Linda E. McMahon  
Administrator

**FROM:** Hannibal "Mike" Ware   
Acting Inspector General

**SUBJECT:** *Review of SBA's Pay Setting Practices for Senior Executive Service Salary Increases*

This management advisory is the third and final report evaluating the Small Business Administration's (SBA's) pay setting practices and notes that SBA improperly granted performance pay increases to Senior Executive Service (SES) members. In the prior two reports, we noted that SBA incorrectly set the pay for politically appointed SES employees and did not prepare the required documentation to justify the higher pay determinations for Schedule C appointees.<sup>1,2</sup> We considered management comments on a draft of this report when preparing the final report. SBA management agreed with three recommendations and partially agreed with one recommendation, but proposed an alternative corrective action to meet the intent of the recommendation. Based on management's response, we consider all recommendations resolved but open pending completion of final actions.

## **Background**

We initiated this review based on a previous Office of Inspector General (OIG) report that identified deficiencies with SBA's practices for SES initial pay setting and on risk indicators that SBA did not comply with Federal pay setting laws and regulations.

The Office of Human Resources Solutions (OHRS) is responsible for providing SBA's human resources services. Executive Resources, a part of OHRS, oversees the Agency-wide executive resources function that includes providing advisory services to SBA leadership on executive and political personnel. Executive Resources also manages most aspects of staffing and pay setting for SES positions. Additionally, OHRS maintains oversight of SBA's standard operating procedure (SOP) 39 20 20 A, *Senior Executive Service Program*, which provides policy for SES employment, performance management, awards, pay, and reduction in force.

To encourage excellence in senior executive performance, Federal regulations require each agency to develop and administer a performance management system, which includes guidance on performance based pay for SES members. Additionally, Federal regulations designate OPM to

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<sup>1</sup> SBA OIG Management Advisory 16-20, *Review of SBA's Practices for Senior Executive Service Initial Pay Setting* (August 22, 2016).

<sup>2</sup> SBA OIG Management Advisory 17-08, *Review of SBA's Practices for Schedule C Political Appointee Initial Pay Setting* (March 13, 2017).

review agencies performance management systems for compliance with the requirements of law, OPM regulations, and OPM performance management policy. Based on OPM guidance, agencies must follow specific guidance when granting performance based pay, to include:

- Establishing a written pay policy for setting and adjusting the rates of basic pay for SES members;
- Setting and adjusting the rate of basic pay on the basis of the individual’s performance and/or contribution to the agency’s performance; and
- Adjusting SES pay not more than once during any 12-month period (12-month rule).<sup>3</sup>

SBA developed the SES performance appraisal process as one component of its performance management system to evaluate senior executive performance and to use the results of the evaluation to train, reward, reassign, retain, remove, or adjust base pay.<sup>4</sup> The participants in the performance appraisal process include the SES member’s official rater, members of the performance review board, and the Administrator.<sup>5</sup> Ultimately, the Administrator approves the final performance awards and bonuses for career SES members after consideration of recommendations from the performance review board.

To ensure each SES salary remains similarly positioned within the SES salary rate range, agencies may grant a performance adjustment, defined as a “maintain relative pay” (MRP) increase. MRPs occur when there is an increase in the minimum or maximum rate of basic pay of the SES rate range, such as the 1 percent increase in January 2015. To justify an increase, Agency officials must consider the SES basic pay rate and the performance rating for the most recent appraisal period (see Appendix II for MRP criteria). Additionally, MRP increases are not pay adjustments when applying the criteria for the 12-month rule.<sup>6</sup>

An authorized official may make an exception for SES members who do not achieve the required performance rating to qualify for a pay increase to maintain their relative position. However, agencies should make these exceptions rarely, and for limited circumstances. Moreover, to provide transparency in the pay setting process, the authorizing official should provide an adequate justification to explain the rationale for approving the increase. SBA designated the Administrator as the authorizing official for making determinations on performance ratings and the associated bonuses.

## Objective

The overall objective of our review was to determine whether SBA’s pay setting practices, including salary increases and bonuses provided for Schedule C appointees and SES members, complied with Federal laws and regulations. This memorandum only addresses our review on SES salary increases and bonuses. (See Appendix I for a detailed discussion of scope and methodology.)

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<sup>3</sup> 5 CFR 534.404 (c)(1), *Setting and adjusting pay for senior executives, 12-month rule*, states that an authorized agency official may adjust the rate of basic pay of a senior executive not more than once during any 12-month period. For the purposes of our review, we refer to this requirement as the “12-month rule.”

<sup>4</sup> SOP 39 20 20 A, *Senior Executive Service Program*, Chapter 4, Performance Management System.

<sup>5</sup> The performance review board consists of five to eight appointed members tasked to review SES performance appraisals, and to make rating recommendations to the Administrator.

<sup>6</sup> 5 CFR 534.404(c)(3)–(c)(4), *Setting and adjusting pay for senior executives, 12-month rule*, provides the few exceptions to the 12-month rule.

## Results

SBA improperly approved pay increases for six SES members in 2015 and one SES member in 2014, for a total of \$19,277 in improper payments. These instances occurred because OHRS did not have effective internal controls in place to detect these improper payments. In addition, OHRS' current policies and procedures do not include sufficient guidance for SES performance based pay increases. If these internal control deficiencies persist, SBA is susceptible to making future improper pay increases and risks losing the Certified SES Performance Appraisal System.

### *Improper "Maintain Relative Pay" Increases*

In October 2015, OPM conducted a routine review of SBA's pay processes to determine whether SBA satisfied the requirements to obtain a certified performance appraisal system.<sup>7</sup> During this review, OPM identified several SES members with potential 12-month rule violations that occurred during FY 2015. In response, OHRS, with guidance from OPM, developed a plan to resolve the violations by reclassifying the type of performance increase issued to the SES members. Specifically, SBA reclassified the performance increases as MRPs in an effort to avoid the 12-month rule violation. Federal regulations do not consider MRPs pay adjustments when applying the criteria for the 12-month rule. The former Chief Human Capital Officer, the official with oversight of SBA's performance management system, issued a memorandum confirming that the intent of the reclassified pay adjustments were MRP increases for each SES. This memorandum, which OHRS personnel used as guidance, did not specify whether the increase should be automatic or based on individual SES performance.

SBA's granting of MRPs did not align with OPM guidance and Federal regulations. Specifically, in January 2015, SBA granted "across-the-board" MRP increases to all eligible SES members without considering individual performance ratings when providing the increases.<sup>8,9</sup> Three SES members received MRP pay adjustments, even though their FY 2014 performance ratings were below the required threshold to receive any MRP increase. During the same appraisal period, three other SES members rated below an outstanding, received MRP pay adjustments without a proper justification to support the increase. Federal regulations provide the example of an exceptionally meritorious accomplishment as a situation that may warrant the approval of an increase for an SES that did not obtain the required performance rating. To provide transparency in the performance management process, OPM recommends that agencies complete a justification detailing the meritorious accomplishments to support a pay increase under these circumstances. Furthermore, Federal regulations require an Agency head or designee to approve pay adjustments in these instances (See Appendix II for MRP Increase Criteria).

The SBA's prior Administrator issued a blanket memorandum to each SES member who received the across-the-board MRP pay adjustment. We analyzed the memorandums for the three SES members who received MRP pay adjustments and determined that the justifications were inadequate to support the increase because the memorandums contained identical language for each SES member and did not address performance on an individual basis. To align with OPM's recommendations, SBA's justification should have included a detailed explanation of each individual's performance accomplishment or contribution to the Agency. Furthermore, SBA

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<sup>7</sup> OPM grants full or provisional certification to agencies that design and implement a SES performance appraisal system that meets certain criteria.

<sup>8</sup> For the purposes of our review, eligible SES members included any executive employed during the FY 2014 performance appraisal period who ultimately received a performance rating.

<sup>9</sup> Agencies must consider the SES basic pay rate and performance rating when granting MRPs.

granted an exception for all of the SES members who did not meet the criteria to receive an MRP. Consequently, we believe that justifications issued in this manner do not constitute rare circumstances, as intended in the regulation governing MRPs. Therefore, we question \$10,484 for the MRP increases for the six SES members (see Table 1).

**Table 1. Maintain Relative Pay Increases, January 2015**

SES Member	Pay Rate Prior to MRP Increase	Pay Rate After MRP Increase	Improper Payment
1	\$174,427	\$176,172	\$1,745
2	\$168,659	\$170,346	\$1,687
3	\$167,740	\$169,418	\$1,678
4	\$181,500	\$183,300	\$1,800
5	\$181,500	\$183,300	\$1,800
6	\$177,332	\$179,106	\$1,774
<b>Total Improper Payments</b>			<b>\$10,484</b>

Source: Generated by OIG using performance data obtained from OHRS' personnel files and OPM supplemental guidance.

Inadequate controls over SBA's performance management system combined with insufficient internal policies contributed to improper performance based pay increases for SES members. Specifically, SBA's SOP governing the performance management system did not contain guidance on MRP increases. Without systematic controls in place to ensure compliance with Federal laws and regulations, SBA is susceptible to providing future improper performance pay increases for SES members. Furthermore, providing rewards to SES members without ensuring the proper level of performance fails to meet the underlying objective of a performance management system, which stresses the results of performance as a basis for rewarding senior executives.

#### *12-Month Rule Violation*

SBA provided one SES member a performance increase to base pay in January 2014 for \$3,135 and another in December 2014 for \$8,793. Federal regulations prohibit more than one increase in the rate of basic pay during a 12-month period.<sup>10</sup> As a result, the \$8,793 pay increase granted to the SES member in December 2014 was unallowable.

As mentioned previously, in October 2015, OPM notified SBA of suspected 12-month rule violations that occurred during 2014. The violation that we identified during the course of our review was included in the listing of potential violations from OPM. However, as of March 2017, SBA has not taken corrective actions to resolve the violation. OHRS cited insufficient resources, and an oversight in the area of performance increases as an explanation for the 12-month rule violation.

Additionally, SBA's SOP governing the performance management system did not contain guidance on performance increases specifically related to the 12-month rule. According to OHRS personnel, they are currently drafting an update to SOP 39 20 20 A, *Senior Executive Service Program*, regarding stipulations for executing a performance management system in accordance with Federal rules and regulations. If implemented correctly, the new SOP would provide employees with sufficient guidance to administer performance increases appropriately, including MRP increases and the 12-month rule violation.

Finally, to maintain a performance appraisal system certified by OPM, SBA's SES pay adjustments must not include violations of pay setting laws, regulations, or policies. Continuing improper pay

<sup>10</sup> 5 CFR 534.404, 6c, 12-Month Rule.

increases, such as the 12-month rule violation, could result in SBA losing its certified performance appraisal system for a second time.<sup>11</sup> A loss of certification affects SBA by (1) limiting initial pay for newly hired SES members to level III of the Executive Schedule, (2) discontinuing salary increases for SES members above level III of the Executive Schedule, and (3) limiting aggregated compensation for SES members to level I of the Executive Schedule. SBA must strengthen controls over its performance management system to ensure it adheres to laws and regulations governing performance increases to members of the senior executive service.

## Recommendations

To improve SBA's management of pay setting practices, we recommend that the Chief Operating Officer implement the following actions:

1. Remedy the \$10,484 in overpayments for the 1 percent MRP increases.
2. Remedy the \$8,793 overpayments for the 12-month rule violation.
3. Update SOP 39 20 2A, Senior Executive Service, to include policies and procedures to ensure compliance with Federal rules and regulations governing performance management systems, to include specific guidance on MRP increases and 12-month rule violations.
4. Ensure current and future OHRS personnel complete training on performance management systems, including the updates to SOP 39 20 2A, Senior Executive Service.

## Analysis of Agency Response

SBA management provided formal comments that are included in their entirety in Appendix IV. SBA management agreed to implement Recommendations 1, 2, and 4, and partially agreed with Recommendation 3, but proposed an alternative corrective action to meet the intent of the recommendation.

## Summary of Actions Necessary to Close the Recommendations

The following provides the status of each recommendation and the necessary action to either resolve or close the recommendation.

1. **Resolved.** The Chief Operating Officer (COO) concurred with our recommendation and plans to complete final action on this recommendation by December 30, 2017. This recommendation can be closed upon the COO providing evidence of the overpayment collection or resolutions for the 1 percent maintain relative pay increases.
2. **Resolved.** The COO concurred with our recommendation and plans to complete final action on this recommendation by December 30, 2017. This recommendation can be closed upon the COO providing evidence of the overpayment collection or resolution for the 12-month rule violation.

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<sup>11</sup> SBA OIG Management Advisory 16-20, *Review of SBA's Practices for Senior Executive Service Initial Pay Setting* (August 22, 2016), identified that SBA lost their certified performance appraisal system in August 2015.

3. **Resolved.** The COO partially agreed with our recommendation and proposed an alternative corrective action to meet the intent of the recommendation. Specifically, the COO plans to develop a document as an appendix to the OHRS Executive Resources Desk Guide, which will include additional criteria regarding MRP increases and 12-month rule violations. We acknowledge that the COO already has taken steps to implement this recommendation. For example, OHRS updated its SOP 39 20 3, Senior Executive Service on April 12, 2017, and included guidance on Federal rules and regulations governing performance management systems. We believe the updated SOP, along with the proposed supplemental guidance to the OHRS internal desk guide, meets the intent of the recommendation. The COO plans to complete final action on this recommendation by December 30, 2017. This recommendation can be closed upon the COO providing evidence that it developed and implemented the supplemental guidance on SES pay setting criteria for MRP increases and 12-month rule violations.
4. **Resolved.** The COO concurred with our recommendation and plans to complete final action on this recommendation by December 30, 2017. The COO has taken action to implement this recommendation by training current personnel on performance management systems. This recommendation can be closed upon the COO providing evidence that it developed and implemented a policy to require current and new personnel to complete performance management systems training.

We appreciate the courtesies and cooperation that we received from your staff during our review. If you have any questions, please contact me at (202) 205-6586 or Riccardo Buglisi, Director, Business Development Programs Group, at (202) 205-7489.

cc: Mary Anne Bradfield, Chief of Staff  
Joseph P. Loddo, Chief Operating Officer  
Elias Hernandez, Chief Human Capital Officer  
Christopher M. Pilkerton, General Counsel  
Martin Conrey, Attorney Advisor, Legislation and Appropriation  
Timothy E. Gribben, Chief Financial Officer and Associate Administrator for  
Performance Management  
LaNae Twite, Director, Office of Internal Controls

## **Appendix I: Objective, Scope, and Methodology**

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The overall objective of our review was to determine whether SBA's pay setting practices, including salary increases and bonuses provided for Schedule C appointees and SES members, complied with Federal laws and regulations. This memorandum only addresses our review on SES salary increases and bonuses.

In conducting this evaluation, we reviewed Federal laws and regulations, and SBA policies and procedures governing SES pay during the period January 1, 2014–March 31, 2016. We also interviewed personnel from OHRS and OPM to gain an understanding of SES pay setting practices. To achieve our objective, we judgmentally sampled eight individuals and reviewed MRP pay increases. In addition, we judgmentally sampled seven individuals and reviewed all performance increases. We selected our sample based on identified risks related to SBA non-compliance with Federal pay setting criteria and OPM's identification of unallowable performance based pay increases for SES members.

We reviewed the Standard Form 50 - *Notification of Personnel Action*, and performance data for all SES members sampled to ensure pay setting complied with Federal laws, regulations, and policies.

We conducted this evaluation in accordance with the Council of the Inspectors General on Integrity and Efficiency's quality standards for inspection and evaluation. Those standards require that we adequately plan and perform the evaluation to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objectives. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our objectives.

## Appendix II: Maintain Relative Pay Criteria

SES Rate of Basic Pay Prior to Adjustment	Resulting Rate of Basic Pay After Adjustment	Rating for Most Recent Appraisal Period	Pay Adjustment
<b>Above EX-III*</b>	Above EX-III	Outstanding	May be granted upon approval by Agency head or designee
		Below Outstanding but Above Fully Successful	May be granted by Agency head or designee in rare circumstances (i.e., exceptionally meritorious accomplishment)
		Fully successful or below	May not be granted
<b>At or Below EX-III</b>	Above EX-III	Outstanding	May be granted upon approval by Agency head or designee
		Below Outstanding	May not be granted
<b>Below EX-III</b>	Below EX-III	Fully successful or above	May be granted

\*For purposes of our review, we used the OPM 2015 Rates of Basic Pay for the Executive Schedule (2015-EX). The 2015-EX Level III pay rate (EX-III) is \$168,700.

Source: Generated by OIG based on 5 CFR 534.404(b)(4)(i)-(iii) and supplementary guidance from OPM.



## Appendix III: OIG Schedule of Questioned Costs

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<b>Questioned Costs<sup>12</sup></b>	<b>Amount</b>
<b>Improper MRP increases</b>	<b>\$10,484</b>
<b>12-month rule violation</b>	<b>\$8,793</b>
<b>Total Questioned Costs</b>	<b>\$19,277</b>

Source: Generated by OIG based on analysis of SES personnel files.

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<sup>12</sup> Questioned costs are expenditures that are not supported by adequate documentation at the time of the audit or otherwise do not comply with legal, regulatory, or contractual requirements.

SBA  
CHIEF OPERATING OFFICER'S  
RESPONSE TO MANAGEMENT ADVISORY



U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, DC 20416

Date: July 28, 2017

To: Hannibal M. Ward  
Acting Inspector General

From: Joseph Loddio  
Chief Operating Officer

Elias Hernandez  
Chief Human Capital Officer

Subject: Review of SBA's Practices for Senior Executive Service Initial Pay Setting  
Draft Management Advisory, Project: 15013-B

We are in receipt of the draft management advisory from your office regarding the findings and recommendations to improve SBA's practices for Senior Executive Service (SES) initial pay setting. We thank you and welcome the opportunity to meet with the Office of the Inspector General (OIG) to improve SBA's practices and procedures for setting SES initial pay.

We are in agreement with all findings and recommendations for finding 1, 2, and 4 in the draft management advisory memo. We are partially in agreement with recommendation 3 and suggest an alternative action to meet the intent of the recommendation. We are taking corrective actions on all four recommendations:

1. Remedy the \$10,484 in overpayments for the MRP increases.
2. Remedy the \$8,793 overpayments for the 12-month rule violation.
3. Develop a document separate from SOP 39 20 3 that will provide additional information regarding Maintain Relative Pay (MRP) increases and 12-month rule violations. SOP 39 20 3 was approved and posted on April 12, 2017 replacing SOP 39 20 2A.
4. Ensure current and future OHRS personnel complete training on performance management systems.

We plan on taking the appropriate actions to correct the findings of the review.

1. To satisfy recommendation 1: OHRS will conduct a thorough review of each action identified and resolve the overpayment by December 30, 2017.
2. To satisfy recommendation 2: OHRS will conduct a thorough review of the action identified and resolve the overpayment by December 30, 2017.
3. To satisfy recommendation 3: OHRS will develop a document that provides additional information regarding MRP increases and 12-month rule violations. The document will be signed by the Chief Human Capital Officer, located in the Office of Human Resources Solutions – Executive Resources shared drive, and added as an appendix to the Executive Resources Desk Guide by December 30, 2017.
4. To satisfy recommendation 4: In order to ensure current and future OHRS Executive Resources personnel complete training on performance management systems, OHRS will update the Executive Resources Desk Guide's training section to require new personnel to complete performance management training by December 30, 2017. Current Executive Resources staff have completed performance management systems training by attending Office of Personnel Management workshops in May of 2017 and an Executive Resources Forum in June of 2017.

We appreciate the work of your staff in conducting this review and share your commitment to strengthen the Agency's internal controls regarding SES initial pay setting.