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HUMAN CAPITAL

Building on DOD's Reform Effort to Foster Governmentwide Improvements

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Comptroller General of the United States





Highlights of [GAO-03-851T](#),
testimony before the Committee on
Governmental Affairs, United States
Senate

Why GAO Did This Study

People are at the heart of an organization's ability to perform its mission. Yet a key challenge for the Department of Defense (DOD), as for many federal agencies, is to strategically manage its human capital. DOD's proposed National Security Personnel System would provide for wide-ranging changes in DOD's civilian personnel pay and performance management and other human capital areas. Given the massive size of DOD, the proposal has important precedent-setting implications for federal human capital management.

This testimony provides GAO's observations on DOD human capital reform proposals and the need for governmentwide reform.

www.gao.gov/cgi-bin/getrpt?GAO-03-851T.

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What GAO Found

GAO strongly supports the need for government transformation and the concept of modernizing federal human capital policies both within DOD and for the federal government at large. The federal personnel system is clearly broken in critical respects—designed for a time and workforce of an earlier era and not able to meet the needs and challenges of today's rapidly changing and knowledge-based environment. The human capital authorities being considered for DOD have far-reaching implications for the way DOD is managed as well as significant precedent-setting implications for the rest of the federal government. GAO is pleased that as the Congress has reviewed DOD's legislative proposal it has added a number of important safeguards, including many along the lines GAO has been suggesting, that will help DOD maximize its chances of success in addressing its human capital challenges and minimize the risk of failure.

More generally, GAO believes that agency-specific human capital reforms should be enacted to the extent that the problems being addressed and the solutions offered are specific to a particular agency (e.g., military personnel reforms for DOD). Several of the proposed DOD reforms meet this test. In GAO's view, the relevant sections of the House's version of the National Defense Authorization Act for Fiscal Year 2004 and the proposal that is being considered as part of this hearing contain a number of important improvements over the initial DOD legislative proposal.

Moving forward, GAO believes it would be preferable to employ a governmentwide approach to address human capital issues and the need for certain flexibilities that have broad-based application and serious potential implications for the civil service system, in general, and the Office of Personnel Management, in particular. GAO believes that several of the reforms that DOD is proposing fall into this category (e.g., broad banding, pay for performance, re-employment and pension offset waivers). In these situations, GAO believes it would be both prudent and preferable for the Congress to provide such authorities governmentwide and ensure that appropriate performance management systems and safeguards are in place before the new authorities are implemented by the respective agency. Importantly, employing this approach is not intended to delay action on DOD's or any other individual agency's efforts, but rather to accelerate needed human capital reform throughout the federal government in a manner that ensures reasonable consistency on key principles within the overall civilian workforce. This approach also would help to maintain a level playing field among federal agencies in competing for talent and would help avoid further fragmentation within the civil service.

Chairman Collins and Members of the Committee:

I am pleased to be here today to discuss legislative proposals to help the Department of Defense (DOD) address its current and emerging human capital challenges. Over the past few weeks, I have been honored to appear as a witness before the Congress on three other occasions to discuss this important issue and related DOD human capital concerns.¹ As the House of Representatives has reviewed DOD's legislative proposal, it has added a number of important safeguards, including many along the lines we were suggesting, that will help DOD maximize its chances of success in addressing its human capital challenges and minimize the risk of failure. Furthermore, the proposed National Security Personnel System Act that is the subject of this hearing also includes a significant number of improvements over DOD's initial proposal. I understand that there are important issues that will need to be resolved in conference that obviously have implications for DOD's reform efforts, and may have major implications for governmentwide reform efforts.

We strongly support the need for government transformation and the concept of modernizing federal human capital policies both within DOD and for the federal government at large. The federal personnel system is clearly broken in critical respects—designed for a time and workforce of an earlier era and not able to meet the needs and challenges of our rapidly changing and knowledge-based environment. Nonetheless, I believe that we have made more progress in addressing the government's long-standing human capital challenges in the last 2 years than in the previous 20, and I am confident that we will make more progress in the next 2 years than we have made in the last 2 years.

The human capital authorities being considered for DOD have far-reaching implications for the way DOD is managed as well as significant precedent-setting implications for the rest of the federal government. DOD has almost 700,000 civilian employees. The Department of Homeland Security, which also has broad human capital flexibilities, has about 140,000 civilian

¹ U.S. General Accounting Office, *Human Capital: DOD's Civilian Personnel Strategic Management and the Proposed National Security Personnel System*, [GAO-03-493T](#) (Washington, D.C.: May 12, 2003); *Defense Transformation: DOD's Proposed Civilian Personnel System and Governmentwide Human Capital Reform*, [GAO-03-741T](#) (Washington, D.C.: May 1, 2003); and *Defense Transformation: Preliminary Observations on DOD's Proposed Civilian Personnel Reforms*, [GAO-03-717T](#) (Washington, D.C.: Apr. 29, 2003).

employees. Other federal agencies that have been granted broad authorities, such as the Federal Aviation Administration and the Internal Revenue Service, have many thousands more federal employees. In essence, we are fast approaching the point where “standard governmentwide” human capital policies and procedures are neither standard nor governmentwide. In this environment, we should pursue governmentwide reforms and flexibilities that can be used by many government agencies, subject to agencies having appropriate infrastructures in place before such authorities are put in operation. Considering certain proposed DOD reforms in the context of the need for governmentwide reform could serve to accelerate progress across the government while at the same time incorporating appropriate safeguards to maximize the ultimate chances of success and minimize the potential for abuse and prevent the further fragmentation of the civil service.

More directly, agency-specific human capital reforms should be enacted to the extent that the problems being addressed and the solutions offered are specific to a particular agency (e.g., military personnel reforms for DOD). Several of the proposed DOD reforms meet this test. Importantly, the relevant sections of the House of Representatives’ version of the National Defense Authorization Act for Fiscal Year 2004 and Chairman Collins, Senator Levin, Senator Voinovich, and Senator Sununu’s National Security Personnel System Act, in our view, contain a number of important improvements over the initial DOD legislative proposal.

Moving forward, we believe it would be preferable to employ a governmentwide approach to address human capital issues and the need for certain flexibilities that have broad-based application and serious potential implications for the civil service system, in general, and the Office of Personnel Management (OPM), in particular. We believe that several of the reforms that DOD is proposing fall into this category (e.g., broad banding, pay for performance, re-employment, and pension offset waivers). In these situations, we believe it would be both prudent and preferable for the Congress to provide such authorities governmentwide and ensure that appropriate performance management systems and safeguards are in place before the new authorities are implemented by the respective agencies. This approach would help to maintain a level playing field among federal agencies in competing for talent. Importantly, employing this approach is not intended to delay action on DOD’s or any other individual agency’s efforts.

However, in all cases whether through a governmentwide authority or agency-specific legislation, in our view, such additional authorities should

be put in operation only when an agency has the institutional infrastructure in place to use the new authorities effectively. This institutional infrastructure includes, at a minimum, a human capital planning process that integrates the agency's human capital policies, strategies, and programs with its program goals and mission and desired outcomes; the capabilities to develop and implement a new human capital system effectively; and a modern, effective, and credible performance management system that includes adequate safeguards, including reasonable transparency and appropriate accountability mechanisms, to ensure the fair, effective, and nondiscriminatory implementation of the system.

My recent statements before the Congress have discussed DOD's human capital challenges and have provided comments and suggestions on the initial DOD proposal to create a National Security Personnel System (NSPS). Building on those statements, today I will comment on current DOD human capital reform proposals, including the National Security Personnel System Act, and how those proposals can be used to help leverage governmentwide change.

Observations on Proposed DOD Reforms

As I observed when I first testified on the DOD proposal in April, many of the basic principles underlying DOD's civilian human capital proposals have merit and deserve the serious consideration they are receiving. Secretary Rumsfeld and the rest of DOD's leadership are clearly committed to transforming how DOD does business. Based on our experience, while DOD's leadership has the intent and the ability to transform DOD, the needed institutional infrastructure is not in place within a vast majority of DOD organizations. Our work looking at DOD's strategic human capital planning efforts and looking across the federal government at the use of human capital flexibilities and related human capital efforts underscores the critical steps that DOD needs to take to properly develop and effectively implement any new personnel authorities.² In the absence of the right institutional infrastructure,

² See, for example, U.S. General Accounting Office, *Human Capital: Effective Use of Flexibilities Can Assist Agencies in Managing Their Workforces*, [GAO-03-2](#) (Washington, D.C.: Dec. 6, 2002); *DOD Personnel: DOD Actions Needed to Strengthen Civilian Human Capital Strategic Planning and Integration with Military Personnel and Sourcing Decisions*, [GAO-03-475](#) (Washington, D.C.: Mar. 28, 2003); and *Defense Logistics: Actions Needed to Overcome Capability Gaps in the Public Depot System*, [GAO-02-105](#) (Washington, D.C.: Oct. 12, 2001).

granting additional human capital authorities will provide little advantage and could actually end up doing damage if the authorities are not implemented properly.

The following provides some observations on key provisions of the proposed National Security Personnel System Act in relation to the House version of the National Defense Authorization Act for Fiscal Year 2004. First, I offer some comments on the overall design for a new personnel system at DOD. Second, I provide comments on selected aspects of the proposed system.

DOD's Overall Human Capital Program

The House version of DOD's authorization bill would allow the Secretary of Defense to develop regulations with the Director of OPM to establish a human resources management system for DOD. The Secretary of Defense could waive the requirement for the joint issuance of regulations if, in the Secretary's judgment and subject to the decision of the President, it is "essential to the national security"—which was not defined in the proposed bill. As an improvement, the proposed National Security Personnel System Act also requires that the new personnel system be jointly developed by the Secretary of Defense and the Director of OPM, but does not allow the joint issuance requirement to be waived. This approach is consistent with the one the Congress took in creating the Department of Homeland Security.

The proposed National Security Personnel System Act requires the Secretary of Defense to phase in the implementation of NSPS beginning in fiscal year 2004. Specifically, the new personnel authorities could be implemented for a maximum of 120,000 of DOD's civilian employees in fiscal year 2004, up to 240,000 employees in fiscal year 2005, and more than 240,000 employees in a fiscal year after fiscal year 2005, if the Secretary of Defense determines that, in accordance with the bill's requirement that the Secretary and the Director of OPM jointly develop regulations for DOD's new human resources management system, the Department has in place a performance management system and pay formula that meets criteria specified in the bill. We strongly support a phased approach to implementing major management reforms, whether with the human capital reforms at DOD or with change management initiatives at other agencies or across the government. We suggest that OPM, in fulfilling its role under this section of the bill, certify that DOD has a modern, effective, credible, and, as appropriate, validated performance management system with adequate safeguards, including reasonable

transparency and appropriate accountability mechanisms, in place to support performance-based pay and related personnel decisions.

Employee Appeals Procedures

The proposed National Security Personnel System Act states that the Secretary of Defense may establish an employee appeals process that is fair and ensures due process protections for employees. The Secretary of Defense is required to consult with the Merit Systems Protection Board (MSPB) before issuing any regulations in this area. The DOD appeals process must be based on legal standards consistent with merit system principles and may override legal standards and precedents previously applied by MSPB and the courts in cases related to employee conduct and performance that fails to meet expectations. The bill would allow appeal of any decision adversely affecting an employee and raising a substantial question of law or fact under this process to the Merit Systems Protection Board under specific standards of review, and the Board's decision could be subject to judicial review, as is the case with other MSPB decisions. This proposal affords the employee review by an independent body and the opportunity for judicial review along the lines that we have been suggesting.

DOD Human Capital Reform Evaluation and Reporting

The proposed National Security Personnel System Act does not include an evaluation or reporting requirement from DOD on the implementation of its human capital reforms, although DOD has stated that it will continue its evaluation of the science and technology reinvention laboratory demonstration projects when they are integrated under a single human capital framework. We believe an evaluation and reporting requirement would facilitate congressional oversight of NSPS, allow for any midcourse corrections in its implementation, and serve as a tool for documenting best practices and sharing lessons learned with employees, stakeholders, other federal agencies, and the public. Specifically, the Congress should consider requiring that DOD fully track and periodically report on the implementation and results of its new human capital program. Such reporting could be on a specified timetable with sunset provisions. These required evaluations could be broadly modeled on the evaluation requirements of OPM's personnel demonstration program. Under the demonstration project authority, agencies must evaluate and periodically report on results, implementation of the demonstration project, cost and benefits, impacts on veterans and other Equal Employment Opportunity groups, adherence to merit principles, and the extent to which the lessons from the project can be applied elsewhere, including governmentwide. The reports could be done in consultation with or subject to review of OPM.

Specific DOD Human Capital Policies and Practices

Performance Management and Pay Reform

There is widespread understanding that the basic approach to federal pay is outdated and that we need to move to a more market- and performance-based approach. Doing so will be essential if we expect to maximize the performance and assure the accountability of the federal government for the benefit of the American people. DOD has said that broad banded performance management and pay for performance systems will be the cornerstone of its new system.

Reasonable people can and will debate and disagree about the merits of individual reform proposals. However, all should be able to agree that a modern, reliable, effective, and validated performance management system with adequate safeguards, including reasonable transparency and appropriate accountability mechanisms, must serve as the fundamental underpinning of any successful results-oriented pay reform. We are pleased that both the House version of DOD's fiscal year 2004 authorization bill and the proposed National Security Personnel System Act contain statutory safeguards and standards along the lines that we have been suggesting to help ensure that DOD's pay for performance efforts are fair to employees and improve both individual and organizational performance.

The statutory standards described in the National Security Personnel System Act proposal are intended to help ensure a fair, credible, and equitable system that results in meaningful distinctions in individual employee performance; employee involvement in the design and implementation of the system; and effective transparency and accountability measures, including appropriate independent reasonableness reviews, internal grievance procedures, internal assessments, and employee surveys. In our reviews of agencies' performance management systems—as in our own experience with designing and implementing performance-based pay reform for ourselves at GAO—we have found that these safeguards are key to maximizing the chances of success and minimizing the risk of failure and abuse.

The proposed National Security Personnel System Act also takes the essential first step in requiring DOD to link the performance management system to the agency's strategic plan. Building on this, we suggest that DOD should also be required to link its performance management system to program and performance goals and desired outcomes. Linking the

performance management system to related goals and desired outcomes helps the organization ensure that its efforts are properly aligned and reinforces the line of sight between individual performance and organizational success so that an individual can see how her/his daily responsibilities contribute to results and outcomes.

The proposed National Security Personnel System Act includes a detailed list of elements that regulations for DOD's broad band pay program must cover. These elements appear to be taken from DOD's experience with its civilian acquisition workforce personnel demonstration project as well as the plan, as described in an April 2, 2003 *Federal Register* notice to integrate all of DOD's current science and technology reinvention laboratory demonstration projects under a single human capital framework.³ Many of the required elements in the proposed National Security Personnel System Act are entirely appropriate, such as a communication and feedback requirement, a review process, and a process for addressing performance that fails to meet expectations. However, other required elements, such as "performance scores", appear to imply a particular approach to performance management that, going forward, may or may not be appropriate for DOD, and therefore may have the unintended consequence of reducing DOD's flexibility to make adjustments. Congress has an important and continuing role to play in the design and implementation of the federal government's personnel policies and procedures. Congress should consider how best to balance its responsibilities with agencies' needs for the flexibility to respond to changing circumstances.

Finally, under the proposed act, for fiscal years 2004 through 2008, the overall amount allocated for compensation for civilian employees of an organizational or functional unit of DOD that is included in NSPS shall not be less than the amount of civilian pay that would have been allocated to such compensation under the General Schedule. After fiscal year 2008, DOD's regulations are to provide a formula for calculating an overall amount, which is to ensure that employees in NSPS are not disadvantaged in terms of the overall amount of pay available as a result of their conversion into NSPS while providing DOD with flexibility to accommodate changes in the function of the organization, the mix of employees performing those functions, and other changes that might affect pay levels.

³ 68 *Fed. Reg.* 16,119-16,142 (2003).

Congress has had a longstanding and legitimate interest in federal employee pay and compensation policies and, as a result, there are provisions consistent with that interest in the National Security Personnel System Act. However, as currently constructed, the proposed bill may have the unintended consequence of creating disincentives, until fiscal year 2009, for DOD to ensure that it has the most effective and efficient organizational structure in place. This is because, based on our understanding of the bill's language, if DOD were to reorganize, outsource, or undertake other major change initiatives through 2008 in an organizational or functional unit that is part of NSPS, DOD may still be required to allocate an overall amount for compensation to the reorganized unit based on the number and mix of employees in place prior to conversion into NSPS. In other words, if priorities shift and DOD needs to downsize a unit in NSPS significantly, it may still be required that the downsized unit's overall compensation level remain the same as it would have been in the absence of the downsizing. While pay protections during a transition period are generally appropriate to build employee support for the changes, we believe that, should the Congress decide to require overall organizational compensation protection, it should build in additional flexibilities for DOD to make adjustments in response to changes in the size of organizations, mix of employees, and other relevant factors.

DOD Senior Executive Service Performance and Pay Reforms

The current allowable total annual compensation limit for senior executives would be increased up to the Vice President's total annual compensation (base pay, locality pay, and awards and bonuses) in the proposed National Security Personnel System Act and the House National Defense Authorization Act for Fiscal Year 2004. In addition, the highest rate of (base) pay for senior executives would be increased in the House version of the authorization bill.

The Homeland Security Act provided that OPM, with the concurrence of the Office of Management and Budget, certify that agencies have performance appraisal systems that, as designed and applied, make meaningful distinctions based on relative performance before an agency could increase its total annual compensation limit for senior executives. While the House version of DOD's fiscal year 2004 authorization bill would still require an OPM certification process to increase the highest rate of pay for senior executives, neither the proposed National Security Personnel System Act nor the House bill would require such a certification for increasing the total annual compensation limit for senior executives.

To be generally consistent with the Homeland Security Act, we believe that the Congress should require that OPM certify that the DOD senior executive service (SES) performance management system makes meaningful distinctions in performance and employs the other practices used by leading organizations to develop effective performance management systems, including establishing a clear, direct connection between (1) SES performance ratings and rewards and (2) the degree to which the organization achieved its goals. DOD would be required to receive the OPM certification before it could increase the total annual compensation limit and/or the highest rate of pay for its senior executives.

Attracting Key Talent for DOD

The National Security Personnel System Act contains a number of provisions designed to give DOD flexibility to help obtain key critical talent. It allows DOD greater flexibility to (1) hire experts and pay them special rates for temporary periods up to six years, and (2) define benefits for certain specialized overseas employees. Specifically, the Secretary would have the authority to establish a program to attract highly qualified experts in needed occupations with the flexibility to establish the rate of pay, eligibility for additional payments, and terms of the appointment. These authorities give DOD considerable flexibility to obtain and compensate individuals and exempt them from several provisions of current law. Consistent with our earlier suggestions, the bill would limit the number of experts employed at any one time to 300. The Congress should also consider requiring that these provisions only be used to fill critically needed skills identified in a DOD strategic human capital plan, and that DOD report on the use of the authorities under these sections periodically.

Governmentwide Human Capital Reforms

As I mentioned at the outset of my statement today, the consideration of human capital reforms for DOD naturally suggests opportunities for governmentwide reform as well. The following provides some suggestions in that regard.

Governmentwide Performance-Based Pay and Other Human Capital Authorities

We believe that the Congress should consider providing governmentwide authority to implement broad banding, other pay for performance systems, and other personnel authorities whereby whole agencies are allowed to use additional authorities after OPM has certified that they have the institutional infrastructures in place to make effective and fair use of those authorities. To obtain additional authority, an agency should be required to have an OPM-approved human capital plan that is fully integrated with the agency's strategic plan. These plans need to describe the agency's

critical human capital needs and how the new provisions will be used to address the critical needs. The plan should also identify the safeguards or other measures that will be applied to ensure that the authorities are carried out fairly and in a manner consistent with merit system principles and other national goals.

Furthermore, the Congress should establish statutory principles for the standards that an agency must have in place before OPM can grant additional pay flexibilities. The standards for DOD's performance management system contained in the National Security Personnel System Act are the appropriate place to start. An agency would have to demonstrate, and OPM would have to certify, that a modern, effective, credible, and, as appropriate, validated performance management system with adequate safeguards, including reasonable transparency and appropriate accountability mechanisms, is in place to support more performance-based pay and related personnel decisions before the agency could put the new system in operation. OPM should be required to act on any individual certifications within prescribed time frames (e.g., 30–60 days).

Consistent with our suggestion to have DOD evaluate and report on its efforts, agencies should also be required to evaluate the use of any new pay or other human capital authorities periodically. Such evaluations, in consultation with or subject to review of OPM, could be broadly modeled on the evaluation requirements of OPM's personnel demonstration program.

Governmentwide SES Performance and Pay Reforms

Additional efforts should be undertaken to move the SES to an approach where pay and rewards are more closely tied to performance. This is consistent with the proposed Senior Executive Service Reform Act of 2003. Any effort to link pay to performance presupposes that effective, results-oriented strategic and annual performance planning and reporting systems are in place in an agency. That is, agencies must have a clear understanding of the program results to be achieved and the progress that is being made toward those intended results if they are to link pay to performance. The SES needs to take the lead in matters related to pay for performance.

Performance Management Improvement Funds

We believe it would be highly desirable for the Congress to establish a governmentwide fund where agencies, based on a sound business case, could apply to OPM for funds to be used to modernize their performance

management systems and ensure that those systems have adequate safeguards to prevent abuse. Too often, agencies lack the performance management systems needed to effectively and fairly make pay and other personnel decisions.

The basic idea of a governmentwide fund would be to provide for targeted investments needed to prepare agencies to use their performance management systems as strategic tools to achieve organizational results and drive cultural change. Building such systems and safeguards will likely require making targeted investments in agencies' human capital programs, as our own experience has shown. (If successful, this approach to targeted investments could be expanded to foster and support agencies' related transformation efforts, including other aspects of the High Performing Organization concept recommended by the Commercial Activities Panel.⁴)

Additional Targeted Governmentwide Reforms

Finally, we also believe that the Congress should enact additional targeted and governmentwide human capital reforms for which there is a reasonable degree of consensus. Many of the provisions in the proposed Federal Workforce Flexibility Act of 2003 and the governmentwide human capital provisions of the House version of DOD's fiscal year 2004 authorization bill fall into this category.

Summary Observations

Since we designated strategic human capital management as a governmentwide high-risk area in January 2001, the Congress, the administration, and agencies have taken steps to address the federal government's human capital shortfalls. In a number of statements before the Congress over the last 2 years, I have urged the government to seize on the current momentum for change and enact lasting improvements. Significant progress has been—and is being—made in addressing the federal government's pressing human capital challenges. But experience has shown that in making major changes in the cultures of organizations,

⁴The panel was mandated by section 832 of the National Defense Authorization Act for Fiscal Year 2001, which required the Comptroller General to convene a panel of experts to study the process used by the federal government to make sourcing decisions. After a yearlong study, the panel published its report on April 30, 2002. See Commercial Activities Panel, *Improving the Sourcing Decisions of the Government: Final Report* (Washington, D.C.: Apr. 30, 2002). The report can be found on GAO's Web site at www.gao.gov under the Commercial Activities Panel heading.

how it is done, when it is done, and the basis on which it is done can make all the difference in whether we are ultimately successful.

DOD and other agency-specific human capital reforms should be enacted to the extent that the problems being addressed and the solutions offered are specific to particular agencies. A governmentwide approach should be used to address certain flexibilities that have broad-based application and serious potential implications for the civil service system, in general, and OPM, in particular. This approach will help to accelerate needed human capital reform in DOD and throughout the rest of the federal government.

Chairman Collins and Members of the Committee, this concludes my prepared statement. I would be pleased to respond to any questions that you may have.

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