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HUMAN CAPITAL

Preliminary Observations on the Administration's Draft Proposed "Working for America Act"

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GAO-06-142T

October 5, 2005

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Highlights

Highlights of GAO-06-142T, a testimony before the Subcommittee on the Federal Workforce and Agency Organization, Committee on Government Reform, U.S. House of Representatives

Why GAO Did This Study

The federal government must have the capacity to plan more strategically, react more expeditiously, and focus on achieving results. Critical to the success of this transformation are the federal government's people—its human capital. We have commended the progress that has been made in addressing human capital challenges in the last few years. Still, significant opportunities exist to improve strategic human capital management to respond to current and emerging 21st century challenges. A key question, for example, is how to update the federal government's classification and compensation systems to be more market-based and performance-oriented.

The Administration's draft proposed "Working for America Act" is intended to ensure that agencies are equipped to better manage, develop, and reward their employees. Under this proposal, the Office of Personnel Management (OPM) is to design a new core classification and pay system, among other things. In addition, the draft proposal amends some provisions of Title 5 covering labor management relations and adverse actions and appeals.

This testimony presents preliminary observations on the draft proposal; presents the principles, criteria, and processes for human capital reform; and suggests next steps for selected and targeted actions.

www.gao.gov/cgi-bin/getrpt?GAO-06-142T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Lisa Shames at (202) 512-6806 or shamesl@gao.gov.

What GAO Found

GAO supports moving forward with appropriate human capital reforms and believes that implementing more market-based and performance-oriented pay systems is both doable and desirable. Importantly, broad-based human capital reform must be part of a broader strategy of change management and performance improvement initiatives and cannot be simply overlaid on existing ineffective performance management systems. In addition, organizations need to build up their basic management capacity and must have adequate resources to properly design and effectively implement more market-based and performance-oriented systems.

Before implementing dramatic human capital reforms, executive branch agencies should follow a phased approach that meets a "show me" test. That is, each agency should be authorized to implement a reform only after it has shown it has met certain conditions, including an assessment of its related institutional infrastructure and an independent certification by OPM that such infrastructure meets specified statutory standards. In any event, OPM's and agencies' related efforts should be monitored by Congress.

Given the above, GAO has the following observations on the draft proposal.

- Congress should make pay and performance management reforms the first step in governmentwide reforms. The draft proposal incorporates many of the key principles of more market-based and performance-oriented pay systems and requires that OPM certify that each agency's pay for performance system meets prescribed criteria. Going forward, OPM should define in regulation what it will take in terms of fact-based and data-driven analyses for agencies to demonstrate that they are ready to receive this certification and implement new authorities.
- OPM should play a key leadership and oversight role in helping individual agencies and the government as a whole work towards overcoming a broad range of human capital challenges. OPM's role would be expanded in several areas under the draft proposal. It is unclear whether OPM has the current capacity to discharge these new responsibilities.
- Congress should move more cautiously in connection with labor management relations and adverse actions and appeals reforms. Selected federal agencies have been implementing more market-based and performance-oriented pay systems for some time and thus they have built a body of experience and knowledge about what works well and what does not that allows the sharing of lessons learned. On the other hand, the federal government has had far less experience in changes regarding labor management relations and adverse actions and appeals. Congress may wish to monitor the Departments of Homeland Security's and Defense's implementation of related authorities, including lessons learned, before moving forward in these areas for the rest of the federal government.

Chairman Porter, Representative Davis, and Members of the Subcommittee:

I appreciate the opportunity to be here today to discuss human capital reform and to offer preliminary observations on the Administration's draft proposed "Working for America Act," which is intended to ensure that agencies are equipped to better manage, develop, and reward their employees. In order to respond to a daunting array of governance and fiscal challenges in the 21st century, the federal government must have the institutional capacity to plan more strategically, react more expeditiously, and focus on achieving results. Critical to the success of this transformation are the federal government's people—its human capital. We have commended the progress that has been made in addressing human capital challenges in the last few years. Still, significant opportunities exist to improve strategic human capital management to respond to current and emerging 21st century challenges.[1] For example, the government has not transformed, in many cases, how it classifies, compensates, develops, and motivates its employees to achieve maximum results within available resources and existing authorities. Thus, a key question for the 21st century is "How should the federal government update its compensation systems to be more market-based and performance-oriented?"[2]

Congress has recognized that federal agencies will need the most effective human capital systems to succeed in their transformations and has given selected agencies statutory authorities intended to help them manage their people strategically to achieve results.[3] Most recently, the Departments of Homeland Security (DHS) and Defense (DOD) received the authority to

[1]GAO, *High-Risk Series: An Update*, GAO-05-207 (Washington, D.C.: January 2005) and GAO, *High-Risk Series: Strategic Human Capital Management*, GAO-03-120 (Washington, D.C.: January 2003).

[2]GAO, *21st Century Challenges: Reexamining the Base of the Federal Government*, GAO-05-325SP (Washington, D.C.: February 2005).

[3]GAO, *Human Capital: Selected Agencies' Statutory Authorities Could Offer Options in Developing a Framework for Governmentwide Reform*, GAO-05-398R (Washington, D.C.: Apr. 21, 2005).

establish "flexible and contemporary" human capital and pay systems.[4] GAO has also received human capital authorities that have given our agency the tools to more effectively support Congress in meeting its constitutional responsibilities. We strive to lead by example and understand that effective implementation of any new policies and procedures is of critical importance.

Before discussing the Administration's draft proposal as we understand it, I would like to emphasize the following three themes that I believe are critical to considering any governmentwide approach to civil service reform.

- First and foremost, we need to move forward with appropriate human capital reforms, but how it is done, when it is done, and the basis on which it is done can make all the difference in whether such efforts are successful. Human capital reforms to date recognize that the "one-size-fits-all" approach is not appropriate to all agencies' demands, challenges, and missions. However, we have reported that a reasonable degree of consistency across the government is still desirable and that broader reforms should be guided by a common framework consisting of principles, criteria, and processes.[5]

- Before implementing dramatic human capital reforms, executive branch agencies should follow a phased approach that meets a "show me" test. That is, each agency should be authorized to implement a reform only after it has shown it has met certain conditions, including an assessment of its institutional infrastructure to effectively, efficiently, economically, and fairly implement any new authorities. The Office of Personnel Management (OPM) should also independently certify that such infrastructure meets specified statutory standards before the agency could implement such reforms. In any event, OPM's and agencies' related efforts should be monitored by Congress.

[4]For more information on DHS's and DOD's human capital authorities, see for example, GAO, *Human Capital: Preliminary Observations on Final Department of Homeland Security Human Capital Regulations*, GAO-05-320T (Washington, D.C.: Feb. 10, 2005) and GAO, *Human Capital: Preliminary Observations on Proposed DOD National Security Personnel System Regulations*, GAO-05-432T (Washington, D.C.: Mar. 15, 2005).

[5]GAO and the National Commission on the Public Service Implementation Initiative, *Highlights of a Forum: Human Capital: Principles, Criteria, and Processes for Governmentwide Federal Human Capital Reform*, GAO-05-69SP (Washington, D.C.: Dec. 1, 2004).

- GAO strongly supports the need to expand pay reform in the federal government and believes that implementing more market-based and performance-oriented pay systems is both doable and desirable. Specifically, pay increases should no longer be treated as an entitlement but should be based on employees' contributions to the organizations' missions and goals. However, GAO's and other organizations' experiences demonstrate that the shift to more market-based and performance-oriented pay must be part of a broader strategy of change management and performance improvement initiatives and cannot be simply overlaid on existing ineffective performance management systems[6].

Hearings such as this one today offer opportunities for stakeholders to express their views as we move forward with human capital reforms. As I have testified on other occasions, reasonable people can and will disagree about the merits of an individual proposal. This morning I would like to speak broadly about the Administration's draft proposal and highlight three preliminary observations based on our understanding of it.

- Congress should make pay and performance management reforms the first step in governmentwide reforms. The draft proposal incorporates many of the key principles of more market-based and performance-oriented pay systems and requires that OPM certify that each agency's pay for performance system meets prescribed criteria. Going forward, OPM should define in regulation what it will take in terms of fact-based and data-driven analyses for agencies to demonstrate that they are ready to receive this certification and implement new authorities.

- Second, OPM should play a key leadership and oversight role in helping individual agencies and the government as a whole work towards overcoming a broad range of human capital challenges. OPM's role would be expanded in several areas under the draft proposal. It is unclear whether OPM has the current capacity to discharge these new responsibilities.

- Third, Congress should move more cautiously in connection with labor management relations and adverse actions and appeals reforms. Selected federal agencies have been implementing more market-based

[6]GAO, *Human Capital: Symposium on Designing and Managing Market-Based and More Performance-Oriented Pay Systems*, GAO-05-832SP (Washington, D.C.: July 27, 2005).

and performance-oriented pay for some time—some organizations for well over a decade—and thus they have built a body of experience and knowledge about what works well and what does not that allows the sharing of lessons learned. On the other hand, the federal government has had far less experience in changes regarding labor management relations and adverse actions and appeals. Congress granted DHS and DOD related new authorities in these areas and may wish to monitor the implementation of those authorities, including lessons learned, before moving forward for the rest of the federal government.

I will now provide some more specific comments on the Administration's draft proposal. I will then suggest next steps for human capital reform, including selected and targeted authorities and a framework comprised of principles, criteria, and processes for governmentwide reform.

The Administration's Draft Proposed "Working for America Act"

The draft proposed "Working for America Act" is intended to ensure that agencies are equipped to better manage, develop, and reward employees to better serve the American people.[7] Its purpose is to establish a federal human capital system under which employees have clear performance goals and opportunities for professional growth; managers who help them succeed; and pay increases based on performance rather than the passage of time. In addition, any new flexibilities are to be exercised in accordance with the merit system principles; related core values; and protections, such as against discrimination, political influence, and personal favoritism, of the civil service. Today I will provide observations on three central areas of the draft proposal as we understand it: pay and performance management; OPM's new responsibilities to implement the proposed pay reform; and labor management relations and adverse actions and appeals.

Pay and Performance Management

As I stated earlier, GAO strongly supports the need to expand pay reform in the federal government and believes that implementing more market-based and performance-oriented pay systems is both doable and desirable. The federal government's current pay system is weighted toward rewarding length of service rather than individual performance and contributions; automatically providing across-the-board annual pay increases, even to

[7]The observations made today are based on the draft version given to GAO dated July 18, 2005.

poor performers. It also compensates employees living in various localities without adequately considering the local labor market rates applicable to the diverse types of occupations in the area. Importantly, the draft proposal, as we understand it, incorporates many of the key practices of more market-based and performance-oriented pay systems and requires that OPM certify that each agency's pay for performance system meet prescribed criteria. Going forward, OPM should define in regulation what fact-based and data-driven analyses agencies will need to provide to OPM to receive certification.

More Market-Based and Performance-Oriented Pay

Clearly, a competitive compensation system can help organizations attract and retain a quality workforce. 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 various levels of responsibility. In addition, organizations generally structure their competitive compensation systems to separate base salary from bonuses and other incentives and awards.

Under the draft proposal, OPM is to design a new core classification and pay system and agencies, in coordination with OPM, are to establish performance appraisal systems to promote high performance. Specifically, the General Schedule is to be repealed and to replace it, OPM is to establish pay bands for occupational groups based on factors such as mission, competencies, or relevant labor market features. For each pay band, OPM is to establish ranges of basic pay rates that apply in all locations. There are to be market-oriented pay adjustments. The governmentwide national market adjustment is to vary by occupational group and band with the flexibility to make additional local market adjustments. Going forward, more information is needed on what compensation studies are to be conducted in setting these market-based pay rates.

Effective performance management systems can be a vital tool for aligning the organization with desired results and creating a "line of sight" showing how team, unit, and individual performance can contribute to overall organizational results. Such systems work to achieve three key objectives: (1) they strive to provide candid and constructive feedback to help individuals maximize their contribution and potential in understanding and realizing the goals and objectives of the organization, (2) they seek to provide management with the objective and fact-based information it needs to reward top performers, and (3) they provide the necessary information and documentation to deal with poor performers.

The draft proposal incorporates many of the key practices that we have reported have helped agencies implement effective performance management systems.[8] These practices include:

Linking Organizational Goals to Individual Performance. Under the draft proposal, agencies are to set performance expectations that support and align with the agencies' mission and strategic goals, organizational program and policy objectives, annual performance plans, results, and other measures of performance. Further, agencies are to communicate the performance expectations in writing at the beginning of the appraisal period.

Making Meaningful Distinctions in Performance. Supervisors and managers are to be held accountable for making meaningful distinctions among employees based on performance, fostering and rewarding excellent performance, and addressing poor performance, among other things. Agencies are not to impose a forced distribution of performance ratings in terms of fixed numeric or percentage limitations on any summary rating levels. Performance appraisal systems are to include at least two summary rating levels, essentially a "pass/fail" system, for employees in an "Entry/Developmental" band and at least three summary rating levels for other employee groups.

Pass/fail systems by definition will not provide meaningful distinctions in performance ratings. In addition, while a three-level system might be workable, using four or five summary rating levels is preferable since it naturally allows for greater performance rating and pay differentiation. Moreover, this approach is consistent with the new governmentwide performance-based pay system for the members of the Senior Executive Service (SES), which requires agencies to use at least four summary rating levels to provide a clear and direct link between SES performance and pay as well as to make meaningful distinctions based on relative performance.[9] Cascading this approach to other levels of employees can help agencies recognize and reward employee contributions and achieve the highest levels of individual performance.

[8]GAO, *Results-Oriented Cultures: Creating a Clear Linkage between Individual Performance and Organizational Success*, GAO-03-488 (Washington, D.C.: Mar. 14, 2003).

[9]For more information, see GAO, *Human Capital: Senior Executive Performance Management Can Be Significantly Strengthened to Achieve Results*, GAO-04-614 (Washington, D.C.: May 26, 2004).

Linking Pay to Performance. Employees must receive at least a "fully successful" rating to receive any pay increase. Those employees who receive less than a fully successful rating are not to receive an increase, including the national and local market adjustments discussed above. Performance pay increases for employees are to be allocated by the "performance shares" of a pay pool. Agencies are to determine the value of one performance share, expressed as a percentage of the employee's basic pay or as a fixed dollar amount. There are to be a set number of performance shares for each pay pool so that the employees with higher performance ratings are to receive a greater number of shares and thus, a greater payout. At the agency's discretion, any portion of the employee's performance pay increase not converted to a basic pay increase may be paid out as a lump-sum payment.

Providing Adequate Safeguards to Ensure Fairness and Guard Against Abuse. Agencies are to incorporate effective safeguards to ensure that the management of systems is fair and equitable and based on employee performance in order to receive certification of their pay for performance systems. We have found that a common concern that employees express about any pay for performance system is whether their supervisors have the ability and willingness to assess employees' performance fairly. Using safeguards, such as having independent reasonableness reviews of performance management decisions before such decisions are final, can help to allay these concerns and build a fair and credible system. This has been our approach at GAO and we have found it works extremely well.

In addition, agencies need to assure reasonable transparency and provide appropriate accountability mechanisms in connection with the results of the performance management process. This can include publishing internally the overall results of performance management and individual pay decisions while protecting individual confidentiality. For example, we found that several of OPM's demonstration projects publish information for employees on internal Web sites that include the overall results of performance appraisal and pay decisions, such as the average performance rating, the average pay increase, and the average award for the organization and for each individual unit.[10] GAO is also publishing aggregate data for all

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

of our pay, promotion, and other important agency-wide human capital actions.

OPM Certification

As I noted, before implementing any human capital reforms, executive branch agencies should follow a phased approach that meets a "show me" test. That is, each agency should be authorized to implement a reform only after it has shown it has met certain requirements, including an assessment of its institutional infrastructure and an independent certification by OPM of the existence of this infrastructure. This institutional infrastructure includes (1) a strategic human capital planning process linked to the agency's overall strategic plan; (2) capabilities to design and implement a new human capital system effectively; (3) a modern, effective, credible, and validated performance management system that provides a clear linkage between institutional, unit, and individual performance-oriented outcomes, and results in meaningful distinctions in ratings; and (4) adequate internal and external safeguards to ensure the fair, effective, and nondiscriminatory implementation of the system.

A positive feature of the draft proposal is that agencies are to show that their pay for performance systems have met prescribed criteria in order to receive certification from OPM to implement their new systems. Among these criteria are having the means for ensuring employee involvement in the design and implementation of the pay for performance system; adequate training and retraining for supervisors, managers, and employees in the implementation and operation of the pay for performance system; a process for ensuring periodic performance feedback and dialogue between supervisors, managers, and employees throughout the appraisal period; and the means for ensuring that adequate agency resources are allocated for the design, implementation, and administration of the pay for performance system. Further, OPM may review an agency's pay for performance systems periodically to assess whether they continue to meet the certification criteria. If they do not, OPM may rescind the agency's certification and direct the agency to take actions to implement an appropriate system, which the agency must follow.

Going forward, I believe that OPM should define in regulation what it will take in terms of fact-based and data-driven analyses for agencies to demonstrate that they are ready to receive this certification. Clearly, the President's Management Agenda, and its standards for the strategic management of human capital, can inform the certification process. Also, as an example of the analyses that have been required, OPM has outlined in regulations for the SES performance-based pay system the necessary data

and information agencies need to provide in order to receive certification and thus raise the pay cap and total compensation limit for their senior executives. Specifically, agencies must provide, among other things, the data on senior executives' performance ratings, pay, and awards for the last 2 years to demonstrate that their systems, as designed and applied, make meaningful distinctions based on relative performance. Under the SES regulations, agencies that cannot provide these data can request provisional certification of their systems. In our view such provisional certifications should not be an option under any broad-based classification and compensation reform proposal.

OPM's Roles and Responsibilities

OPM should play a key leadership and oversight role in helping individual agencies and the government as a whole work towards overcoming a broad range of human capital challenges. Our understanding of the Administration's draft proposal is that OPM's leadership and oversight role is to expand in several areas, such as establishing a more market-based and performance-oriented pay system governmentwide and implementing a new core classification system. At the request of Chairman Collins and Ranking Member Lieberman, Senate Committee on Homeland Security and Governmental Affairs, along with Chairman Voinovich and Ranking Member Akaka, Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia, and to assist Congress as it considers OPM's additional responsibilities as outlined in this draft proposal, we are assessing OPM's current capacity to lead a broad-based governmentwide human capital reform effort, including providing appropriate assistance to federal agencies as they revise their human capital systems and conducting effective monitoring of any related reform implementation efforts.

OPM is in the process of its own transformation—from being a rulemaker, enforcer, and independent agent to being more of a consultant, toolmaker, and strategic partner in leading and supporting executive agencies' human capital reform efforts and management systems. However, it is unclear whether OPM has the current capacity to discharge its new responsibilities. Specifically, OPM reported in its June 2001 workforce analysis that 4.2 percent of its employees (about 123 per year), on average, were projected to retire each year over the next 10 years, and the largest percentage of projected retirements, about 8 percent each year, would come from members of its SES. OPM's expected retirement rate for its workforce overall is more than the annual retirement rate of 2 percent governmentwide that we identified in a report issued in 2001.[11]

Our prior work has shown that when required to implement new legislation, OPM could have done more to accomplish its leadership and oversight mission in a decentralized human capital environment. For example, Congress passed a law in 1990 authorizing agencies to repay, at their discretion, their employees' student loans as a means to recruit and retain a talented workforce. In 2001, OPM issued final regulations to implement the program. The regulations were subsequently changed in 2004 to reflect legislative amendments that increased the ceiling on annual and total loan repayments. In our review of the federal student loan repayment program, we found that while human capital officials recognized OPM's efforts, they felt they could use more assistance on the technical aspects of operating the program, more coordination in sharing lessons learned in implementing it, and help consolidating some of the program processes.[12]

Similarly, we found that while OPM had several initiatives underway to assist federal agencies in using personnel flexibilities currently available to them in managing their workforces, OPM could more fully meet its leadership role to assist agencies in identifying, developing, and applying human capital flexibilities across the federal government.[13] In addition, we reported that in its ongoing internal review of its existing regulations and guidance, OPM could more directly focus on determining the continued relevance and utility of its regulations and guidance by asking whether they provide the flexibility that agencies need in managing their workforces while also incorporating protections for employees.

Labor Management Relations and Adverse Actions and Appeals

The Administration's draft proposal would amend some provisions of Title 5 of the U.S. Code covering labor management relations and adverse actions and appeals. Selected federal agencies have been implementing more market-based and performance-oriented pay for some time—some organizations for well over a decade—and thus they have built a body of

[11]GAO, *Federal Employee Retirements: Expected Increase Over the Next 5 Years Illustrates Need for Workforce Planning*, GAO-01-509 (Washington, D.C.: Apr. 27, 2001).

[12]GAO, *Federal Student Loan Repayment Program: OPM Could Build on Its Efforts to Help Agencies Administer the Program and Measure Results*, GAO-05-762 (Washington, D.C.: July 22, 2005).

[13]GAO, *Human Capital: OPM Can Better Assist Agencies in Using Personnel Flexibilities*, GAO-03-428 (Washington, D.C.: May 9, 2003).

experience and knowledge about what works well and what does not that allows the sharing of lessons learned. On the other hand, the federal government has had far less experience in changes regarding labor management relations and adverse actions and appeals. Congress granted DHS and DOD related new authorities in these areas and may wish to monitor the implementation of those authorities, including lessons learned, before moving forward for the rest of the federal government. Discussion of selected proposed amendments follows.

Labor Management Relations

Under Title 5, agencies now have a duty to bargain over conditions of employment, other than those covered by a federal statute; a governmentwide rule or regulation; or an agency rule or regulation for which the agency can demonstrate a compelling need. Under the draft proposal, agencies are to be obligated to bargain with employees only if the effect of the change in policy on the bargaining unit (or the affected part of the unit) is "foreseeable, substantial, and significant in terms of impact and duration."

In addition, an agency now has the right to take any action to carry out the agency's mission in an emergency, without a duty to bargain. However, what constitutes an emergency can be defined through a collective bargaining agreement. Under the draft proposal, an agency is to have the right to take any action to prepare for, practice for, or prevent an emergency, or to carry out the agency's mission in an emergency. The draft proposal also adds a new definition of "emergency" as requiring immediate action to carry out critical agency functions, including situations involving an (1) adverse effect on agency resources, (2) increase in workload because of unforeseeable events, (3) externally imposed change in mission requirements, or (4) externally imposed budget exigency. By broadly defining "emergency" without time limits and adding to management's right an explicit authority to take action to prepare for, practice for, or prevent any emergency, the proposed change as we understand it, could serve to significantly restrict the scope of issues subject to collective bargaining.

Adverse Actions and Appeals

Under Title 5, conduct-based adverse actions are reviewed by the Merit Systems Protection Board (MSPB) under the preponderance of the evidence standard (there is more evidence than not to support the action). Performance-based adverse actions are reviewed under the lower standard of substantial evidence (evidence that a reasonable person would find sufficient to support a conclusion), but agencies must first give employees a reasonable opportunity to demonstrate acceptable performance under a performance improvement plan. Under the draft proposal, MSPB is to

apply a single standard of proof—the higher standard of preponderance of the evidence—to review adverse actions taken for either performance or conduct. On the other hand, while due process features, such as advance written notice of a proposed adverse action are still required, performance improvement plans are no longer required. As we understand the draft proposal, applying the same standard to both types of adverse actions could add more consistency to the appeals process.

Also under Title 5, MSPB now reviews penalties during the course of a disciplinary action against an employee to ensure that the agency considered relevant prescribed factors and exercised management discretion within tolerable limits of reasonableness. MSPB may mitigate or modify a penalty if the agency did not consider prescribed factors. Under the draft proposal, MSPB will be able to mitigate a penalty only if it is totally unwarranted in light of all pertinent circumstances. This change would restrict MSPB's ability to mitigate penalties.

Framework for Governmentwide Human Capital Reform

To help advance the discussion concerning how governmentwide human capital reform should proceed, GAO and the National Commission on the Public Service Implementation Initiative co-hosted a forum on whether there should be a governmentwide framework for human capital reform and, if so, what this framework should include.[14] While there was widespread recognition among the forum participants that a one-size-fits-all approach to human capital management is not appropriate for the challenges and demands government faces, there was equally broad agreement that there should be a governmentwide framework to guide human capital reform. Further, a governmentwide framework should balance the need for consistency across the federal government with the desire for flexibility so that individual agencies can tailor human capital systems to best meet their needs. Striking this balance would not be easy to achieve, but is necessary to maintain a governmentwide system that is responsive enough to adapt to agencies' diverse missions, cultures, and workforces.

While there were divergent views among the forum participants, there was general agreement on a set of principles, criteria, and processes that would serve as a starting point for further discussion in developing a

[14]GAO-05-69SP.

governmentwide framework in advancing human capital reform, as shown in figure 1. We believe that these principles, criteria, and processes provide an effective framework for Congress and other decision makers to use as they consider and craft governmentwide civil service reform proposals.

Figure 1: Principles, Criteria, and Processes

Principles that the government should retain in a framework for reform because of their inherent, enduring qualities:

- Merit principles that balance organizational mission, goals, and performance objectives with individual rights and responsibilities
- Ability to organize, bargain collectively, and participate through labor organizations
- Certain prohibited personnel practices
- Guaranteed due process that is fair, fast, and final

Criteria that agencies should have in place as they plan for and manage their new human capital authorities:

- Demonstrated business case or readiness for use of targeted authorities
- An integrated approach to results-oriented strategic planning and human capital planning and management
- Adequate resources for planning, implementation, training, and evaluation
- A modern, effective, credible, and integrated performance management system that includes adequate safeguards to help ensure equity and prevent discrimination

Processes that agencies should follow as they implement new human capital authorities:

- Prescribing regulations in consultation or jointly with the Office of Personnel Management
- Establishing appeals processes in consultation with the Merit Systems Protection Board
- Involving employees and stakeholders in the design and implementation of new human capital systems
- Phasing in implementation of new human capital systems
- Committing to transparency, reporting, and evaluation
- Establishing a communications strategy
- Assuring adequate training

Source: GAO.

Next Steps for Human Capital Reform

Moving forward with human capital reform, in the short term, Congress should consider selected and targeted actions to continue to accelerate the momentum to make strategic human capital management the centerpiece of the government's overall transformation effort. One option may be to provide agencies one-time, targeted investments that are not built into

agencies' bases for future year budget requests. For example, Congress established the Human Capital Performance Fund to reward agencies' highest performing and most valuable employees. However, the draft proposal proposes to repeal the Human Capital Performance Fund. According to OPM, the provision was never implemented, due to lack of sufficient funding. We believe that a central fund has merit and can help agencies build the infrastructure that is necessary in order to implement a more market-based and performance-oriented pay system. To be eligible, agencies would submit plans for approval by OPM that incorporated features such as a link between pay for performance and the agency's strategic plan, employee involvement, ongoing performance feedback, and effective safeguards to ensure fair management of the system. In the first year of implementation, up to 10 percent of the amount appropriated would be available to train those involved in making meaningful distinctions in performance. These features are similar to those cited in the draft proposal as the basis for OPM's certification for agencies to implement their new pay and performance management systems.

In addition, as agencies develop their pay for performance systems, they will need to consider the appropriate mix between pay awarded as base pay increases versus one-time cash increases, while still maintaining fiscally sustainable compensation systems that reward performance. A key question to consider is how the government can make an increasing percentage of federal compensation dependent on achieving individual and organizational results by, for example, providing more compensation as one-time cash bonuses rather than as permanent salary increases. However, agencies' use of cash bonuses or other monetary incentives has an impact on employees' retirement calculations since they are not included in calculating retirement benefits. Congress should consider potential legislative changes to allow cash bonuses that would otherwise be included as base pay increases to be calculated toward retirement and thrift savings benefits by specifically factoring bonuses into the employee's basic pay for purposes of calculating the employee's "high-3" for retirement benefits and making contributions to the thrift savings plan.

As we continue to move forward with broader human capital reforms, they should be guided by a framework consisting of principles, criteria, and processes. While the reforms to date have recognized that the "one-size-fits-all" approach is not appropriate to all agencies' demands, challenges, and missions, a reasonable degree of consistency across the government is still desirable. Striking this balance is not easy to achieve, but is necessary

to maximize the federal government's performance within available resources and assure accountability for the benefit of the American people.

Chairman Porter, Representative Davis, and Members of the Subcommittee, this concludes my statement. I would be pleased to respond to any questions that you may have.

Contact and Acknowledgments

For further information regarding this statement, please contact Lisa Shames, Acting Director, Strategic Issues, at (202) 512-6806 or shamesl@gao.gov. Individuals making key contributions to this statement include Anne Inserra, Carole Cimitile, Janice Latimer, Belva Martin, Jeffrey McDermott, and Katherine H. Walker.

Highlights of Selected GAO Reports

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Highlights

Highlights of GAO-05-1048T, a testimony before the Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

The federal government must have the capacity to plan more strategically, react more expeditiously, and focus on achieving results. Critical to the success of this transformation are the federal government's people—its human capital. Yet, in many cases the federal government has not transformed how it classifies, compensates, develops, and motivates its employees to achieve maximum results within available resources and existing authorities. A key question is how to update the federal government's compensation system to be market-based and more performance-oriented.

To further the discussion of federal pay reform, GAO partnered with key human capital stakeholders to convene a symposium in March 2005 to discuss public, private, and nonprofit organizations' successes and challenges in designing and managing market-based and more performance-oriented pay systems.

This testimony presents the strategies that organizations considered in designing and managing market-based and more performance-oriented pay systems and describes how they are implementing them.

www.gao.gov/cgi-bin/getrpt?GAO-05-1048T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Lisa Shames at (202) 512-6806 or shamesl@gao.gov.

September 27, 2005

HUMAN CAPITAL

Designing and Managing Market-Based and More Performance-Oriented Pay Systems

What GAO Found

GAO strongly supports the need to expand pay reform in the federal government. While implementing market-based and more performance-oriented pay systems is both doable and desirable, organizations' experiences in designing and managing their pay systems underscored three key themes that can guide federal agencies' efforts.

- The shift to market-based and more performance-oriented pay must be part of a broader strategy of change management and performance improvement initiatives.
- Market-based and more performance-oriented pay cannot be simply overlaid on most organizations' existing performance management systems. Rather, as a precondition to effective pay reform, individual expectations must be clearly aligned with organizational results, communication on individual contributions to annual goals must be ongoing and two-way, meaningful distinctions in employee performance must be made, and cultural changes must be undertaken.
- Organizations need to build up the basic management capacity of their organizations. Training and developing new and current staff to fill new roles and work in different ways will play a crucial part in building the capacity of the organizations.

Organizations presenting at our symposium considered the following strategies in designing and managing their pay systems.

1. Focus on a set of values and objectives to guide the pay system.
2. Examine the value of employees' total compensation to remain competitive in the market.
3. Build in safeguards to enhance the transparency and help ensure the fairness of pay decisions.
4. Devolve decision making on pay to appropriate levels.
5. Provide training on leadership, management, and interpersonal skills to facilitate effective communication.
6. Build consensus to gain ownership and acceptance for pay reforms.
7. Monitor and refine the implementation of the pay system.

Moving forward, it is possible to enact broad-based reforms that would enable agencies to move to market-based and more performance-oriented pay systems. However, before implementing reform, each executive branch agency should demonstrate and the Office of Personnel Management should certify that the agency has the institutional infrastructure in place to help ensure that the pay reform is effectively and equally implemented. At a minimum, this infrastructure includes a modern, effective, credible, and validated performance management system in place that provides a clear linkage between institutional, unit, and individual performance-oriented outcomes; results in meaningful distinctions in ratings; and incorporates adequate safeguards.

United States Government Accountability Office

GAO
Accountability · Integrity · Reliability
Highlights

Highlights of GAO-05-832SP

July 2005

HUMAN CAPITAL

Symposium on Designing and Managing Market-Based and More Performance-Oriented Pay Systems

Why GAO Convened This Symposium

Critical to the success of the federal government's transformation are its people—human capital. Yet the government has not transformed, in many cases, how it classifies, compensates, develops, and motivates its employees to achieve maximum results within available resources and existing authorities. One of the questions being addressed as the federal government transforms is how to update its compensation system to be more market based and performance oriented.

To further the discussion of federal pay reform, GAO, the U.S. Office of Personnel Management, the U.S. Merit Systems Protection Board, the National Academy of Public Administration, and the Partnership for Public Service convened a symposium on March 9, 2005, to discuss organizations' experiences with market-based and more performance-oriented pay systems. Representatives from public, private, and nonprofit organizations made presentations on the successes and challenges they experienced in designing and managing their market-based and more performance-oriented pay systems. A cross section of human capital stakeholders was invited to further explore these successes and challenges and engage in open discussion. While participants were asked to review the overall substance and context of the draft summary, GAO did not seek consensus on the key themes and supporting examples.

www.gao.gov/cgi-bin/getrpt?GAO-05-832SP.

To view the full product, including the scope and methodology, click on the link above. For more information, contact J. Christopher Mihm at (202) 512-6806 or mihmj@gao.gov.

What Participants Said

While implementing market-based and more performance-oriented pay systems is both doable and desirable, organizations' experiences show that the shift to market-based and more performance-oriented pay must be part of a broader strategy of change management and performance improvement initiatives. GAO identified the following key themes that highlight the leadership and management strategies these organizations collectively considered in designing and managing market-based and more performance-oriented pay systems.

1. Focus on a set of values and objectives to guide the pay system. Values represent an organization's beliefs and boundaries and objectives articulate the strategy to implement the system.

2. Examine the value of employees' total compensation to remain competitive in the market. Organizations consider a mix of base pay plus other monetary incentives, benefits, and deferred compensation, such as retirement pay, as part of a competitive compensation system.

3. Build in safeguards to enhance the transparency and ensure the fairness of pay decisions. Safeguards are the precondition to linking pay systems with employee knowledge, skills, and contributions to results.

4. Devolve decision making on pay to appropriate levels. When devolving such decision making, overall core processes help ensure reasonable consistency in how the system is implemented.

5. Provide training on leadership, management, and interpersonal skills to facilitate effective communication. Such skills as setting expectations, linking individual performance to organizational results, and giving and receiving feedback need renewed emphasis to make such systems succeed.

6. Build consensus to gain ownership and acceptance for pay reforms. Employee and stakeholder involvement needs to be meaningful and not pro forma.

7. Monitor and refine the implementation of the pay system. While changes are usually inevitable, listening to employee views and using metrics helps identify and correct problems over time.

These organizations found that the key challenge with implementing market-based and more performance-oriented pay is changing the culture. To begin to make this change, organizations need to build up their basic management capacity at every level of the organization. Transitioning to these pay systems is a huge undertaking and will require constant monitoring and refining in order to implement and sustain the reforms.

United States Government Accountability Office

GAO Accountability · Integrity · Reliability

Highlights

Highlights of GAO-04-83, a report to congressional requesters

January 2004

HUMAN CAPITAL

Implementing Pay for Performance at Selected Personnel Demonstration Projects

Why GAO Did This Study

There is a growing understanding that the federal government needs to fundamentally rethink its current approach to pay and to better link pay to individual and organizational performance. Federal agencies have been experimenting with pay for performance through the Office of Personnel Management's (OPM) personnel demonstration projects.

GAO identified the approaches that selected personnel demonstration projects have taken to implement their pay for performance systems. These projects include: the Navy Demonstration Project at China Lake (China Lake), the National Institute of Standards and Technology (NIST), the Department of Commerce (DOC), the Naval Research Laboratory (NRL), the Naval Sea Systems Command Warfare Centers (NAVSEA) at Dahlgren and Newport, and the Civilian Acquisition Workforce Personnel Demonstration Project (AcqDemo). We selected these demonstration projects based on factors such as status of the project and makeup of employee groups covered.

We provided drafts of this report to officials in the Department of Defense (DOD) and DOC for their review and comment. DOD provided written comments concurring with our report. DOC provided minor technical clarifications and updated information. We provided a draft of the report to the Director of OPM for her information.

www.gao.gov/cgi-bin/getrpt?GAO-04-83.

To view the full product, including the scope and methodology, click on the link above. For more information, contact J. Christopher Mihm at (202) 512-6806 or mihmj@gao.gov.

What GAO Found

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, as shown in the table below.

Demonstration Project Approaches to Implementing Pay for Performance
Using competencies to evaluate employee performance.
High-performing organizations use validated core competencies as a key part of evaluating individual contributions to organizational results. To this end, AcqDemo and NRL use core competencies for all positions. Other demonstration projects, such as NIST, DOC, and China Lake, use competencies based on the individual employee's position.
Translating employee performance ratings into pay increases and awards.
Some projects, such as China Lake and NAVSEA's Newport division, established predetermined pay increases, awards, or both depending on a given performance rating, while others, such as DOC and NIST, delegated the flexibility to individual pay pools to determine how ratings would translate into performance pay increases, awards, or both. The demonstration projects made some distinctions among employees' performance.
Considering current salary in making performance-based pay decisions.
Several of the demonstration projects, such as AcqDemo and NRL, consider an employee's current salary when making performance pay increases and award decisions to make a better match between an employee's compensation and contribution to the organization.
Managing costs of the pay for performance system.
According to officials, salaries, training, and automation and data systems were the major cost drivers of implementing their pay for performance systems. The demonstration projects used a number of approaches to manage the costs.
Providing information to employees about the results of performance appraisal and pay decisions.
To ensure fairness and safeguard against abuse, performance-based pay programs should have adequate safeguards, including reasonable transparency in connection with the results of the performance management process. To this end, several of the demonstration projects publish information, such as the average performance rating, performance pay increase, and award.

Source: GAO.

GAO strongly supports the need to expand pay for performance in the federal government. How it is done, when it is done, and the basis on which it is done can make all the difference in whether such efforts are successful. High-performing organizations continuously review and revise their performance management systems. These demonstration projects show an understanding that how to better link pay to performance is very much a work in progress at the federal level. Additional work is needed to strengthen efforts to ensure that performance management systems are tools to help them manage on a day-to-day basis. In particular, there are opportunities to use organizationwide competencies to evaluate employee performance that reinforce behaviors and actions that support the organization's mission, translate employee performance so that managers make meaningful distinctions between top and poor performers with objective and fact-based information, and provide information to employees about the results of the performance appraisals and pay decisions to ensure reasonable transparency and appropriate accountability mechanisms are in place.

United States General Accounting Office

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Highlights

Highlights of GAO-03-488, a report to congressional requesters

March 2003

RESULTS-ORIENTED CULTURES

Creating a Clear Linkage between Individual Performance and Organizational Success

Why GAO Did This Study

The federal government is in a period of profound transition and faces an array of challenges and opportunities to enhance performance, ensure accountability, and position the nation for the future. High-performing organizations have found that to successfully transform themselves, they must often fundamentally change their cultures so that they are more results-oriented, customer-focused, and collaborative in nature. To foster such cultures, these organizations recognize that an effective performance management system can be a strategic tool to drive internal change and achieve desired results.

Based on previously issued reports on public sector organizations' approaches to reinforce individual accountability for results, GAO identified key practices that federal agencies can consider as they develop modern, effective, and credible performance management systems.

www.gao.gov/cgi-bin/getrpt?GAO-03-488.

To view the full report, including the scope and methodology, click on the link above. For more information, contact J. Christopher Mihm at (202) 512-6806 or mihmj@gao.gov.

What GAO Found

Public sector organizations both in the United States and abroad have implemented a selected, generally consistent set of key practices for effective performance management that collectively create a clear linkage—"line of sight"—between individual performance and organizational success. These key practices include the following.

1. Align individual performance expectations with organizational goals. An explicit alignment helps individuals see the connection between their daily activities and organizational goals.

2. Connect performance expectations to crosscutting goals. Placing an emphasis on collaboration, interaction, and teamwork across organizational boundaries helps strengthen accountability for results.

3. Provide and routinely use performance information to track organizational priorities. Individuals use performance information to manage during the year, identify performance gaps, and pinpoint improvement opportunities.

4. Require follow-up actions to address organizational priorities. By requiring and tracking follow-up actions on performance gaps, organizations underscore the importance of holding individuals accountable for making progress on their priorities.

5. Use competencies to provide a fuller assessment of performance. Competencies define the skills and supporting behaviors that individuals need to effectively contribute to organizational results.

6. Link pay to individual and organizational performance. Pay, incentive, and reward systems that link employee knowledge, skills, and contributions to organizational results are based on valid, reliable, and transparent performance management systems with adequate safeguards.

7. Make meaningful distinctions in performance. Effective performance management systems strive to provide candid and constructive feedback and the necessary objective information and documentation to reward top performers and deal with poor performers.

8. Involve employees and stakeholders to gain ownership of performance management systems. Early and direct involvement helps increase employees' and stakeholders' understanding and ownership of the system and belief in its fairness.

9. Maintain continuity during transitions. Because cultural transformations take time, performance management systems reinforce accountability for change management and other organizational goals.

United States General Accounting Office

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