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May 31, 2005

The Honorable John Warner
Chairman
The Honorable Carl Levin
Ranking Member
Committee on Armed Services
United States Senate

Subject: *Questions for the Record Regarding the Department of Defense's National Security Personnel System*

It was a pleasure to appear before the Committee on April 14, 2005, to discuss the Department of Defense's (DOD) implementation of the National Security Personnel System (NSPS).¹ This letter responds to your request for my views on the following questions for the record.

Questions from Senator Inhofe

American Federation of Government Employees

Please comment on each of the “flashpoints” that the AFGE has raised through Mr. Gage’s written statement:

Q. “DOD has proposed radically reducing the scope of collective bargaining in the proposed regulations. . . . The proposed regulations do not follow the law with respect to its instructions to maintain collective bargaining rights for affected DOD employees.”

Our previous work on individual agencies’ human capital systems has not directly addressed the scope of specific issues that should or should not be subject to collective bargaining and negotiations.

Q. “The board that hears labor-management disputes arising from NSPS must be independent of DOD management. . . . In the proposed NSPS regulations, DOD would establish an internal board made up entirely of individuals appointed by the Secretary.”

¹ GAO, *Human Capital: Preliminary Observations on Proposed Regulations for DOD’s National Security Personnel System*, [GAO-05-559T](#) (Washington, D.C.: Apr. 14, 2005).

In our previous testimonies on the proposed and final Department of Homeland Security (DHS) regulations, we stressed the importance of the actual and perceived independence and impartiality of such boards.² Members of these types of boards should be, and appear to be, free from interference in the legitimate performance of their duties and should adjudicate cases in an impartial manner, free from initial bias and conflicts of interest.

Consistent with fostering board independence and impartiality, DOD's proposed NSPS regulations provide for staggered-term appointments for members of the proposed National Security Labor Relations Board and place some limited conditions on the removal of a member. For example, members of the Board would be appointed for terms of 3 years, except that the appointments of the initial Board members will be for terms of 1, 2, and 3 years. The Secretary of Defense may extend the term of any member beyond 3 years when necessary to provide for an orderly transition and/or appoint the member for up to two additional 1-year terms. DOD could further enhance the independence and impartiality of the Board through the appointment and removal process of Board members. This could include such areas as (1) a nomination panel that reflects input from appropriate parties and a reasonable degree of balance among differing views and interests in the composition of the Board to ensure credibility and (2) appropriate notification to interested parties in the event that a Board member is removed.

The proposed regulations allow the Secretary of Defense to appoint and remove individual Board members; however, this raises the question of the independence of the Board. If the proposed regulations were modified to allow the Secretary of Defense to appoint but not remove members, then this may help the credibility and independence of the Board.

Q. “The standard for mitigation by the Merit System Protection Board (MSPB) of discipline and penalties imposed on employees under NSPS in the proposed regulations is virtually impossible to meet and effectively removes the possibility of mitigation.”

The U.S. Merit Systems Protection Board will not know the actual impact until a number of cases are adjudicated.

Q. “. . . under the proposed regulations, not only is there no requirement for management to present written standards against which performance will be measured, but employees are also denied the right. . .to use negotiated grievance and arbitration system. . . .”

² GAO, *Human Capital: Preliminary Observations on Proposed DHS Human Capital Regulations*, [GAO-04-479T](#) (Washington, D.C.: Feb. 25, 2004) and *Human Capital: Preliminary Observations on Final Department of Homeland Security Human Capital Regulations*, [GAO-05-320T](#) (Washington, D.C.: Feb. 10, 2005).

On the basis of our previous work, we believe that performance standards should be written. We also advocate the use of competencies—the skills, knowledge, and abilities staff need to accomplish the work. We have found that competencies can help reinforce employee behaviors and actions that support the department’s mission, goals, and values, and can provide a consistent message to employees about how they are expected to achieve results. These core competencies must be in writing to assure that managers, supervisors, and employees see and understand the criteria that will be used to manage and assess employee performance.

Regarding grievance and arbitration systems, during testimony in April 2005, we reaffirmed our position that there should be both informal and formal appeal mechanisms within and outside of the organization if individuals feel that there has been abuse or a violation of the policies, procedures, and protected rights of the individual. Internal mechanisms could include independent Human Capital Office and Office of Opportunity and Inclusiveness reviews that provide reasonable assurances that there would be consistency and nondiscrimination.³ Furthermore, it is of critical importance that the external appeal process be independent, efficient, effective, and credible. As DOD’s human resources management system efforts move forward, DOD will need to define, in more detail than is currently provided, how it plans to review such matters as the establishment and implementation of the performance appraisal system—and, subsequently, performance rating decisions, pay determinations, and promotion actions—before these actions are finalized to ensure they are merit based.

Q. “Strong and unambiguous safeguards must be in place to prevent a general lowering of pay for DOD civilian workforce. The proposed regulations permit a general reduction in salaries for all DOD personnel compared to rates they would have been paid under statutory systems.”

Under the proposed regulations, DOD could not reduce employees’ basic rates of pay when converting to pay bands. However, employees’ compensation may increase at a rate higher or lower than under the current compensation system because under NSPS compensation is designed to be (1) market sensitive, with consideration of local market conditions to set pay rates, and (2) performance based.

Q. “Procedures for deciding who will be affected by a reduction in force must be based on more than a worker’s most recent performance appraisal. The proposed NSPS regulation would allow an employee with 1 year of service and an outstanding rating to have superior retention rights to an employee with 30 years of outstanding appraisals and 1 year of having been rated merely “above average.”

³ GAO, *Human Capital: Preliminary Observations on Proposed Department of Defense National Security Personnel System Regulations*, [GAO-05-517T](#) (Washington, D.C.: Apr. 12, 2005).

Under DOD's proposed regulations, greater emphasis will be given to job performance in the reduction-in-force process by placing performance ahead of length of service. Under the proposed regulations, employees will be placed on a competitive group's retention list in the following order of precedence: (1) tenure group, (2) veterans' preference, (3) individual performance rating, and (4) length of service. DOD may also establish a minimum reduction-in-force competitive area on the basis of one or more of the following factors: geographic location(s), line(s) of business, product line(s), organizational unit(s), and funding line(s). The proposed regulations provide DOD with the flexibility to define competitive groups on the basis of career group, pay schedule, occupational series or specialty, pay band, and/or trainee status.

Questions from Senator Lieberman

Civilian Pay

Q. John Gage in his testimony expressed concern that the NSPS will create downward pressure on DOD civilian pay. Are there mechanisms that you could suggest to assure that pay levels are adequate for employee recruitment and retention and to truly reward good performance?

We have observed that a competitive compensation system can help organizations attract and retain a quality workforce.⁴ To begin to develop such a system, organizations assess the skills and knowledge they need; compare compensation against other public, private, or nonprofit entities competing for the same talent in a given locality; and classify positions along levels of responsibility. While one size does not fit all, organizations generally structure their competitive compensation systems to separate base salary—which all employees receive—from other special incentives, such as merit increases, performance awards, or bonuses, which are provided based on performance and contributions to organizational results.

We have reported that direct costs associated with salaries were one of the major cost drivers of implementing pay for performance systems, based on the data provided us by selected Office of Personnel Management demonstration projects.⁵ We found that some of the demonstration projects intended to manage costs by providing a mix of one-time awards and permanent pay increases. Rewarding an employee's performance with an award instead of an equivalent increase to base pay can help contain salary costs in the long run because the agency only has to pay the amount of the award one time, rather than annually.

⁴ GAO, *Additional Posthearing Questions Related to Proposed Department of Homeland Security (DHS) Human Capital Regulations*, [GAO-04-617R](#) (Washington, D.C.: Apr. 30, 2004).

⁵ GAO, *Human Capital: Implementing Pay for Performance at Selected Personnel Demonstration Projects*, [GAO-04-83](#) (Washington, D.C.: Jan. 23, 2004).

This practice is consistent with modern compensation systems, which typically include a mix of base pay increases plus other compensation incentives, such as one-time performance awards or bonuses. In developing pay for performance systems, agencies must consider what percentage of performance-based pay should be awarded as base pay increases versus one-time cash increases while still maintaining fiscally sustainable compensation systems that reward performance. In addition, to the costs associated with base pay increases, modern compensation systems typically consider an employee's salary in relation to a competitive range when determining the amount of performance pay that should be provided as a base pay adjustment versus a cash bonus amount. This base versus bonus concept differs from the largely longevity driven base pay adjustments provided to employees under the General Schedule. This new direction concerns employees, especially those who are close to retirement, who see these regular base pay increases as the foundation of future retirement benefits.

Safeguards Against Abuse

Q. In your testimony you expressed concern that the proposed regulations do not contain adequate safeguards to help ensure fairness and guard against abuse. Could you elaborate on what kinds of safeguards you believe should be considered in this context?

As we noted in our statement, although DOD's proposed regulations provide for some safeguards to ensure fairness and guard against abuse, additional safeguards should be developed. We have developed an initial list of possible safeguards to help ensure that pay-for-performance systems in the government are fair, effective, and credible.⁶ The safeguards include, among other things, the following.

- Assure that certain predecisional internal safeguards exist to help achieve the consistency, equity, nondiscrimination, and nonpoliticization of the performance management process (e.g., independent reasonableness reviews by Human Capital Offices and/or Offices of Opportunity and Inclusiveness or their equivalent in connection with the establishment and implementation of a performance appraisal system, as well as reviews of performance rating decisions, pay determinations, and promotion actions before they are finalized to ensure that they are merit-based; internal grievance processes to address employee complaints; and pay panels whose membership is predominately made up of career officials who would consider the results of the performance appraisal process and other information in connection with final pay decisions).
- Assure that there are reasonable transparency and appropriate accountability mechanisms in connection with the results of the performance management

⁶ GAO, *Defense Transformation: Preliminary Observations on DOD's Proposed Civilian Personnel Reforms*, [GAO-03-717T](#) (Washington, D.C.: Apr. 29, 2003).

process. This includes reporting periodically on internal assessments and employee survey results relating to the performance management system and publishing overall results of performance management and individual pay decisions while protecting individual confidentiality.

- Assure that the agency's performance management systems (1) link to the agency's strategic plan, related goals, and desired outcomes and (2) result in meaningful distinctions in individual employee performance. This should include consideration of critical competencies and achievement of concrete results.
- Involve employees, their representatives, and other stakeholders in the design of the system, including having employees directly involved in validating any related competencies, as appropriate.

Q. Do you know of agencies where such mechanisms have proven effective to guard against unfairness and abuse in a pay-for-performance system?

The list of safeguards mentioned above are based on our extensive body of work looking at the performance management practices used by leading public sector organizations both in the United States and in other countries. However, we previously reported that DHS created a Homeland Security Compensation Committee that is to provide oversight and transparency to the compensation process. The committee—consisting of 14 members, including 4 officials of labor organizations—is to develop recommendations and options for the Secretary's consideration on compensation and performance management matters, including the annual allocation of funds between market and performance pay adjustments. We also reported that high performing organizations seek to create pay, incentive, and reward systems based on valid, reliable, and transparent performance management systems with adequate safeguards and link employee knowledge, skills, and contributions to organizational results.⁷ To that end, we found that the demonstration projects took a variety of approaches to designing and implementing their pay for performance systems to meet the unique needs of their cultures and organizational structures. For example, the Department of Commerce uses a second-level review process as a safeguard. In this review process, the pay pool manager is to review recommended scores from subordinate supervisors and select a payout for each employee. The pay pool manager is to present the decisions to the next higher official for review if the pay pool manager is also a supervisor. In addition, the department had a grievance procedure that allowed employees to request reconsideration of performance decisions, excluding awards, by the pay pool manager through the department's Administrative Grievance Procedure or appropriate negotiated grievance procedures.

⁷ GAO-04-83.

Questions from Senator Akaka

Employee Training

Q. An issue raised repeatedly in discussions over the personnel changes at DOD and DHS is the need for adequate training for all employees on the new personnel system. Have you looked into this issue, and if so, what recommendations do you have regarding the amount, type, or regularity of personnel training that is needed to launch and sustain a new personnel system?

As we noted in our report, *Human Capital: A Guide for Assessing Strategic Training and Development Efforts in the Federal Government*,⁸ training and developing new and current staff to fill new roles and work in different ways will be a crucial part of the federal government's endeavors to meet its transformation challenges. DOD and DHS are significant components of this transformation.

In April 2004, GAO and the National Commission on the Public Service Implementation Initiative hosted a forum on whether there should be a governmentwide framework for human capital reform and, if so, what this framework should include. As part of the criteria that agencies should have in place as they plan for and manage their new human capital authorities, participants generally agreed that adequate resources for planning, implementation, training, and evaluation were needed. Additionally, they noted that agencies should ensure adequate training as they implement new human capital authorities.

Selected Office of Personnel Management personnel demonstration projects trained employees on the performance management system prior to implementation to make employees aware of the new approach, as well as periodically after implementation to refresh employee familiarity with the system. The training was designed to help employees understand their applicable competencies and performance standards; develop performance plans; write self-appraisals; become familiar with how performance is evaluated and how pay increases and awards decisions are made; and know the roles and responsibilities of managers, supervisors, and employees in the appraisal and payout processes. According to the DHS regulations, its performance management system is designed to incorporate adequate training and retraining for supervisors, managers, and employees in the implementation and operation of the system.

GAO currently is reviewing training and development issues at DHS. Our work includes a review of DHS's training efforts on its new personnel system, maxHR. Our report is scheduled to be released this fall.

⁸ GAO, *Human Capital: A Guide for Assessing Strategic Training and Development Efforts in the Federal Government*, [GAO-04-546G](#) (Washington, D.C.: March 2004).

Employee Performance

Q. Both the DHS and DOD personnel systems permit managers to convey performance expectations to employees orally. I think this can put employees at a disadvantage, especially as their pay will be more closely tied to their performance. How can employees be held accountable for performance expectations provided orally?

To help enhance credibility and fairness and avoid any problems, some sort of written documentation of performance expectations is appropriate, in addition to orally communicating performance expectations. However, the means can vary.

Guard Against Abuse

Q. You testified as to the lack of details in the NSPS proposed regulations, including the absence of adequate safeguards to ensure fairness and guard against abuse in measuring performance and paying employees. What sort of oversight do you believe is needed to promote consistency of the performance management system and do you believe external review of pay and performance decisions is necessary?

In April 2003, when commenting on DOD civilian personnel reforms, we testified that Congress should consider establishing statutory standards that an agency must have in place before it can implement a more performance-based pay program, and we developed an initial list of possible safeguards to help ensure that pay-for-performance systems in the government are fair, effective, and credible.⁹ One of the safeguards we identified is to assure that certain predecisional internal safeguards exist to help achieve the consistency, equity, nondiscrimination, and nonpoliticization of the performance management process. For example, independent reasonableness reviews by Human Capital Offices and/or Offices of Opportunity and Inclusiveness or their equivalent in connection with the establishment and implementation of a performance appraisal system, as well as reviews of performance rating decisions, pay determinations, and promotion actions before they are finalized to ensure that they are merit-based; internal grievance processes to address employee complaints; and pay panels whose membership is predominately made up of career officials who would consider the results of the performance appraisal process and other information in connection with final pay decisions.

Q. What kind of external review would you propose?

We reported that independent reasonableness reviews by Human Capital Offices and/or Offices of Opportunity and Inclusiveness or their equivalent in connection with the establishment and implementation of a performance appraisal system and

⁹ GAO-03-717T.

the effective implementation of a compensation committee similar to the Homeland Security Compensation Committee are important to assuring that predecisional internal safeguards exist to help achieve consistency and equity and assure nondiscrimination and nonpoliticization of the performance management process.¹⁰

In our report on implementing pay for performance at selected personnel demonstration projects, we mentioned that some of the demonstration projects implemented as safeguards a second-level review and grievance process, as these examples illustrate.

Second-level review process:

- Second-level supervisors are to review all assessments. In addition, an overall assessment of “highly successful” is to be sent to the appropriate department’s Performance Review Board for the assignment of an official rating of “1” or “2”. The supervisor and reviewer are to assign a “4” or “5” rating based on a problem-solving team’s findings and a personnel advisor’s input.
- Pay pool managers review recommended scores from supervisors and select a payout for each employee. The pay pool manager is to present the decisions to the next higher official for review if the pay pool manager is also a supervisor.

Grievance process:

- Employees may request reconsideration of their ratings in writing to the third-level supervisor and indicate why a higher rating is warranted and what rating is desired. The third-level supervisor can either grant the request or request that a recommending official outside of the immediate organization or chain of authority be appointed. The employee is to receive a final decision in writing within 21 calendar days.
- Employees may grieve their ratings and actions affecting the general pay increase or performance pay increases. An employee covered by a negotiated grievance procedure is to use that procedure to grieve his or her score. An employee not under a negotiated grievance procedure is to submit the grievance first to the rating official, who will submit a recommendation to the pay pool panel. The pay pool panel may accept the rating official’s recommendation or reach an independent decision. The pay pool panel’s decision is final unless the employee requests reconsideration by the next higher official to the pay pool manager. The official would then render the final decision on the grievance.

¹⁰ GAO-04-320T.

Employee Appeals Process

Q. The proposed regulations provide for an accelerated MSPB adjudication process for employee appeals. I have long been concerned about the impact a shortened processing time for one agency may have on employees at other agencies with cases pending before the MSPB. Do you believe the NSPS regulations will have an adverse effect on employee appeals both at DOD and at other federal agencies?

The U.S. Merit Systems Protection Board will not know the actual impact until a number of cases are adjudicated.

Question from Senator Nelson

Performance-Based Pay System

Q. What do you recommend to minimize or mitigate risks?

The key to a successful organizational transformation is to implement strategies to help individuals maximize their full potential in the new organization, while simultaneously managing the risk of reduced productivity and effectiveness that often occurs as a result of the changes. While there is no one right way to manage a successful merger, acquisition, or transformation, the experiences of both successful and unsuccessful efforts suggest that there are practices that are key to their success. These key practices include the following.

1. *Ensure top leadership drives the transformation.* Leadership must set the direction, pace, and tone and provide a clear, consistent rationale that brings everyone together behind a single mission.
2. *Focus on a key set of principles and priorities at the outset of the transformation.* A clear set of principles and priorities serves as a framework to help the organization create a new culture and drive employee behaviors.
3. *Set implementation goals and a timeline to build momentum and show progress from day one.* Goals and a timeline are essential because the transformation could take years to complete.
4. *Dedicate an implementation team to manage the transformation process.* A strong and stable team is important to ensure that the transformation receives the needed attention to be sustained and successful.
5. *Establish a communication strategy to create shared expectations and report related progress.* The strategy must reach out to employees, customers, and stakeholders and engage them in a two-way exchange.¹¹

¹¹ GAO, *Results-Oriented Cultures: Implementation Steps to Assist Mergers and Organizational Transformations*, [GAO-03-669](#) (Washington, D.C.: July 2, 2003).

For additional information on our work on human capital issues at DOD, please contact me on 512-5559 or stewartd@gao.gov, or Eileen Larence, Director, Strategic Issues, on governmentwide human capital issues at 512-6510 or larencee@gao.gov.

A handwritten signature in black ink that reads "Derek B. Stewart". The signature is written in a cursive, flowing style.

Derek B. Stewart
Director, Defense Capabilities and
Management