

# ALTERNATIVE PERSONNEL SYSTEMS: ASSESSING PROGRESS IN THE FEDERAL GOVERNMENT

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## HEARING

BEFORE THE

OVERSIGHT OF GOVERNMENT MANAGEMENT,  
THE FEDERAL WORKFORCE AND THE DISTRICT  
OF COLUMBIA SUBCOMMITTEE

OF THE

COMMITTEE ON  
HOMELAND SECURITY AND  
GOVERNMENTAL AFFAIRS  
UNITED STATES SENATE

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# **ALTERNATIVE PERSONNEL SYSTEMS: ASSESSING PROGRESS IN THE FEDERAL GOVERNMENT**

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**TUESDAY, SEPTEMBER 27, 2005**

U.S. SENATE,  
OVERSIGHT OF GOVERNMENT MANAGEMENT, THE FEDERAL  
WORKFORCE, AND THE DISTRICT OF COLUMBIA SUBCOMMITTEE,  
OF THE COMMITTEE ON HOMELAND SECURITY  
AND GOVERNMENTAL AFFAIRS,  
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 10:07 a.m., in room SD-342, Dirksen Senate Office Building, Hon. George V. Voinovich, Chairman of the Subcommittee, presiding.

Present: Senators Voinovich, Collins (ex officio), Akaka, and Carper.

## **OPENING STATEMENT OF SENATOR VOINOVICH**

Senator VOINOVICH. The Subcommittee will please come to order.

Good morning and thank you all for coming. I am particularly pleased that the Chairman of our Committee is here with us. Thank you for being here, and my good friend, Senator Akaka, the Ranking Member of the Subcommittee.

Today's hearing, Alternative Personnel Systems: Assessing Progress in the Federal Government, will assess the progress of Federal agencies in utilizing established workforce authorities to develop alternative personnel systems.

I first of all would like to thank Senator Akaka for being at today's hearing. Senator Akaka continues to be a strong partner in this Subcommittee's efforts to address the Federal Government's workforce challenges. Oversight of the Federal workforce by this Subcommittee this year has focused on recently enacted legislation. The Federal workforce is in a great state of change. Almost half of the Federal workforce will be transitioned into new personnel systems over the next several years, and all agencies now can use significant new flexibilities that have been provided to them.

Further change for the remainder of the Federal workforce has been proposed, but that is not the subject of today's hearing. Indeed, we must do our due diligence and determine how change has been managed. Congress cannot expect the Federal Government to successfully implement workforce reforms, however sound and meritorious in their own right, if the capacity of the Federal Govern-

ment to implement the reform and accompanying change is lacking. Even the best ideas need to be tested and validated.

As many of the reforms are so new that we cannot yet fully judge their effectiveness, alternative personnel systems might offer us the best window right now into change in the Federal workforce. The purpose of this hearing is to assess how existing alternative personnel systems, two at the Department of Commerce and one at the Federal Deposit Insurance Corporation, were developed, implemented, and subsequently refined.

We hope to learn more about what rules were changed. We seek to learn how successfully these agencies managed difficult transitions. In my mind, this is just as important as any of the new workforce management concepts that are being employed.

For example, what was the role of the key management agencies, such as the Office of Personnel Management? And is it indicative of its ability to drive and manage workforce transformation throughout the Executive Branch? Mr. Blair, you are completely familiar with this, and we will have a hearing later on about the capacity of OPM to handle this transition, particularly in oversight over the new personnel management systems. Do Federal managers require specialized and additional training before they use pay banding and classification? I would also like to learn how Federal employees have been involved in these alternative personnel systems.

From their prepared statements, I know that the American Federation of Government Employees has opted out of participating in some of the new systems, while the National Treasury Employees Union members are participating at the Federal Deposit Insurance Corporation. I look forward to learning more about their experiences.

It is important to learn the lessons from the experience of these agencies and others. We all want a better system, and although individuals may differ as to the details, this is not the key question. The key question is: What do we have to do to prepare and manage the transition from the old to the new?

I hope that today we will develop a good sense of how these three Federal agencies have fared in this regard.

Senator Akaka, since we have the Chairman of our Committee here, would you permit me to yield to our Chairman before your opening statement?

Senator AKAKA. Yes.

#### **OPENING STATEMENT OF CHAIRMAN COLLINS**

Chairman COLLINS. Thank you very much, Mr. Chairman.

First, let me take a moment to thank you and Senator Akaka for your continued leadership in ensuring that our Federal Government has the ability to recruit, retain, and reward the highest quality workforce needed to accomplish its many missions. Your December 2000 report to the President, "The Crisis in Human Capital," highlighted the critical importance of addressing the government's human capital challenges and helped our Committee to focus on the need for more flexible Federal personnel management systems.

This hearing provides a valuable opportunity for the Committee to evaluate the success of the Federal Government's current alternative personnel systems. It is particularly timely given the reforms underway at the Departments of Defense and Homeland Security, as well as the ongoing debate about whether and when to proceed with more comprehensive personnel reform.

I look forward to learning more about the practical and cultural challenges associated with the development and implementation of the Federal Government's existing alternative systems. I think that the Administration would have done well to focus more on what was working out there right now before moving to transform the personnel systems of large departments.

I am particularly interested in learning how the agencies have worked with their employees to ensure that they have the necessary training and a clear understanding of the new systems as they were brought forward. I know that GAO did a lot of work in this area, and as a result, the employee acceptance of the new personnel systems has been quite high at the Government Accountability Office.

Today's dialogue will provide constructive guidance as we ensure that our civil service system continues to meet the government's current and future workforce needs. So thank you so much for your leadership on this. Senator Voinovich, you truly are the Senate's leader on human capital issues, and I appreciate your having this hearing.

Senator VOINOVICH. Thank you, Madam Chairman.

I would now like to call on the Ranking Member of our Subcommittee, Senator Akaka.

#### **OPENING STATEMENT OF SENATOR AKAKA**

Senator AKAKA. Thank you very much, Mr. Chairman, for holding this hearing, which I believe will make a huge difference because I believe in the future of our government and our country. You and I have been good partners. I very much appreciate, Mr. Chairman, working with you on such joint efforts like the chief human capital officers council and other workforce flexibilities.

As you know, the first and third largest Federal agencies have been granted broad flexibility to develop their own personnel systems, and the Administration is endorsing similar authority for the rest of the government. I also want to thank Chairman Collins for her leadership on our full Committee. Our Committee has really been focusing, as she mentioned, which for me is very important, on existing systems and possible future systems. And I want to tell her that I enjoy working with her.

Chairman COLLINS. Thank you.

Senator AKAKA. Today's hearing focuses on the effectiveness of existing alternative personnel systems. I am interested in learning from our witnesses how they designed and implemented pay for performance and other changes to their personnel systems. I am also interested in hearing from our union witnesses regarding any concerns they may have with these alternative personnel systems. And I believe today's testimony will underscore the importance of meaningful employee input.

Working with employees and their representatives will increase acceptance of the changes, improve employee morale, allow for quick identification and response to any problems, and improve the employee-manager working relationship in other areas as well. My goal is to solidify the acceptance of meaningful employee involvement in any personnel reform.

I am curious to learn how our witness agencies have used what GAO and organizations such as NAPA have told us for years—that when implementing personnel reform, agencies need money to reward performance, training on how to measure performance, accountability for those in charge when problems arise, oversight to address such problems, and meaningful union and employee participation.

Employees need to be assured that the reforms represent an improvement over the current system, that they will not be subjected to arbitrary adverse action because of the changes, and that any proposed changes will indeed work.

I thank all of our distinguished witnesses for sharing their testimony with us today, and I thank you again, Mr. Chairman, for your continued diligence in making the Federal Government an employer of choice. Thank you.

Senator VOINOVICH. Thank you, Senator Akaka.

If the witnesses will please stand. As you know, the custom of this Subcommittee is swearing our witnesses. Do you swear that the testimony you are about to give this Subcommittee is the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. BLAIR. I do.

Mr. WALKER. I do.

Senator VOINOVICH. Time is always at a premium in the Senate, and we have three panels of distinguished witnesses today. I would ask that the witnesses limit their oral statements to 5 minutes, and remind everyone that their entire written statement will be inserted in the record today.

On our first panel, we have the Hon. Dan Blair, the Deputy Director of the Office of Personnel Management, and the Hon. David M. Walker, Comptroller General of the United States. And I want to thank you both for coming.

Comptroller General, I just want to thank you publicly for the tremendous support—and I am sure that the Chairman shares my appreciation—that you have given this Subcommittee over the years. So much of your testimony has been so valuable to us as we have crafted legislation to make a difference in our personnel systems here in the Federal Government.

Mr. Blair, will you please proceed?

**TESTIMONY OF HON. DAN G. BLAIR,<sup>1</sup> DEPUTY DIRECTOR, U.S. OFFICE OF PERSONNEL MANAGEMENT**

Mr. BLAIR. Thank you. Chairman Voinovich, Chairman Collins, and Senator Akaka, thank you for including me in this hearing today. On behalf of Director Springer, I want to thank you for the opportunity to appear before you here today. She was disappointed that the Subcommittee schedules and her schedules didn't permit

<sup>1</sup> The prepared statement of Mr. Blair appears in the Appendix on page 51.



her to be here. She is looking forward to her next opportunity to testify.

I think we have a good story to share with you today.

Senator VOINOVICH. As I mentioned, we are looking forward to having Director Springer testify before the Subcommittee on the capacity of OPM to manage governmentwide transformation.

Mr. BLAIR. I think she would jump at that opportunity.

I have a longer statement, and I would ask that be included in the record as well.

The concept of alternative personnel systems is most clearly connected with the demonstration projects that Congress authorized the Office of Personnel Management (OPM) to establish as part of the Civil Service Reform Act of 1978. That authority provided a means for the government to try out alternative merit-based approaches to specific personnel management tasks and processes before making them generally applicable and available.

Alternatives successfully tested in some demonstration projects have already been made available governmentwide. These include recruitment and retention incentives and examining using category rating. We have leaders in Congress like you and the Subcommittee Members to thank for helping achieve this goal. That is why we particularly appreciate your interest today in the other broad category of alternative systems, those that try alternatives to the General Schedule classification and pay system, and those alternatives all emphasize performance.

Across government, more than 90,000 employees are covered by such systems. They are employed by a variety of agencies, serve in a variety of occupations, and perform a variety of functions. Our test beds are not narrow. Together they provide significant and compelling evidence that these alternative approaches work and work well.

We have been successful at meeting goals to better manage, develop, and reward employees through these alternative pay systems. Evaluations of these alternative systems, particularly the Department of Defense (DOD) labs, have produced evidence of success against several benchmarks. Better performers are paid more. Employees are more satisfied with their pay. Turnover among high performers is significantly reduced. Teamwork and morale have not suffered. Communication has improved, and so has trust in management.

These agencies are better equipped to compete for talent. They use their pay systems to reinforce the message that performance makes a difference and will be rewarded. We understand that implementing these pay systems takes dedication and strong leadership and, of course, effective performance management systems. OPM plays a significant role in providing design assistance and support as well as ensuring that appropriate oversight and accountability are maintained.

When one looks across these successful alternative pay systems, the original intent of the demonstration project authority remains unfulfilled. We believe the record is clear. These approaches can and do work, and we have shared with you and stakeholders our approach to do so.

We are convinced some agencies are ready to implement these ideas now, and we are leading efforts at other agencies to ready themselves for such changes. Using the President's management scorecard, we have set goals for agencies to demonstrate they are ready to move into systems where pay is more directly linked to performance. OPM and the Federal Government have already learned and applied lessons through these alternative personnel systems. We believe the time has come to allow these alternatives to achieve the same performance as other successful demonstration projects have earned.

Title 5 should be amended to give all agencies carefully controlled access to the classification and pay approaches already tested successfully in these alternative pay systems and make them a permanent part of their strategic human capital management.

That concludes my oral statement, Mr. Chairman. I am happy to answer any questions you may have.

Senator VOINOVICH. Thank you, Mr. Blair. Mr. Walker.

**TESTIMONY OF HON. DAVID M. WALKER,<sup>1</sup> COMPTROLLER  
GENERAL, U.S. GOVERNMENT ACCOUNTABILITY OFFICE**

Mr. WALKER. Chairman Voinovich, Chairman Collins, and Senator Akaka, it is always a pleasure to be back before you.

I would like to start off, if I can, with a brief comment on a strategic framework for addressing this Nation's challenges. As you all know, GAO issued on February 16 of this year our "21st Century Challenges" report, which I believe provided a clear and compelling case on the need to fundamentally review and re-engineer the base of the Federal Government. One of the questions in the "21st Century Challenges" document is how should the Federal Government update its compensation systems to be more market-based and more performance-oriented, which is the subject of today's hearing. I would like to commend you on addressing this important topic, and I hope to have the opportunity to work with the Senate Homeland Security and Governmental Affairs Committee and other committees to address this and other topics that need to be addressed.

As you know, we are involved in this area from two perspectives: One, we are leading by example. We are in the vanguard of change. We are practicing what we preach, and we have real live examples of what works and what does not work. What we have done is one way, it is not the only way; but it is scalable, it is transferable, and we are trying to help others help themselves see the way forward in this area.

Second, with regard to the work that we have done dealing with government at large, we strongly believe that a more market-based and more performance-oriented pay system is called for. The current classification and annual compensation adjustments that apply to a vast majority of the Executive Branch agencies, are based on the Federal workforce in the 1950s. Much has changed since the 1950s, and we need to update and modernize our policies to recognize 21st Century realities.

At the same point in time, how it is done, when it is done, and on what basis it is done makes all the difference in the world as

<sup>1</sup>The prepared statement of Mr. Walker appears in the Appendix on page 61.

to whether or not you are likely to be successful or not. There needs to be a very inclusive and participatory process, working with employees, their representatives, and others in order to try to figure out the best way to move forward.

At the same point in time, I don't want to kid anybody. This is a very complex and controversial endeavor. It involves fundamental cultural transformation, and there will be segments of the population that will not like it, and that is a fact. Nonetheless, I believe very strongly that this is the way forward, and we need to make sure that we try to do it the right way in order to maximize the chance of success and to minimize the possibility of not only failure, but abuse of employees.

There are three key themes that I think have to be kept in mind. First, a shift to a more market-based and performance-oriented pay system needs to be part of a more comprehensive change management and performance improvement strategy throughout the Federal Government. This is a means to an end. It is not an end in and of itself. But it is a critically important element.

Second, more market-based and performance-oriented pay systems cannot be overlaid on most organizations' existing performance management systems. Most of the current performance appraisal and management systems in the Federal Government, frankly, aren't very good. They don't provide for meaningful feedback to employees. They don't provide meaningful distinctions between top performers and people who aren't performing as well as they should. They don't necessarily have adequate checks and balances to assure consistency throughout the organization and equity throughout the organization. It is not just having the authority to implement a market-based and performance oriented pay system, it is making sure that the infrastructure is in place before an agency can operationalize that authority. That is of critical importance.

Third, organizations need to build up their basic management capacity, and they also have to engage in fundamental training, development, and a variety of communications initiatives in order to be able to make this shift successful.

We believe that before Executive Branch agencies should be able to implement more market-based and performance-oriented compensation systems, they should be required to demonstrate to OPM that they have met certain critical criteria before they move forward. They need an objective third party to be able to do that because, otherwise, they could not only be hurting themselves and their employees, they could be tainting the water for broader-based reforms throughout the Federal Government.

Again, I would be happy to answer any questions with regard to work that we have done in the past or with regard to our own experience, and thank you for the opportunity to be here.

Senator VOINOVICH. Thank you, Mr. Walker.

Madam Chairman, I am not aware of what your schedule is. If it is all right with you, Senator Akaka, I would be more than happy to let Chairman Collins start off with the questioning.

Chairman COLLINS. Thank you very much, Mr. Chairman. That is very generous of you. I do have an Armed Services meeting right now, so I am being torn between two priorities.

Mr. Blair, the Administration has proposed legislation that would extend certain personnel flexibilities, some of which are associated with the Departments of Defense and Homeland Security to agencies throughout the Federal Government. In drafting the proposal, did the Administration consider instead building upon the authority that OPM already has to work with agencies to develop more pilot projects or to expand existing ones rather than seeking legislation for a governmentwide approach?

Mr. BLAIR. Right now, the authority we have for demonstration projects is severely limited. It is limited to no more than 10 projects, I believe, and no more than 5,000 employees. We think that the experience that we have had, especially with the lab demos, offers us the experience base we need to apply it on a more governmentwide basis.

I was glad to hear Mr. Walker's comments. It is important that in expanding this, we make sure that there are safety measures in place, and that is one of the things that the proposal that we have drafted and is still subject to comment and review would do, is allow for OPM certification. But as far as the current demo projects, it is very limited in scope, and it doesn't offer us the needed flexibility to expand it on a governmentwide basis as we would want.

Chairman COLLINS. Mr. Walker made a very important point when he said you cannot just overlay a new system on an old system and think it is going to work. It takes a lot of training. I know this is an issue which Senator Voinovich has stressed, and that you need to make sure that managers understand the system, and that they are trained in it.

The year 2000 baseline evaluation of the demonstration project at the Department of Commerce indicated that the employees felt that their supervisors were "too busy" to provide a greater level of attention to their individual performance appraisals. This is a fear that I hear expressed by Federal employees all the time—that there is not going to be the training and that their supervisors are not going to apply it fairly because they will not know exactly how to do it or it just will not be done.

If you are going to try pay to performance, something I do strongly support, you have to have an infrastructure that ensures that you have trained, committed supervisors performing the appraisal.

What steps is OPM taking to ensure that agencies' managers are trained? And I would ask you that question with DHS and DOD as well as the pilot programs you have ongoing.

Mr. BLAIR. I think you hit an important point. You know, what we have heard from the field in our feedback is not just that some managers aren't prepared to do this, but the question is my manager is a bonehead and what am I supposed to do when that manager is in charge of my pay. Very legitimate question.

One is training. We have to properly train our managers and supervisors to begin work that they should have been doing in the first place, but because of the lack of incentives in the current system, haven't always been doing.

In our President's Management Agenda right now, in the scorecard, we are going to ask that agencies have robust performance

management systems in place covering 60 percent of their workforce. It is a start. We are also asking that agencies develop what we call a beta site or a pilot project, essentially, whereby agencies would have robust performance management in place, having constant and ongoing feedback between supervisors and employers, and be ready to link at the appropriate time, when given the authorization, pay to performance.

I think that this beta site concept is critical because it gives critical mass within an agency or department to begin expanding the performance management culture, which we need to do.

Chairman COLLINS. Mr. Walker, you have emphasized not only the need for training, but also employee involvement and constant communication. What steps did GAO take to ensure that its workforce was prepared for the cultural changes associated with its shift to a pay-for-performance system since in my view you are a model that other agencies could learn from?

Mr. WALKER. Thank you, Madam Chairman. We are not perfect. We never will be. But we try very hard to lead by example and to get this right.

It starts with communication from the very top of the agency, in our case, myself. The case for change starts with explaining why the status quo is unacceptable, why there is a need for change, and then establishing mechanisms to make sure that employees and their representatives, to the extent that they are unionized, have a key part in helping to see the way forward from where we are at to where we need to be. The process needs to be very participatory, involving a lot of players, and considering information from a variety of parties. Ultimately the buck stops at the agency head's desk, and obviously, before I make final decisions, we end up having informal focus groups and task teams, publish proposed regulations, and obtain comments on those proposed regulations before final decisions are made.

I cannot emphasize enough the importance of making the case from the top, having consistent communications, and having a broad net of involvement by all key stakeholders. In the final analysis, there are people that are going to like and not like what ultimately gets decided on. But hopefully nobody will be able to credibly argue about the process. The process must have integrity. Everybody has to be heard. All of their thoughts have been considered, and that is really important for credibility in order to provide the necessary degree of trust.

Chairman COLLINS. Thank you.

And thank you so much, Mr. Chairman, for accommodating my schedule. I really appreciate it.

Mr. WALKER. Mr. Chairman, can I mention one thing before Chairman Collins leaves? I know you are on the Armed Services Committee. I would like to have an opportunity in the near future to brief you on our recent report on military compensation. The average military compensation for active-duty military is \$112,000 a year when the average compensation in the United States is \$50,000. That system is fundamentally broken, just like the civilian pay system, and I would love to have a chance to talk to you about it. Thank you.

Chairman COLLINS. I would look forward to that. Thank you, Mr. Chairman.

Senator VOINOVICH. Thank you, Madam Chairman. I just want to publicly say how much Senator Akaka and I appreciate the support that we are getting from you, too, in our endeavor over the last several years. Thanks.

Chairman COLLINS. You are doing good work.

Senator VOINOVICH. Senator Akaka.

Senator AKAKA. Thank you, Mr. Chairman.

I want to add to Chairman Collins, my thanks for the support she has given the Chairman and me on these critical human capital issues. Thank you.

I want to add my welcome to our panelists, Mr. Blair and Mr. Walker. Director Blair, I am interested in knowing where agencies get the money to fund new training programs. You have mentioned this is one important part of moving into a new system. And, on average, what are the costs associated with training for demonstration projects? Can you comment on that?

Mr. BLAIR. For the most part, agencies have funded the costs for training out of their existing budgets. Some agencies have independent authority, and I think you will hear more from them. They may have had alternative sources to fund these types of things. To expand this on a government-wide basis certainly is going to require some start-up costs, and there is no doubt about that, and let's be up front about that. We will have to anticipate what those costs will be.

At this present time, I don't know what the exact costs of the demonstration projects have been, but I would be happy to provide that for the record.<sup>1</sup>

As far as the overall costs, agencies that have been part of these demo projects have funded it out of their current appropriations and have been able to do so without costs varying significantly from their General Schedule costs.

Senator AKAKA. Mr. Walker.

Mr. WALKER. Senator, in the case of GAO, we made a business case to the Congress, not only our oversight committees but also the appropriators. We were up front that there was going to be a one-time, up-front cost in moving from the old system to the new system. There are incremental costs, and I seriously question whether or not agencies will be able to fund that one-time incremental cost out of their baseline budget without having adverse implications in other areas. Designing these new systems and effectively implementing them includes training and development.

The Administration, at one point in time, had requested a governmentwide human capital fund for pay for performance. While I don't think that made sense, I do think that a governmentwide fund on which agencies might be able to draw upon as a basis to design and implement new performance appraisal systems and other actions that are necessary to build the infrastructure to make performance-based pay work would make sense. That is something that I think should be considered by the Congress because if agen-

<sup>1</sup> The charts submitted by Mr. Blair for the record appear in the Appendix on page 157.

cies don't have the necessary infrastructure in place, they will not be successful.

Senator AKAKA. Yes, and I want to repeat that Director Blair had mentioned the importance of training in bringing this about, and I have said I am interested in how much it will cost, and, of course, to be sure that we have that money so that we can do it properly.

Mr. BLAIR. Senator, if I may, I have in my report, according to GAO, start-up costs for designing, installing, and maintaining automation and data systems at one of the DOD laboratories cost \$125,000 at NAVSEA's Dahlgren Division, and the acquisition demo was \$4.9 million. So let the record be clear there are those up-front costs that will have to be either funded or absorbed within existing budgets. Smaller organizations may be able to do so. For large organizations, it is going to be something that we will have to account for.

Senator AKAKA. Mr. Blair, you said that in a pay-for-performance system, agencies need to have strong management systems in place. Do you feel that we do have that in our agencies, or is that something that we need to work on as well?

Mr. BLAIR. I think we need to work on that, and we are doing that. As we speak, we have been urging agencies to move away from pass-fail systems because those systems don't make meaningful distinctions in levels of performance. We have the revised Senior Executive Service (SES) system, which is relatively new but will be improving year after year, as it continues to operate. And that allows those meaningful distinctions in levels of performance to be recognized and tied to any pay increases. But most importantly, we are looking at what can we do within the current system to ensure that every—I don't want to use the term "flexibility," but that every opportunity is being used to enhance performance short of pay. So if pay is taken off the table, what can we do?

We have asked agencies again to establish a pilot project in each of their own organizations which, short of linking it to pay, would have a performance management system up and running in place. Employees and supervisors would be providing meaningful feedback to one another. Expectations would be established, communications would be set, and what we would want to do is, from that pilot project within an agency, or a beta site, as we call it, have that expand to the rest of the agency or department in preparation for linking it to the reward system.

In answer to your question, though, we are not there yet, but we are preparing agencies.

Senator AKAKA. I have further questions for the next round. Thank you.

Senator VOINOVICH. Mr. Blair, Mr. Walker has said that it would be a joke to overlap a new system on the current system of performance evaluation. What puzzles me is that performance appraisals are very important to management, and basically what Mr. Walker has said—and you can speak for yourself, Mr. Walker—is that effective systems are not in place. We have had hearings before about the performance systems rating, and that all employees are rated about 95 out of 100. I specifically might reference the General Services Administration where I have spent time with Mr. Perry, who, in spite of the fact GSA does not have the authority

to implement pay for performance, he is instituting a whole new performance system as part of his management objectives in the Department.

Don't you believe that this might be the best way to move in preparation for the long-term goals of the proposed Working for America initiative that has been talked about?

Mr. BLAIR. I think that is the direction we are moving. By requiring agencies to re-evaluate what their performance appraisal systems are and the performance management systems are, we are asking them to prepare themselves for the day that we can link it to pay. Are we there yet? Absolutely not. But we do have evidence and signs of success. The General Services Administration is one of them. The Department of Labor is another. And we are moving in that direction.

Does it mean that you continue to do the same things the same old way? No. It means that you have to start focusing managerial attention and leadership on developing these systems in ways in which you have meaningful employee feedback, expectations are set up front, and distinctions are made between levels of performance.

It is a cultural change. What we are trying to say within government now is that performance matters. Unfortunately, we have that undertow of the current General Schedule system that says time rather than performance matters, and we have to fight against that undertow. But we are urging and pushing agencies in the direction of developing and implementing and getting results from better performance management systems.

Senator VOINOVICH. OK. And you think you can do that without the incentive of being tied to pay reform?

Mr. BLAIR. We will do everything that we can, but I will tell you that providing that incentive of linking it to pay would be the primary driver in something like this. But short of that, we will continue within the Executive Branch and those agencies affected to make sure that we have better systems in place. But until you can actually say that your performance is linked to pay, you don't have that hammer there to really put strength behind your performance management system.

Senator VOINOVICH. One other question, and that is, have you identified an existing alternative personnel systems?

Mr. BLAIR. Well, we have through the alternative personnel systems looked at benchmarks such as employee satisfaction, turnover rates, commitment to mission. And for the most part, we have seen increases in employee satisfaction, and employees don't want to go back to the old systems that they had before these alternative systems. But I think that a driver here is how are we going to change, not only the culture, and the culture is that performance should matter, but also other values that are affected by that, such as commitment to mission, commitment to work, and job satisfaction. By better linking performance with pay, you start helping driving those other cultural changes as well.

We have established well-known benchmarks for our demonstration projects, and in the Administration draft proposal, known as Working for America, agencies couldn't move, and couldn't link their performance management systems to pay until they are cer-



tified by OPM according to—I believe it is nine criteria that the draft legislation proposes. So what we are not proposing, is to turn a switch on overnight and suddenly overlay a pay system on top of the current performance management systems. We know we have a substantial amount of work to do. We are starting that work. I think we will be seeing progress over the next couple of years. But in no way would we say that we are turning a switch on today and that it would happen. It is going to take dedication and commitment from the Congress and from the Executive Branch to get this done, but we think it is very important because it is a value that we think that we should inculcate in the Federal Government.

Senator VOINOVICH. Mr. Walker.

Mr. WALKER. Two things, Mr. Chairman.

First, if you want a high-performing organization, whether you are in the private sector, the government, or the not-for-profit sector, you must link institutional, unit, and individual performance measurement and reward systems on an outcome basis. There are some exceptions in the Federal Government, but the vast majority of the Federal Government has not done that. That is fundamental. That must be done first before you go to pay for performance. Frankly, even if you don't have pay for performance, as you pointed out, you should do it anyway.

Now, the other difficulty is that there hasn't been a lot of incentives or accountability for people to do that in the past, in part because of the current classification and pay system. For most of the Executive Branch, 85 percent of the annual pay adjustments have nothing to do with skills, knowledge, and performance. They relate to the across-the-board pay adjustments and the passage-of-time step increases. Even the QSIs, the quality step increases, which are supposed to be performance-related, aren't realistic because you have performance appraisal systems where everybody walks on water. Therefore, too many people get the increases.

Therefore, when you have a situation where there is no meaningful distinction made between top performers and people who aren't performing as well—you have a big problem. Don't get me wrong, a vast majority of people in the Federal Government are dedicated and capable. They are just as good as the private sector, and are doing a really good job day in and day out. But when there is no meaningful distinction made between top and poor performers, it is a fundamental flaw in the system, and it needs to be corrected. But, again, how you do it, when you do it, and on what basis you do it matters to make sure that you are successful in the transition.

Mr. BLAIR. Mr. Chairman, if I could add to that, in our demonstration project experience, we have seen that where we have had these linkages, we have had a better distribution in the performance ratings. I think we can certainly provide that for the record,<sup>1</sup> but I think that it goes to show you that when the incentives are there, these government entities are up to the challenge and can perform. But where these incentives aren't in place, it is harder to accomplish that kind of cultural change.

<sup>1</sup> The chart submitted by Mr. Blair for the record appears in the Appendix on page 159.

Senator VOINOVICH. It will be interesting to hear from the folks that are talking about alternative personnel systems to just see how much the linkage to the pay was an incentive for them to move forward with their system.

Senator Akaka.

Senator AKAKA. Yes, Mr. Blair, you mentioned about OPM certifying agencies. I want to ask Mr. Walker the question. You testified that agencies should be authorized to implement reform only after they have met certain requirements, including an assessment of demonstrated institutional infrastructure and an independent certification by OPM.

In your opinion, does OPM have the capacity to certify agencies, and if not, who should certify agencies?

Mr. WALKER. For the Executive Branch, I think OPM is the logical choice. It has to be somebody independent from the line agency, and obviously there are a lot of very capable and dedicated people at OPM that have a lot of human capital and human resources expertise.

I do, however, have a serious concern as to whether OPM has adequate capacity, both as to number and as to skills and knowledge, to be able to deal with a significant volume of certifications that may be required in any given period of time. I think that is a real issue. Frankly, I think one of the biggest transformation challenges in the Federal Government is OPM, and I have told Linda Springer that.

Mr. BLAIR. If I can respond to that, Senator Akaka. I know that Mr. Walker and Director Springer have had conversations about this, and over the last decade, OPM has substantially changed from where it was 10, 15 years ago and is continuing to change.

I think the evidence of our capacity and evidence of the willingness to build on our current capacity has been seen through our leadership role in the President's Management Agenda. We are the only outside agency other than the Office of Management and Budget that owns an initiative, the Strategic Management of Human Capital, and we have been leading that now for 5 years and have been pushing agencies forward, constantly raising the bar for agencies to improve their management of human capital.

Are we better off today than where we were last year? Absolutely. Are we going to be better off tomorrow than where we are today? We expect so and we are going to push agencies to do so. But, we are subject to the vagaries of the appropriations process. Just this past year, there were attempts to cut our appropriation from one of our policy shops which had been helping to drive that change. That is not helpful for us, and we understand that process can go through several permutations, and we understood the strains on the budget as well. But to cut our policy shop, the very people who are doing the work that Mr. Walker just described that we need to be doing seems to run counter to where we really want to be.

And so I think that is one of the challenges to our capacity, is making sure that we have the proper funding and that we avoid attempts like that to undermine us that we have seen in the past.

Senator AKAKA. Thank you, Mr. Blair. I would like to have you comment on this. In her testimony, Ms. Kelley at NTEU, writes

that there is a shortage of information to indicate that alternative pay systems have had any significant impact on recruitment, on retention, or on performance, and that a January 2004 GAO report on demonstration projects found no evidence that the systems improved any of those measures. I would like to get your response on her comments.

Mr. BLAIR. Well, Ms. Kelley is a friend of mine, and we were just talking before the hearing began on some other issues. And I certainly respect her point of view, but I strongly differ with that. We have had 25 years of experience at this, and the 25 years of experience shows that these are better alternatives to a 50-year-old system that is currently in place.

Can any one of the demonstration projects be held up as an example of reform that can be extended out to the rest of the system? No. But taken in their totality, I think we have important lessons that we have learned, and those lessons are that performance does matter and that we can shed the 15-grade, 10-step General Schedule in favor of a better pay-banding system. We can have more market-based pay in something like that, as well as rewarding performance. When you give poor performers, high performers, outstanding performers, and mediocre performers the same pay raise in the same year, what message does that send? I don't think it sends the appropriate message that we want to send to the American people nor our workforce, that your performance is valued and will be rewarded.

Senator AKAKA. Mr. Walker, your comments?

Mr. WALKER. Yes, Senator. To the extent that you move to a more market-based, skills-, knowledge-, and performance-oriented compensation system, I think you will find several things. The people that have the higher degrees of skills and knowledge and performance will like it. The younger people, by and large, because of their philosophy, will like it. At the same point in time, there are segments of the population who are good people, who are performing well day in and day out, that may not like it. The reason they may not like it is because right now under the Federal system, once you end up getting into a grade level—whether it is GS-12, GS-15, whatever—you have an entitlement to make the pay cap. It is not a matter if you are going to make the pay cap. It is only a matter when you are going to make the pay cap if you stay there long enough, unless you are promoted.

Since 85 percent-plus of Executive Branch pay adjustments are on autopilot and have nothing to do with skills, knowledge, and performance, by definition that can create a system where there is a negative correlation to skills, knowledge, and performance for people who are the pay cap because they are the people that didn't get promoted. You can actually have people who are making more money than the people at the next level but have poorer performance and less responsibility because of the way the system is structured.

The current system made sense when a significant majority of the Federal workforce was clerks, which it was in the 1950s. But now we have some of the most skilled, knowledgeable and dedicated people in this country working for the Federal Government, and we need to move to a system that reflects that fact.

Senator AKAKA. Thank you, Mr. Walker.

Mr. Chairman, I, too, have to go to Armed Services, but I am hoping to be back here as soon as I ask my questions there. Thank you very much.

Senator VOINOVICH. Thank you, Senator Akaka.

The point that was just made by Senator Akaka, again, I am anxious to hear from the folks that have put in alternative systems, personnel systems, about the impact that it has had on the agency's effectiveness and performance. Mr. Walker, has it made a measurable difference at GAO? Is GAO a better organization, more effective, working harder and smarter and doing more with less?

Mr. WALKER. It clearly has, but I can also say that we have made a number of other changes. This is one of many changes that we have made.

I will also say, Mr. Chairman, we didn't take a vote on this. When my predecessor, Chuck Bowsher, implemented broadbanding in 1989, he didn't take a vote on whether or not we were going to go to broadbanding. More recently, we didn't take a vote as to whether or not we were going to go to a more market-based performance compensation system. We didn't take a vote as to whether we were going to go to skills-, knowledge-, and performance-based system. And there were differences of opinion. There were differences of opinion within our workforce, as there will be in others. Some people like it and some people don't like it. It depends on where you sit and how you think it will affect you. That is human nature. It is understandable.

But there is absolutely no question in my mind it has been a major contributor to our doubling our performance in virtually every category as compared to 5 years ago.

Senator VOINOVICH. Mr. Blair, with the war in Iraq and now Hurricanes Katrina and Rita, some of my colleagues are talking about paying for the natural disasters out of an across-the-board reduction in various departments in the Federal Government. I have argued that, yes, we should look for economies, but there are so many unmet needs in some of these agencies that we have got to be careful about what we are doing. And the question I have is: Does the Administration understand the financial commitment that must be made in order to move forward with this human capital reform?

How knowledgeable is this Administration in terms of the kind of financial commitment that is going to have to be made in the agencies to move with new systems like MaxHR and the Defense Department's National Security Personnel System?

Mr. BLAIR. Well, you are always going to have the budget considerations, and the budget considerations are going to be exacerbated by the disasters that have occurred over the last month in terms of Hurricanes Katrina and Rita. That is the atmosphere in which we are operating today. Are we going to be asked to do more with less resources? I think that is assumed. That is something that I think we can expect. I have no specific knowledge of anything, but I would just say from having two decades of experience here in Washington, you can see that happening.

But you have to also ask the question: If not now, when? We are always going to have budget considerations on board like this, and

if we are going to say that we spend—\$105 billion or \$108 billion a year on Federal payroll, are we spending it in the best way possible? I think the answer is no.

So I think that we need to make a concerted effort to improve the way that we award these scarce dollars that we have, however, many dollars we have. And I think that we also need to say that in awarding that, what is the value that we want to place in our culture, in our Federal workplace culture? And I think that the value that we want to have is performance. Right now, time drives that. Time on the job is the factor for within-grades. Basically if you are on the job and have a pulse, you get the annual increase. I think that is the wrong value that we want to send.

If we talk about the war for talent, being able to bring in the best and the brightest, being able to bring in good and high performers into a high-performing organization, having a multi-level, multi-step system, which is complicated and foreign to those who are not familiar with the Federal workforce, isn't the best way of recruiting. We have seen with the demonstration projects that we can bring in better talent, and the best talent we bring in does, in fact, stay.

But as far as the costs are concerned, the up-front costs, we will have to negotiate that as time goes on. We have to admit that those are going to be there, though. I think that to ignore that would be to ignore reality. We have to make sure that we have the investment in time and energy and resources in order to get this done.

Senator VOINOVICH. It will be interesting to hear from the second panel what resources they needed. For example, have they hired consultants to help with implementing the new system?

Mr. Walker, would you like to comment?

Mr. WALKER. Yes, I can, several quick points.

First, we did hire outside consultants to help us, and it did cost money. It was a one-time cost, and we will be happy to provide that for the record. I think it will provide you with a sense as to what that one-time investment might be for other agencies.

Second, the across-the-board annual pay adjustment that the Deputy Director just referred to is—even unacceptable performers are currently entitled to that by law. Let me restate: Even unacceptable performers are entitled to it by law. I don't know of anything that is performance-oriented about that.

Third, I think the worst thing that Congress could do is across-the-board cuts. That is exactly the opposite of promoting high-performing organizations. That means that high-performing organizations would suffer just as much as ones that aren't deserving, that haven't done the job of re-engineering the base of their operations and transforming for the 21st Century. We need to look at the base of government. A vast majority of government is based on the 1950s and 1960s, whether it is spending or whether it is tax policy. Our current base of government is not only unaffordable; it is unsustainable. And you know that, Mr. Chairman. You have read our "21st Century Challenges" document. I just wish all your colleagues would, because it is clear and compelling that our children and grandchildren are going to pay a huge price if we don't start getting our act together soon.

Thank you, Mr. Chairman.

Senator VOINOVICH. When I was governor and mayor, our senior management was paid according to performance. Implementing that wasn't easy. I will never forget it. At the State level, we talked about implementing it, but it was just such a gigantic task, we decided to spend our time on quality management.

But I can tell you this, that through quality management, when I left the governor's office, we had 17 percent less people working for the State of Ohio than we had when I came into office, except for the Department of Corrections.

The point is we had a better workforce. People came to me and said through quality management, they participated, they were happier, they felt better about the job that they were doing. It made a big difference. It seems to me that if a new system isn't going to make a difference in terms of, (1) the effectiveness of the organizations for the benefit of the people of the United States, and, (2) for the betterment of employees, then you have to ask yourself, well, why go through the exercise?

So I am anxious to hear from our next witnesses about what impact these respective systems have made in their operations. Mr. Blair, I would like to say to you that at this stage, I am pleased with what is going on in the Department of Defense, even though the regulations are not final. Implementation will begin in several spirals. We have several of them in Ohio. I want you to know I am monitoring them to see what is happening. I have become familiar with the people involved in Ohio and what they are doing. I think it is important for your OPM to understand that a lot of this is in your hands. You are going to have to be as candid as you possibly can be with us and with the Administration in terms of the commitment of resources they are going to need to make this system a successful system.

Mr. BLAIR. Well, Senator, we are certainly not shy internally about voicing our opinions about what would be needed in order to get the job done. And I think that you know from our relationship and the organization's relationship with you, we have, I believe, a straight-talking relationship in which we value what you say and we share with you what our thoughts are. And I hope we can continue along those lines.

We seem to have focused quite a bit on the start-up costs of these demonstration projects and what the start-up costs would be should a systemwide reform be enacted. Let's remember what has been taking place, too, over the last 5 years in the Federal Government. You referenced a report that you provided to then-incoming President George Bush in 2000. I think that we have made substantial progress on the Strategic Management of Human Capital in those 5 years, and during those 5 years we have devoted significant resources to improving human capital management in government. We are not where we should be, and we are not where we want to be, but we are on the path of where we want to be.

The efforts that we have put in over the last 5 years at your insistence and with your help will also enable us to better lay the foundation for this robust performance management system which would best be linked with pay.

Senator VOINOVICH. I have just one last comment I will make, and that is, if we peel back a lot of the problems that we have in the hearings on FEMA and so forth—it is the issue of having the right people with the right knowledge and skills at the right place. And the public has got to understand, as well as Members of Congress, that people do make the difference. In any good organization you have good finance and you have good people; and the better the people that you have, the better the organization that you have. That is what we should be striving for—the best and the brightest people in the Federal Government. We should be able to attract them, and we should be able to motivate those individuals. How well we do on that is going to have a lot to do with what kind of a country we live in in the future.

Mr. Walker.

Mr. WALKER. I can underline that, Mr. Chairman. There is a natural tendency when something as tragic as Katrina happens or a similar event for the Congress to want to act and to provide support and assistance. Candidly, the Federal Government, as you know, tends to be a lag indicator. It tends to get involved late, in many cases when others have failed to act or when things go wrong. Government tends to do three things: one, throw spending at it, the more the better, the assumption is you care more if you spend more; two, throw tax preferences at it, again, the more the better, it shows that you care more; and, three, throw new players at it or new organizations at it.

You hit the key. The key is not that. You can throw all kinds of money, you can throw all kinds of tax preferences, you can throw all kinds of players. But if you don't have the right people with the right skills, the right knowledge, in the right place at the right time, and if we don't have our organizational structures functioning given 21st Century realities, we are wasting a bunch of time and money, and we are never going to be effective. So you are so right, and that underlines the importance of this fundamental review and re-examination of the base of government, including the issue that you are holding a hearing on today.

So thank you, sir.

Senator VOINOVICH. Thank you very much. You are right. We are at it again, and we haven't even heard from the agencies. Of course, I think that they have some responsibilities. In fact, several of us have written to Secretary Mike Chertoff and to Andy Card, requesting the Administration come back to us and tell us what it is that they are doing to respond to all of the questions being raised in the Congress. We should give them that opportunity. Rather than throw more money at a problem, we have to make people understand it is the quality of the people that we have that really make the difference.

Thank you very much.

Our next witnesses are the Hon. Jeffery K. Nulf, Deputy Assistant Secretary for Administration, Department of Commerce; Arleas Upton Kea, Director of the Division of Administration, the Federal Deposit Insurance Corporation, FDIC; and Dr. Hratch Semerjian, the Deputy Director of the National Institute of Standards and Technology.

I want to thank the witnesses for coming. As you know, it is customary to swear in witnesses. Before you sit down—if you will raise your right hand. Do you swear that the testimony you are about to give this Subcommittee is the whole truth, and nothing but the truth, so help you, God?

Mr. NULF. I do.

Ms. KEA. I do.

Dr. SEMERJIAN. I do.

Senator VOINOVICH. They all answered yes.

Mr. Nulf, we will call on you first, and I thank you very much for being here today, and we are anxious to hear your testimony. Again, as I reminded the other witnesses, please keep your statement to 5 minutes, understanding that your full testimony will be part of the record, I would appreciate it. Thank you.

**TESTIMONY OF HON. JEFFERY K. NULF,<sup>1</sup> DEPUTY ASSISTANT SECRETARY FOR ADMINISTRATION, U.S. DEPARTMENT OF COMMERCE**

Mr. NULF. Good morning, Mr. Chairman. Thank you for the opportunity to appear before you today on the Department's efforts in managing alternative personnel systems. I have the honor of serving President Bush and Secretary Gutierrez as the Deputy Assistant Secretary for Administration at the Department of Commerce. As one of the principal tenets of President Bush's Management Agenda, strategically managing Commerce's workforce to better achieve our mission-critical objective is a key priority for Secretary Gutierrez and the Department.

Commerce has been managing pay for performance since 1988. As Dr. Semerjian will testify, our involvement in alternative pay-for-performance systems occurred at the National Institute of Standards and Technology following the success of China Lake. Based on the successful results achieved with that effort, we established the Commerce Demonstration Project in 1998. Over the last 7 years, it has grown to 4,200 employees in five operating units stationed throughout the Nation.

In October, we anticipate adding 33 employees represented by two local bargaining units that have asked to participate. We are also working with OPM to include 3,500 additional NOAA employees.

The demo's benefits are perhaps most clearly evident in five areas:

One, performance. Under the demo, managers have greater flexibility to recognize the contributions made by high performers. Since pay level adjustments and bonuses are determined as part of the annual performance appraisal, the nexus between performance and salary is very clear to all employees at all levels.

During our most recent program evaluation, 53 percent of supervisors in the demo project reported that they were able to identify and reward good performers under the new system as compared with 26 percent in the GS schedule.

Two, recruitment. Recognizing the highly competitive job market in which we must operate, the demo provides managers with a real

<sup>1</sup> The prepared statement of Mr. Nulf appears in the Appendix on page 82.



opportunity to effectively negotiate salaries with job candidates. The tool is serving us well, particularly in recruiting individuals with specialized skills in mission-critical occupations. The most recent evaluation of the demo indicated that 41 percent of participating supervisors believe that they are better equipped to recruit well-qualified employees as a result of being able to offer competitive salaries. Only 19 percent of GS supervisors felt the same way.

Three, classification. Under the Commerce demo, the GS classification system of hundreds of career series has been streamlined into four career paths. This allows managers to more quickly advertise to fill vacancies and to consider a broader range of skill sets to meet their specific needs.

Four, employee satisfaction. As employees and managers have gained experience with the demo, trust in the system has grown. Over half of the demo employees surveyed agreed that increases were directly related to an employee's performance compared to roughly one-third within the GS schedule.

Five, employee retention. It is clear that the demo project has had a positive effect on retaining good performers. Employees are rated on a 100-point scale. Those receiving a score of 40 or above are eligible to receive a bonus and/or pay increase. By allowing managers to better distinguish and reward differences in performance, we have found that turnover is lower among high performers, for example, a 1.5-percent turnover rate for those employees receiving 90 or above, while a 7.7-percent turnover rate for those employees receiving lower scores.

Based on our experience, we believe that the success of alternative performance systems depends on several factors:

Communication. We have learned that first and foremost a well-developed approach to educate employees and managers about any new system is essential. This helps to create a mutual understanding of the objectives of the new system and provide a shared perception that change will be implemented together as a team.

Effective management. As with any personnel management system, if pay for performance is not managed well, it can be problematic. Employees need to feel confident that their rights are protected under a new system. Managers must have the skills needed to manage employees effectively. This can only be accomplished by providing training in performance management and performance feedback to all affected individuals.

At Commerce, we provide quarterly briefings to all new demo employees and quarterly training on demo flexibilities to new supervisors. This year and last year we conducted training on performance feedback both for supervisors and employees at the end of the appraisal cycle to better position everyone for success.

Routine and objective evaluation. Not only do annual evaluations ensure transparency to interested stakeholders and that the merit system principles are followed and the system is free of discriminatory reprisal, they also provide the basis on which human resource managers may objectively assess the success of the demo and determine any need for adjustment.

At Commerce, such adjustments have included strengthening supervisory training in providing performance feedback; instituting performance management training and communicating perform-

ance expectations to employees; establishing a centralized data manager to oversee and ensure the quality of automated systems and data collection; and adjusting how service retention credit is calculated based on performance rating.

Furthermore, we are more closely examining the impact of the demo on minority employees by adding focus groups and expanding how we analyze the results for annual evaluations.

We have had very good success with testing pay for performance and believe that the experiences that Commerce and other Federal agencies have had provide a sound basis on which we can continue to move forward.

Change is never easy. Far-reaching changes to a decades-old system that will profoundly affect the work lives of hundreds of thousands of Federal employees will inevitably, and justifiably, cause concern and merit careful consideration. Based on our experience and that of Federal agencies across the government, however, we believe the tools are in place that are needed to continue the forward momentum initiated by the various demonstration projects.

Thank you for giving me the opportunity to speak, sir, and I welcome your questions.

Senator VOINOVICH. Thank you very much. Ms. Kea.

**TESTIMONY OF ARLEAS UPTON KEA,<sup>1</sup> DIRECTOR, DIVISION OF ADMINISTRATION, FEDERAL DEPOSIT INSURANCE CORPORATION**

Ms. KEA. Good morning, Mr. Chairman, and thank you for the opportunity to testify on behalf of the Federal Deposit Insurance Corporation regarding our experiences administering and managing a personnel system at an independent Federal corporation.

I will briefly highlight how the FDIC's personnel system has helped us achieve our mission, the importance of flexible personnel policies in today's rapidly changing financial industry, and our experience with "pay banding" and "pay for performance."

The FDIC has served as an integral part of our Nation's financial system for over 70 years. Established at the depth of the most severe banking crisis in the Nation's history, the immediate contribution of the FDIC was the restoration of public confidence in banks. Today, the FDIC's mission remains unchanged. We maintain our Nation's confidence in our financial system in three important ways: We insure the deposits held in our Nation's banking system; we examine and supervise banks for safety and soundness and compliance with laws and regulations; and, we handle the resolution of failed banks when that becomes necessary.

In carrying out its mission, the FDIC does not receive appropriated funds. The FDIC is funded by insurance assessments on the deposits held by insured institutions and by the interest earned on the deposit insurance funds.

In the late 1980s and early 1990s, the FDIC faced a banking crisis unprecedented since the Great Depression. The FDIC successfully responded to that challenge as it has to other challenges throughout its history.

<sup>1</sup> The prepared statement of Ms. Kea appears in the Appendix on page 90.

Part of the reason for that success was the flexibility the FDIC had to adjust the size of its workforce rapidly and substantially. In the early 1980s, the FDIC employed 4,000 people. By the early 1990s, the FDIC employed over 23,000 people, and today the FDIC employs fewer than 5,000 people. The FDIC was able to use its hiring flexibility in managing a mix of temporary, term, and permanent appointments to meet changing workforce needs and its authority to set compensation and benefits to encourage voluntary departures of employees through buyouts instead of involuntary, disruptive reductions in force.

My written statement covers the history and the major lessons the FDIC has learned in using its flexibility to develop our personnel programs, and I would like to highlight five of the lessons that we believe may be of most interest to the Subcommittee.

First, the rapidly changing technology in financial fields of the 21st Century demand that government agencies have access to flexible hiring authority as a part of their staffing options. The FDIC used a temporary appointment authority to meet its fluctuating personnel needs during the banking crises of the 1980s and the 1990s.

Over the past year, working with the U.S. Office of Personnel Management (OPM), the FDIC has received delegated authority to offer competitive term appointments with the possibility of conversion to a permanent position without further competition. This kind of approach should address our need to expand and contract the FDIC's workforce to meet our future work challenges.

The employees hired into this "Corporate Employee Program" are given introductory training in three critical business functions. They are then trained to become commissioned in one or more of these functions. If retained by the FDIC at the end of their term appointment, these employees will have a broad range of skills and perspective that will serve to benefit the Corporation. In addition, we are also close to finalizing delegated authority from OPM to quickly reemploy recent retirees to handle any banking crisis.

My second point is that managing fluctuating personnel needs requires creative solutions. Setting targets and conducting RIFs is fast and effective, but such actions do not permit an organization to consider other more time-consuming and employee-friendly alternatives. For example, when the FDIC's failure resolution activity declined, we knew we had employees with great ability but little work. And so to address this issue, we received authority from OPM to waive certain critical job level requirements and create a crossover program which allowed employees who were trained to handle bank failures to become bank examiner trainees without a significant reduction in pay. This was a very successful program.

In addition, the FDIC's compensation flexibility permitted us to offer more generous buyout programs than those offered in the Executive Branch. This also ensured that we had large numbers of voluntary separations of those in surplus positions. As we have used them, buyouts have taken a little bit longer, but they have saved money in the long run over RIFs, and they were better received by the employees.

My third point is that compensation programs that recognize performance rather than longevity are very beneficial to organizations,

but they do need to be implemented very carefully. The experience at the FDIC is that pay-for-performance program implementation works best when executives lead by example and compensation changes are made first for the executives and then managers and supervisors.

My fourth point is that it is important to listen to employee feedback and be willing to adapt and evolve any changes in performance-based programs. An organization should expect that implementing pay-for-performance systems will need to make changes based on practical experience and from the feedback from those involved and subjected to the program.

The FDIC is currently on its fourth iteration of its pay-for-performance system for managers and executives and has made a number of changes based on feedback received from the surveys and focus groups tasked with suggesting improvements. We do have indications that our managers agree with this change in the pay philosophy and culture. They are committed, as we are, to improving the system going forward.

My final and fifth point is that it is extremely important that the organization invest the time and effort to train both managers and employees on the new pay system, and that it create a system that is perceived to be fair by those evaluated and compensated under it.

This concludes my oral statement, and I would be happy to answer any questions that you may have.

Senator VOINOVICH. Thank you very much. Dr. Semerjian.

**TESTIMONY OF HRATCH G. SEMERJIAN,<sup>1</sup> DEPUTY DIRECTOR,  
NATIONAL INSTITUTE OF STANDARDS AND TECHNOLOGY,  
TECHNOLOGY ADMINISTRATION, U.S. DEPARTMENT OF  
COMMERCE**

Dr. SEMERJIAN. Thank you, Mr. Chairman, and thank you for the opportunity to testify today before this Subcommittee regarding the Alternative Personnel Management System used at the National Institute of Standards and Technology.

Originally founded in 1901 as the National Bureau of Standards, NIST is a non-regulatory Federal agency within the U.S. Commerce Department's Technology Administration. NIST serves industry, academia, and other parts of the government by advancing measurement science, standards, and technology to enhance economic security and improve the quality of life for all Americans. In order to accomplish this mission, NIST has primarily relied on one key asset: Its staff of dedicated scientists and engineers, technicians, administrative, and support staff. Recognizing the need to attract and retain top-quality staff, NIST's management worked with Congress, starting in the mid-1980s, to establish an alternative personnel management system.

NIST's Authorization Act for Fiscal Year 1987 established a 5-year project to demonstrate an alternative personnel management system. The NIST demonstration system became permanent as of

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<sup>1</sup>The prepared statement of Dr. Semerjian with an attachment appears in the Appendix on page 109.

March 1996 through the National Technology Transfer and Advancement Act of 1995.

The goals of the NIST system were to improve hiring of high-quality personnel and retention of high performers in order to more effectively accomplish the mission and goals of NIST. Evaluations and feedback from managers and employees show that these changes have significantly improved NIST's ability to recruit and retain high-quality staff. In addition, a basic objective of the original project was to design the system to serve as a model for simplifying and improving Federal personnel systems governmentwide, not just at NIST. The so-called new and improved system has dramatically changed NIST's management of human resources. It also has provided a model of reform to other agencies within the Department of Commerce, such as the Technology Administration, NOAA, and the Bureau of Economic Analysis. And I understand NASA is in the process of implementing an APS based on the NIST experience.

NIST's alternative personnel management system has enabled us to do several things much better. Today, NIST competes more effectively in the labor market through more efficient and faster staffing mechanisms. NIST compensates and retains good performers more effectively. NIST has simplified, accelerated, and improved the classification process. We use performance appraisal results as the basis for granting pay increases and performance bonuses. NIST has streamlined the personnel Administration process through a reduction of paperwork, automation of personnel processes, and delegation. And, line management is more directly involved in the recruiting.

The NIST system covers approximately 2,500 NIST employees in four career paths: Scientific and engineering professionals, technicians, administrative professionals, and administrative support staff. Senior Executive Service employees and "trades and craft"—wage grade—employees are not covered by this system.

Since implementing the alternative personnel management system, according to an OPM report, NIST is more competitive for talent, has retained more top performers than a comparison group, and NIST managers reported significantly more authority to make decisions concerning employee pay. Key indicators of NIST's ability to attract and retain world-class scientists and engineers are the numerous awards and recognition that NIST staff have received, since the implementation of the APMS. NIST staff have won two Nobel Prizes for Physics, been selected for a MacArthur "Genius" Award, received the National Medal of Science, received UNESCO's 2003 Women in Science Award, received 21 Presidential Early Career Awards for Science and Engineering, and 16 members of the staff have been inducted into the National Academies of Science and Engineering.

While I would like to say everything has worked perfectly since its implementation, the fact is that NIST has had to make minor adjustments to the system over time. This was not unexpected, and has improved the functionality of the system. Over the years, both supervisory and nonsupervisory employees have provided ideas for improving the system, through focus groups and other forums. NIST responded to this feedback by developing a revised perform-

ance appraisal and payout system in 1991, more recent feedback—from the 2000 and 2002 NIST Employee Surveys, the NIST Research Advisory Committee's 2002 Report, and stakeholder focus groups—has led to the latest changes which will be implemented during the next performance cycle.

Starting on October 1, NIST will replace the current 100-point rating scale with six performance ratings and link pay increases to these ratings. This will simplify the system, strengthen the pay-for-performance link, and increase the transparency of the system.

In its present form, I think the NIST system offers improvements in position classification, recruitment, extended probationary period for research positions, performance appraisal, pay for performance, automation and paperwork reductions, and delegations of authority to managers, all of which have many advantages over the current GS system.

In conclusion, the NIST Alternative Personnel Management System is meeting its objectives to recruit and retain quality staff; to make compensation more competitive; to link pay to performance; to simplify position classification; to streamline processing; to improve the staffing process and get new hires on board faster; and to increase the manager's role and accountability in personnel management. The NIST system continues to operate as an innovative personnel system which has a proven track record of demonstrating new ideas in the area of human resources management.

Mr. Chairman, thank you for inviting me to testify today, and I would be happy to answer any questions you may have.

Senator VOINOVICH. Thank you very much.

My first observation is in the FDIC and in NIST, particularly in NIST, you are going after the best and brightest people in the country. The conclusion must have been made some time ago that if you were going to get them, you had to mirror the private sector or you were not going to be able to be competitive. I would like you to comment. Do you think at this stage, because of the new system, that you are in that position where you can be competitive?

Dr. SEMERJIAN. From personal experience, I can assure you that we are a lot more competitive than we were 15 or 20 years ago. As a supervisor, when I was trying to recruit people, I felt that I had a high obstacle to jump over to be able to compete with offers from the private sector. I think we are doing much better in that regard. Our recruiting is much more successful, and our retention of our high-quality people is much better. Those two Nobel Prize winners are still at NIST. I am not sure that would not have been the case if we were operating in the old system.

Senator VOINOVICH. In other words, could you comment on how pay for performance has helped? The question is: If I am being interviewed for a job at NIST, how important is it for me to know I am going to work for an organization that is going to pay me on the basis of my performance?

Dr. SEMERJIAN. The people we recruit aren't necessarily coming to NIST to get rich, so to speak, but obviously they have to have a reasonable living, and they want to make sure that they are not going to get stuck on some level, artificial level, that they have the opportunity to move up in terms of their salary as well as in the organization. And I think that the fact that we have this docu-

mented experience, where the statistics are actually on our website for everybody to see for transparency's sake, I think, helps us a great deal in our recruitment.

Senator VOINOVICH. In other words, they can see how you reward people. And, of course, once they are on board, that is very important in terms of retaining them.

Dr. SEMERJIAN. Absolutely.

Senator VOINOVICH. A very good friend of mine has a son—and I will not mention the agency he worked with, but he went to work for them for about a year and a half, and left. He just said that it was mediocrity. He felt that people were not being rewarded for what they were contributing, that it was an automatic thing, and he left them.

Ms. Kea, how about the FDIC? How much of a difference has pay for performance made in recruiting and retention at FDIC?

Ms. KEA. Thank you, Mr. Chairman. There are several areas, which we look at. First, I would like to say that there is a comparability statute, which does require us at the FDIC to remain comparable with the other financial institution regulators. That is one factor we look at as we are setting our pay and our benefits.

But in addition to that, we do find—

Senator VOINOVICH. Just a minute. It is an independent agency, but you are allowed to establish compensation the FDIC maintains comparable with other regulatory agencies?

Ms. KEA. That is correct, sir, and the history behind that is, I believe, Congress did not want us to be in danger, each of the financial institution regulators, of losing some of our best and brightest to the other financial institution regulators. And so each year, we do take that into consideration, and we share and exchange information.

In addition to that, we do believe that we do lose employees in some instances to the industry which we regulate. We also have some difficulty attracting certain professionals in the area of research, which is the heart and soul of some of our work at the FDIC. We do believe that our flexibilities allow us the opportunity to do a better job of recruiting those individuals in particular.

Senator VOINOVICH. Is pay for performance taken a factor in their coming to work with you?

Ms. KEA. Yes, because it is the pay for performance that would allow us to give them increases in their pay.

Senator VOINOVICH. And that helps with retention, too.

Ms. KEA. Yes, sir.

Senator VOINOVICH. I have a theory that one of the reasons why we had the tremendous scandal in our financial institutions is in part due to the Securities and Exchange Commission losing a lot of their people to other regulatory agencies because of their compensation. And, of course, we found out about it too late.

At the FDIC, how do you determine whether or not the system is really working, that people indeed are being paid on the basis of their performance and it is not arbitrary? I am sure you hear constantly from folks that this is an arbitrary system, it is very subjective, not objective, and leads to favoritism and so forth. How do you guarantee that is not present in the organization?

Ms. KEA. That is something that we pay a lot of attention to. We have tried to create a process that has transparency. We have well-defined objectives that are linked to the mission of each of the divisions, the offices, the branches, or the entire corporate mission. We publicize those. We provide training to our employees with regard to how they can achieve those objectives.

We also provide, and invest, much time in training our managers on the new system. With regard to the nominations, that is a very rigorous process and a number of different individuals participate in that process.

We provide a formal opportunity for our executive levels to give us feedback through a survey. We make adjustments based on what we hear in that survey. With regard to our bargaining unit employees, whether or not we conduct a survey is something that we would bargain with our union. We have not done that thus far, but we have found other means to get feedback from our employees. We have large employee gatherings, where our executives are available to hear feedback about our system.

I should say that we are in our fourth iteration of our pay-for-performance system for our executives, and those changes have come directly from the feedback that we have heard.

I should also mention—

Senator VOINOVICH. All of your employees are in pay for performance now, including those represented by unions?

Ms. KEA. That is correct.

Senator VOINOVICH. OK.

Ms. KEA. I should also mention that every 3 years we bargain pay and compensation with our union. This year is a pay and compensation bargaining year, and we are in negotiations at this point with our union.

Senator VOINOVICH. OK, but you negotiate the pay-for-performance system in place.

Ms. KEA. In fact, the pay-for-performance system is something that is also subject to the negotiation. The system that we have in place right now today is one that the union did participate in the details of creating through that negotiation.

Senator VOINOVICH. But it is a pay-for-performance system.

Ms. KEA. Yes.

Senator VOINOVICH. How long have you worked with the agency?

Ms. KEA. I have been at the FDIC since June 1985, so it is over 20 years.

Senator VOINOVICH. OK. So you have a good indication of the history. How do you think that they feel about this new system, in terms of their happiness on the job and their productivity, self-worth?

Ms. KEA. I would say that there are mixed reviews from the employees. We have some pretty specific information, as I indicated earlier, from our executives. Overall, they have indicated that they certainly prefer this. They think that it is more fair than everyone receiving the same pay for work that is at varying levels, of high or low contribution.

We have also surveyed our non-bargaining unit employees, and they have confirmed to us that they certainly prefer a system that gives a greater reward for a greater contribution.



I think that it is probably mixed with regard to the greater part of the population, the remaining part of the population, and the reason for that would be that it is a very large shift in the culture. I think as some comments have already been made by OPM and GAO, the culture has been one of everybody receiving everything across the board. This is a very different culture, one where you receive an award based on how great your contribution.

I feel that this pay-for-performance system provides some sense of motivation and encouragement. I have been involved in some conversations with some of our employees where they wanted to know: Well, how did that employee get that? How can I get it? And what sort of plan can I put myself on where I can get that?

Senator VOINOVICH. So you would agree that for management this has been helpful?

Ms. KEA. Yes.

Senator VOINOVICH. With respect to the organization, do you see it as a more efficient, vibrant organization that is getting the job done, with this system contributing to that? It has not been a negative but, rather, a positive type of exercise that has helped.

Ms. KEA. I think that it has helped us to be more efficient as an organization in terms of achieving our mission. If you recall, when I gave the numbers of how we were a very small organization, we became very large in response to a crisis, and then we had to shrink back down. I think that there is no question we are doing much more work with a smaller number—

Senator VOINOVICH. You went from 4,000 to 23,000 employees, and then from 23,000 down to 5,000?

Ms. KEA. Slightly under 5,000 today.

Senator VOINOVICH. Amazing.

Ms. KEA. So we are doing much more with fewer resources, and I think one of the ways that we have met that challenge is to provide these kinds of incentives to attract individuals and for those who are there to motivate them to work harder.

Senator VOINOVICH. Thank you. Senator Akaka.

Senator AKAKA. Thank you, Mr. Chairman. Sorry I had to run off to another committee, but I am delighted to be back here to ask my questions. I want to add my welcome to the panel.

Mr. Nulf, I understand that there are over 100 employees in Hawaii participating in a demonstration project at the Department of Commerce. Can you explain how pay for performance works for those employees who receive what we call a non-foreign COLA and whether it differs from the system in place for other employees?

Mr. NULF. Thank you, sir. In Hawaii, as well as throughout, with the demo project in Commerce, my fellow members on the panel have been speaking to the fact of expectations being laid out and the pay-for-performance aspect that is brought to the table by ringing out an entitlement and rewarding your performers. At the end of the day, pay for performance does a number of things, some with purpose and some maybe as an indirect complement to what otherwise is going on. Your performers stay. We have 1.5-percent turnover in 90 and above. We have performers that are down into the 40s that we have high turnover almost double-digit.

I think those things are reflective of the fact that people want to be successful. When you put this type of system in place, I think

it is well received by employees. I think the managers enjoy the flexibilities to it. But, most importantly, I think whether it is a team unit, a department, whether it is a group stationed in Hawaii, whether it is a group stationed here at the Herbert Hoover Building, people and teams and agencies want to be successful. I would agree with what Mr. Walker said earlier that the Federal workforce, on the whole, is an incredibly talented and diverse group of folks that are committed to what they are doing, and the opportunity to serve is extremely important. But the other aspect of that is people do have bills and people do have mortgages, and given the opportunity for your performers to have access to a greater degree than your lesser performers, I think it creates a win-win situation, sir.

Senator AKAKA. The employees' non-foreign COLA that we are talking about, will they be impacted at all?

Mr. NULF. Will they be impacted? In what way, sir?

Senator AKAKA. Well, will the COLA still be an allowance?

Mr. NULF. Yes, sir.

Senator AKAKA. And my question is how does this new system impact COLA?

Mr. NULF. Yes, they receive their COLA for those that are in place regardless. And for those that are rated eligible by the performance ratings they receive, of course, the additional performance pay that is put on the table. But, yes, they are certainly eligible for COLAs, sir.

Senator AKAKA. Will the COLA be reduced or increased based on performance? Do you have an idea at this point in time?

Mr. NULF. I do not, sir. I can certainly respond back to this Subcommittee.

Senator AKAKA. Thank you. My next question is to the entire panel. Was there an increase in the number of discrimination and unfair treatment complaints following the implementation of a pay-for-performance system at your respective agencies? If so, what type of redress options do employees have if they believe their pay is based on matters other than their performance?

Ms. KEA. I will speak first on behalf of the FDIC, and my answer is yes, we did see a number of increases in the number of complaints. These were either a labor grievance or an EEO complaint. Management feels, at the FDIC, that it is very important to have an appeals process to the pay-for-performance system. We anticipated that because it is such a great cultural change that there would be a number of such increases.

I will say that with regard to the number of cases that have come through the system, a number of them have been overturned in favor of management. However, we do look at those cases and what is said in them, and if there are lessons to be learned, or if there is information that we find helpful, we certainly look at that information and use that as we try to improve our system.

Senator AKAKA. Mr. Nulf.

Mr. NULF. Yes, sir. In the early stages, we as well saw similar numbers, I would say, as we experienced within the GS. That being said, though, we have a focus similar to what has been testified today to make sure that the communication process and the involvement from affinity groups and monthly meetings and quar-

terly meetings with the CFO ASA, that all the various groups and everybody has a stake, if you will, in the process. And that has in the long run, certainly over the course of the last survey, in the last 5 years those numbers have gone down and, in fact, are below what we have otherwise with the GS schedule.

Senator AKAKA. Dr. Semerjian.

Dr. SEMERJIAN. Senator, we have not seen any major increase in grievances, but, first of all, I think NIST had a culture of technical excellence, so rewarding excellence was not a foreign concept. But, also, I think it is very important to make sure that we establish the metrics as part of the contract, so to speak, the performance agreement that we establish at the beginning of the year. We provided quite a bit of training for our managers to make sure that they know how to prepare appropriate performance agreements with the appropriate metrics. Performance appraisal is always a subjective process, of course. The question is how can we make it as objective as possible, and by establishing the metrics, the expectations at the beginning of the year, I think goes a long way to avoid those kinds of grievances. But we have not seen, when we started this process almost 20 years ago, any major increase.

Senator AKAKA. Thank you for your responses. Mr. Chairman, my time has expired.

Senator VOINOVICH. Senator Carper, welcome.

#### **OPENING STATEMENT OF SENATOR CARPER**

Senator CARPER. Thanks, Mr. Chairman. I was just meeting with one of your constituents from Toledo, CEO of Owen Illinois, who used to run a big part of Dupont's fibers business. He sends his best. He is interested in asbestos.

Senator VOINOVICH. Hopefully we will get that bill.

Senator CARPER. In Delaware, in my old job, as well as Governor Voinovich, we used to focus a lot on education, and we had a problem in my State, with being able to get enough well-qualified substitute teachers to show up on a daily basis at schools who could come into the classroom and do a good job when the regular teacher was not there. One of the ways that we finally settled on to address the problem was we tried to get retired teachers who still wanted to be in the classroom but they just did not want to do it every day, but they were willing to work as a substitute teacher. And the pay was not great, but what we finally worked out was an arrangement where they could come back to work as a substitute teacher, still receive their pension benefits, full pay, full pension pay, which you were entitled to, and they would also receive the daily stipend that was paid in a particular school district as a substitute teacher.

I am told that you mentioned in your testimony before I got here, that the FDIC would like to have the authority to bring back some of your former employees with skills that might be needed when your workload increases, maybe for a merger or bankruptcy, or that kind of thing.

I just shared with you one example of what we have done in a little State to enable us to do something like that with some success, and I just want to ask if you know of any other agencies that have a similar kind of authority, that I think you are looking for

for the FDIC. Is there a model out there, at least at the Federal level, or maybe a non-Federal level, that you think could be adopted by the FDIC or other agencies in similar circumstances?

Ms. KEA. Thank you, Senator Carper. That is a very good point, and we are very interested in bringing back our retirees, obviously, in the event of some catastrophic failures that would require more than the number of staff that we have available. It would be an excellent resource for being able to go out and get individuals who are already trained, have the knowledge in their head, and could be of immediate assistance to us.

We have been in serious talks with OPM, and we would like to be able to waive the dual compensation to allow them to continue to receive their benefits and still be compensated during the time that they are working for us. We think that it is something that would work quite well, and, obviously, it would alleviate any increase in adding employees to the rolls of the FDIC.

I am not aware, just off the top of my head, of what other organizations currently have that. That is some information that I would be happy to supply back to the Subcommittee, and I could do that.

Senator CARPER. I understand, Dr. Semerjian, that you mentioned in your testimony that the National Institute of Standards and Technology is now, you believe, more competitive in hiring and maybe doing a better job of retaining folks, the kind of folks that you have been seeking to attract since you implemented this—I guess it is called an alternative personnel system. And I would just like to ask two questions. First, what aspects of that system do you think have contributed most to those improvements that have been noted? And, second, did the agency experience the kind of problems earlier that you face today?

First of all, what aspect of the system do you think has contributed most to the improvements that have been noted?

Dr. SEMERJIAN. Certainly, our ability to recruit high performers has been affected, as well as our ability to recruit in a timely fashion, because now we actually have direct hiring authority for our professionals. So that makes a huge difference when we are competing with other offers, so to speak, to be able to make a commitment as opposed to waiting months.

But probably the biggest impact has also been in the retention area.

Senator CARPER. How so?

Dr. SEMERJIAN. As I had mentioned earlier, we have very high performers, such as Nobel Prize winners, and you could imagine they have a lot of transportability, so to speak, that they get a lot of offers just about every week. And to be able to retain them at NIST, we had to be fairly creative, and we have the tools, the ways of rewarding them through retention bonuses and other ways to keep them at NIST as part of our atmosphere, culture of technical excellence.

Senator CARPER. OK. Good. Thanks.

My last question is for Ms. Kea again, and I don't know if we will have time for anyone else to comment, but I would at least ask you to start. I understand that Colleen Kelley from the Treasury Employees will testify later that the pay-for-performance system at the FDIC has been, in her view, demoralizing for at least some of

the folks who work there. And I would like to ask you to comment on that, but I would also like to ask you to speak for a minute about how you—"you" more broadly than "you" as an individual, but how you seek to make the system fair, treating other people the way we would want to be treated?

I know there are always some bad apples in every agency. We have had bad apples in every outfit I have been a part of my whole life. So my guess is you probably have some, too. But we also strive to get everyone, I guess, up to a certain level. Any thoughts you have how you differentiate between employees that are doing a good job and those that are doing a great job? How do you all differentiate there?

Ms. KEA. Thank you, Senator. First, I do want to say I have a great deal of respect for Ms. Kelley, but I do not agree with her opinion or her assessment that our current system has been demoralizing for employees. We actually have worked with the union in developing this system. I am not sure you were in the room when I did state earlier that we at the FDIC do negotiate pay and compensation, which includes our performance appraisal system with the union. We do that every 3 years.

Senator CARPER. I was not here, no.

Ms. KEA. This is a third year for us, and we are, in fact, in negotiations now currently with the union, and one of the items for discussion on the table is our performance evaluation system. We are very interested in hearing continuing and ongoing feedback from the union.

With this program that we currently have in place—we started it at the executive level from the top going down—we surveyed our executives about the program and got pretty specific feedback. They indicated that they definitely felt that a system which gave them higher pay for higher performance, was more fair than one where everybody received the same pay but had unequal performance.

We then implemented a similar pay-for-performance system with our non-bargaining unit employees, and we also surveyed them. And the feedback that we received was that they also felt that it was a more fair system than everybody receiving the same increase across the board.

We have not implemented a formal survey for our bargaining unit employees. We would have to bargain, in fact, to do that. However, we found other ways to receive feedback. We go to staff meetings. We make managers available at the large staff meetings, and we try to talk to employees. We had a very thorough training system where we gave briefings and staff meetings to our employees about the new system so that they could understand what the goals were in order to be eligible for an increase in their pay. And we tried to link those to either a corporate mission or a mission at the branch level or at the division level, thereby giving everybody an opportunity to make a contribution and eliminating the thought or the philosophy that the nature of some jobs provide greater opportunities to make a contribution. We really focused on that.

The review process for determining who would get the award was a very thorough one involving several levels. And, in fact, before the results were released, the union did get the opportunity to re-

view those results just to look at them to see if there was some statistical imbalance. So we tried at all levels to build in some guarantees, some assurances, and to put as much transparency as we possibly could in the process.

One thing that I also stated earlier is that we are in the fourth iteration of our pay-for-performance system for our executives, and we have changed it based on the feedback that we have received through that process. So we feel that while no system is perfect and we have had a number of different systems at the FDIC, we are committed to trying to refine the system based on the feedback, based on the involvement that we have from the individuals who are both managing it and those who are being subjected to it.

Senator CARPER. All right. Great.

Well, Mr. Chairman, you have been generous with the time. I thank you and I thank our witnesses for their comments and responses to these questions. Thank you.

Senator VOINOVICH. I want to thank the witnesses for being here. There may be some other questions that we want to submit to you in writing. We would appreciate your getting back to us as soon as possible. We would like to have you stick around some more, but we have three other witnesses and it is 5 minutes after 12 o'clock. We have got to get on with our work.

Thank you very much for coming.

Senator VOINOVICH. Our next witness is Morgan Kinghorn, who is the President of the National Academy of Public Administration. Colleen Kelley is the National President of the National Treasury Employees Union. John Gage is the National President of the American Federation of Government Employees.

It is good to see all of you again and welcome. Before you sit down, if you would raise your right hand and repeat after me. Do you swear that the testimony you are about to give this Subcommittee is the whole truth, and nothing but the truth, so help you, God?

Mr. KINGHORN. I do.

Ms. KELLEY. I do.

Mr. GAGE. I do.

Senator VOINOVICH. Mr. Kinghorn, if you will begin.

**TESTIMONY OF C. MORGAN KINGHORN, JR.,<sup>1</sup> PRESIDENT,  
NATIONAL ACADEMY OF PUBLIC ADMINISTRATION**

Mr. KINGHORN. Thank you, Mr. Chairman, Senator Akaka, and Members of the Subcommittee, for inviting me to testify on a subject that I have certainly had a personal interest during my 25-year career and my 9-year career in the private sector and now in a non-profit organization, about looking at the alternative public personnel systems.

As President of the National Academy of Public Administration, I am really pleased to appear before you to provide some personal perspectives on the work of the Academy. As you know, the Academy is an independent, nonpartisan organization chartered by the Congress to give trusted advice. The views presented today are my own and are not necessarily those of the Academy as an institution.

<sup>1</sup> The prepared statement of Mr. Kinghorn appears in the Appendix on page 114.

What I would like to do is really depart from my written testimony and reflect on what I have heard in the last 2 hours and really give you some perspectives that are contained in my testimony, but also really are based on my experience in both the private and public sector on what we really should be looking at. I think the fact that there is a consistency in what the Subcommittee is hearing really shows the long evolution of performance-based systems. They have been around for a long time, and they certainly can work.

The first point I would like to make is I think the reforms in this system are absolutely essential. The Academy, about a year and a half ago, did "Conversations on Public Service," which came out of our work on pay for performance and the Volcker Commission. In addition, there was a survey that OPM did about 3 years ago that I would like to share, two questions and answers that I think go to the point.

One question that was asked was: "My performance appraisal is a fair reflection of my performance." Sixty-five percent of the 100,000 responders in the Federal Government said yes. There was obviously a lot of work going on in performance appraisals. The next question, though, is a little more interesting: "Our organization's awards program provides me with an incentive to do my best." Seventy percent of the responders neither agreed or didn't—disagreed or strongly disagreed. That would tell me that we have organizations that are certainly involved in some kind of performance evaluations, but it is unclear to me how they have been used. They certainly haven't been used in terms of awards. So I think the system needs to be changed and probably needs to be changed fairly radically.

Second, you have heard a lot about the importance in these systems at every level in the organization being involved. That is crucial. It also ties into why, in those organizations that are successful, it goes from the top of the organization down to the employee, and it is nearly always tied to a strategic plan and the objective of that organization. Without that, there is rarely a connection between employee performance, whether it is a manager or a working employee, and the agency's core mission.

You have also heard, which I completely agree with, on the transparency of the process and the transparency of the outcomes. I think that is crucial. When I came into consulting 13 years ago, after a 25-year career in the Federal Government, I came out of a structure where I started as a GS-9, ended as an SES-6, and really was appalled for those 25 years at the inability of the system to really appropriately differentiate between the best performers and, in particular, the average or mediocre performers.

I came into a private sector organization that had pay for performance. However, it was often based on which partner in the consulting business liked you or didn't like you. So when I became a partner 2 years later, I decided to change that process and basically created a peer review process in my practice—it was the second largest practice in PricewaterhouseCoopers at the time in the public sector—in which at the end of those review processes the transparency of the decisions to all the employees as well as the outcomes was pretty clear. It passed the laugh test, which is an im-

portant test to pass. Individuals may not have been happy with the outcome, but when they looked at who was rewarded, about 18 percent of the people got cash awards or bonuses or pay increases—not a large number—they understood why, because there was a process in place, training in place, and everyone from the partner down to the employee was involved in that process.

The final thing I would like to share with you is that I think one of our focuses needs to be on the future. Government is transforming in a variety of ways. What government does, how it does it, and who does it is changing radically. A lot of our discussion appropriately focuses on the current 2 million plus or minus Federal employees. But over the next 20 years, which these reforms will impact, we have a different workforce coming in from what our research tells us, one that demands different kinds of rewards, one that wants more agility in the way they work, more flexibility, the ability to move around quickly, the ability to move up, and not be hampered by what appears to them to be a very complex 25- to 30-year career process called the General Service. So they really do expect change, and if they don't get it, we won't be able to retain them and we won't be able to get them.

Finally, I think we have to realize that there is a constistancy in this change. I ran a relatively small practice in Pricewaterhouse that was 600 people with 24 partners, but it was part of a 35,000-person organization, all of which had pay for performance, which worked reasonably well. But we changed it nearly every year. We learned from the process. So I think if we attempt to create and wait for a process that is perfect, certainly for the individual agencies, all of whom are unique, have unique requirements, we are never going to get there. And with the changing nature of the workforce, where many programs that really the primary people involved are no longer Federal employees—they may be contractors, they may be for-profit, they may be nonprofit, they may be grantees, people receiving money from the Federal Government—the relationship of how we reward performers is going to change even further in the next 10 years.

So I think clearly it is time to move on. We have learned a lot from both the experiments that have been performed, we have learned a lot from the private sector, and certainly from State and local governments who have been involved in this for a long time.

I will be glad to answer any questions the Subcommittee may have of me.

Senator VOINOVICH. Thank you very much. Ms. Kelley.

**TESTIMONY OF COLLEEN M. KELLEY,<sup>1</sup> NATIONAL PRESIDENT,  
NATIONAL TREASURY EMPLOYEES UNION**

Ms. KELLEY. Thank you, Chairman Voinovich, and Ranking Member Akaka. I very much appreciate the opportunity to testify here today.

I would like to comment specifically about three alternative pay systems that NTEU has been involved with: The FDIC system, which has been in effect for several years; the Department of

<sup>1</sup> The prepared statement of Ms. Kelley appears in the Appendix on page 119.



Homeland Security system, which is still in the pre-implementation stage; and the IRS system that right now only applies to managers.

I must say at the outset that I believe that these alternative personnel systems have very little positive impact on recruiting, retaining, and maximizing the performance of Federal employees.

NTEU has bargained over compensation at the FDIC since 1997. While we have serious concerns about the current state of the pay system there, we strongly believe that, in the absence of a statutorily defined pay system, like the GS system, pay should be subject to collective bargaining, as it is in the private sector. Especially in a government environment, employees and the public need a credible means of ensuring that pay is set objectively.

NTEU is at odds with the FDIC on the current system to determine performance pay. While the FDIC itself has stated that "more graduated levels of rewards are better than fewer levels," it has dropped a multi-level performance evaluation system, and the FDIC has moved to a pass-fail performance evaluation system. Under this system employees who pass are eligible to be nominated by their supervisor for a pay increase that they call a Corporate Success Award.

Now, NTEU insisted that there be some guarantee that front-line employees would have access to these Corporate Success Awards and that they would receive some of this money, so there is language that guarantees that at least one-third of bargaining unit employees, front-line employees, will receive these CSAs. But that one-third minimum might as well be a limitation because to date the FDIC has only been willing to recognize and reward one-third of the workforce. And the standards for who gets these increases are vague, they are subjective, and they are not apparent to those who are covered by the system.

The application of this one-third limitation on the availability of pay adjustments and its lack of transparency have demoralized FDIC employees. Our members report that the system is divisive, it discourages teamwork, and it sends the message that two-thirds of the workforce are not contributing. The previous system at the FDIC, which was based on multi-level performance evaluations without limits on the number of employees who could receive additional pay, did have credibility with employees. The current system does not.

DHS. While the pay-for-performance system at DHS has not yet been implemented, we are very concerned that it will push employees who are already demoralized out of the agency when the importance of keeping experienced, skilled employees is greater than ever. Let me be clear: The employee opposition to the proposed DHS system is not about "fear of change," as some have tried to portray it. I know firsthand that this group of employees, who are entrusted with protecting our country from terrorists and other criminals, is not a fearful group. What they most object to about the proposed DHS system is that it will make it harder, not easier, to accomplish the critical mission of the agency.

There are several reasons for this: One, the system is not set by statute or subject to collective bargaining as the FDIC's system is, so there is nothing to provide it any credibility among employees. Two, the system will have employees competing against each other

over small amounts of money, discouraging teamwork, which is critically important in law enforcement. Three, the system is subjective, which will lead to at least the appearance of favoritism. Four, the system is enormously complex, the administration of which will require huge amounts of money that is so much more desperately needed in front-line functions, not to mention siphoning off money that could go for more pay in a less administratively burdensome system. And, five, the draft competencies for the new DHS system do not recognize or reward the real work that these employees do to keep our country safe.

The IRS. While employees represented by NTEU are not covered by a paybanding performance-based system at the IRS, IRS managers are. The Hay Group, a consultant which was hired by the IRS, did a senior manager payband evaluation on this system for the IRS last year. Here are just some of the results: 76 percent of covered managers felt the system had a negative or no impact on their motivation to perform their best; 63 percent said it had a negative or no impact on the overall performance of senior managers; only one in four senior managers agree that this paybanding system is a fair system for rewarding job performance or that ratings are handled fairly under the system; and increased organizational performance was not attributed to this paybanding system.

The results of this IRS system are dismal, yet it is pointed to as a model for moving the whole Federal Government to a similar system. In fact, there is a dearth of information to indicate that alternative pay systems have had any significant impact on recruitment, retention, or performance. The GAO report I mentioned in my full testimony includes virtually no evidence that the systems improved any of those measures. In fact, the Civilian Acquisition Personnel Demonstration Project that was reviewed in that report had as one of its main purposes to "attract, motivate, and retain a high-quality acquisition workforce." Yet attrition rates increased across the board under the pilot.

NTEU is not averse to change. We have welcomed, at the FDIC and elsewhere, the opportunity to try new things and new ways of doing things. Based on my experience, these are the things I believe will have the most impact on the quality of applicants and the motivation, performance, loyalty, and success of Federal workers:

One is leadership. Rules and systems don't motivate people. Leaders do.

Two, opportunities for employees to have input into decisions that affect them and the functioning of their agencies. Employees have good ideas that management is currently ignoring.

And, three, a fair compensation system that has credibility among employees, promotes teamwork, is not administratively burdensome, and is appropriately funded.

Unfortunately, I do not believe the systems that are currently being pursued by the Administration follow these standards. I ask that the Members of this Subcommittee closely review and analyze what data exists on these current alternative personnel systems that exist today. I don't think the evidence supports their use as successful models across government.

I thank you for the opportunity to testify and would welcome any questions that you have.

Senator VOINOVICH. Thank you very much. Mr. Gage.

**TESTIMONY OF JOHN GAGE,<sup>1</sup> NATIONAL PRESIDENT, AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES, AFL-CIO**

Mr. GAGE. Thank you, Mr. Chairman, for inviting me to testify today, and also thank you, Senator Akaka, for your support of Federal employees, not just on this Subcommittee but also the VA and Armed Services committees.

I would like to focus my remarks today on the experience of AFGE Local 1904 at the Army's Fort Monmouth, in New Jersey, which has had about 5 years of experience with the Acquisition Demonstration Project. I must say the demo at Fort Monmouth works relatively well for two primary reasons: Collective bargaining and funding.

Crucial aspects of the system have been established through the process of collective bargaining, and the resulting collective bargaining agreements are fully enforceable. Labor and management have a respectful relationship, and the contracts negotiated between Local 1904 and local management reflect the good-faith efforts of both parties. In addition, the demo portion of the pay system is funded separately and is treated as a supplement. Virtually every employee covered receives his regular ECI and locality increase each year. The demo raises are on top of these regular across-the-board increases. Although money formerly used for within-grade and quality step increases is used for the demo, at Fort Monmouth additional program funds have been provided to allow the improvements in overall pay levels.

My written testimony includes a description of some of the terms of the contract between AFGE Local 1904 and Fort Monmouth management. As you know, a contract such as this will be unenforceable in DOD and DHS once the NSPS and MaxHR go into effect. In fact, managers will not even have the authority or flexibility to negotiate with the local union or use a contract like this to navigate the inevitable conflicts that arise over how to implement a pay system that requires subjective evaluations.

This contract, like all collective bargaining agreements, reflects a balance between the rights of management and workers subject to the constraint of mission accomplish. It reflects the joint acknowledgment of various roles and responsibilities and their limits.

Despite the positives I have described, the demo at Fort Monmouth is far from perfect. Like all pay schemes that seek to individualize pay adjustments, it raises the question of what the system is trying to accomplish, whether those aims have been met, whether the pay system should get credit for improvements and results, and whether the costs associated with administering complex, multifaceted pay adjustment processes are offset by measurable benefits.

The most important point is that the crucial protections for employees that are included in the Fort Monmouth demo are absent from both NSPS and MaxHR. The classification system at Fort Monmouth still provides a floor for an employee's salary based on the duties and responsibilities of the job, and they are entirely ob-

<sup>1</sup> The prepared statement of Mr. Gage appears in the Appendix on page 128.

jective criteria. Collective bargaining rights are intact and fully exercised.

The fact is that the demo at Fort Monmouth, and its success, has far more in common with the General Schedule than it does with either MaxHR or NSPS. Time and again the employees at Fort Monmouth urged me to tell you that they oppose the NSPS in the strongest possible terms and that the real reason that their project works as well as it does at Fort Monmouth is the strong, fair, and reliable system of checks and balances achieved and maintained through collective bargaining.

Mr. Chairman, I know you brought up Katrina, and this past week or so I have received incredible reports of Federal workers, who have gone the extra mile. Social Security was down there instantly, gave out 30,000 checks to people who would not have gotten them through the mail or any other way. We have pictures of VA employees standing in knee-deep water doing their job. We received more volunteers from Border Patrol and Homeland Security to go down there on their own to help out.

And, Senator, while you are sitting here trying to look at how to motivate employees, provide fair compensation, then we get hit last week with our retirement going from high three to high five, retiree health insurance being hit, paying for parking—and this comes to about \$7 billion over 5 years. And, Senator, it is hard for Federal employees to see anything objective about new personnel systems, when they see in the wings our benefits, our retirement, and our pay ready to be slashed.

So, Senator, I would like to commend you for having these hearings and for looking at Federal employment, but you have to realize that a tax on our current system certainly is nothing to do and will not help rewarding the best and brightest or attracting the new generation of Federal employees or retaining the ones that we have.

Thank you, Senator.

Senator VOINOVICH. Thank you very much, Mr. Gage.

Senator AKAKA, if it is all right, I will ask you to start asking questions. I have to excuse myself for a minute, but I will be back.

Senator AKAKA [presiding]. Thank you very much, Mr. Chairman. I want to add my welcome to this panel, and thank you for your testimony.

Ms. Kelley, I am concerned about what you said about the personnel system at FDIC. I want you to know that I plan to ask further questions of FDIC regarding the issues you raised.

Ms. KELLEY. Thank you.

Senator AKAKA. The FDIC, Ms. Kelley, as we know, is exempt from the prohibited personnel practices outlined in Title 5, other than the prohibition of retaliation for whistleblowing. Do you believe this exemption has an impact on the number of prohibited personnel practices at FDIC?

Ms. KELLEY. We have been looking at this from a number of angles, Senator, including the pay system, and I don't have any data that I could share with you right now. As we come to any conclusions or recommendations that we see as next steps, I would be glad to provide that to you.

Senator AKAKA. Thank you, also, if you don't have it now, maybe you can provide me with recommendations on how to fix or what you think is the way of fixing the problem.

Ms. KELLEY. I would be glad to do that.

Senator AKAKA. That is fair.

Mr. Kinghorn, you raise a very interesting question and a very interesting issue in your testimony: The challenges associated with a multi-sector workforce. These issues are quite timely given the increasing number of contract employees working for the Federal Government. I am particularly interested in the first challenge you mentioned in your testimony regarding accountability. Do you have any suggestions as to how to assure accountability for a multi-sector workforce?

Mr. KINGHORN. Senator Akaka, it is an incredibly growing issue. For some agencies, perhaps like NASA where there has been what we call multi-sector—we don't think the term "blended workforce" works because we don't think it is necessarily blended or working in all cases. But in many agencies, this is beginning to happen increasingly. So, I think it is one of the major frustrations people have.

I think first of all, many organizations get into alternative work without really thinking through it strategically. I think the thing that bothers many Fellows of the Academy is that agencies and organizations and other people simply slip into the use of contractors, either because of crisis situations—and there is not really a strategic thought given to looking down the road, what could or could not happen and then building in some defense mechanisms per se, that if you are going to go that route, what do you really need to be careful of? And I think we have plenty of evidence in the last 25 years where that has happened.

So one of the key questions on how you deal with it is, you need to think about it in advance, and perhaps the Subcommittee can have some hearings on that subject as to when you go outside a Federal workforce or when a State goes outside its State public service. And this is beyond outsourcing and offshoring. What strategic thought was given to doing that? Was it an economic decision to save money? Which it generally has been. And have the downsides of that been examined?

I don't have any particular off-the-cuff sensibility that it is wrong to do that, but I think it needs to be given thought before it happens.

The other question of accountability, if you look at the grant programs, I came out of the Environmental Protection Agency where I worked for nearly 10 years back in the 1980s, when the EPA obviously with its several statutes, probably 25 statutes, was really the fundamental enforcer of many of the programs until they were delegated to the States. You fast forward now 20 years later, and most of EPA's programs are delegated, and they are paid for and managed through grants to grantees, whether they be States or other organizations. And I think that whole question of grant accountability, how do you hold a Federal employee who is issuing those grants—and we went through a period of 10 or 15 years where the accountability was purposely softened because we wanted block grants and other kinds of grants. What mechanisms do we

need for the next 15 to 20 years to hold the right people accountable?

I was at a large department's senior executive training session about 2 weeks ago, mainly a grantee organization, and they are struggling with that now. What is their role in the 21st Century other than just being an oversight of grantees? Should they have a role that looks at best practices of how the grants are used? Should there be a stronger accountability role?

So it really is a difficult question that not enough thought has been given to.

Senator AKAKA. Yes, I agree and I would like to ask Mr. Gage and Ms. Kelley if they have any further comments on this. Mr. Gage.

Mr. GAGE. Well, I think on the contracting side of it, clearly we are looking—what are there, 6 million contractor employees of the Federal Government now with no accountability that I can see? We have been asking for it in legislation, some sort of accountability. I think the mix of Federal employees and contractors on the work site is a confusing one, and it is something that I don't think really contributes to good government.

So I think when we are looking at pay for performance or any type of personnel system, I think accountability, not just for Federal employees, but also on the contractors and the work that they do or don't do, is something that needs to be magnified.

Ms. KELLEY. And I think that will become even clearer if you look closely at similar work done by Federal employees and that same kind of work being done by contractors. I think, unfortunately, we are going to see this in the very near future as the IRS moves forward with its plan to put collection tax accounts in the hands of private collection agencies, and there will be private collection agencies doing the tax collection work of the IRS instead of IRS employees. And we are going to see, I believe, a lot of accountability questions and conflicts here as this moves forward, and I will give you just one key example of this.

There is a law today in effect that prohibits IRS employees from being evaluated on dollars collected. That law was put into place to protect taxpayers from the fear of aggressive collection tactics by Federal employees. So IRS employees cannot be evaluated on dollars collected. But within the next 12 months, private collection agencies are going to be paid by being able to keep up to 25 percent of what they collect from taxpayers. So they will be paid based on dollars collected, which is going to raise a lot of accountability issues when it comes to who should do this kind of work—IRS employees who are accountable or these private collection agencies who will be paid a bounty to do the same work.

Senator AKAKA. Mr. Gage, you mentioned the proposals being floated by some to offset the funds government is spending for Hurricane Katrina. I share your concern with these proposals, and I assure you that those coming under the purview of this Subcommittee will be carefully reviewed if introduced in the Senate. We are concerned about that, and we will certainly be looking at it further.

Mr. Gage, the Comptroller General said in his written testimony that the current pay system is outmoded because it rewards length

of service over performance and contribution, automatically provides across-the-board annual pay increases, even to poor performers, and compensates employees living in various localities without adequately considering the local labor market rates. And my simple question to you is: Do you agree?

Mr. GAGE. No, I don't agree. I think there are a lot of straw men in that statement by the Comptroller General.

Some of these, when you look at the statistics on the pay for performance, for instance, the one I testified up at Monmouth, in 5 years two employees were unsuccessful. Two in 5 years. So that bugaboo about this system is going to weed out the non-performer is, I think, not accurate.

Obviously, our members don't like non-performers. They work next to them. If there is one, I think there is a peer pressure there that gets it moving. But I don't think that saying that the old system is outmoded because there are—this bugaboo that the Federal Government employees just don't work. And even under the pay-for-performance systems—and I know there is another one in Huntsville, Alabama, and these are all scientists. I think in 4 years there was one Federal employee that was unsuccessful.

I would like to comment on some things that Ms. Kelley said. First of all, the old system is old, therefore, we have to blow it up, and to say that this system will do all these things, there is really no information about that.

The Fort Monmouth people that we talked about in preparation for this, they really feel that it was so much ado about nothing, that the new system is so complex and is so time-consuming and resource-swallowing that it really doesn't motivate them. There is just a little bit of money involved, and that the amount of work that has to go into it really diverts from the mission rather than adds to it.

If I had my say, I think we could do some tinkering, some serious tinkering with the current system, and have one that really works, not just for scientists, but we have to talk about those rank-and-file Federal employees who are in VA hospitals or in Social Security. These are not the high-grade types that most of these projects have involved. Here a consistency and a dedication is really required and necessary to do Social Security claims or VA service, and a lot of that simply will not be captured—a lot of that dedication simply will not be captured in this pay-for-performance system.

Senator AKAKA. Ms. Kelley, do you agree, too? And finally I will ask Mr. Kinghorn.

Ms. KELLEY. I think broad statements about the system being old and needing replacement are just that. They are very broad statements that don't provide specifics. I would not say the GS system is perfect. There are surely things that if there are valid problems, we are more than willing to work with the Administration and with the agencies to address those. But in earlier testimony, just today, for example, Deputy Director Blair said that if an employee has a pulse, they receive a within-grade increase.

Now, I would suggest that any manager who is implementing the current system that way should not be a manager. So once again, the problem is with the implementation of the system, not with the

system itself. And if agencies cannot appropriately implement the GS system that has a lot of structure to it, then I think employees are absolutely right to doubt any agency's ability to implement a system that doesn't have those kinds of structures, that doesn't provide for transparent and fair criteria.

If the within-grade increase needs a framework around it as to what employees need to do to achieve that, then tell the employees what that is, and they will be glad to strive for that and to accomplish it. The things that need fixing are within the system, and the bigger problem, as far as I can see, across the board is implementation of the system. It is not the system itself. It is how agencies and managers implement it. That is only going to get worse in a system that is much more vague, which is exactly the road that all of these agencies are headed down, the ones that have the authority today and where the DHS and DOD and this Administration's proposal are going.

Senator AKAKA. Mr. Kinghorn.

Mr. KINGHORN. I think the objective of a performance system—and performance-based pay is one system. Over time my goal was, and still is in my own organization, which has one, is ultimately not to have anyone that is a poor performer. So the fact that in a system after a couple of years there were no poor performers could be the fact that grade creep has happened again, or it could be simply that the performance system, the ones I am familiar with, ultimately drives out the people that are poorer performers. But that is not the objective per se. The objective is to reward people, and that is the second step.

Again, in systems that I have been familiar with, both in my current job and previously, is that the performance system measured performance, and then even people in the organizations I worked in that received satisfactory, and sometimes above satisfactory, did not receive pay. At the consulting firm, I think we had 2.2 percent of pay to reward people. That doesn't sound like a lot of money, and it may not have been, but that is what we had. So we had a very high standard, and that is why people talked about the transparency of getting there was critically important, because you were not rewarding satisfactory people in that system, and you weren't even rewarding above average people.

So if you didn't have transparency, it would have fallen apart, and in that practice, we improved retention. At one point we had about a 36-percent attrition rate in consulting, in the consulting business. That dropped down to 14 percent. Some of that was market, but some of it was the fact that people understood the performance system was much fairer.

So you have to differentiate how you measure performance, I think, and its objectives, which can be different for different places, and then in that performance structure, with all the people you have, how do you use your reward system to provide the rewards? And some organizations might want to go down to satisfactory. Others want to stay at a higher end because they have certain objectives. And, again, as I suggested, you review that and the way you use both the system itself and the reward mechanisms might change, because your organization may change. Very different for NIST than it would be for IRS.



Senator AKAKA. Thank you, panelists. Thank you, Mr. Chairman.  
 Senator VOINOVICH [presiding]. Thank you, Senator Akaka.

I am a little perplexed because we are moving forward with MaxHR at DHS and NSPS at the Department of Defense. What I hope that we get out of this hearing today is some benchmark information that should be followed implementing alternative systems in a fair way. I think we heard some good things about involving employees, and I would hope that we continue to get input from the unions on things that could be done administratively or legislatively.

I am interested in hearing from you and your members in those agencies under an alternative personnel system, including the Department of Defense's NSPS that are the first to transition in—what do you call them again?

Mr. GAGE. Spirals.

Senator VOINOVICH. Spirals, thank you. We must get as much information on the transition as we possibly can from you. Ms. Kelley, do you represent anybody at the DFAS in Columbus?

Ms. KELLEY. No.

Mr. GAGE. We do.

Senator VOINOVICH. That is right. You have a strong, active union there. I think I have met with the woman who leads that local.

Mr. GAGE. That is right. Patty Viers.

Senator VOINOVICH. Yes, she is terrific. I would really like to have input from people like Ms. Viers and others, so we can monitor and make corrections if necessary.

Also, I was pleased to hear that OPM understands that there are many things that need yet to be done in terms of preparing for this. For example, having in place a performance evaluation system period, whether unionized or not, I think people like to know whether they are doing good or whether they need to make improvements. I think that helps everyone.

So I just would like to say to you that we are going forward. It seems to me that we also ought to be looking at the kinds of employees involved in the various alternative personnel systems. Ms. Kelley, you just mentioned that there is a stark difference between NIST and other agencies. It is a whole different culture when competing for Ph.Ds, and if you didn't have a pay-for-performance system in place, you may not get them to come to work for you, and for sure they wouldn't stay very long.

I think that there has to be some distinction between types of employees and a need to maintain comparability with the private sector. What kind of a system do agencies have in place in order to attract employees? And then once they are on board, how do you get them to stay?

So I think maybe that is the direction that I would be interested in directing your reaction to. Maybe that is the direction that we should go and to make sure that this isn't a one-size-fits-all because if we do, I don't think we are going to be successful for anybody.

Any reaction?

Senator AKAKA. Mr. Chairman, let me say that I am so pleased to hear your comments on MaxHR at DHS and also NSPS at DOD.

And I want you to know I look forward to working with you and your employee organizations on this. Thank you.

Senator VOINOVICH. Thank you.

Would you like to comment on what I just said?

Mr. GAGE. Well, I agree with you. I think to say that we are going to have pay for performance, it is going to be based on these competencies and thrown out there, when most of the experience comes from scientists and that we really haven't looked at the broad scope of Federal employment, and as we have been saying all along, I think this is a disaster for law enforcement. I don't even think you should try it. I think in many of our other jobs where there is such a team element, I don't think it is going to work there either.

So I really respect and appreciate your comments that we have to try, since we are going down this road, but we definitely have to customize it to the different agencies and the different jobs.

Ms. KELLEY. In my view, the accountability is what needs to be there, though, for the agencies because absent a collective bargaining agreement or a statutory definition of what their system is, they will be left to their own devices. And if there is not the leadership, if there is not the employee involvement, if there is not the transparency and the funding, it will fail. And the evidence or the facts as we have lived them, that I have presented in my testimony, are to highlight that, our biggest fear right now is that there are—we know that NSPS and MaxHR are moving forward. That is very clear. But the models that are being pointed to as a reason to expand governmentwide are full of flaws, and they should not be held up as a model to expand.

There will be a lot of things I believe that can be learned from the DOD and DHS implementation. They are still in the pre-implementation stages. This rush to point to other systems in place—like the IRS management system. If the IRS managers who are under it give the feedback to the consultant hired by the IRS that we have in the report, these are the same managers that are then going to be responsible for implementing a paybanding system someday for the front-line employees? I mean, it is doomed to failure if that system is looked to as a model for something that should be rolled out in that or any other agency.

For whatever reason, there seems to be a resistance or a hesitancy to acknowledge the flaws in these systems and to learn from them, and also to look and see what we can learn from DOD and DHS. You have such a variety of occupations within both of those agencies that cut across the gamut of Federal employees if you look at all of the employees in DHS and DOD. So you are going to have this wide range of everything from IT workers to accountants to lawyers to scientists to engineers, so all that experience will be there. And yet there seems to be no interest in seeing what can be learned from that and instead trying to point to these other APSS as models. And there is not one of them that I think employees should trust as the model that their system should be based on.

So that is what I would ask, is for your help to acknowledge that there is a lot to learn, not because they can be applicable in every agency, but there will be things that should be looked to and not

to buy into the reports that are issued about how great these other models are.

Ask the employees who are living under them, and that is what I did before I submitted my testimony. And I do it every time I visit with them, and the feedback is consistent that these are not systems that should be in place for them today, much less be held up as a model anywhere else.

Mr. KINGHORN. I think it would be unfortunate for the other million employees not covered by some of these new systems either to become at a competitive disadvantage in terms of the flexibilities of the systems but also just the confusion that could arise. So I certainly would support much like what the Administration has proposed. And if you look at the DOD and Homeland Security, 85 percent of it is probably very similar. There are some key differences, certainly, in the appeals process and collective bargaining, which I think are appropriate for discussion. But I think it would be unfortunate to have the rest of the million doing it piecemeal, either agency by agency, bureau by bureau. So I think that would be important to proceed.

I think it does need a set of core values to work with what are many of the key elements under Title 5, everything from diversity in the workforce to inherently governmental work defined. And I think there does need to be a criteria in which OPM needs to look at these flexible authorities before implemented. But I really look toward the future of the civil service, and this civil service system does not attract and I don't think will hold the kind of workforce that we are going to require in the next 20 years. Again, they need more agility. They need a different look at what career means. For them, career is going to be coming and going. It is going to be rare, I think, we can keep someone for 20 years in any organization, public or private. And if they see a system that prevents them from easy entry and easy exit and coming back perhaps, I think it will be difficult to attract the new government.

People don't like to change. I am no different than anyone else, and you have 2 million Federal employees, all of whom are dedicated. But I think we need to also look toward the new employees that we are going to be bringing in over the next two decades.

Senator VOINOVICH. That is interesting. As I observe the workforce around the country, there are less and less places that you can go and have some sense of having a career. I think that is a real advantage in the Federal workforce. Individuals can come and work until retirement. I think people are looking for an opportunity where they can make a contribution, but at the same time have some security because there is such uncertainty today in the private sector.

Mr. KINGHORN. I think it is mixed. I think as Mr. Gage has indicated—and I think we talked about it before—what might make sense for the IRS in its existing service centers, for example, or for law enforcement it may be different. But a lot of what I think government is going to be doing—and, again, this diverse workforce we are working with. What I have seen in terms of people I hired and I see people going in from the private sector finally, I don't see them interested particularly in many cases in a 20- or 25-year career anywhere.

Some agencies have had to deal with that. If you go to PTO or go to SEC, many people go into those organizations at a very young age out of school to get experience of how to understand the SEC and they leave. I think that concept is increasing.

I agree with you. I enjoyed a 25-year career. But, I don't think I am completely reflective of the new workforce that is coming in. But, clearly, there will be people that like the security, like the excitement, and do want to stay 30 years. But I am not sure the current system also rewards them in the appropriate ways, either.

Senator VOINOVICH. It is interesting that Mr. Walker always talks about how well reform has worked. He is very careful to explain how elements are in place before reforms are implemented. The real question is are we going to commit the resources so that agencies can dot the I's and cross the T's so that new systems are successful? That is my real concern about all of this that we are undertaking.

Also, I have to say this to you, Senator Akaka. I think that a lot of our colleagues don't get it. I don't think they do. I don't think a lot of our colleagues understand how important people are in the Federal Government and how important they are to the system. We are going to do oversight of FEMA, but I am going to be really interested to see what happens at the Department of Homeland Security. In creating the Department, people from one organizational culture were merged with people from another. I would not be surprised if people in FEMA left because they didn't like the merger. We had hearings and witnesses testified that employees were leaving because of changes in the culture of the new organization.

So all of these things, I think, have to be examined. We ought to consider what do agencies have to do to compete to get the people that they need. Then Congress must act. Implementing reform so it cascades, rather than doing massively across the board may be more effective. Your point is it should be available to all the agencies. The fact of the matter is that if you don't commit the resources, then it is not going to work.

Mr. KINGHORN. I would concur with that. I think everyone today I heard said that. Even in a small organization, in consulting, every partner is directly involved. And when we went through the evaluation process, we basically shut the place down for 5 days with the people involved and went through the evaluations. It is an enormous undertaking, and we knew what to expect. We were trained at what to expect. We were trained in a system that was different. And I think everyone's concerns about that issue, I think you need to monitor that and keep oversight on it.

Senator VOINOVICH. I just went through mine with my chief of staff. I am still not finished with it. I think the whole process is going to take 4 to 5 hours. I just think it is easier said than done. In some areas—maybe, Mr. Gage, you point out that because of the nature of some jobs, a different personnel system is needed. But we are moving, and the idea is moving, and we must do it right.

Senator Akaka.

Senator AKAKA. Mr. Chairman, I just want to tell you that I am concerned, as you are. There are those who feel that this is a program of the future. My concern is trying to overlay this throughout the whole system at one time. We should consider limiting this.

Now that we have it at DHS and DOD, we should limit it to those two organizations and see how it works before expanding it to the total system, and we should correct whatever needs to be corrected before it is expanded.

I would look forward to discussing that possibility. Thank you, Mr. Chairman.

Senator VOINOVICH. Thank you for being here today.

[Whereupon, at 1 p.m., the Subcommittee was adjourned.]



# A P P E N D I X

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STATEMENT OF THE HONORABLE DAN G. BLAIR  
DEPUTY DIRECTOR  
U.S. OFFICE OF PERSONNEL MANAGEMENT

before the

SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT, THE  
FEDERAL WORKFORCE, AND THE DISTRICT OF COLUMBIA  
COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS  
UNITED STATES SENATE

on

ALTERNATIVE PERSONNEL SYSTEMS:  
ASSESSING PROGRESS IN THE FEDERAL GOVERNMENT

SEPTEMBER 27, 2005

Good morning, Mr. Chairman and Members of the Subcommittee. On behalf of Director Springer, I want to thank you for the opportunity to appear before you today to discuss alternative personnel systems in the Federal Government. We are pleased to share that record with you because we believe these systems have successfully established work places and cultures where “performance matters” and where high and low performers are distinguished and rewarded accordingly.

The concept of “alternative personnel systems” is most clearly connected with the demonstration projects Congress authorized the Office of Personnel Management (OPM) to establish as part of the Civil Service Reform Act of 1978. That authority provided a means for the Government to try out alternative merit-based approaches to specific personnel management tasks and processes before making them more generally applicable.

The demonstration projects that established alternative personnel systems over the years since 1978 have covered several different areas of human resources management policy, including recruitment, examining, employee relations, and, of course, classification and pay.

These projects have consistently pursued the goals of better managing, developing, and rewarding employees to better serve the American people.

Many successful efforts have already led to Congress enacting permanent changes to title 5 for the entire Federal Government, as the architects of the demonstration authority intended. As early as 1990, the pay system changes enacted in the Federal Employees Pay Comparability Act, or FEPCA, included authorities for flexibilities like recruitment and retention incentives that had been successfully tested in demonstration projects.

More recently, the Chief Human Capital Officers Act of 2002, which you, Mr. Chairman, shepherded as part of the Homeland Security Act of 2002, authorized a significant alternative examining method known as “category rating.” This method had originally been developed in a demonstration project at the Department of Agriculture. Now any Federal agency is free to use that method as a standard hiring practice, and we continue to see an increase in its successful adoption across Government.

These successes illustrate the original intent of the demonstration project authority – develop and refine alternatives under OPM supervision and oversight and then make them available throughout Government.

That brings us to the largest – and oldest – set of alternative personnel systems I would like to focus on today. By far, agencies have most often sought flexibilities to use alternatives to the General Schedule classification and pay system. Agencies determined to pursue improvements to the strategic management of their human capital and achieve success in the heated competition for talent continually seek opportunities to move beyond the General Schedule. They seek to leave behind our 50-year-old 15-grade pay structure of fixed steps with



its automatic and longevity-based pay increases. They want to advance to job evaluation and pay designs that emphasize and reinforce performance and results.

By now, we have substantial experience with using alternative pay systems that cover over 90,000 Federal employees in a wide variety of agencies, occupations, and work settings. More than half these employees are in systems established under the title 5 demonstration project authority. Another third are in independent systems that their agencies established using separate, agency-specific authorities. And another 9 percent are covered in executive pay systems that have recently become true pay-for-performance systems where all pay increases are driven by measured performance.

Although each of these alternative pay systems is unique in some respects, common design features emerge. They use open ranges of pay rates rather than fixed steps. Any pay increase is usually contingent on an assessment that the employee's performance is at least fully successful. The pay increases that move employees through their pay ranges are directly – and differentially – linked to performance assessments, rather than the passage of time. Position classification is streamlined and pay ranges cover more broadly defined levels of work than the narrow General Schedule grades. Overall these alternative pay systems emphasize and reward strategic value and contributions over simply encumbering a position and meeting minimum acceptable standards.

The positive results and trends across these systems are clear. We do not have to wonder whether they work. We know they work based on a range of widely accepted effectiveness benchmarks.

- The highest rated performers are paid the most, and rewards can vary significantly based on performance. Annual pay increases ranged from 0% for low performers to

as much as 20% for top performers. At China Lake, the first demonstration project, there was a 40 percent difference in pay between the average and high performers after 10 years.

- Performance – not time – drives pay. The alternative systems replace statutory waiting periods for within-grade step increases and career-ladder promotions. In the majority of systems, the annual general increase is at risk and not granted to poor performers.
- Agencies implement these systems within their existing budgets, and costs can be controlled. As we have applied lessons learned from the earliest demonstration projects, we have developed effective cost management techniques built around pre-determined salary increase budgets. Training and implementation costs are generally absorbed as necessary business expenses.
- Managers are trained to manage performance more effectively and are held accountable for that and for making meaningful distinctions across levels of performance. Clearly, taking the time to make sure managers understand the new systems and how to use them effectively and transparently is key to achieving acceptance and support for the systems. Rating reconsideration processes are built in to these systems to ensure procedural justice. Techniques like calibration discussions help ensure meaningful distinctions among levels of performance are made across organizational units. Performance ratings distributions in most locations clearly demonstrate that distinctions are being made.
- Turnover among the better performers is significantly reduced. Among employees rated Outstanding in four Department of Defense laboratory demonstration projects

(DoD Lab Demos) where this measure was tracked most carefully, the annual turnover rates were reduced by 64 percent, 51 percent, 48 percent, and even 11 percent in a lab where external competition was particularly pronounced.

Of course, employee perceptions of how well these alternative systems are working are critical. The various program evaluation efforts that are an integral part of demonstration projects have produced a rich store of employee survey data from before and after implementing systems and as comparisons to control sites.

- Employees report seeing a direct link between their performance and their pay. In the Lab Demos, that link was reported by two out of three employees, compared with only one out of three employees in control sites under the General Schedule.
- Pay satisfaction is higher after the systems are implemented. Bearing in mind that pay satisfaction starts out at fairly high levels in our traditional Federal pay systems, the fact that pay satisfaction measures showed increases in the 19 to 48 percent range is encouraging.
- Teamwork is supported and not destroyed. LabDemo survey results showed not only that teamwork was not negatively affected, but it increased more in the demonstration sites than in control sites.
- Employees can and do come to understand and accept these alternative pay systems. Measures of support for the demonstration projects range as high as 80 percent. Even where the explicit support is more temperate (e.g., 26 percent, 48 percent), the largest proportion of employees are undecided (e.g., 44 percent, 41 percent) rather than opposed, and other data in those settings suggest some standard implementation efforts require better attention and monitoring.

- Procedural justice is addressed and reinforced. The procedures governing appraisal and pay decisions are crucial, particularly those that give employees a chance to seek reconsideration or redress. Employees in the LabDemos report they understand how their appraisal systems work (72 to 89 percent agreement) and how pay decisions are made (58 to 70 percent agreement). Further they generally agree adequate reconsideration procedures are available. Such results are key to achieving an overall perception of fairness and transparency.
- The trust that leads to success can be earned through good communication and fair administration. Demonstration projects showed significant improvements in communication from management and across organizational units. And, in turn, the already high correlations between communication and procedural justice, as well as between communication and trust, remain strong.

Of course achieving this success does entail significant culture change. Such change requires commitment and communication and training and followthrough, but agencies have proven willing to make the investment. OPM is careful to check for that commitment and ensure it is in place and well founded before encouraging an agency to proceed with any alternatives.

When such commitments are present, the results are definitely encouraging. By the standard benchmarks discussed above, these alternative pay systems are successful. We can indeed devise and operate fair, credible and transparent pay systems in the Federal Government that shift the value proposition.

Generally speaking, under an alternative pay system the money distributed as salary increases is comparable to what would have been distributed under the General Schedule. The important difference lies in the basis used to make pay determinations and the value that basis

represents. For the General Schedule, time is the overwhelming basis for distributing increases, so the message to employees is “Time matters.” In the alternative pay systems tested in demonstration projects in the Departments of Defense and Commerce and in other independent systems, pay increases differ based on differences in appraisal outcomes. By making performance much more clearly the basis for distributing pay increases, the message to employees becomes “Performance matters.”

Particularly in the war for talent, establishing the right value proposition – that performance is what we value and what makes a difference – can be critical. It definitely has been worth pursuing.

You asked us to discuss the role OPM has played in developing and overseeing these alternative systems. Congress clearly gave OPM a key role in the demonstration projects because we establish them only after carefully considering a proposed design for conceptual and technical soundness. We take very seriously the requirement that demonstration projects include a thorough evaluation. The information those evaluations produce has been a rich source of best practices and lessons learned to apply as designs evolve further both within the demos specifically and wherever possible, Governmentwide. For example, effective cost control techniques like salary increase budgets, the value of balancing base pay adjustments and lump-sum bonuses to recognize performance, and the clear impact of communications and effective manager training on understanding and acceptance of system changes have all been recognized and applied more generally as a result of the demonstration projects.

In that respect, OPM is leveraging its leadership of the Human Capital Initiative of the President’s Management Agenda. Using a “beta site” or piloting approach, we are establishing goals for agencies that will further the development of robust performance management systems.

For a particular site within the agency, evidence must be clear that managers are effectively setting expectations, providing employees ongoing feedback, appraising employee performance, and using awards programs to reward results. In other words, we will require evidence that the site is ready to link pay to performance appraisal systems, with the expectation that such improvements will expand and continue throughout the agency.

Even where Congress has granted an agency some independent authority, OPM still plays a role. In some instances, Congress assigns us a specific role, as with the Internal Revenue Service broadbanding authority which requires OPM to issue criteria the Secretary of the Treasury must follow in establishing any broadbanded system at IRS.

Beyond that, however, OPM has its normal oversight and accountability responsibilities. Of course we are always mindful of those responsibilities, but especially when alternatives to the standard title 5 provisions are being used. When OPM observes or even foresees difficulties in implementing a system feature, our experts step right in to notify the agency and assist in making appropriate design corrections or otherwise address emerging issues.

OPM's leadership role is also essential to making these alternative pay systems work successfully. In particular, we try to anticipate unintended consequences, to act on lessons learned, and to articulate and share best practices. OPM provides expert guidance which the agencies find invaluable in tailoring sensible approaches to meet their unique needs and avoiding problems.

Improvements in implementation and cost management strategies have evolved over time with the more recent projects. For example, after recognizing the cost consequences of certain design features in some early demonstration projects, OPM ensured they would not be duplicated in subsequent systems. We take particular care in reviewing which General Schedule grades an

agency is proposing to band together because that can have a significant impact on overall system costs.

In that sense, OPM's role as a gatekeeper is well-placed. The Congress understood that the freedom to do different things meant the consideration of some options that might be ineffective or inefficient, and has looked to OPM to keep agencies on course and not let them steer into harm's way.

OPM and the Federal Government have already learned and applied important lessons through these alternative pay systems. We believe the time has come to allow these alternatives to achieve the same permanence other successful demonstration projects like category rating have earned. The ideas the Administration is incorporating into our Working for America legislation are the legacy of these successful projects and systems. We are convinced these ideas work. And we are convinced these and other agencies are ready to be given carefully controlled access to making these ideas a permanent part of their human capital management systems.

The Working for America Act would give OPM a central leadership role and the responsibility to establish core classification and pay systems. We believe Congress should authorize core systems for two main reasons. First, applying a basic principle of leveraging scale to achieve efficiency makes it more sensible to assign the task and resources necessary to set up, adjust, and maintain market-sensitive pay schedules to one lead agency with well-established expertise. Second, we have enough evidence from recent experience with independent systems and authorities to agree concerns about dysfunctional inter-agency competition are well placed and are best addressed through common pay structures and pay rules.

As a step toward transitioning to alternative systems, by using the President's Management Agenda and Executive Branch Management Scorecard, the Administration has

been hard at work readying agencies to demonstrate they use robust performance management systems. Agencies are preparing themselves to embrace a truly results-oriented performance culture through the use of more performance- and market-sensitive classification and pay systems. Already the performance management systems in some agency settings are ready to support making stronger links between pay and performance, and elsewhere significant progress is being made. OPM is determined to ensure their success and we look forward to your continued support as we do so.

That concludes my testimony, Mr. Chairman. I would be happy to answer any questions you may have.



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United States Government Accountability Office

GAO

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

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HUMAN CAPITAL

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

Statement of David M. Walker  
Comptroller General of the United States



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GAO-05-1048T

September 27, 2005

## HUMAN CAPITAL

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

### GAO 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](http://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](mailto:shamesl@gao.gov).

#### 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.

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Chairman Voinovich, Senator Akaka, and Members of the Subcommittee:

I appreciate the opportunity to be here today to discuss what has been learned from alternative personnel systems' implementation of pay for performance. As the federal government transforms to be better positioned to address 21st century challenges, a key question is "How should the federal government update its compensation systems to be more market-based and performance-oriented?"<sup>1</sup> 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. 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.

Recognizing that the federal government's pay system does not align well with modern compensation principles, Congress has provided various agencies exemptions from current statute in performance management and pay administration.<sup>2</sup> Most recently, the Departments of Homeland Security (DHS) and Defense (DOD) received the authority to establish "flexible and contemporary" human capital and pay systems.<sup>3</sup> We at GAO have also received human capital authorities and strive to lead by example, especially in implementing more market-based and performance-oriented classification and compensation systems.

GAO strongly supports the need to expand pay reform in the federal government. To further the discussion of federal pay reform, GAO partnered with the U.S. Office of Personnel Management (OPM), the U.S. Merit Systems Protection Board, the National Academy of Public Administration, and the Partnership for Public Service and convened a

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<sup>1</sup>GAO, *21st Century Challenges: Reexamining the Base of the Federal Government*, GAO-05-325SP (Washington, D.C.: February 2005).

<sup>2</sup>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).

<sup>3</sup>For more information on DHS's and DOD's human capital authorities, see 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).

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symposium in March 2005 to discuss public, private, and nonprofit organizations' successes and challenges with designing and managing market-based and more performance-oriented pay systems.<sup>4</sup>

While we believe that implementing market-based and more performance-oriented pay systems is both doable and desirable, these organizations' experiences in designing and managing their pay systems underscored three key themes that can guide federal agencies' efforts to better link pay with performance.

- First, 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 is only one part—albeit a critical one—of a larger effort to improve the performance of an organization.
- Second, 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. Specifically, these organizations recognize that pay increases are no longer an entitlement but should be based on employees' contributions to the organization's mission and goals.
- Third, 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. In particular, there needs to be growth and development at every level of the organization: top leaders with the vision, commitment, capabilities, and persistence to lead and facilitate the change; managers with the skills and abilities to fairly and honestly assess employee performance; and individual employees who are engaged and empowered to seek opportunities to enhance their careers.

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<sup>4</sup>The organizations included the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Commonwealth of Virginia, IBM Corporation, and American Red Cross. For more information, see 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).

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Federal agencies have also been experimenting with pay for performance through OPM's personnel demonstration projects authorized under Title 5. We reported that these demonstration projects show an understanding that linking pay to performance is very much a work in progress and that 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.<sup>5</sup> In particular, there are opportunities to 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 appraisal and pay decisions to ensure reasonable transparency and appropriate accountability mechanisms are in place, among other things.<sup>6</sup>

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 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.

Nevertheless, we need to move forward with 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 each agency's demands, challenges, and missions. However, we have reported that a reasonable degree of consistency across the

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

<sup>6</sup>For more information on our review of OPM's demonstration projects and other GAO human capital reports, see app. I.

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government is still desirable and that broader reforms should be guided by a framework consisting of a common set of principles, criteria, and processes.<sup>7</sup>

Before implementing any human capital reforms, executive branch agencies should follow a phased approach that meets the "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 demonstrated institutional infrastructure and an independent certification by OPM 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.

GAO will continue to work with Congress, OPM, and other key stakeholders on future human capital reforms. This morning I will highlight the strategies that organizations considered in designing and managing market-based and more performance-oriented pay systems and how they are implementing them. These organizations include selected OPM demonstration projects, organizations presenting at the symposium, and GAO.

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### Strategies for Designing and Managing Market- Based and More Performance-Oriented Pay Systems

Even though people are critical to an agency's successful transformation, a number of agencies still try to manage their people with a "one-size-fits-all" approach to compensation. For example, employees are compensated through an outmoded system that (1) rewards length of service rather than individual performance and contributions; (2) automatically provides across-the-board annual pay increases, even to poor performers; and (3) compensates employees living in various localities without adequately considering the local labor market rates for these employees. We have

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<sup>7</sup>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).

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observed that a competitive compensation system can help organizations attract and retain a quality workforce. 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.

The strategies that the organizations at our symposium considered in designing and managing market-based and more performance-oriented pay systems and examples of how organizations are implementing them are as follows.

**1. Focus on a set of values and objectives to guide the pay system.**

Organizations need to focus on a set of values and objectives when designing and managing their market-based and more performance-oriented pay systems. Values are inherent and enduring principles that represent the organization's beliefs and boundaries. For example, GAO's core values—accountability, integrity, and reliability—were a focus in identifying and validating the competencies for our new performance management system. With authority from Congress, we have implemented a market-based compensation system that places greater emphasis on a person's skills, knowledge, and job performance and not the passage of time while, at a minimum, protecting the purchasing power of employees who are performing acceptably and are paid within competitive compensation ranges. Under the new market-based pay system, which is in the first phase of implementation, employee compensation now considers current salary and allocates individual performance-based compensation amounts between a merit increase (i.e., salary increase) and a performance bonus (i.e., cash). In addition, we received authority from Congress to adjust the rates of basic pay on a separate basis from the annual adjustments authorized for employees in the executive branch. We also recently finalized a performance-based compensation system with pay banding for the remainder of GAO's workforce, the administrative professional and support staff.

While core values define the organization's beliefs and boundaries, objectives articulate the strategy the organization plans to take to implement a market-based and more performance-oriented pay system to help it recognize and reward employees and maintain a competitive position in the market. For example, the Red Cross recognizes that salary is its main lever to fulfill its mission and values, and thus one of its objectives is to pay salaries that are externally competitive and internally equitable. To

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meet this objective, the Red Cross sets its employees' pay slightly higher than the market in order to remain competitive and attract, motivate, and retain its employees. Similarly, a main objective of the Office of the Comptroller of the Currency's (OCC) pay system is to maintain comparability regarding compensation and benefits with the other federal financial regulatory agencies, such as the Federal Deposit Insurance Corporation (FDIC) and the U.S. Securities and Exchange Commission. To maintain comparability in compensation and benefits, OCC participates in an annual survey that gathers information and data on the financial regulatory agencies' total compensation packages. This information helps OCC set its pay increase budget for the next year based on the average pay for its market.

**2. Examine the value of employees' total compensation to remain competitive in the market.** The organizations at our symposium found that it is important to be flexible in the mix of what constitutes total compensation so they can remain competitive with the market. Organizations should 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. For example, to help it compete in the market and retain its employees, IBM offers its employees a "total rewards" package including work-life benefits such as tuition reimbursement for employee development, along with retirement and health care benefits.

At GAO, we believe that providing employees with individualized total compensation summary statements each year helps provide clarity on the employees' total compensation packages and specifically, how employees' pay increases received during the year fit into their total compensation. The annual summary statements include GAO's contributions to employees' benefits, incentives and other awards, and other GAO paid or subsidized benefits. The statements include items such as student loan repayments and transit subsidies, as well as adjustments to employees' pay, such as across-the-board salary adjustments, performance-based pay adjustments, and promotion-related increases.

Transparency is becoming an urgent matter today as federal agencies face tough choices ahead managing the serious and growing long-term fiscal challenges facing the nation. We recently reported that DOD's historical piecemeal approach to military compensation has resulted in a lack of transparency that creates an inability to, for example, assess the allocation



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of total compensation investments to cash and benefits.<sup>8</sup> In order to help improve the transparency over total compensation, we recommended that DOD develop a comprehensive communication and education plan to inform servicemembers of the value of their pay and benefits and the competitiveness of their total compensation package when compared to their civilian counterparts that could be used as a recruiting and retention tool.

**3. Build in safeguards to enhance the transparency and help ensure the fairness of pay decisions.** Agencies need to have modern, effective, credible, and as appropriate validated performance management systems in place with adequate safeguards to ensure fairness and prevent politicization and abuse. These systems are the precondition to linking pay, incentive, and reward systems with employee knowledge, skills, and contributions to organizational results.

GAO's performance management and pay system has built in numerous safeguards, including multiple levels of review, to ensure consistency and fairness in the process and resulting decisions. Specifically, before performance ratings are finalized, they receive second-level reviews, typically by a senior executive within the employee's team. This reviewer checks if raters have consistently and reasonably applied the performance standards. Subsequently, the Human Capital Office and the Office of Opportunity and Inclusiveness review the performance ratings and pay decisions across all of GAO to determine whether there are any irregularities or potential adverse impacts to be addressed. To further help ensure consistency in ratings and in applying performance standards within and across GAO's teams, we implemented standardized rating scores (SRS) for employees for the first time in the fiscal year 2004 performance appraisal cycle. The SRS indicates the employee's position relative to the average rating of that employee's team. Employees in different teams with the same SRS have the same relative performance, thus achieving better comparability in ratings across teams. Employees' SRS and the midpoint for their pay range are key factors in calculating their performance-based compensation for that year. We are continually working with the employees to identify the best way to communicate the

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<sup>8</sup>GAO, *Military Personnel: DOD Needs to Improve the Transparency and Reassess the Reasonableness, Appropriateness, Affordability, and Sustainability of Its Military Compensation System*, GAO-05-798 (Washington, D.C.: July 19, 2006).

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SRS information as part of GAO's ongoing commitment to employee feedback on the new system and transparency about pay decisions.

IBM built in several accountability mechanisms to help achieve consistency and equity in pay decisions across employee groups and teams. For example, to help ensure there is no discrimination in pay decisions, IBM conducts a base pay equity analysis to review the pay of women or minority employees if their proposed pay is one standard deviation away from the mean of the majority of employees and looks for an explanation for these pay differences, such as poor performance, a recent promotion into the pay band, or an extended leave of absence. In addition, IBM built in second-level reviews of pay decisions before employees receive any pay increases to ensure consistency in the compensation process. The first-line managers discuss their proposed pay decisions with managers at the next level—the up-line managers—to ensure the performance assessments and justifications are consistent across groups. Up-line managers can also shift pay allocations across groups if necessary in order to ensure employees who perform similarly are compensated the same regardless of their first-line managers. As a final check, the senior managers sign off on the pay decisions for each employee.

To help provide transparency on how employees' performance compares to the rest of the organization, we previously reported that the Naval Sea Systems Command Warfare Center's Newport division publishes the results of its annual performance cycle. Newport aggregates the data so that no individual employee's rating or payout can be determined to protect confidentiality. Employees can compare their performance rating category against others in the same unit, other units, and the entire division.

**4. Devolve decision making on pay to appropriate levels.** In implementing market-based and more performance-oriented pay systems, organizations need to determine what parts of their pay systems should be maintained centrally and what parts can be devolved to "lower" levels of the organization. When devolving these types of decisions, organizations have maintained overall core processes to help ensure reasonable consistency in how the systems are implemented.

Virginia shifted the responsibility for administering pay from its central office to the commonwealth's agencies and their managers as part of its compensation reforms and developed core processes outlining how agencies should develop and implement their pay systems. Specifically, Virginia developed a salary plan that provides broad guidelines regarding

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the commonwealth's overall compensation philosophy, funding for pay increases, and the pay ranges for the employees' positions that reflect market conditions. Each agency is held accountable for developing its own salary administration plan which is approved by the central office prior to being implemented. As part of this plan, the agency is to select from among designated "pay practices" that it considers useful to best meet its specific needs, such as promotions or in-band pay adjustments to recognize employees for taking on additional duties.

**5. Provide training on leadership, management, and interpersonal skills to facilitate effective communication.** We have reported that training and developing new and current staff to fill new roles and work in different ways will play a crucial part in the federal government's endeavors to meet its transformation challenges.<sup>9</sup> Agencies will need to invest resources to ensure that employees have the information, skills, and competencies they need to work effectively in a rapidly changing and complex environment.

Organizations found that training employees and managers on performance management skills, such as setting expectations, linking individual performance to organizational results, and effectively giving and receiving feedback, as well as placing an emphasis on communicating the content of the pay reforms in a simple and clear format, are needed to make market-based and more performance-oriented pay succeed. For example, FDIC emphasized the importance of training its managers on how to make the necessary distinctions in ratings and pay since it found that some managers have trouble making the distinctions and would prefer to give all employees the same pay increase.

Virginia found that employees needed the information on its compensation reforms in as simple and clear a format as possible without using technical compensation terms or "HR" terminology. As a result, Virginia used its Employee Advisory Committee to help develop training and supporting materials on the compensation reform initiatives and communicate the information to the other employees. Virginia found that using the committee was very effective and allowed employees to better understand how the reforms would affect them directly.

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<sup>9</sup>GAO, *Human Capital: A Guide for Assessing Strategic Training and Development Efforts in the Federal Government*, GAO-04-546G (Washington, D.C.: March 2004).

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Regarding the frequency of the training, we found that the OPM pay for performance 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. For example, the Civilian Acquisition Workforce Personnel Demonstration Project (AcqDemo) found that, in addition to training prior to implementation, it needed more in-depth and varied training in later years for current AcqDemo employees to refresh their proficiency in the system; for new participants to familiarize them with appraisal and payout processes; as well as for senior management, pay pool managers and members, and human resources personnel to give them greater detail on the process. The training prior to implementation and throughout the project was designed to help employees understand 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.

Virginia defined a new role for its employees by holding them accountable for identifying the training they need to enhance the skills necessary to develop their careers. For example, Virginia developed career guides to inform employees on what they may personally need to do to develop, advance, or change their careers. The guides provide important occupational information for employees interested in developing their careers and improving opportunities for advancement in any work environment. Virginia found that an added benefit is that these career guides help employees understand that they have knowledge, skills, and abilities that cut across different occupations and are transferable across the commonwealth's government.

**6. Build consensus to gain ownership and acceptance for pay reforms.** Involving employees and other stakeholders helps to improve overall confidence and belief in the fairness of the system, enhance their understanding of how the system works, and increase their understanding and ownership of organizational goals and objectives. Organizations have found that the inclusion of employees and their representatives needs to be meaningful, not just pro forma.

At GAO, to obtain direct feedback from employees, we created the elected Employee Advisory Council (EAC) to serve as an advisory body to the

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Comptroller General and other senior executives on management and employee issues. Comprising employees who represent a cross-section of the agency, the EAC's participation is an important source of front-end input and feedback on our human capital and other major management initiatives. Specifically, EAC members convey the views and concerns of the groups they represent, while remaining sensitive to the collective best interest of all GAO employees; propose solutions to concerns raised by employees; provide input to and comment on GAO policies, procedures, plans, and practices; and help to communicate management's issues and concerns to employees. Similarly, FDIC found that in its experience it was better to have the union involved in the implementation of its pay reforms. When negotiating compensation for its bargaining unit employees with representatives of the National Treasury Employees Union, FDIC views them as true partners instead of following an "us versus them" approach. FDIC noted that both parties want to work together to reach an agreement in terms of compensation levels that will satisfy them.

In designing its compensation reforms, Virginia involved stakeholders, such as representatives from Virginia's legislative and executive branches, as well as human resource representatives from private sector organizations. Virginia also formed an Employee Advisory Committee of nonsupervisory employees from diverse occupations, demographic groups, and geographic locations to help the commonwealth as a whole improve its compensation program, not just for their select interest groups. Further, to implement the compensation reforms, Virginia developed implementation teams—composed of human resource staff across the agencies—to help ensure the details of the compensation reforms were consistently communicated to all the employees across the commonwealth. The teams represented various priority areas, such as funding, compensation management, performance management, training, and communications.

**7. Monitor and refine the implementation of the pay system.** High-performing organizations understand they need to continuously review and revise their performance management systems to achieve results and accelerate change. These organizations continually review and revise their human capital management systems based on data-driven lessons learned and changing needs in the environment. We have reported that agencies seeking human capital reform should consider doing evaluations that are broadly modeled on the evaluation requirements of the OPM

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demonstration projects.<sup>10</sup> 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 system principles, and the extent to which the lessons from the project can be applied governmentwide. Such an evaluation could facilitate congressional oversight; allow for any midcourse corrections; assist the agency in benchmarking its progress with other efforts; and provide for documenting best practices and sharing lessons learned with employees, stakeholders, other federal agencies, and the public.

For example, at GAO, we recently saw the need to restructure part of our pay banding system to better reflect real differences in responsibilities and competencies as well as respective pay within the pay band for our senior analysts by creating two sub-band categories. To begin the process of this restructuring effort, GAO formed task teams to study and develop proposals, and engaged employees by holding town hall meetings, focus groups, meeting with employee representatives, and having a review and comment period for each phase of the restructuring.

Organizations monitor their systems by listening to employees' and stakeholders' views—informally and formally—on the pay systems. FDIC found that listening to the “level of noise” among employees and stakeholders, such as the union, is essential in evaluating whether a new initiative is working or not. To track employee views, IBM sends out a pulse survey quarterly with only a few questions on the compensation program to a sample of its 300,000 employees. IBM believes it is doing well in implementing the program if over 70 percent of the employees' responses to these questions are “neutral” or “favorable.” When consolidating its classification structure, Virginia made some revisions as a result of employee feedback so that employees could more easily see where they fit into the structure. Virginia plans to continually monitor the structure and identify needed refinements by soliciting employee feedback at least annually.

Organizations also use other metrics as an indicator of the employees' acceptance of pay and performance management decisions to track the effectiveness of their pay systems. For example, IBM tracks its attrition rates to determine why employees are leaving and compares them to its

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<sup>10</sup>GAO-05-69SP.

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competitors' attrition rates. Virginia tracks the number of employee grievances and works with managers to educate them on what the metrics mean and how they affect their agencies and employees.

Monitoring the implementation of new pay systems is important because unintended consequences may arise. Organizations have found they should be open to refining their systems. For example, in order to spread the pay increases among as many employees as possible, FDIC found that managers tended not to award merit pay increases to top-performing employees when they were to be promoted in the career ladder and as a result, these high-performing employees were not getting the merit pay increases they deserved. FDIC recognized that this unintended consequence needed to be corrected in future iterations of the pay system and managers needed help in learning how to make the necessary distinctions in employees' contributions.

While the need for refining the system is inevitable, organizations found that there is value in stabilizing the pay system for a period of time to let employees get accustomed to the new initiative and see how it works. For example, OCC plans to reassess its labor market pay differentials every 3 years rather than annually to provide continuity in implementing the system. This continuity benefits employees because they know how much their geographic differential will be for a period of time and benefits OCC because it makes managing the pay system more stable.

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### Next Steps for Results-Oriented Pay and Human Capital Reform

In summary, there is widespread agreement that the basic approach to federal pay is broken and we need to move to a market-based and more performance-oriented approach. Doing so will be essential if we expect to maximize the performance within available resources and assure the accountability of the federal government for the benefit of the American people. While reasonable people can and will disagree about the merits of individual reform proposals, there is widespread recognition that pay increases are no longer an entitlement but should be based on employees' contributions to the organization's mission and goals. Experience shows that this shift to market-based and more performance-oriented pay must be part of a broader strategy of change management and performance improvement initiatives and cannot be simply overlaid on most organizations' existing performance management systems. Before implementing any pay reform, each executive branch agency should have demonstrated and OPM should have certified that the agency has in place

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the institutional infrastructure to help ensure that this reform is effectively and equally implemented.

We need to move forward with human capital reforms. In the short term, such reforms could include select and targeted authorities, such as prohibiting guaranteed pay increases for persons who do not perform at acceptable levels; allowing agency heads to make a limited number of term appointments awarded noncompetitively; and rightsizing and restructuring that can place additional emphasis on factors such as knowledge, skills, and performance. As momentum continues to accelerate to make strategic human capital management the centerpiece of the government's overall management transformation effort, comprehensive reforms should be guided by a framework consisting of a common set of principles, criteria, and processes.

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


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## 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](mailto:shamesl@gao.gov). Individuals making key contributions to this statement include Janice Latimer and Katherine H. Walker.



## “Highlights” of Selected GAO Reports



**GAO**  
Highlights  
Highlights of GAO-05-832SP

**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/gettrpt?GAO-05-832SP](http://www.gao.gov/cgi-bin/gettrpt?GAO-05-832SP)

To view the full product, including the audio and methodology, click on the link above. For more information, contact J. Christian Miron at (202) 512-6800 or [mironj@gao.gov](mailto:mironj@gao.gov).

July 2005

### HUMAN CAPITAL

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

**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

Appendix I  
"Highlights" of Selected GAO Reports



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

**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/lev/airp77GAO-04-83](http://www.gao.gov/lev/airp77GAO-04-83)

To view the full product, including the scope and methodology, click on the link above. For more information, contact J. Christopher Mirmir at (202) 512-6896 or [jcmirmir@gao.gov](mailto:jcmirmir@gao.gov).

January 2004

## HUMAN CAPITAL

### Implementing Pay for Performance at Selected Personnel Demonstration Projects

**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
<b>Using competencies to evaluate employee performance.</b> 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.
<b>Translating employee performance ratings into pay increases and awards.</b> 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.
<b>Considering current salary in making performance-based pay decisions.</b> 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.
<b>Managing costs of the pay for performance system.</b> 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.
<b>Providing information to employees about the results of performance appraisal and pay decisions.</b> 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 increases, 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

Appendix I  
"Highlights" of Selected GAO Reports



**Why GAO Convened This Forum**

There is widespread agreement that the federal government faces a range of challenges in the 21<sup>st</sup> century that it must confront to enhance performance, ensure accountability, and position the nation for the future. Federal agencies will need the most effective human capital systems to address these challenges and succeed in their transformation efforts during a period of likely sustained budget constraints.

More progress in addressing human capital challenges was made in the last 3 years than in the last 20, and significant changes in how the federal workforce is managed are underway.

On April 14, 2004, GAO and the National Commission on the Public Service Implementation Initiative hosted a forum with selected executive branch officials, key stakeholders, and other experts to help advance the discussion concerning how governmentwide human capital reform should proceed.

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

To view the full report, including the scope and methodology, click on the link above. For more information, contact J. Christopher Mehn at (202) 512-6006 or jmehn@gao.gov.

December 2004

## HIGHLIGHTS OF A FORUM

### Human Capital: Principles, Criteria, and Processes for Governmentwide Federal Human Capital Reform

**What Participants Said**

Forum participants discussed (1) Should there be a governmentwide framework for human capital reform? and (2) If yes, what should a governmentwide framework include?

There was widespread recognition that a "one size fits all" approach to human capital management is not appropriate for the challenges and demands government faces. However, there was equally broad agreement that there should be a governmentwide framework to guide human capital reform built on a set of beliefs that entail fundamental principles and boundaries that include criteria and processes that establish the checks and limitations when agencies seek and implement their authorities. While there were divergent views among the participants, there was general agreement that the following served as a starting point for further discussion in developing a governmentwide framework to advance needed human capital reform.

**Principles**

- 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**


- 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 ensure equity and prevent discrimination

**Processes**

- 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

United States Government Accountability Office

Appendix I  
"Highlights" of Selected GAO Reports



**Highlights**

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

**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/getat?GAO-03-488](http://www.gao.gov/cgi-bin/getat?GAO-03-488)

To view the full report, including the scope and methodology, click on the link above. For more information, contact J. Cheneau at (202) 512-6808 or [jcheneau@gao.gov](mailto:jcheneau@gao.gov).

March 2003

## RESULTS-ORIENTED CULTURES

### Creating a Clear Linkage between Individual Performance and Organizational Success

**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

Appendix I  
"Highlights" of Selected GAO Reports

**GAO**

**Highlights**

Highlights of GAO-05-798, a report to congressional committees

**Why GAO Did This Study**

Over the years, the Department of Defense's (DOD) military compensation system has become an increasingly complex and piecemeal accretion of pay, allowances, benefits, and special tax preferences. DOD leaders have expressed concern that rising compensation costs may not be sustainable in the future and could crowd out other important investments needed to recapitalize equipment and infrastructure. Given the looming fiscal challenges facing the nation in the 21<sup>st</sup> century, GAO believes it is time for a baseline review of all federal programs to ensure that they are efficiently meeting their objectives. Under the Comptroller General's authority, GAO (1) assessed whether DOD's approach to compensation provides adequate transparency over costs; (2) identified recent trends in active duty compensation, and how costs have been allocated to cash and benefits; and (3) reviewed how active duty servicemembers perceive their compensation and whether DOD has effectively explained the value of the military compensation package to its members.

**What GAO Recommends**

GAO is making a number of recommendations to improve the transparency, reasonableness, appropriateness, affordability, and sustainability of the military compensation system. DOD generally concurred with GAO's recommendations. [www.gao.gov/cgi-bin/getrpt?GAO-05-798](http://www.gao.gov/cgi-bin/getrpt?GAO-05-798). To view the full product, including the scope and methodology, visit [www.gao.gov](http://www.gao.gov). For more information, contact Daniel Stewart at (202) 512-5555 or [dstewart@gao.gov](mailto:dstewart@gao.gov).

July 2006

**MILITARY PERSONNEL**

**DOD Needs to Improve the Transparency and Reassess the Reasonableness, Appropriateness, Affordability, and Sustainability of Its Military Compensation System**

**What GAO Found**

DOD's historical piecemeal approach to military compensation has resulted in a lack of transparency that creates an inability to (1) identify the total cost of military compensation to the U.S. government and (2) assess the allocation of total compensation investments to cash and benefits. No single source exists to show the total cost of military compensation, and tallying the full cost requires synthesizing about a dozen information sources from four federal departments and the Office of Management and Budget. Without adequate transparency, decision makers do not have a true picture of what it costs to compensate servicemembers. They also lack sufficient information to identify long-term trends, determine how best to allocate available resources to ensure the optimum return on compensation investments, and better assess the efficiency and effectiveness of DOD's current compensation system in meeting recruiting and retention goals. To address this and other major business transformation challenges in a more strategic and integrated fashion, GAO recently recommended the creation of a chief management official at DOD.

Transparency over military compensation is critical because costs to provide compensation are substantial and rising, with over half of the costs allocated to noncash and deferred benefits. In fiscal year 2004, it cost the federal government about \$112,000, on average, to provide annual compensation to active duty enlisted and officer personnel. Adjusted for inflation, the total cost of providing active duty compensation increased about 29 percent from fiscal year 2000 to fiscal year 2004, from about \$123 to \$158 billion. During this time, health care was one of the major cost drivers, increasing 69 percent to about \$23 billion in fiscal year 2004. In addition, military compensation is weighted more toward benefits compared with other government and private sector civilian compensation systems. Furthermore, less than one in five service members will serve 20 years of active duty service to become eligible for retirement benefits. Increasing compensation costs make the need to address the appropriateness and reasonableness of the compensation mix and the long-term affordability and sustainability of the system more urgent.

DOD survey results and analysis of GAO focus groups and survey data have shown that servicemembers are dissatisfied and harbor misperceptions about their pay and benefits in part because DOD does not effectively educate them about the competitiveness of their total compensation packages. About 80 percent of the 400 servicemembers that GAO surveyed believed they would earn more as civilians; in contrast, a 2002 study showed that servicemembers generally earn more cash compensation alone than 70 percent of like-educated civilians. Servicemembers also expressed confusion over aspects of their compensation, like retirement, and many complained that benefits were eroding despite recent efforts by Congress and DOD to enhance pay and benefits. By not systematically educating servicemembers about the value of their total compensation, DOD is essentially allowing a culture of dissatisfaction and misunderstanding to perpetuate.

United States Government Accountability Office

**Statement of Jeffery K. Nulf  
Deputy Assistant Secretary for Administration  
U.S. Department of Commerce  
Before the  
Subcommittee on Oversight of Government Management,  
the Federal Workforce and the District of Columbia  
Committee on Homeland Security and Governmental Affairs  
United States Senate  
September 27, 2005 - 10:00 a.m.  
  
Statement for the Record**

**INTRODUCTION**

Good morning, Mr. Chairman and members of the subcommittee. My name is Jeffery Nulf and I have the honor of serving as the Deputy Assistant Secretary for Administration at the Department of Commerce. As one of the principal tenants of President Bush's management agenda, strategically managing Commerce's workforce to better achieve our mission-critical objectives is a key priority for Secretary Gutierrez and the Department. While Otto Wolff, our Chief Financial Officer and Assistant Secretary for Administration was unable to attend this morning's hearing, I am pleased to appear before you again today to discuss the Department's efforts in this area, particularly as they relate to alternative personnel systems.

**COMMERCE DEMONSTRATION PROJECT**

Commerce has been managing pay for performance systems since 1988. As Dr. Semerjian will testify, our first involvement in alternative pay for performance systems occurred at the National Institute of Standards and Technology. Based on the

success achieved with that effort and other early attempts, including the Department of Navy's China Lake, Commerce established a second alternative personnel system, referred to as the Commerce Demonstration Project, in 1998. Over the seven years in which it has been in operation, the Commerce Demo has grown to cover approximately 4,200 employees in five of our operating units stationed throughout the nation. These include:

- National Oceanic and Atmospheric Administration (NOAA), with approximately 3,300 employees;
- Technology Administration, with about 25 employees;
- Bureau of Economic Analysis, with about 500 employees;
- National Telecommunications and Information Administration, with 80 employees;
- and
- Office of the Chief Financial Officer and Assistant Secretary for Administration, with about 360 employees.

In October, we anticipate further expanding this alternative personnel system to include employees represented by two local bargaining units that have asked to participate. This expansion, which attests to the positive attitude with which employees generally view the Demo, involves 33 employees represented by the Washington Printing and Graphic Communications Union, Local 1-C of the Graphic Communications International Union, and the American Federation of Government Employees, Local 2186. Additionally, the statutory limit of 5,000 employees was recently increased in relation to the number of

NOAA employees covered. We are now working with the Office of Personnel Management to implement this legislation and add 3,500 additional NOAA employees to the Demo.

### **BENEFITS**

The Demo's benefits to managing employees are perhaps most clearly evident in five areas:

- Performance. Under the Demo, Commerce managers have greater flexibility to recognize the contributions made by high performers through salary increases and bonuses. Salary increases are no longer tied to the largely fixed schedule of steps and grades under the GS system, but are established under a series of five broad bands of salary levels. The fifteen level schedule for salaries – each subdivided by 10 “steps” has been replaced with a system of five bands with five intervals each. Since salary adjustments and bonuses are determined as part of the annual performance appraisal system, the nexus between performance and salary is very clear to employees at all levels.

Program operations are reviewed each year through detailed evaluations conducted by third-party organizations, e.g., Booz Allen Hamilton. The results, once finalized, are made publicly available to ensure transparency. During our most recent program evaluation, fifty-three percent of supervisors in the Demo Project reported that they



are able to identify and reward good performers under the new system compared with 26 percent of GS supervisors.

- Recruitment. Recognizing the highly competitive job market in which federal managers must operate, the Commerce Demo provides them with a real opportunity to effectively negotiate salaries with job candidates. This tool is serving us well, particularly in recruiting individuals with specialized skills in mission-critical occupations. The most recent evaluation of the Demo indicated that 41 percent of participating supervisors believe that the ability to offer competitive salaries has better equipped them to recruit well-qualified employees. Only 19 percent of the supervisors operating within the traditional GS system felt this way.
- Classification. Under the Commerce Demo, the GS classification system of hundreds of career series has been streamlined into four career paths:
  - Administrative Professionals,
  - Administrative Support Staff,
  - Scientific and Engineering Technicians, and
  - Scientific and Engineering Professionals.

This system allows managers to more quickly advertise to fill vacancies and to consider a broader range of skill sets to meet their organization-specific needs during the hiring process.

- Employee Satisfaction. As employees and managers have gained experience with the Demo, trust in the system has grown. Over half -- 52 percent -- of the Demo employees surveyed this year agreed that salary increases were directly related to an employee's performance compared to roughly one-third of GS employees.
- Employee Retention. It is clear that the Demo Project has had a positive effect on retaining good performers. Employees are rated on a 100-point scale. Those receiving a score of 40 or above are eligible to receive a bonus and/or pay increase relative to their performance. This feature has allowed managers to distinguish and reward differences in performance. As a result, demo evaluations show that turnover is lower among high performers. For example, there was a 1.5 percent turnover rate for those employees receiving at least a 90 performance score, while there was a 7.7 percent turnover rate for those employees receiving lower performance scores (60-69).

#### **FACTORS AFFECTING SUCCESS**

Based on our experience, we believe that the success of alternative performance systems depends on several factors:

- Communication. Change is never easy, particularly where it concerns what we consider to be our most important asset -- our employees. Over time, we have learned that, first and foremost a well-developed approach to educating employees

and managers about any system that is intended to replace the existing GS system is essential. This helps to create a mutual understanding of the objectives of the new system and provide a shared perception that change will be implemented together as a team.

- Effective Management. As with any personnel management system, if pay-for-performance is not managed well, it can be a disaster. Employees need to feel confident that their rights are protected under a new system. Managers must have the skills needed to manage employees effectively, make well-informed and fair decisions regarding salaries and bonuses, and provide effective feedback regarding performance expectations. This can only be accomplished by providing training in performance management and performance feedback to all affected individuals – managers and employees alike.
- We provide quarterly briefings to all new Demonstration Project employees as well as quarterly individual training on various Demo flexibilities to new supervisors. This year and last year we conducted training on Performance Feedback both for supervisors and employees at the end of the appraisal cycle to better prepare them for the appraisal process. By providing everyone involved with a full understanding of the system and the benefits it offers, the uncertainty and frequent reluctance that are inherent to such an undertaking can be significantly mitigated.

- Routine and Objective Evaluation. Not only do annual evaluations ensure transparency to interested stakeholders, but also they provide the basis on which human resources managers may objectively assess the success of the Demo and determine any need for adjustment. At Commerce, such adjustments have included:
  - strengthening supervisory training in providing performance feedback;
  - instituting performance management training for employees;
  - establishing a centralized data manager to oversee and ensure the quality of automated systems and data collection; and
  - adjusting how service retention credit is calculated based on performance rating.

Furthermore, we have taken steps beyond what is required by OPM and have expanded our reporting and analyses of this project relative to its impact on diversity groups. Our next report includes pay and performance data broken down by race and national origin, not just by minority and non-minority groupings. It also includes additional focus groups to capture concerns expressed by minority employees. These additions are designed to strengthen our already rigorous approach to ensuring that the Demonstration Project is operating according to merit system principles.

## **RECOMMENDATIONS**

We have had very good success with testing pay for performance under 5 U.S.C 47, the legislative authority for the Demonstration Project, and are pleased with the results that

have been achieved so far. The experiences that Commerce and other federal agencies have had provide a sound basis on which to continue moving forward.

Current legislative limitations, such as the 5,000-employee ceiling and five-year lifespan, for demonstration projects may unnecessarily discourage agencies from pursuing the flexibilities available under a demonstration project. The potential costs and limited lifespan of these projects may make it difficult – in some agencies – to appreciate the potential benefits. We support efforts to build on successful demonstration projects by establishing a permanent, Governmentwide core classification and pay system that makes use of lessons learned from the demonstration project experience.

## **CONCLUSION**

As I mentioned earlier, change is never easy. Far reaching changes to a decades-old system that will profoundly affect the work lives of hundreds of thousands of federal employees will inevitably – justifiably -- cause concern and merit careful consideration. Based on our experience and that of federal agencies across government, however, we believe that many of the tools are in place that are needed to continue the forward momentum initiated by the various demonstration projects now in place.

Thank you for giving me the opportunity to speak to you today on these important matters. I look forward to answering any questions that you may have.

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STATEMENT OF

ARLEAS UPTON KEA  
DIRECTOR  
DIVISION OF ADMINISTRATION  
FEDERAL DEPOSIT INSURANCE CORPORATION

on

ALTERNATIVE PERSONNEL SYSTEMS  
THE FDIC EXPERIENCE

before the

SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT,  
THE FEDERAL WORKFORCE AND THE DISTRICT OF COLUMBIA

of the

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS  
U.S. SENATE

September 27, 2005  
Room 342, Dirksen Senate Office Building

Chairman Voinovich, Senator Akaka, and members of the subcommittee, thank you for the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) on our experiences administering and managing a personnel system at an independent federal corporation.

The FDIC, having long managed a personnel system that is more flexible than most government departments and agencies, has significant insights into the importance of personnel systems that permit a government agency to react to change and achieve its mission. In my testimony today, I will briefly highlight how the FDIC's personnel system has helped us achieve our mission, the importance of flexible personnel policies in today's rapidly changing financial industry and our experience with "pay banding" and "pay for performance."

### **Background**

The FDIC has served as an integral part of the nation's financial system for over 70 years. Established by the Banking Act of 1933 at the depth of the most severe banking crisis in the nation's history, the immediate contribution of the FDIC was the restoration of public confidence in banks. Today, the FDIC's mission remains unchanged. We maintain public confidence in our nation's financial system in three important ways. First, we insure deposits held in our nation's banking system. Second, we examine and supervise banks for safety and soundness and compliance with laws and regulations. Finally, we handle the resolution of failed banks when that becomes

necessary. In carrying out its mission, the FDIC does not receive appropriated funds. The FDIC is funded by insurance assessments on the deposits held by insured institutions and by interest earned on the deposit insurance funds.

*Benefits of Flexibility in the Use of Temporary Appointments*

In the late 1980s and early 1990s, the FDIC faced a banking crisis unprecedented since the Great Depression. With as many as 200 bank failures a year at the peak of the crisis, the FDIC was faced with a massive challenge of handling these failures in a way that maintained public confidence in the financial system. The FDIC successfully responded to that challenge as it has to other challenges throughout its history.

Part of the reason for that success was the flexibility the FDIC had to adjust the size of its workforce rapidly and substantially. In the early 1980's, the FDIC employed 4,000 people. By the early 1990's, the FDIC employed over 23,000 people. Some employees were hired for one year terms that could be renewed annually as justified by the workload. Others were hired for terms of up to four years that could not be renewed. Other government agencies had similar excepted authorities and in some case those authorities may have been abused. As a result, the FDIC and other government agencies no longer have these authorities, except under the most limited conditions.

As significant as the hiring process was, so too was the downsizing that followed over the past decade. Today, the FDIC again employs fewer than 5,000 people. As the



workload associated with the banking crisis decreased, these limited term employment contracts were ended. Employees hired under term authorities were essential to the success of the liquidation and resolution activities of the FDIC and performed very well. However, they understood that eventually they would work themselves out of a job. These employees enjoyed certain civil service protections and FDIC benefits and gained marketable skills. The FDIC is grateful to the literally thousands of employees who saw this nation through its banking crisis.

#### *Benefits of Flexible Buyout Authority*

To complete the downsizing necessary at the FDIC, more than the nonrenewal of temporary appointments was necessary. For over a decade, the FDIC, whenever possible, consistently chose voluntary departures of employees through buyouts instead of involuntary reductions-in-force (RIFs). The FDIC's greater flexibility to offer generous buyouts proved very useful. Many career employees accepted these offers, greatly reducing the need for involuntary separations.

#### *Benefits of Retraining*

Retraining is not always the answer but the FDIC has used this method successfully in order to provide flexibility in the workforce, prepare the FDIC for the future, avoid RIFs, and retrain and retain highly skilled employees. When the FDIC's failure resolution activity declined, we knew we had employees with great ability but no

work. To address this issue, the FDIC received authority from the U.S. Office of Personnel Management (USOPM) to waive certain job level requirements and create “Crossover Programs” to allow employees who were trained to handle bank failures to become bank examiner trainees without a significant reduction in pay. These employees began a rigorous retraining program and started new careers at the FDIC’s expense. It was a successful program. Two-thirds of these employees became commissioned bank examiners and the FDIC retains the resolution experience should the need arise to redeploy these “crossover employees” to handle bank failures.

*Costs of Existing Reduction-in-Force Procedures*

Despite all of the above-mentioned efforts, involuntary separations still were necessary. RIFs are difficult to do and do not always provide satisfactory results. They are disruptive to an organization and the outcomes are unpredictable. Seniority and positions previously occupied heavily influence the results. Performance and skills sets have far less of an impact. This makes it difficult for an organization to ensure that the necessary skill sets are retained to carry out its mission effectively.

RIF rules also are highly complex and truly understood only by a limited number of experts. They involve “bump and retreat” rights which factor in an individual employee’s personal career history. Despite outward appearances, this is not a transparent process. For employees subject to these rules, it sometimes appears that luck is a major factor. The FDIC would like to have more flexibility in the RIF process. The

current rules are too complex, too tied to seniority and do not sufficiently factor in job performance.

*Today's Growing Challenges*

The challenges facing the FDIC today are very different from those of the past two decades. The consolidation of the financial services industry has reduced the number of banks, increased the size and complexity of the remaining institutions, and inevitably affected the potential impact of bank failures, particularly large bank failures, on the economy. Since the mid-1980s, consolidation has reduced the number of federally-insured banks and thrifts from over 18,000 to less than 9,000. From 1985 to June 2005, the share of industry assets held by the ten largest insured banking organizations rose from 18 percent to 48 percent. Similar trends are evident in the concentration of industry deposits and revenues. Moreover, globalization, evolving technology, privacy concerns and increased use of nontraditional banking business lines, such as Internet banking, securitization, expanded credit card banking, and sub-prime lending, pose new, and potentially much greater, challenges for the FDIC. These challenges cross all of our business lines: risk assessment for insurance purposes, supervision for safety and soundness and consumer protection, and the resolution of failed institutions.

**A Flexible and Skilled Workforce**

Our workforce is remarkably dedicated and effective. The employees of the FDIC know the importance of the Corporation's mission and take pride in their accomplishments in serving the public. The FDIC must continue to develop and retain expertise within its ranks to respond to the challenges presented by the changing financial services industry. Part of the challenge that the FDIC faces is maintaining the ability to adapt rapidly to emerging business and regulatory demands in the financial services sector, through changes in the size and composition of its employment levels and skill mixes. The speed with which problems can occur and their potential complexity are much greater than in the past. Like many other federal agencies, we have concerns that the current civil service system, put in place more than a half century ago, does not adequately address the priorities of a 21<sup>st</sup> century workforce and the realities of the 21<sup>st</sup> century workplace.

The statutory framework for the FDIC provides a number of human capital flexibilities, either as a direct result of provisions in the Federal Deposit Insurance Act (FDI Act) or as a result of exclusions from certain provisions in Title 5 of the United States Code, resulting from the Corporation's status as a government corporation. Nevertheless, even with the flexibility already possessed, the FDIC continues to face challenges in ensuring that the Corporation will promote the utmost in performance and excellence from its workforce in the future.

*Reshaping the Workforce*

Federal employees hired in the 1970's and 1980's had an expectation that they would spend their careers employed within the federal government. That premise of life-long employment was based on a more stable workforce requirements model, one that did not foresee rapid changes in the financial marketplace driven by ever-growing sources of information, technology and globalization. This staffing model is now outdated. Employees no longer necessarily expect to remain with one organization for their entire career. The continuing changes in the financial industry require a staffing strategy that hires for developing knowledge and skill sets. This is common in the area of information technology where rapid change drives the need for a constantly evolving skill mix, but it is no less essential in the financial regulatory environment of the 21<sup>st</sup> century.

*Streamlining the Hiring Process*

The FDIC already has taken some steps to streamline the hiring process. Those who apply for positions in the private sector often find a more streamlined, simpler application process that produces a faster response to a job application. We have implemented an automated hiring process which, while not a complete answer, can be a useful tool in recruitment for certain types of positions.

*Corporate Employee Program*

Over the past year, working with the USOPM, the FDIC has received delegated authority to offer competitive term appointments with the possibility of conversion to a permanent position without further competition to address the variable workload present in our bank examination and resolution functions. This kind of approach should address our need to expand and contract the FDIC's workforce to meet our future work challenges. A staffing plan with a mix of variable term and permanent appointments hopefully will allow the FDIC to handle workload changes without the need for periodic downsizings.

The employees hired into this "Corporate Employee Program" are given introductory training in three critical functions: Safety and Soundness Examinations, Compliance Examinations, and Resolution and Receivership work. The employees are then trained to become "commissioned" in one or more of these functions. If retained by the FDIC at the end of their term appointment, these employees will have a broad range of skills and perspective that will serve to benefit the Corporation. If they are not retained at the end of this period, they will have been given valuable training in financial market activities that will benefit them well in future jobs elsewhere.

The Corporate Employee Program is administered through the FDIC's Corporate University. The Corporate University represents an enhanced effort at the FDIC to assure

that employees at all levels in the Corporation receive the training necessary to be effective in today's rapidly changing and complex financial environment.

*Need for Additional Employment Flexibilities*

The FDIC also needs the ability to hire experts and consultants. The increasingly complex banking and economic issues that are the staple of FDIC research and regulatory activity require the flexibility to hire such individuals. Unlike the rest of the federal government, the general expert and consultant provision in Title 5 does not apply to the FDIC.

The challenge of meeting specific skill needs for a limited time can be met with term appointments and the selective hiring of experts and consultants, but the continuing concentration within the banking industry into fewer, but larger banks poses a different challenge. The failure of one or more large banks will require trained resolution and liquidation specialists in numbers far larger than is economically feasible to maintain on a standby basis. Backup contracts will address much of the workload, but having access to experienced resolutions and liquidation specialists to oversee such contracts would be an additional safeguard in times of crisis. The FDIC needs the authority, on a quick but temporary basis, to rehire large numbers of such specialists who have retired from the FDIC and who possess the necessary skills. Those skills are acquired over several years, making it impossible to hire and train new staff to respond to a major crisis. The FDIC

currently is finalizing a delegation of authority from USOPM to waive the dual compensation restrictions in emergency situations.

### **Compensation**

As I referenced earlier, the FDIC has certain statutory flexibilities to manage its organizational structure, staffing levels and human resources programs. In particular, the FDIC has the express statutory authority to set the compensation of its employees. This authority derives from the FDIC's enabling legislation, first enacted in 1933, which provides that the Board of Directors of the FDIC "shall have power . . . [t]o appoint . . . officers and employees . . . , to define their duties, [and] *fix their compensation*" [emphasis added]. Consistent with this independent pay-setting authority, government-wide pay rates and schedules (set by chapter 53 of Title 5 of the United States Code) specifically exclude employees of government-controlled corporations like the FDIC. Similarly, as a government-controlled corporation, the FDIC is exempt from government-wide position classification requirements (chapter 51 of Title 5). Instead, the FDIC is able to administer its own program of setting occupational groupings, titles and grades. In addition, because the FDIC is a government corporation, its senior executives are not part of the Senior Executive Service in the Executive Branch of government.

In independently defining the duties and setting the pay of its workforce, the FDIC adheres to other laws that impact the manner in which pay is set. In the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Congress gave



the other financial regulatory agencies pay authorities similar to the FDIC and required these agencies (including the FDIC) to seek to maintain “pay comparability” with one another in order to avoid competition for employees. This law does not mandate perfect equality in pay and benefits among the banking agencies, just coordination and earnest efforts toward comparability. The FDIC has the discretion to set pay and is subject to the Federal Labor Management Relations Statute (chapter 71 of Title 5 ). Employee compensation and benefits at the FDIC are the subject of collective bargaining with the union that represents our bargaining-unit employees -- the National Treasury Employees Union (NTEU). The FDIC first began negotiating pay with our employee union in the early 1990’s.

#### *Early Efforts at Pay for Performance*

Although free to chart its own pay and classification course, until the last decade, the FDIC generally adhered to the federal pay and classification systems as a matter of administrative convenience. Pay ranges at the FDIC were somewhat higher in grades 1 through 15 and the Corporation had its own executive classification and pay program, but the majority of FDIC employees were evaluated and paid under systems and guidelines that were very similar to those being used across the Executive Branch.

Beginning in the mid-1990’s, the FDIC embarked on a path toward a pay-for-performance concept, by implementing relatively minor changes to our programs, such as eliminating within-grade pay steps for grades 1 through 15 and linking a portion of

annual pay increases to an employee's annual performance evaluation. These programs were negotiated with the union for application to the bargaining unit and were extended to the managerial and supervisory positions for uniformity and consistency across the agency.

The objective of pay for performance at the FDIC is to be able to make meaningful distinctions in pay based on performance while retaining overall budget control within whatever parameters are determined to be appropriate. Like many agencies we have not always been successful in doing that. A consistent challenge is getting managers and supervisors to make meaningful distinctions between levels of performance.

Initially, the FDIC had a system that tied specific annual pay increases to performance ratings without specifying the total amount that would be spent on employee pay. The result was that most employees were rated well above average and received the higher pay increases which put total pay increases well above our original budgetary expectations.

That system was then modified to specify the total amount that would be spent for pay increases rather than specifying the pay increase allowed for each rating level. The result was that most employees were still rated well above average but, to stay within budget, the pay distinctions between performance rating levels were not meaningful.

*Recent Experience – Pay Banding & Pay for Performance -- Beginning at the Top*

In 2001, the FDIC began a complete classification review of our executive and senior management positions to address an agency that had grown top-heavy during a period of significant downsizing. We also desired more flexibility to recruit, retain, promote and reassign management officials to meet changing organizational needs.

Today we have a single, *Executive Management (EM)* classification band which replaced a five-level executive program that had existed since the late 1980s. The 90 positions in the EM band (positions that are analogous to those in the Senior Executive Service in the Executive Branch) – out of approximately 5,000 total employees at the FDIC – occupy positions that were scored against objective criteria after evaluation by an outside classification and pay consultant. This band provides the FDIC with greater flexibility in hiring from the outside, in moving executives within the agency, and in rewarding high performers -- we are not constrained by rigid pay-setting within multiple grade levels or the difficulty of movement from one grade to the next.

The FDIC next applied the same criteria to the managerial and supervisory positions below the EM level and established two *Corporate Management (CM)* pay bands, which number approximately 500 positions. These bands replaced what were largely grade 14, 15 and Executive Level I positions in the former classification systems. Again, with these bands, the FDIC has easier movement within management positions, broader pay and promotion flexibility and enhanced ability to recruit from the outside.

Both the EM and CM employees operate under a “pay at risk” philosophy -- there is no guarantee of a pay increase for any of these employees. Any pay increase or bonus for senior managers at the FDIC is tied directly to an assessment of their contributions to defined Corporate, Division or Unit annual performance objectives.

For 2005 pay determinations (based on 2004 contributions), these senior managers were eligible for pay increases within a range of zero to 10 percent while half were eligible for a cash bonus within a range of 2 percent to 8 percent of base pay. To ensure that costs were controlled, there was a budgetary limit on the sum of the executive and managerial pay raises (4.5 percent of total executive payroll) and on the sum of bonuses (2.5 percent of total executive payroll). There are various levels of review to ensure fairness in the process and that meaningful distinctions are made in executive and managerial pay based on performance.

While it is too early to determine with certainty that these programs are fully successful, we believe these programs have produced positive results in a number of important areas. First, consistent with the President’s Management Agenda, they have allowed the FDIC to tie managerial pay and recognition directly to the agency’s strategic and annual performance plans. Achievement of our strategic goals and objectives is measured each quarter and reported within the agency. Second, implementing a program that tied group as well as individual performance to specific corporate goals began a change in a culture that historically had longevity as the foundation for reward.

The FDIC continually assesses how these programs are working and annually conducts an anonymous survey of our EM and CM employees to obtain their views of the program. From this survey, we have identified areas for improvement that include better and more frequent individual feedback on progress toward the objectives and more discussion on the linkage between an employee's position and the strategic objectives and standards by which we differentiate between contributors at the EM and CM levels. However, those surveys also show that the concept of true pay for performance and making meaningful distinctions with respect to employee performance is, in fact, taking root at the FDIC. Executives, managers and supervisors do not expect or want to return to a culture that is unable to truly reward the best performers. Nor do they expect or want to return to a time when the level of their own contributions is not the primary basis for a pay increase.

*Pay for Performance Below the Managerial Level*

Non-managerial positions for both the bargaining and non-bargaining positions are classified under our Corporate Graded (CG) 1 through 15 classification structure. However, there are no step increases within CG grades or pay bands. Pay increases at these grade levels depend, in part, on an individual employee's contribution to defined Corporate, Division or Unit annual performance objectives, not on their length of service.

In 2002, the FDIC and the NTEU negotiated a new compensation agreement that included a new pay system. Effective in 2003, the approximately 3,200 bargaining unit employees were placed under a “Corporate Success Award” (CSA) program. The CSA is a 2-level system whereby all employees with a rating of “meets expectations” on their “pass/fail” performance appraisal receive a 3.2 percent pay raise. Depending on overall corporate success in achieving stated annual corporate objectives, a minimum of the top one-third of contributors – as nominated by direct supervisors and then vetted through a process up to division and office directors – receive an additional 3.0 percent pay raise. This system has been in place for 2003 through 2005 for bargaining unit employees. We are currently in negotiations with NTEU for a new compensation agreement to be effective beginning in 2006.

The approximately 900 non-bargaining unit, non-supervisory employees are under a “Contribution Based Compensation” (CBC) program with no guarantee of a pay increase (5 percent received no pay raise based on 2004 performance). Under CBC, there were five levels of pay raises and lump sum payments depending on the employees’ relative level of contribution.

In both of these programs, the relative value of an employee’s contribution (the output of performance) is first assessed by their supervisor relative to that of other employees in the same unit against the defined Corporate, Division or Unit annual performance objectives. Actual pay increases and/or lump sum bonuses (in the case of the CBC program) are awarded on the basis of an overall assessment made at the division

and office level. This program requires a forced distribution to ensure that there are meaningful distinctions in employee pay increases based on relative performance. A fixed percentage of employees are placed within each rating category depending on their comparative contributions.

Both of these programs have had mixed reviews and the FDIC is learning from the experience. A pay for performance program was a radical change for the workforce and was not expected to be fully embraced from the beginning. However, the concept of making meaningful distinctions among employees and thus allowing meaningful rewards for high performers is valid. The FDIC is committed to improving these programs for its managers and executives, its non-bargaining unit employees and through collective bargaining with the NTEU.

### **Lessons Learned**

The FDIC has learned a number of lessons from its experience managing an alternative personnel system.

1. Organizations with variable workload demands need flexible, non-permanent appointments in their staffing plans, particularly in the rapidly changing technology and financial fields of the 21<sup>st</sup> century.
2. Pay flexibility is critical in order to design and implement separation incentive programs to meet changing workforce demographics and employment markets.
3. Be sure to fully fund and give maximum effort to those programs that assist employees in adapting to change, whether that change is preparing to accept a different job, considering a buyout and leaving for other opportunities or working under different pay for performance programs.

4. Be creative in your solutions to downsizing. Setting targets and conducting RIFs is fast and effective, but such actions do not let you consider other, more time-consuming alternatives, such as a “crossover” program or slower, voluntary separations.
5. Pay for performance programs must have sufficient funds to deliver significant reward for significant contributions in the form of pay raises and/or bonuses.
6. Managers must have the will and the means to make meaningful distinctions among employee contributions, and this should be reflected in the levels of compensation.
7. Change by example. Make the change first for executives, then for managers and supervisors. Use the lessons learned at these higher levels to craft a system for the rest of your employees. The FDIC is on the fourth iteration of its pay-for-performance system.
8. Create a pay for performance process that ensures fairness, with appropriate checks and balances.
9. Listen to employee feedback and be willing to adapt and evolve the system.
10. Accept that there will be unintended consequences to whatever program changes are implemented.
11. Develop hiring programs that seek to instill a sense of corporate or agency identity to recruit employees who can serve across organizational or disciplinary lines. Administer these programs at the corporate level to ensure no divisional bias. The FDIC’s Corporate Employee Program, administered through its Corporate University, is an example of such a program.
12. Last, and possibly most importantly, train both managers and employees on your new systems.

This concludes my remarks, I will be happy to answer any questions.



Testimony of

Dr. Hratch G. Semerjian  
Deputy Director

National Institute of Standards and Technology  
Technology Administration  
U.S. Department of Commerce

Before the

Subcommittee on Oversight of Government  
Management, the Federal Workforce and the District  
of Columbia  
Senate Committee on Homeland Security and  
Government Affairs

“Alternative Personnel Systems: Assessing Progress  
in the Federal Government”

September 27, 2005

Chairman Voinovich and Ranking Member Akaka, I am pleased to have this opportunity today to testify before the subcommittee regarding the Alternative Personnel Management System (APMS) used at the National Institute of Standards and Technology. I would first like to provide the subcommittee with a little background on what NIST does and why it switched from the General Schedule system and instituted our APMS.

Originally founded in 1901 as the National Bureau of Standards, NIST is a non-regulatory federal agency within the U.S. Commerce Department's Technology Administration. NIST has serves industry, academia, and other parts of the government by by advancing measurement science, standards, and technology thus enhancing economic security and improving the quality of life for all Americans. In order to accomplish this mission, NIST has chiefly relied on one key asset; its staff of dedicated scientists and engineers, technicians, administrative, and support staff. Recognizing the need to attract and retain top quality staff, NIST's management, starting in the mid 1980's, worked with Congress to establish an alternative personnel management system.

NIST's Authorization Act for Fiscal Year 1987 (P.L. 99-574) established a 5-year project to demonstrate an alternative personnel management system. The NIST demonstration system became permanent as of March 1996 through the National Technology Transfer and Advancement Act of 1995 (P.L. 104-113).

The NIST system is based on the concepts of:

- market sensitivity and competitiveness
- pay for performance
- administrative simplicity
- management flexibility, and
- government-wide applicability

The goals of the NIST system were to improve hiring of high-quality personnel and retention of high performers, in order to more effectively accomplish the mission and goals of NIST. Evaluations and feedback from managers and employees show that these changes have significantly improved NIST's ability to recruit and retain high quality staff. In addition, a basic objective of the original project was to design the system to serve as a model for simplifying and improving Federal personnel systems government-wide, not just at NIST. The "new and improved" system has dramatically changed NIST management of human resources. It also has provided a model of reform to other agencies within the Department of Commerce, such as the Technology Administration, the National Oceanic and Atmospheric Administration, and the Bureau of Economic Analysis.

The basic features of the NIST personnel system are:

- Recruiting: NIST competes more effectively in the labor market through more efficient and faster staffing mechanisms, such as direct hire authority, more direct management involvement in recruiting and hiring, flexible entry salaries, recruiting allowances, and more flexible paid advertising.

- Retention: NIST compensates and retains good performers more effectively through pay-for performance, the higher pay potential of pay banding, supervisory differentials, and retention allowances.
- Classification: NIST has simplified, accelerated, and improved the classification process through pay banding, generic NIST-specific classification standards, automated position descriptions, and delegation of authority to line managers.
- Performance: To more effectively support pay-for-performance, NIST uses performance appraisal results as a basis for granting comparability and locality increases, performance pay increases, performance bonuses, and evaluating and improving individual and organizational performance.
- Administration: NIST has streamlined the personnel administration process through reduction of paperwork, automation of personnel processes, and delegation.
- Line Management Authority: more direct involvement in recruiting has strengthened the manager's role in personnel management through delegation of authority and accountability to line managers.

The most noticeable difference between the NIST system and the General Schedule (GS) system used by other agencies is that NIST positions are classified according to career path and pay band, instead of grade. Career paths are categories of occupations grouped by similarities in work, qualification requirements, pay ranges, and career progression. A pay band encompasses a broader salary and classification range than does a General Schedule (GS) grade. A single band usually covers the same range as two or more grades (See Attachment I).

The NIST system covers approximately 2,500 NIST employees in four career paths:

- Scientific and Engineering Professionals (ZP)
- Scientific and Engineering Technicians (ZT)
- Administrative Professionals (ZA)
- Administrative Support Staff (ZS)

Senior Executive Service (SES) employees and "trades and craft" (wage grade) employees are not covered.

The APMS groups employees in "pay pools"-- which are groupings of the same career path within a defined organizational unit. The pay pool manager is the line manager who manages his or her organization's pay increase and bonus fund and has final decision authority over the performance ratings and bonuses of subordinate employees. Annual pay pool allocations are based on aggregate salaries of employees eligible for an increase. Performance cycle results are published on the NIST internal Web and available to all staff.

Since implementing the Alternative Personnel Management System, according to findings in the *Office of Personnel Management's "Summative Evaluation Report National Institute of Standards and Technology Demonstration Project: 1988-1995,"* NIST is more competitive for talent; NIST retained more top performers than a

comparison group; and NIST managers reported significantly more authority to make decisions concerning employee pay. Key indicators of NIST's ability to attract and retain world-class scientists and engineers are the numerous awards and recognition that have been bestowed upon them since the implementation of the APMS. NIST staff have won two Nobel Prizes for Physics, been selected for a MacArthur Fellowship "Genuis Award", received the National Medal of Science, received UNESCO's 2003 Women in Science Award, received 21 Presidential Early Career Awards for Science and Engineering (PECASE) awards, and earned 16 inductions into the National Academies of Science and Engineering.

While I would like to say everything has worked perfectly since initial implementation, the fact is that NIST has had to make minor adjustments to the system over time. This was not unexpected and has improved the functionality of the system. Over the years both supervisory and nonsupervisory employees have provided ideas for improving the system, through focus groups and other forums. NIST responded to this feedback by developing a revised performance appraisal and payout system in 1991, more recent feedback -- from the 2000 and 2002 NIST Employee Surveys, the NIST Research Advisory Committee's 2002 Report to the NIST Director, and stakeholder focus groups -- has led to the latest changes which will be implemented during the next performance cycle.

Starting on October 1, NIST will replace the current 100-point rating scale with six performance ratings and link pay increases to these ratings. Pay increases will be based on an annually determined percentage of the mid-point salary for each pay band in the career path and linked directly to the top three performance ratings, thus strengthening the pay-for-performance link, increasing transparency, and reducing potential payout variations among employees in the same career path and pay band and with the same performance ratings. In addition, the new change will implement a required bonus for high-performing employees who cannot receive a pay increase because they are at the top or close to the top of their pay band.

The NIST system offers improvements in position classification, recruitment, extended probationary period for research positions, performance appraisal, pay for performance, automation and paperwork reduction, and delegations of authority to managers-- all of which have many advantages over the current GS system.

In conclusion, the NIST Alternative Personnel Management System is meeting its objectives to recruit and retain quality staff; to make compensation more competitive; to link pay to performance; to simplify position classification; to streamline processing; to improve the staffing process and get new hires onboard faster; and to increase the manager's role and accountability in personnel management. The NIST system continues to operate as an innovative personnel system which has a proven track record of demonstrating new ideas in the area of human resources management. Thank you for inviting me to testify today, and I would be happy to answer any questions.

# **NIST Career Paths and Bands**

CAREER PATHS	BANDS														
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Scientific and Engineering (ZF)				I				II			III		IV		V
S&E Technician (ZT)				I			II		III		IV		V		
Administrative (ZA)				I				II			III		IV		V
Support (ZS)		I		II		III		IV		V					
Corresponding GS Grades	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15





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**C. Morgan Kinghorn, Jr.**  
**President**  
**National Academy of Public Administration**

**Before the Senate Homeland Security and  
Governmental Affairs  
Subcommittee on Oversight of Government  
Management, the Federal Workforce, and the  
District of Columbia**

**September 27, 2005**

Mr. Chairman and Members of the Subcommittee, thank you for inviting me to testify on the principles for a successful alternative public personnel system.

As President of the National Academy of Public Administration I am pleased to appear before you to provide some perspectives based on work at the Academy. As you know, the Academy is an independent, non-partisan organization chartered by the Congress to give trusted advice. The views presented today are my own and are not necessarily those of the Academy as an institution.

Academy study and research panels composed of Academy Fellows and other experts have focused on the challenges faced by personnel systems in individual agencies, as well as on human capital management governmentwide. My comments today focus on two aspects of that work. First, we can draw conclusions about specific characteristics of the robust human resources systems needed to support federal missions. Second, much greater attention needs to be devoted to the management issues raised by the increasingly multisector workforce carrying out federal missions today.

There are several characteristics common to robust human resource systems:

One, all of our recent HR studies have emphasized the need for top agency leadership – both political and career – to become totally invested in the design, implementation, evaluation and communication of the human capital management system. This is particularly important with respect to the implementation of alternative HR systems.

Two, agencies should have the flexibility and agility necessary to establish human capital management systems which allow them to meet their unique missions. In a study of the Patent and Trademark Office (USPTO), the Academy panel stressed that for the agency to fulfill its key mission of furthering innovation in the US and around the world, it needed to establish its own competitive recruitment, training and career development plan. Development of a targeted strategic workforce planning and staffing process was also one of our lead recommendations for improving the capacity of the Federal Bureau of Investigation (FBI).

Three, an appropriately designed and implemented performance management system can increase employee morale and organizational performance. Critical components are that the agency's mission be clearly articulated and that individual employees can see how their own work contributes to that mission. Ongoing training and communication among all participants is key. This has been discussed in detail in several Academy reports, including one issued by our Human Resources Management Consortium last year.

Four, the importance of leadership development and succession planning, based on a comprehensive human capital strategy, was stressed in a study we did of the Senior Executive Service for the Office of Personnel Management. Our FBI study panel recommended that their leadership and succession planning program be designed to ensure that the best candidates fill leadership positions and to reduce the excessive turnover in those positions. In our ongoing work with NASA we have recommended that the agency carefully analyze its leadership resources, competencies and needs, and that it broaden the scope of its leadership and career development program.



I have copies of our most recent FBI, NASA and USPTO reports for the Subcommittee's use and they are also available on the Academy's web site. ([www.napawash.org](http://www.napawash.org))

The application of these principles and systems – involvement of top leadership; individualized workforce planning and competitive hiring; performance management; and leadership and succession planning, will likely result in differing approaches in different agencies, depending on their organization and mission. The Academy is examining the issue of what values and systems should remain governmentwide in an increasingly flexible civil service system. Stakeholder interviews and surveys to date show strong support for the establishment of an underlying, governmentwide framework of values, principles and processes to support individual agency systems. In other words, there should be a common framework for all federal personnel management systems, within which individual agencies have the flexibility to develop and implement their individual human management strategies to accomplish their particular missions.

A second area of Academy work that has a direct bearing on the Subcommittee's inquiry is our consideration of the management implications of the multisector workforce. The federal government's work is increasingly carried out by a combination of federal, state, local, private contractor and non-profit entities. In many cases, private sector employees work side by side with federal civil servants. Federal human capital systems should take the management implications of this multisector workforce into account, but there is little evidence that they are doing so systematically or effectively. One place where such work is underway is at NASA, where the Academy is assisting the agency as it develops

a strategic workforce planning directive and process that takes into account the total workforce, encompassing civil servants, contractors and other employees.

An Academy working group has identified several challenges and questions raised by the multisector workforce, including:

- How can we assure accountability for achieving the results expected of federal programs with a multisector workforce?
- How do we improve the skills and competencies of federal managers to manage programs being performed by a multisector workforce?
- How can federal managers effectively manage non-federal workers who are reporting to a third party?
- What is the impact of contractors supervising other contractors?
- Is it important that the federal civil service retain core competencies?
- What is the impact of the multisector workforce on values traditionally promoted by the federal government? For example, the federal government has been a leader in providing career opportunities for individuals with disabilities and for those who need work flexibility to meet family needs.

I believe that these questions and related ones need to be carefully addressed as part of the federal government's workforce strategy and planning.

I appreciate the Subcommittee's ongoing work on these issues and would be glad to respond to any questions that you have for me.



**Testimony of**  
**Colleen M. Kelley**  
**National President**  
**National Treasury Employees Union**

**Before The**  
**Subcommittee on Oversight of Government**  
**Management, the Federal Workforce and**  
**The District of Columbia**  
**on**  
**Alternative Personnel Systems:**  
**Assessing Progress in the Federal Government**

**September 27, 2005**

Chairman Voinovich, Ranking Member Akaka, other members of the Subcommittee, I appreciate the opportunity to provide you with the views of the frontline employees represented by NTEU at this important hearing on alternative pay systems in the federal government. I am grateful that the members of this Subcommittee, and particularly its leaders, have so much experience, knowledge and interest in efforts to make our federal government operate more effectively and efficiently for those it serves. NTEU wants to be a productive contributor to those efforts.

I would like to comment specifically about three alternative pay systems that NTEU has been involved with, the Federal Deposit Insurance Corporation (FDIC) system, which has been in effect for several years and the Department of Homeland Security (DHS) system, which is still in the implementation stage and the IRS system that right now only covers managers. But before I do that I have some broader comments I would like to share.

As we sit here today, our country is reeling from the effects of natural disasters in the Gulf Coast and from the perceived shortcomings in the federal government's response. Thousands of NTEU members have been deployed to perform disaster recovery related functions and thousands more have volunteered for assignments outside their regular duties. Like the millions of Americans who have been moved to contribute money and volunteer their time to help the

hurricane victims, they are motivated by a desire to help others. That is also a motivation for their choice to have a career in public service. I know this Committee is looking into what went wrong and what went right in response to Hurricane Katrina. That is a critically important undertaking, especially because of its impact on our capabilities to respond to other emergency situations. I would hope that in the Committee's review, it will hear from frontline employees.

I believe that factors such as the alternative personnel systems we are focused on here have a very small, if not negligible, impact on recruiting, retaining and maximizing the performance of federal employees. To quote Robert Behn, author and lecturer at Harvard University's John F. Kennedy School of Government, "Systems don't improve performance; leaders do." I believe that leadership that solicits, values and acts on the ideas of frontline employees in efforts to achieve agency missions is missing in many agencies today and I believe that providing that kind of leadership would do more to improve the quality of applicants and performance of employees than any of the alternative personnel systems we will discuss at this hearing. I know Mr. Chairman, that you are a believer in Total Quality Management. I believe there is a great need to institute that kind of employee involvement right now and I would submit that such an initiative would be successful in attracting, retaining and improving the

performance of federal workers and I would welcome the opportunity to work on such an initiative with you.

### **FDIC**

NTEU is the union for bargaining unit employees at the FDIC. We have bargained over compensation there since 1997. While we have serious concerns about the current state of the pay system at the FDIC, we strongly believe that in the absence of a statutorily defined pay system, like the GS system, pay should be subject to collective bargaining, as it is in the private sector. Especially in a government environment, employees and the public, need a credible means of ensuring that pay is set objectively. That can be by statute, as the GS system, or by collective bargaining, but without one of these approaches, the system will lack credibility and be open to charges of subjectivity and favoritism. I believe FDIC management agrees that bargaining over compensation has been positive for the organization.

I believe that NTEU and FDIC management also agree that you have to have the money to reward good performance. As you know, guaranteeing that the money will be there to fund additional pay in a system reliant on Congressional appropriations is virtually impossible. It is only slightly more possible in a government corporation like FDIC, that is funded by fees.

A key area, however, in which NTEU is at odds with FDIC is the current system to determine performance pay. While the FDIC itself has stated that, “more graduated levels of rewards are better than fewer levels,” it has dropped a multi-level performance evaluation system and moved to a pass fail system. Under this system employees who pass are eligible to be nominated by their supervisor for a pay increase known as a Corporate Success Award. Such increases are limited to one third of the eligible employees and the standards for who gets these increases are vague, subjective and not apparent to those covered by the system.

The arbitrary limitation on the availability of pay adjustments to just one third of the work force has demoralized and angered FDIC employees. Our members report that the system is divisive and discourages teamwork. It is discouraging employees from taking risks and sending the message that two thirds of the work force is not contributing.

With the elimination of the multi-level performance evaluation system, employees do not know what standards are being used to determine who gets the Corporate Success Awards. This lack of clear distinctions, coupled with the lack of transparency under the current system has caused employees to question its fairness. Hundreds of individual grievances have been filed alleging unfair pay determinations. The previous system at FDIC, based on multi-level performance evaluations, without arbitrary limits on the number of employees who could get

additional pay had credibility with employees. This system does not. I believe that is a major factor in the FDIC's ranking 25<sup>th</sup> out of 30 in the Partnership for Public Service's recent "Best Places to Work in the Federal Government" study.

### **DHS**

Holding down the 29<sup>th</sup> spot out of 30 in the "Best Places to Work" study is the Department of Homeland Security (DHS) where NTEU represents Customs and Border Protection employees. While the pay for performance system at DHS has not yet been implemented, we are very concerned that the implementation of the proposed system will push employees who are clearly already demoralized out of the agency when the importance of keeping experienced, skilled employees is greater than ever. One needs only to look at the virtually unanimous opposition to the proposed regulations in the over 3,000 comments submitted to see the extent of employee dissatisfaction with the DHS plan. Let me be clear, the employee opposition to the proposed DHS system is not about "fear of change," as some have tried to portray it. I know firsthand that this group of employees, entrusted with protecting our country from terrorists and other criminals, is not a fearful group. What they most object to about the proposed DHS system is that it will make it harder, not easier, to accomplish the critical mission of the agency.

There are several reasons for this: 1) The system is not set by statute or subject to collective bargaining as the FDIC's system is, so there is nothing to



provide it credibility among employees; 2) The system will have employees competing against each other over small amounts of money, discouraging teamwork, which is critically important in law enforcement; 3) The system is subjective, which will lead to at least the appearance of favoritism, which destroys esprit de corps; 4) The system is enormously complex with a virtually limitless number of pay differentials, the administration of which will require huge amounts of money that is so much more desperately needed in frontline functions, not to mention siphoning off money that could go for more pay in a less administratively burdensome system; 5) the consultant prepared draft competencies for the new DHS system do not recognize or reward the real work that these employees do to keep our country safe. When it is more monetarily beneficial to have “streamlined a process” (not that most frontline employees have the authority to do that) than to have stopped a terrorist from entering the country, we are engaged in an expensive and dangerous diversion from a critical national priority.

### **IRS**

While bargaining unit employees represented by NTEU are not covered by a paybanding performance based system at the IRS, managers are. I would like to comment briefly about that system. The Hay Group did a Senior Manager Payband (SMPB) Evaluation on this system for the IRS last year. (June 25, 2004) Here are some of the results: 1) 76% of covered employees felt the system had a

negative or no impact on their motivation to perform their best; 2) 63% said it had a negative or no impact on the overall performance of senior managers; 3) “Only one in four senior managers agree that the SMPB is a fair system for rewarding job performance or that ratings are handled fairly under the system;” 4) “Increased organizational performance is not attributed to the SMPB.”

The results of this system are dismal, yet it is pointed to as a model for moving the whole federal government to a similar system. In fact, there is a dearth of information to indicate that alternative pay systems have had any significant impact on recruitment, retention or performance. A GAO report on “Human Capital, Implementing Pay for Performance at Selected Personnel Demonstration Projects” from January 2004 (GAO-04-83) included virtually no evidence that the systems improved any of those measures. In fact, the Civilian Acquisition Personnel Demonstration Project reviewed in that report had as one of its main purposes, to “attract, motivate, and retain a high-quality acquisition workforce.” Yet, attrition rates increased across the board under the pay for performance pilot.

It is a mystery to me where the evidence is that these systems have produced successes to justify putting them in place throughout the federal government as called for in the Administration’s government wide proposal, Working For America, or WFA. We think the WFA would more aptly stand for, Won’t Fix America.

NTEU wants to be a productive participant in efforts to deliver the best government services to the public. We are not averse to change. We have welcomed, at FDIC and elsewhere, the opportunity to try new ways of doing things. After working as a frontline IRS Revenue Agent in Pittsburgh for 15 years and serving at NTEU for many years, including the last 6 as National President, these are the things I believe will have the most impact on the quality of applicants and the motivation, performance, loyalty and success of federal workers.

1) Leadership. As I said earlier, rules and systems don't motivate people. Leaders do.

2) Opportunities for employees to have input into decisions that affect them and the functioning of their agencies. They have good ideas that management is currently ignoring.

3) A fair compensation system that has credibility among employees, promotes teamwork and is not administratively burdensome.

Unfortunately, I do not believe the systems currently being pursued by the Administration follow these standards and I do not believe they will be successful. I urge the Members of this Subcommittee to closely review and analyze what data exists on current alternative personnel systems before moving to make them government wide. I don't think the evidence supports their use as successful models. Thank you for this opportunity to share my views. I would be happy to answer any questions you may have.



# **AFGE**

## **Congressional Testimony**

STATEMENT BY

**JOHN GAGE**  
NATIONAL PRESIDENT  
AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES, AFL-CIO

BEFORE

THE SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT  
THE FEDERAL WORKFORCE AND THE DISTRICT OF COLUMBIA

SENATE COMMITTEE ON HOMELAND SECURITY  
AND GOVERNMENTAL AFFAIRS

REGARDING

COLLECTIVE BARGAINING AND ADEQUATE FUNDING:  
THE KEYS TO SUCCESS FOR ALTERNATIVE PERSONNEL SYSTEMS

ON

SEPTEMBER 27, 2005

American Federation of Government Employees, AFL-CIO  
80 F Street, NW, Washington, D.C. 20001 • (202) 737-8700 • [www.afge.org](http://www.afge.org)



My name is John Gage, and I am the National President of the American Federation of Government Employees, AFL-CIO (AFGE). On behalf of the more than 600,000 federal and District of Columbia employees represented by AFGE, I thank you for the opportunity to testify today on lessons learned from demonstration projects involving alternative personnel systems in federal agencies.

My testimony will focus on the experience of only one AFGE local because you have asked about cases where alternative personnel systems have been "successfully employed and what steps have been taken in their development to ensure effective implementation and operation." While I appreciate the premise that what is learned from relatively successful experiments is valuable, in the context of personnel management and union rights, what is learned in relatively unsuccessful experiments might prove to be even more valuable? Indeed, the majority of AFGE locals that have tried demonstration projects have regretted it and voted as soon as they could to end the experiments.

I will focus my remarks today on the experience of AFGE Local 1904 at the Army's Fort Monmouth in New Jersey, which has had about five years of positive experience with the Acquisition Demonstration Project. At the same location Local 1904 agreed to participate in a Science and Technology Laboratory Demonstration Project less than a year ago, so it is too soon to report on that experience.

The alternative personnel system in place at Fort Monmouth works relatively well for two primary reasons:

- **Collective Bargaining:** Crucial aspects of the system are established through the process of collective bargaining and the resulting collective bargaining agreements are fully enforceable. Labor and management have a respectful relationship at Fort Monmouth, and the collective bargaining agreements that have been jointly negotiated between AFGE Local 1904 and local management reflect the good faith efforts of both parties.
- **Funding:** A substantial portion of the pay system that is subject to alternative procedures is funded separately from regular pay adjustment system and is treated as a supplement. Virtually every employee covered receives his or her regular Employment Cost Index (ECI) and locality increase each year, and the demonstration project-based pay adjustments are on top of these regular across-the-board increases. Although the salary account money used for within-grade increases and quality step increases is allocated to the alternative pay system, at Fort Monmouth additional program funds have supplemented the salary accounts allowing the alternative to provide improvements in overall pay levels.

These are necessary, but not sufficient conditions for the success of federal alternative personnel systems. Success also requires a legal infrastructure that

upholds *all* the merit system principles, and provides strong, accessible, independent legal avenues for holding the political appointees responsible for managing agencies accountable for implementing the project in ways that are transparent and not designed to lower anyone's pay.

Neither of those two necessary conditions for success exists in either the Department of Homeland Security's MaxHR, or the Department of Defense's National Security Personnel System (NSPS). As a result, we know that both MaxHR and NSPS are guaranteed to fail. The only questions are the size of the scandals and lawsuits that arise from the inevitable corruption and mismanagement these systems encourage, and how much taxpayer money that is sorely needed elsewhere will be wasted on "Human Resource" contractors and other cronies. Furthermore, the version of NSPS and MaxHR that DoD and DHS have put forward deserve to fail because their flaws are well-known to DoD and DHS and have been repeatedly described to the Congress.

What follows is a description of some of the terms of the contract between AFGE Local 1904 and Fort Monmouth management that our members and local officers believe make the system work. As you know, the provisions I will describe below will eventually become unenforceable once the NSPS goes into effect throughout DoD. Indeed, managers will not have the authority or flexibility to negotiate with the local union or use a contract such as this to navigate the inevitable conflicts that arise over how to implement a pay system that requires one person to

evaluate another. This contract, like all collective bargaining agreements, reflects a balance between the rights of management and workers, subject to the constraint of mission accomplishment. It reflects the joint acknowledgement of various roles and responsibilities and their limits.

The "Acquisition Demo" differs from the NSPS outline and DoD's opinion of what constitutes "best practices" in the area of alternative personnel systems published in April, 2003 not only because its primary feature is not the elimination of the union, but also because it focuses a portion of the annual salary adjustment on an employee's "contribution" to the agency's mission rather than an employee's "performance" relative to long lists of "competencies." As such, its rationale seems more objective and less political than schemes based on subjective assessments of an employee's personal attributes.

The Collective Bargaining Agreement at Fort Monmouth Covering the Acquisition Demonstration Project

The collective bargaining agreement between AFGE Local 1904 and Department of the Army management at Fort Monmouth that addresses the operation of the alternative personnel system was first negotiated in 1999. The current agreement was signed in 2003 by seven managers and the union president, and America was not made less safe, and DoD was not impeded in the conduct of war.



#### The Evaluation of an Employee's "Contribution"

The contract includes an article setting forth how an employee's contribution to mission is evaluated. The evaluation forms part of the basis for an employee's eligibility for a general pay increase (GPI), a contribution rating increase (CRI) and a (CA) contribution award. The GPI and the CRI are base salary adjustments, and the CA can either be a base salary adjustment or a bonus. This latter decision is under the discretion of the Pay Pool Manager, although a supervisor can make a recommendation regarding whether to make the CA a bonus or a salary adjustment.

The collective bargaining agreement requires that the "contribution-based compensation and appraisal system provide "to the maximum extent possible a fair, objective, accurate, and job-related evaluation of employee contributions to the mission." It states that these evaluations be carried out in a "fair and equitable manner" and that employees be given "periodic counseling" to help them meet their contribution goals.

#### Discussions between Employees and Supervisors

Under the contract, each employee is guaranteed to receive his or her evaluation in accordance with the demonstration project procedures. This means that a supervisor is required to discuss the six factors which will be evaluated sometime during the first 45 days of an appraisal period. If an employee obtains a new supervisor within three months of the end of a rating period, no changes in

expectations regarding the employee's contribution relative to the six factors discussed with the previous supervisor can be made. However, during this period of change, the new supervisor must discuss many issues relative to "contribution evaluation" with the employee, including "career path, broadband level, factors and weights...expected contribution level and the expected range corresponding to current salary. In addition, each employee has to be "informed that all six factors are critical."

#### Employees' "Self Assessment" Given Weight in Final Evaluation

Each employee is required to make a "self assessment" in writing in accordance with the demonstration project procedures. "Self assessments" must include a summary of the employee's contribution to each of six factors and make use of an official demonstration project form. This "self assessment" is attached to the "appraisal packet" considered by managers who will make decisions regarding the employee's eligibility for contribution-based salary increases and/or bonuses. At the end of the rating period, a "rating official" will submit an assessment of the employee's contribution relative to each of the six factors which may include reference to the employee's "self-assessment." This submission is considered a "draft" until a higher official, the "pay pool manager," approves it.

#### All Supervisors With Input into Evaluation Must be Known to Employees

The contract further requires that each employee be clearly informed of the identity of the "supervisory chain" involved in the production, approval, and use of

their contribution evaluation. Employees are guaranteed that all of their assignments will be made by individuals within this chain or other "designated authorities" in order that those evaluating them will have been involved in assigning their work.

#### Description of Contribution Categories

The managers who comprise the "supervisory chain" place the employee in one of three regions on a simple graph depicting pay, which I have attached for your review. The three regions are described as follows: Region A, "inappropriately compensated above the rails", Region B "inappropriately compensated below the rails," and Region C "appropriately compensated within or on the rails." Their "overall contribution score" is the factor that decides their place on the graph and thus their eligibility for general pay increases, contribution rating increases, and contribution awards.

#### All Evaluation Requirements and Information Must be in Writing

In the midst of all this, supervisors are required to inform employees in the bargaining unit, one by one, of the mission requirements and any changes to mission requirements. This occurs, according to the contract, during both the initial and midpoint counseling sessions that the supervisor must conduct using official documents.

In order to assure transparency and avoid corruption, the collective bargaining agreement guarantees each employee the right to be given "the originals" of their contribution appraisals and their final evaluations as well as "counseling notes." The date on which the employee is given the originals with the required signatures is the date when time limits to file any grievances relative to the contribution appraisal begin to apply. Time limits regarding the Alternative Dispute Resolution process for issues involving the employee's evaluation that are excluded from grievance procedures also begin on this date.

#### Holding Management Accountable for Contribution Evaluations

The contract sets forth the minimum of what should occur at the three meetings between supervisors and employees which must take place over the course of a rating period. The first meeting establishes the employee's goals and their connection to the agency's mission. The mid-point meeting provides the employee with feedback, guidance, and recommendations. If at the second meeting things aren't going well, the supervisor has to document alleged shortcomings and give the employee at least 90 days to improve. At the final meeting, the employee has the opportunity to discuss his or her contributions to the mission.

The employee's actual score is not discussed even at the last meeting. Why not? Because contrary to popular belief, the supervisor who has monitored the employee and worked with the employee to set goals and discuss the

employee's six criteria will not be making the final assessment. Rather, the next level of management – the Pay Pool Panel – and the Pay Pool Manager have to approve the score. In fact, the Pay Pool Manager has wide latitude to change the score given to an employee by his supervisor. But an employee has the right to grieve such a change under a negotiated grievance procedure, which keeps the system somewhat honest. In the context of the investigation of a grievance, the justification for the original score as well as the Pay Pool Manager's change will be thoroughly examined. As a further means of holding the Pay Pool Manager accountable, a union representative is entitled to be present during all deliberations of the Pay Pool Panel.

In the event that an employee is judged to be making an "inadequate contribution" according to the rules, definitions, and procedures peculiar to the Acquisition Demonstration Project, the employee is guaranteed in the collective bargaining agreement that he will receive a written notification telling him that he must improve his contribution and how. The employee will receive a Contribution Improvement Plan (CIP) that is at least 90 days long. If the employee is found not to have improved during this period, management may propose a pay cut or removal.

Under the terms of the contract, any "adverse information concerning performance" in a manager's files cannot be used as the basis for a change in an employee's rating unless the employee has been told about the information, and

given the chance to review it. Thus, no secret data or appraisal can be sprung on the employee or used against him in his evaluation report.

#### Employee Rights with Regard to Negative Evaluations

In cases where an employee has an up and down record and has been through an improvement plan, for example: His contribution declines, then improves as a result of the improvement plan, but declines again within two years; a pay cut, demotion, or removal can be proposed. However if this variation occurs more than two years after an improvement plan, the employee has the right to a new CIP period.

All of the provisions of the collective bargaining agreement involving the procedures and rights of the employee with regard to the evaluation of contributions are subject to the union's negotiated grievance procedure. In addition, the final contribution assessment, which is called the "overall contribution score" or OCS rating as well as the scores on individual factors are grievable. Only the dollar amounts of a contribution rating increase (CRI) and a contribution award (CA) are excluded from the grievance procedure. Disputes arising from these issues may be handled by the Alternative Dispute Resolution (ADR) procedures, which are also described in the collective bargaining agreement.

Both the negotiated grievance procedures and the alternative dispute resolution procedures set forth in the contract provide for independent third party review. Neither DHS nor NSPS provides this basic protection to the employee or accountability to the taxpayer. Whether it is an arbitrator analyzing whether the procedures for evaluating employees have been followed, or a “moderator” analyzing whether an employee’s overall contribution score has been calculated accurately and in accordance with the procedures set forth in the contract, the employee has some assurance that neither his supervisor nor the Pay Pool Manager, nor the Secretary of an agency, will be the perpetrator, judge, and jury with regard to everything, as is the case with the new personnel systems at DHS and DoD.

#### Financial Results from the Fort Monmouth Acquisition Demonstration

While the procedures for setting each employee’s contribution goals and defining and weighting the six factors against which his or her contributions will be measured are laborious and time-consuming, there is a substantial potential payoff for the employee. The data from Fort Monmouth show that the unionized employees who have participated in this program are *as a group* better off financially than they would have been without the extra resources provided through the project.

It is important to note, however, that the money used for the contribution-based payments have come in part from regular salary accounts. It includes funds that

under the GS system would have been used for within-grade increases, quality step increases, and some promotions. The extra money is only available at Fort Monmouth when other programs have surpluses. Thus, there is no guarantee of extra funding beyond what the regular GS system provides.

Although the justification for destroying collective bargaining rights and denying federal employees an annual market-based salary adjustment in DoD and DHS has often been the "poor performer" and the beleaguered federal manager's difficulty in punishing or otherwise terminating him, at Fort Monmouth, the data do not indicate that type of focus. Instead, it seems actually to have been about improving pay.

Between 1999 and 2004, only two employees have ever been denied a contribution rating increase or contribution award because of inadequate contribution. Both of those employees missed out on contribution payments in 2004. These instances of "poor performance" constitute about 0.02% of all contribution scores calculated over the period.

Over the years, the Contribution Rating Increases (CRI) paid to bargaining unit members at Fort Monmouth under the program have ranged from less than 1% to as much as 7.67%. These increases are adjustments to base salaries. In cases where an employee, because of promotions and/or seniority is at the top of a pay band defined by the limits of General Schedule salaries e.g. a GS-15-10,



the earned CRI is provided to the employee as a bonus. In both 1999 and 2000, the bargaining unit as a whole received CRIs equivalent to 2.4% of payroll. In 2001 and 2002, the amount was 2.0% of payroll. And in 2003 and 2004, the amount was 4.0% of payroll.

The dollar value of these CRIs has varied from \$583 to \$1,530 in 1999 (and 1999 dollars). By 2004, the year with the only two workers ever to have been denied a CRI increase, the dollar amounts varied from nothing to \$7,334. During those years the averages have varied somewhat: In 1999, the average CRI was 2.75% and was worth \$1,530 (1999 dollars). In 2003, the average was 3.94% and was worth \$2,732 (2003 dollars).

The Contribution Awards (CA) are similar. These bonus payments are not salary adjustment, but rather one-time payments. They are tied to an employee's Overall Contribution Score just as is the case with the CRI. The average CA in the bargaining unit in 1999 was \$2,075; in 2000 the average was \$2,426; in 2001 the average CA was \$2,970; in 2002 the average CA was \$2,340; in 2003 the average CA was \$1,735 and in 2004 the average CA was \$2,629 despite the fact that two employees brought down the average by not receiving any CA at all. All the numbers described here are nominal, and not adjusted for inflation.

Has the Demonstration Project Improved Contributions to Mission?

One constant criticism of merit pay, contribution pay, performance pay and other such systems is the difficulty and questionable validity of making small distinctions among employees, and what the distinctions mean or encourage.

The data from Fort Monmouth demonstrate the truth of this criticism. Among the Overall Contribution Scores, an employee can receive as low a rating as negative four (-4) and as high a rating as positive nine (+9). In 1999, more than half of all employees measured were in the top third; in 2002 only 8% were in the top third of the range; and in 2003 just 13% were in the top third of the range. Yet averages were higher in the later years. What does this mean? We cannot say that employees were responding to different financial incentives because they never know how much a particular score is worth until after the fact. Thus in 2003 when a top score was worth more than it was in 1999, fewer people reached it. But can we ever say fewer reached *for* it or that their actual contributions were smaller or of less significance?

Some Dangers of Relaxing General Schedule Rules

One way of describing the impact of the Fort Monmouth Demonstration Project is that it allows employees to obtain promotions non-competitively. While this is undoubtedly a positive attribute of the program from the perspective of those who are in it, it is not particularly defensible from the outside. Under the current procedures for federal agencies that are not experimenting with alternative personnel systems, an entry level employee who, for example, was hired to

provide general administrative support would be hired at anywhere from a GS-02 to a GS-04.

Under ordinary circumstances, in order to be promoted to the next level for that position, a GS-05, the candidate for promotion would have to apply for the new position, be interviewed and tested, and compete against other qualified applicants from inside and outside the government. In that way, the federal government, spending the taxpayers' money, would be sure to have the most qualified applicant selected for the position. Under the alternative personnel system in place at Fort Monmouth and other locations with similar flexible authorities, the person hired to provide general administrative support could be promoted as far as the equivalent of a GS-08-10 without ever having to compete for a promotion.

Understandably, employees who benefit from this rapid advance up the salary scale appreciate it. But the bigger picture must also be considered. Who is excluded from opportunities for these positions and the associated salaries by virtue of this system? Inevitably, qualified veterans are excluded. Inevitably, candidates who might improve the diversity of the federal workforce are excluded. Inevitably, the merit system principles will be violated.

Conclusion

The Demonstration Project at Fort Monmouth is far from perfect. Like all pay schemes that seek to individualize pay adjustments, it raises the question of what the system is aiming to accomplish, whether those aims have been met, whether the pay system can be fairly credited with contributing to the accomplishment of those aims, and whether the costs associated with the administration of a complex, multi-faceted pay adjustment process are offset by measurable benefits.

The most important point is that the crucial protections for employees that are included in the Fort Monmouth Acquisition demonstration are absent from both NSPS and MaxHR. The classification system at Fort Monmouth still provides a floor for an employee's salary based upon the duties and responsibilities of the job which are entirely objective criteria. Collective bargaining rights are intact and fully exercised.

But the question of its efficacy in changing even one employee's contribution to the Army's mission remains unanswered. The members of Local 1904 are deeply ambivalent about the value of the project. They stress the fact that it is an extremely inefficient and time-consuming process for allocating a relatively small amount of money, most of which would have been allocated identically under the General Schedule through within-grade increases and Quality Step increases. They understand that the college-educated scientists and engineers that make

up the bargaining unit at Fort Monmouth are in a far better position to hold management accountable for administering the system and adhering to the collective bargaining agreement than other groups at DoD and DHS that will soon be subject to the harsh, Wal-Mart style systems of MaxHr and NSPS.

The Acquisition Demonstration Project at Fort Monmouth has far more in common with the General Schedule than it does with either the DHS MaxHr or DoD's NSPS. Time and again, the employees at Fort Monmouth urged me to tell the Subcommittee that they oppose the NSPS in the strongest possible terms, and that the only reason that their project works as well as it does is the strong, fair, and reliable system of checks and balances achieved and maintained through collective bargaining.

This concludes my statement. I will be happy to answer any questions the Chairman or other Members of the Subcommittee may have.



Testimony  
Before the United States Senate  
Senate Homeland Security and Governmental Affairs Committee  
Subcommittee on Oversight of Government Management, the Federal Workforce and the  
District of Columbia  
Tuesday, September 27, 2005

Alternative Personnel Systems: Assessing Progress in the Federal Government

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## **New Systems for a New Workforce: Improving Federal Productivity Through Alternative Personnel Systems**

**Statement of  
Michael B. Styles  
National President  
Federal Managers Association**



Chairman Voinovich, Ranking Member Akaka and Members of the Senate Subcommittee on Oversight of Government Management, the Federal Workforce and the District of Columbia:

Established in 1913, FMA is the largest and oldest Association of managers and supervisors in the Federal Government. FMA has representation in some 35 different Federal departments and agencies. We are a non-profit advocacy organization dedicated to promoting excellence in government. We would like to, first and foremost, thank the Subcommittee Chairman and Ranking Member for allowing us this opportunity to share our thoughts on the pertinent topic of alternative personnel systems. Our membership located around the country and world is responsible for conducting the day-to-day business of the government, and as such particularly appreciates knowing that Congress is continuing to take an active interest in the quality of work-life for all federal employees and their supervisors.

The face of America's growing workforce is changing. As a model once attractive for the employing the most talented members of the workforce, by today's standards the federal civil service system seems to be unreflective of the expectations of new job seekers. As those who will be responsible for the implementation of any new personnel program, it is our view that changes do need to take place. The overhaul of the Department of Defense and Department of Homeland Security personnel systems has opened the door to avail the rest of the federal government to a culture of modernization.

The current General Schedule pay system and performance review methods are antiquated. However, certain fundamental principles of merit remain crucial to preserving the integrity and accountability of a new employment system. We have seen through demonstration projects and pilot programs in various agencies around the country over the past few decades that implementing human resources management structures can help improve the productivity and mission of the affected agencies. We would like to highlight for you the direction we believe alternative personnel systems should be taking and what current governing rules they should retain.

#### **ASSESSING THE PAY-FOR-PERFORMANCE MODEL**

The most notable pay structure that our membership has had experience with – through demonstration projects and agency reform efforts – is a pay-for-performance model of compensation. We believe that the hardest working employees should be rewarded with the highest rate of pay, and those employees who fall below the curve on their overall performance should not be rewarded at the same rate. The link between performance and pay provides greater incentive to employees that their



efforts will be appropriately recognized. For where is the incentive in doing a better job than your colleague when little is done to differentiate additional efforts? The move into an alternative pay system must be a deliberate process that takes into account both an internal and independent review mechanism for the implementation of a pay-for-performance system within the agency and elsewhere in the Federal government.

The current pay systems being used at the Navy's NAVAIR China Lake, Ca. facility and the Keyport Naval Warfare Center in Keyport, Wa. are two demonstration projects that represent good examples of what to expect in alternative personnel systems. China Lake has been a demonstration project for more than 20 years, whereas Keyport Naval Warfare Center has only been in a demonstration project for five years. According to data provided by the Human Resources division of the China Lake facility, 70 percent of the employees surveyed approve of the overall project.

However, as we have stated in previous testimony, of major importance to the implementation of any pay-for-performance system is ensuring an adequate pool of funds is available to the supervisor to recognize the efforts of his/her employee. As it stands, agency budgets feel the pinch from cuts due to unforeseen events such as Hurricanes Katrina and Rita, which can effectively drain the availability of funds to support the rewards pool. If this pool of money is lacking, the performance of some deserving federal employees may go unrecognized, causing the new system to fail in meeting its objective, in addition to creating dissension in the workplace.

In short, the integrity of "pay-for-performance" will be severely hindered if all high performers are not rewarded accordingly. We believe that any new personnel system should continue to allocate at least the annual average pay raise that is authorized and appropriated by Congress for General Schedule employees to those employees under the new system who are "fully successful" (or the equivalent rating), in addition to other merit-based rewards based on "outstanding" performance (or equivalent rating).

#### **SUGGESTIONS FOR CHANGES TO THE PERFORMANCE APPRAISAL PROCESS**

The performance appraisal process is key to this new personnel system. The review determines the employee's pay raise, promotion, demotion or dismissal in a far more uninhibited way than is currently established in the General Schedule. We support the premise of holding federal employees accountable for performing their jobs effectively and efficiently. More specifically, the removal of a





pass/fail performance rating system that does not allow for meaningful distinction of productivity is a step in the right direction.

We are concerned, however, that within any review system there must be a uniform approach that takes into account the clear goals and expectations of an employee and a system that accurately measures the performance of that employee, with as little subjectivity on the manager's part as possible. According to our members at Keyport, the managers were provided more than 20 hours of onsite, in-person training, and employees were provided four hours of training highlighting their responsibilities, duties and expectations. This level of training has been critical to the overall success of the implementation of the new system.

Training helps alleviate concerns of bias. It is essential that within any alternative review process, the methodology for assessment is objective and unmistakable in order to reduce the negative effects of an overly critical or overly lenient manager. The most important component in ensuring a uniform and accepted approach is proper training, and funding thereof, that will generate performance reviews reflective of employee performance. We would like to submit the following necessary elements for executing a pay-for-performance system that has a chance to succeed:

- adequate funding of "performance funds" for managers to appropriately reward employees based on performance;
- development of a performance rating system that reflects the mission of the agency, the overall goals of the agency, and the individual goals of the employee, while removing as much bias from the review process as possible;
- a transparent process that holds both the employee being reviewed and the manager making the decision accountable for performance as well as pay linked to that performance;
- a well-conceived training program that is funded properly and reviewed by an independent body (we recommend the Government Accountability Office as an auditor) which clearly lays out the expectations and guidelines for both managers and employees regarding the performance appraisal process.

We believe that *transparency* leads to *transportability*, as intra-Department job transfers could be complicated by the lack of a consistent and uniform methodology for performance reviews. While we need training and training dollars, we should allocate those funds towards a program that takes into



account the various functions and missions within the overall mission of the departments. If we are to empower managers with the responsibility and accountability of making challenging performance-based decisions, we must arm them with the tools to do so successfully. Without proper funding of “performance funds” and training, we will be back where we started – with a fiscally restricted HR system that handcuffs managers and encourages them to distribute limited dollars in an equitable fashion.

### MOVING INTO A PAY BANDING SYSTEM

Pay banding is not a new concept to the private- and public-sector industries. It is currently underway in a few government agencies, notably in the Federal Aviation Administration as well as in the Internal Revenue Service – where FMA has a large number of members. The job classification and pay system was developed in the late 1980s, and has seen varying levels of success across private industry and in the public sector.

First and foremost, we cannot stress enough the importance of offering market based pay in reforming any current pay structure. An incentive for working for the federal government is the stability in employment, compensation and benefits. Despite the best intentions of the Federal Employee Pay Comparability Act of 1990, there still remains a considerable pay gap of 32 percent according to the recent numbers from the Bureau of Labor Statistics (BLS) that indicate market forces are not at work in federal employment. We concede that many federal jobs might pay employees higher salaries as compared to the private sector, but from the BLS data, it is also clear that there exists a far greater disparity in wages for the underpaid in federal service.

According to a survey of college graduates, Federal and non-Federal employees conducted by the Partnership for Public Service<sup>1</sup>, the Federal government is not considered an employer of choice for the majority of graduating college seniors. In the survey, nearly 90 percent said that offering salaries more competitive with those paid by the private sector would be an “effective” way to improve Federal recruitment. Eighty-one percent of college graduates said higher pay would be “very effective” in getting people to seek Federal employment. When Federal employees were asked to rank the effectiveness of 20 proposals for attracting talented people to government, the second-most popular

<sup>1</sup> Survey conducted by Hart-Teeter for the Partnership for Public Service and the Council for Excellence in Government, Oct. 23, 2001, p. 1-3.



choice was offering more competitive salaries (92 percent). The public sector simply has not been able to compete with private companies to secure the talents of top-notch workers because of cash-strapped agency budgets and an unwillingness to address pay comparability issues.

By shifting to a compensation model that looks at the local and national job markets for the pay range of a given position, the federal government makes themselves a more competitive employer. In certain fields, particularly higher paying professions such as law, medicine, science and engineering, market-based pay will allow for the federal government to offer prospective employees attractive recruitment packages that would include benefits such as \$60,000 towards student loans and hiring bonuses as already authorized by Congress. It is the coalescing of all these factors that will allow the government to maintain a top-notch, results-oriented workforce that rivals any other in the world.

Pay banding offers considerable benefits to managers and supervisors that otherwise were unavailable under the rigid GS pay and job classification system. Without the tedious task of having to obtain laborious job descriptions, managers have the flexibility to move employees into better positions and higher-paying salaries without as much red tape. This frees the supervisor up to accomplish his or her day-to-day tasks, while providing more incentive and motivation to the employee. Employees are given a broader range of options to explore various job functions that will demonstrate greater ability and more closely align their work to their compensation.

While the exact determination of the pay range for each pay band varies, we believe that predicated any alternative system on the current GS salary structure acts as a fair baseline for moving an employee into the new band, as well as serves as a guide for determining the low and high ends of each band. It is also important to create a system that is familiar to the employee and manager while still enabling the change that is needed to help ease all parties through the process further. Along those lines, it would be a disservice to recruitment and specifically retention efforts to reduce any employee or manager's pay, and in fact qualified employees should be able to receive higher salaries from this transition. The GS system has been in existence for decades, and moving into a new pay-banding system in and of itself creates some consternation. Using the base salaries of the GS system as the foundation will allay concerns that pay rates will be significantly reduced.

The General Schedule places its emphasis on longevity, and the new system will place more emphasis on job performance than duration of employment. Pay bands provide the opportunity to have



accelerated salary progression for top performers. As in the IRS pay-band system, managers are eligible for a performance bonus each year. Those managers with “Outstanding” summary ratings will receive a mandatory performance bonus, while managers with “Exceed” summary ratings are eligible for performance bonuses.

Pay bands can also be designed to provide a longer look at performance beyond a one-year snapshot. Many occupations have tasks that take considerable lengths of time. Pay bands can be designed to recognize performance beyond one year. Arbitrary grade classifications in the GS system inhibit non-competitive reassignments while broader bands foster non-competitive reassignments. This enhances management flexibility and developmental opportunities.

Of course, there remain challenges with any proposed pay-band system for that matter. First, pay-for-performance systems are only as good as the appraisal systems they use. Since performance is the determining factor in pay-band movement, if there is no confidence in the appraisal system, there will be no buy-in for the pay system.

Another considerable drawback to moving current GS employees into a pay banding system is that some workers will enter at the top of the band. This leaves little room for increase in the base pay of an employee. While they are still eligible for bonuses, the overall base pay goes towards final calculation of their retirement annuities, and could end up having a negative impact on their expected payout, even if they are performing well and receiving comparable bonuses. The idea behind pay bands is to give supervisors greater flexibility in increasing the pay of high-performing employees with the potential for moving up higher in the pay band than in the GS system. If you hamstring them from the beginning from being able to offer that incentive, you are crippling a system that is supposed to be designed to both encourage and reward results. Finally, pay-band performance requirements can discourage non-banded employees from applying for banded positions. If the employee is converted in the upper range of a band s/he may not have confidence s/he can achieve the higher ratings requirements.

Closing the pay gap between public and private-sector salaries is critical if we are to successfully recruit and retain the “best and brightest.” In this regard, we are pleased to see a shift in the determination of “locality” pay from strictly geographical to occupational. Locality pay adjustments based on regions across the country did not take into account the technical skills needed for a given occupation. The new regulations allow for a look nationwide at a given occupation within the labor



market that more accurately ties the rate of pay to job function, which could overcome geographic impediments in the past in closing the gap between public- and private-sector salaries.

#### **ADHERING TO THE MERIT SYSTEM PRINCIPLES**

There has also been a commitment on the part of the Office of Personnel Management, DHS and DOD to hold close the Merit System Principles as they undergo their reformation process. We cannot stress adherence to these timely standards enough. For generations they have acted as a protective lining for managers and employees to feel confident that their employer is accountable for any misdirected actions taken. Further, they provide a foundation of ideals that should be upheld by all employers that wish to create a results-oriented culture that promotes creative thinking and rewards exceptional productivity. They are timeless standards that should remain the bricks and mortar of any alternative personnel system introduced to govern federal service.

#### **TRAINING AND FUNDING OF ALTERNATIVE PERSONNEL SYSTEMS**

Two key components to any successful alternative personnel system are training and funding. As any federal employee knows, the first item to get cut when budgets are tightened is training. Mr. Chairman, you have been stalwart in your efforts to highlight the importance of training across government. Training of managers and employees on their rights, responsibilities and expectations through a collaborative and transparent process will help to allay concerns and create an environment focused on the mission at hand.

For any new personnel system, we must keep in mind that managers will also be reviewed on their performance, and hopefully compensated accordingly. A manager or supervisor cannot effectively assign duties to an employee, track, review and rate performance, and then designate compensation for that employee without proper training. Part of the success for those employees in the demonstration projects and pilot alternative pay systems was the commitment to adequate training and persistent evaluation. The better we equip managers to supervise their workforce, the more likely we are to ensure the accountability of the new system – and the stronger the likelihood that managers will be able to carry out their non-supervisory responsibilities in support of the department's mission.

For employees, they will now be subject in a much more direct way to their manager's determination of their performance. Employees would be justified in having concerns about their



manager's perception of their work product in any performance review if they felt that the manager was not adequately trained. Conversely, if employees have not been properly trained on their rights, responsibilities and expectations under the new human resources requirements, they are more apt to misunderstand the appraisal process.

Our message is this: As managers and supervisors, we cannot do this alone. Collaboration between manager and employee must be encouraged in order to debunk myths and create the performance and results oriented culture that is so desired by the final regulations. Training is the first step in erasing doubt and opening the door to such a deliberate and massive change in the way the government manages its human capital assets. We need the support of the department's leadership, from the Secretary on down, in stressing that training across the board is a top priority. We also need the consistent oversight and input of Congress to ensure that both employees and managers are receiving the proper levels of training in order to do their jobs most effectively.

The Secretary and Congress must also play a role in proposing and appropriating budgets that reflect these priorities. Agencies must also be prepared to invest in their employees by offering skill training throughout their career. This prudent commitment, however, will also necessitate significant technological upgrades. OPM has already developed pilot Individual Learning Account (ILA) programs. An ILA is a specified amount of resources such as dollars, hours, learning technology tools, or a combination of the three, that is established for an individual employee to use for his/her learning and development. The ILA is an excellent tool that agencies can utilize to enhance the skills and career development of their employees.

Clearly agency budgets should allow for the appropriate funding of the ILA as an example. However, history has shown that training dollars have been a low priority for many agency budgets. In fact, in the rare event that training funds are available, they are quickly usurped to pay for other agency "priorities." Toward this end, we at FMA support including a separate line item on training in agency budgets to allow Congress to better identify the allocation of training funds each year.

Neither the Office of Management and Budget (OMB) nor OPM collects information on agency training budgets and activities. This has only served to further diminish the minimal and almost cursory attention on training matters. Many agencies do not even have dedicated employee "training" budgets. Training funds are often dispersed through other accounts. It is no surprise that budget cuts inevitably target training funds, which is why FMA continues to advocate for the establishment of a training officer



position within each Federal agency. This would allow for better management and recognition of training needs and resources, in addition to placing increased emphasis on critical training concerns.

The Federal government must, once and for all, take the issue of continuous learning seriously. FMA advocated for the existing Chief Human Capital Officers Council, which both you, Mr. Chairman and Senator Akaka, were instrumental in bringing about as part of the Homeland Security Act of 2002. While we applaud the Council's creation of two needed subcommittees to examine performance management as well as leadership development and succession planning, we would urge the Council to add another subcommittee to evaluate training programs across government. Without proper training, and funding for training, we cannot hope to effectuate expansive human resources changes and fully achieve them.

#### CONCLUSION

We are in an historic time of civil service reform. With so many varied demonstration projects and pilot personnel systems having been underway throughout the federal government for years, and the authorization by Congress to revamp nearly half the federal workforce at the Departments of Homeland Security and Defense, there is hope that the antiquated personnel systems of yore will soon enter into the history books. Nonetheless, in closing a chapter and opening a new one, we must ensure that we all reading the same book and turning the page at the same time. A shift in the culture of any organization cannot come without an integral training process that brings together the managers responsible for implementing the new personnel system and the employees they supervise. A total overhaul of the GS pay system to reflect a more modern approach to market- and performance-based pay must be funded properly in order for it to succeed. As we have explained, the lack of proper funding for "pay for performance" will work contrary to its intended results. Ensuring that employees feel their rights are protected and safeguards are in place to prevent abuse or adverse actions necessitates a strict adherence to the Merit System Principles.

There are many challenges ahead, but we at FMA cannot emphasize enough the need to take a cautious and deliberate path for implementing any new alternative personnel system. We recommend continued collaboration with management and employee groups as well as independent review and auditing by the Government Accountability Office, with the oversight of Congress. Through these



checks and balances, we are hopeful that a set of guiding principles will emerge to assist other agencies in their expected personnel reform efforts.

Thank you again, Mr. Chairman, for the opportunity to testify before your committee and for your time and attention to this important matter. Should you need any additional feedback or questions, we would be glad to offer our assistance.



OPM does not measure demonstration projects based on the cost of implementation. Therefore, the following cost information comes from the GAO report "Human Capital: Implementing Pay for Performance at Selected Personnel Demonstration Projects" dated January 2004.

#### Training Costs

Demo project	Cost per demonstration project employee						Total Cost Prior to Implementation through year 5
	Year prior to Implementation	Year 1	Year 2	Year 3	Year 4	Year 5	
China Lake	\$203	\$21	No data	No data	No data	No data	\$1,226,000
NIST	0	0	0	0	0	0	0
DOC	12	6	\$5	\$8	\$8	No data	105,000
NRL	84	5	4	0			248,000
NAVSEA Dahlgren	17	0	0	0	0	0	33,000
NAVSEA Newport	26	4	1	1	1		68,000
AcqDemo	No data	8	10	9	20	\$19	458,000

Source: GAO analysis of DOC and DOD data

Cost figures for Dahlgren and Newport are estimates

Notes: The cost per demonstration project employee is based on the number of employees in the demonstration

project at the same time each year, not the actual number of employees trained on the demonstration project.

Data are as reported by the demonstration projects without verification by GAO.

Shaded squares indicate that the demonstration project has not yet reached those years.

#### Automation and Data Systems Costs

Inflation-Adjusted Cost of Automation and Data Systems for Selected Demonstration Projects (in 2002 Dollars), as Reported by the Demonstration Projects			
Dollars in thousands			
Demo Project	Prior to Implementation	Cumulative Cost since Implementation	Total
China Lake <sup>a</sup>	No data	No Data	No Data
NIST	0	0	0
DOC	0	\$2,317	\$2,317
NRL	\$1,467	\$2,166	\$3,633
NAVSEA Dahlgren	\$125	0	\$125
NAVSEA Newport	\$333	\$463	\$796
AcqDemo	0	\$4,871	\$4,871

Source: GAO analysis of DOC and DOD data

<sup>a</sup>Automation systems were not widely used when the China Lake demonstration project was implemented in 1980.

Cost figures are estimates

Notes: Data are as reported by the demonstration projects without verification by GAO.

Costs may not sum to totals due to rounding.

## Additional Cost Data

## GAO Competency-based Performance Management and Performance-based Compensation Costs

Fiscal Year	Expenditures/Obligations
2001	\$593,299
2002	\$376,043
2003	\$232,400
2004	\$159,594
2005	\$142,500

## GAO expenditures for employee learning:

Fiscal Year	Expenditures/Obligations
2004	\$665,482
2005	\$425,000

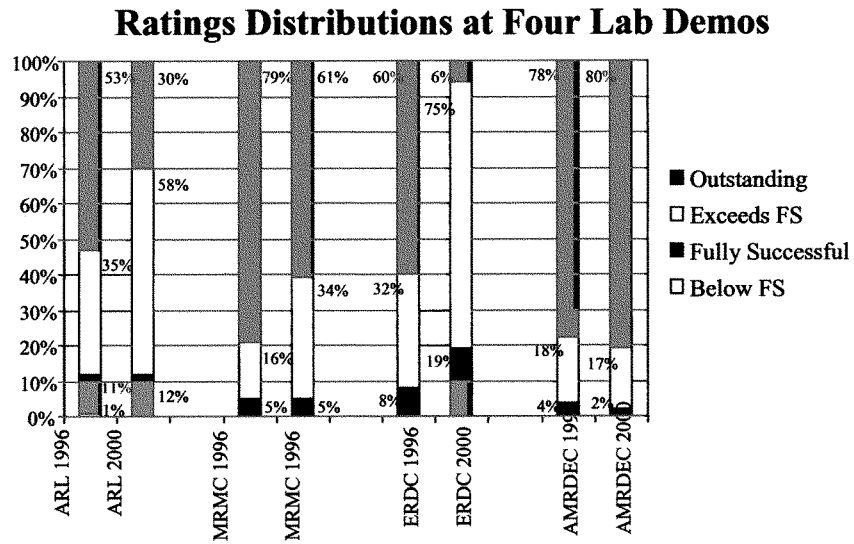
## Department of Commerce Summary of Demonstration Project Costs

Time Frame	Implementation Costs	Evaluation Costs	Operating Costs <sup>^</sup>	Total Costs
Pre-Implementation	\$1,392,025*	\$44,177	\$30,000	\$1,466,202
Demo Year One	\$435,094	\$266,468	\$14,000	\$715,562
Demo Year Two	\$755,500	\$76,441	\$14,050	\$845,991
Demo Year Three	\$336,745	\$276,930	\$22,750	\$636,425
Demo Year Four	\$287,962	\$84,075	\$20,050	\$392,087
Demo Year Five	\$412,000	\$264,827	\$0	\$676,827
Total	\$3,619,326	\$1,012,918	\$100,850	\$4,733,094

\* Includes \$1,388,025 for Within Grade Increase (WGI) buyout.

<sup>^</sup> Operating Costs include training costs but not staff time to train.

When comparing the before (1996) and after (2000) demonstration project implementation rating distributions, there was generally more spread after implementation of pay-for-performance. The following chart illustrates changes in ratings distributions over time for four Lab Demo sites:



**Senate Hearing  
Committee on Governmental Affairs  
Subcommittee on Oversight of Government Management  
Alternative Personnel Systems: Assessing Progress in the Federal Government  
September 27, 2005**

**Post-Hearing Questions from Senator Daniel K. Akaka to Dan Blair**

**Responses from Dan Blair, Deputy Director, Office of Personnel Management**

**Question 1:** With the exception of the Department of Agriculture's use of category ratings, which reportedly has a positive impact on hiring veterans, what impact have demonstration projects had on veterans, including their preference in hiring, their placement in reductions-in-force, and their success in a pay-for-performance system? What impact have alternative personnel systems had on recruiting and retaining minorities and women?

**OPM Response:**

In addition to the positive impact on hiring veterans, categorical grouping of applicants at the Department of Agriculture was also shown to have no adverse impact on minorities or women. All Government agencies now have the authority to use categorical grouping of applicants as an alternative way to assess job applicants for positions filled through competitive examining (5 U.S.C., 3319).

From additional personnel management demonstration projects, we see no evidence of adverse impact on veterans, minorities and women in terms of pay progression (DOD Laboratory Demonstration Projects). Reductions in force (RIFs) were too small in most cases (National Institute of Standards and Technology, Lab Demo Projects) to yield statistics to analyze impact on these groups. Due to downsizing, hiring was too limited during the evaluation period for the Lab Demo Projects to yield reliable statistics on hiring for any of these groups. Similar to the experience at the Department of Agriculture, more veterans were hired under Categorical grouping in the Lab Demo Projects than under traditional hiring rules.

**Question 2:** General Walker's testimony touches on the impact that pay-for-performance could have on employees' retirement. For example, awarding a one-time cash bonus instead of a permanent salary increase will affect an employee's retirement annuity. Does OPM support legislative action to allow employees in alternative personnel systems to count one-time cash bonuses as base pay for calculating an employee's high-three for retirement purposes and for making contributions into their Thrift Savings Plan accounts?

**OPM Response:**

We do not object to permitting employees to deposit one-time cash bonuses in their Thrift Savings Plan (TSP) accounts, subject to the limit on overall contributions under the Internal Revenue Code.

However, we would not support legislation to allow employees to count cash bonuses as base pay for retirement purposes. Retirement annuities are intended to replace a proportion of an

individual's income which is consistently earned over the course of a career. For that reason, the statutory definition of basic pay generally "does not include bonuses, allowances, overtime pay, military pay, or pay given in addition to the base pay of the position as fixed by law or regulation."

However, making a one-time award for retirement could create a windfall for some employees, and unfairly penalize other employees by effectively reducing the amount of their award. It would create a three-year period during which the individual's average salary could be artificially increased. Should the individual retire during that window, it would result in a lifetime increase in annuity payments. The present value of the annuity increase would vary greatly depending upon the individual's particular circumstances, but could go as high as slightly more than four times the amount of the award. On the other hand, an employee who is not retirement-eligible or who does not wish to retire would have to pay retirement contributions on the one-time bonus for which no benefit would ever be received.

**Question 3:** According to General Walker's testimony, organizations use metrics as an indicator of employees' acceptance of pay and performance management decisions to track the effectiveness of their pay systems. For example, IBM tracks its attrition rates to determine why employees are leaving and compares them to its competitors' attrition rates. Do agencies participating in demonstration projects track why employees leave?

**OPM Response:**

The demonstration projects tracked a variety of information related to turnover. The results of this tracking indicate that the projects had a direct impact on the reasons employees leave and the turnover rate. The results cluster into three areas.

1. Pay-for-performance systems tend to decrease turnover in high-performing employees and increase it in low performing employees. This finding is supported by evaluations of demonstration projects at DOD Lab Demos, DOD Acquisition Demonstration Project and the Navy Demonstration Project at China Lake, which compared the performance and/or criticality of the employees who had left with those who remained. These results indicate a clear positive link between an individual's performance/criticality and their likelihood of staying. For example, in the AcqDemo project the loss rate for the lowest contributors was 26.4 percent while the loss rate for the highest contributors was 9.2 percent.
2. The areas targeted by a demonstration project (e.g., pay satisfaction) are cited with decreasing frequency over the project's lifetime as reasons for leaving. Toward the end of the project the reasons for leaving were frequently individual in nature (e.g., "difficulty in keeping up with new technology.") and were not related to areas targeted by the project. With the improvements in the areas targeted (as evidenced by being cited less frequently as reasons to leave) support for the demonstration projects increases significantly over their lifetime. For example, support for the NIST project increased from 47 percent in the baseline year to 70 percent in the final year of the project.
3. The demonstration projects have strengthened both the actual and perceived link between pay and performance (DOD Lab Demo and NIST regression analyses show an increasing impact of performance on pay over time; surveys show increasing perception of link between performance and pay.) Surveys also show increasing support for pay-for-

performance systems over time. Other metrics tracked include “trust in supervisor” since employee pay is linked to supervisory ratings. Trust has also been tracked under several of the pay-for-performance systems (DOD Lab Demo, NIST) and has been found to increase over time.

**Question 4:** One question raised by moving to a pay-for-performance system is whether giving managers more authority over pay decisions provides less incentive for employees to raise tough questions, provide critical analysis, and give candid advice. Have there been any studies addressing this issue in agencies with pay-for-performance systems?

**OPM Response:**

While the specific question about raising tough questions was not asked in the demonstration projects, questions related to employee/supervisor communication and trust were asked. These areas are directly related as changes in communication and trust are strong indications of employees’ willingness to raise tough questions. Some specific examples include:

DOD Lab Demos: Supervisory communication increased in all but one of the labs and was correlated with demonstration project support, perceptions of fairness and trust, and organizational commitment.

NIST: Findings from the 1991 employee survey indicated that the vast majority of employees (77%) agreed there was mutual trust between them and their supervisors. This level had increased since the baseline measure conducted in 1987.

Navy - China Lake: The demonstration laboratories’ objectives-based performance appraisal system was found to be more satisfactory to employees and supervisors. Both groups cited improved communication, more objective focus, and clearer performance expectations.

Commerce: There were few differences found in perceptions of the work environment between demonstration group and comparison group participants. The two groups responded similarly on questions that pertained to supervisor trust, job satisfaction, person-job fit, attraction of high quality candidates, and fairness in job competition.

**Question 5:** Are there any alternative personnel systems that have a pay-for-performance system that impact an employee’s non-foreign COLA, and if so, please list those systems and describe how non-foreign COLA is affected?

**OPM Response:**

We are not aware of any alternative personnel systems that impact non-foreign COLAs.

**Question 6:** Are there any alternative personnel systems that have a pay-for-performance system that affect employees paid under the federal wage system, and if so, please list them and describe how they work?

**OPM Response:**

No. Pacer Share is the one alternative personnel system that affected Federal Wage System (blue-collar) employees; however, it was not a pay-for-performance system. Pacer Share was allowed to sunset after 5 years.

**Question 7:** Robert Behn, author and lecturer at Harvard University's John F. Kennedy School of Government, said, "Systems don't improve performance; leaders do." National Treasury Employees Union (NTEU) President Colleen Kelley testified in reference to this quote that "I believe that leadership that solicits, values and acts on the ideas of frontline employees in efforts to achieve agency missions is missing in many agencies today and I believe that providing that kind of leadership would do more to improve the quality of applicants and performance of employees than any of the alternative personnel systems we will discuss at this hearing." How do you respond to Ms. Kelley's comment? What programs are in place to develop this type of leadership in the federal government?

**OPM Response:**

Employee engagement, employee respect, and productive communications are essential to effective leadership and results driven organizations. OPM's developmental and leadership programs are built around this leadership model. We offer a variety of interagency development programs which stress leadership responsibility and accountability. Additionally, as part of the leadership development continuum, OPM has created programs such as the Presidential Management Fellows Program and the Federal Candidate Development Program to develop the competencies of future Federal leaders.

Another critical component of the leadership development pipeline are agencies' own Senior Executive Service Candidate Development Programs (CDPs). A recent review of agency candidate development programs revealed that all CDPs incorporate ethics, integrity, interpersonal relationships, and team building into their curriculum; several agencies specifically identify the additional element of empowerment within these dimensions; and one agency incorporates relationship-based leadership training in developing its own candidates.

Another critical area for us is developing an employee workforce focused on results. Through our e-Learning initiatives, we bring to the desktop opportunities for employees to understand their vital role in meeting our commitment to excellence in customer service, to understand their constitutional roles, and we provide necessary tools and resources to produce outstanding organizational results.

**Question 8:** How many alternative personnel systems allow for collective bargaining over pay? What has been the success of those systems? Is collective bargaining an impediment to those systems?

**OPM Response:**

No collective bargaining units have negotiated over pay at any of the demonstration projects. Alternative personnel systems under separate legislation, such as FAA, have sometimes allowed bargaining over pay.

The agencies involved in collective bargaining over pay are in the best position to identify any impediments to their alternative personnel systems that result from such bargaining. Permitting collective bargaining over pay could result in significant and inappropriate variations in pay between employees within a given agency based solely on the status of some bargaining unit employees.

**Question 9:** In the alternative pay systems that OPM deems to be successful regarding pay-for-performance, which systems were able to use more money for the pay system than currently provided by conversion of the general schedule system of step and within-grade increases, the average annual pay increase, and locality pay? How much additional money did those systems put into their pay systems?

**OPM Response:**

Generally, organizational units participating in demonstration projects remained budget neutral with regard to funding of pay systems. According to the summative evaluation of NIST, "NIST has remained budget neutral under its own spending guidelines." At the Department of Commerce, participating units must operate the pay-for-performance system within operating budgets. Bonuses and pay increases are limited by historical three-year pay studies to ensure costs are maintained generally at the same level as the GS.

Although demonstration projects have not received additional funding for their pay-for-performance systems, average pay increased under these demonstration projects over time, as low performers leave. These increases were absorbed in their annual budgets. Overall, the percentage of demonstration projects' payroll budgets used for pay increases and bonuses was similar to that of the GS system.

**Question 10:** NTEU President Kelley testified that problems with the personnel system at the Department of Homeland Security (DHS) as currently written include: 1) the system is not set by statute or subject to collective bargaining as the FDIC's system is, so there is nothing to provide it credibility among employees; 2) the system will have employees competing against each other over small amounts of money, discouraging teamwork, which is critically important in law enforcement; 3) the system is subjective, which will lead to at least the appearance of favoritism, which destroys *esprit de corps*; 4) the system is enormously complex with a virtually limitless number of pay differentials, the administration of which will require huge amounts of money that is so much more desperately needed in frontline functions, not to mention siphoning off money that could go for more pay in a less administratively burdensome system; 5) the consultant prepared draft competencies for the new DHS system do not recognize or reward the real work that these employees do to keep our country safe. How do you respond to these criticisms?

**OPM Response:**

We disagree with the conclusions expressed by NTEU.

(1) The DHS pay system is based on common-sense principles (e.g., the need for performance and labor market sensitivity) that most employees understand. In fact, experience with demonstration projects has shown that employees gain confidence in performance-based pay systems over time.



(2) A performance-based pay system can support teamwork through appraisals that take team-supportive behaviors into account.

(3) Supervisors will be assessed on how well they evaluate their employees; any evidence of favoritism based on non-work-related factors, in addition to violating merit system principles, will be reflected in their performance appraisals.

(4) The new DHS HR system is designed to provide the Department with more flexibility. The current, one-size-fits-all pay system may be simple, but it is also ineffective and wasteful.

(5) The “competencies” to be used in the DHS system are still under development. Employee representatives will have an opportunity to provide input to DHS on these and other features of the DHS system as part of the “continuing collaboration” process outlined in the final regulations.

**Question 11:** What is OPM doing to assist agencies with building the infrastructure to support pay-for-performance?

**OPM Response:**

OPM believes the foundation for a Governmentwide infrastructure for pay-for-performance is firmly in place. Through demonstration projects and alternative personnel systems, 90,000 Federal employees are already covered by such systems. With the implementation of DOD’s National Security Personnel System, and DHS’ MaxHR, that number will rise to over 1,000,000 employees, which represents over half of the Federal workforce. Moreover, Federal senior executives are now evaluated and compensated through performance-based pay systems. In 2004, OPM certified 34 such Senior Executive Service (or equivalent) systems in 32 agencies, and to date, a total of 35 such systems in 30 agencies have been certified for 2005.

Additionally, through the President’s Management Agenda and its supporting initiative, Proud-To-Be, agencies are moving to close skill gaps and to ensure potential future supervisors, managers and executives are available and prepared to manage in a performance-based environment. They have already made significant progress in these areas.

Finally, under the PMA, agencies are upgrading their performance management systems to ensure their systems support performance management based on results. Each agency has been asked to designate a beta site where there is demonstrable evidence all the criteria listed above have been met. Each agency must also demonstrate they are working to include all agency employees under such systems. OPM will evaluate the agencies’ assessments and provide a Governmentwide evaluation of agency readiness for implementing performance-based pay systems, and will lead appropriate efforts to improve agency performance management systems where necessary.



Comptroller General  
of the United States

December 1, 2005

The Honorable George V. Voinovich  
Chairman  
The Honorable Daniel K. Akaka  
Ranking Member  
Subcommittee on Oversight of Government Management,  
the Federal Workforce, and the District of Columbia  
Committee on Homeland Security and Governmental Affairs  
United States Senate

Subject: *Posthearing Questions Related to Alternative Personnel Systems*

Dear Chairman Voinovich and Senator Akaka:

On September 27, I testified before your subcommittee at a hearing entitled "Alternative Personnel Systems: Assessing Progress in the Federal Government."<sup>1</sup> During my testimony, I offered to provide for the record the expenditures for the development and implementation of GAO's competency-based performance management and performance-based compensation systems. In addition, I am providing the resources GAO allocated for the employee training curriculum (see enc. I). GAO's investments to develop and continuously improve these systems were critical to our implementation of these systems. Further, these costs were one time in nature and we did not need to build them into the base of our budget. GAO employees' time spent developing, delivering, or attending training on the systems are not reflected in the expenditures.

This letter also responds to your request that I provide answers to follow-up questions from the hearing. The questions, along with my responses, follow.

**1. Comptroller General Walker, your testimony lays out best practices for designing a pay for performance system, including building consensus to gain ownership and acceptance for pay reforms. How would you rate the efforts of the Department of Homeland Security (DHS) and the Department of Defense (DOD) to gain consensus of their employees for their new personnel systems?**

<sup>1</sup>GAO, *Human Capital: Designing and Managing Market-Based and More Performance-Oriented Pay Systems*, GAO-05-1048T (Washington, D.C.: Sept. 27, 2005).

As you have noted, high-performing organizations have found that actively involving employees and key stakeholders helps gain ownership of the pay for performance system and improves employees' confidence and belief in the fairness of the system. While we have not recently assessed DHS's progress in involving employees in the implementation of its new human capital system, we reported in September 2003 that DHS's effort to design the system was collaborative and facilitated participation of employees from all levels of the department.<sup>2</sup> DHS provided employees multiple opportunities to be included in the design process, including participation in the design team, the town hall meetings, the focus groups, and an e-mail mailbox for employee comments. In addition, DHS developed a communication plan that provides a structured and planned approach to communicate with DHS stakeholders regarding the human capital system. Subsequently, we found that DHS's final regulations to implement its new human capital system recognize the importance of involving employees and union officials throughout the implementation process, including participating in the development of the implementing directives and holding membership on the Homeland Security Compensation Committee.<sup>3</sup> The final regulations also provide that DHS is to involve employees in evaluations of the human capital system.

On the other hand, we recently reported that DOD faces a significant challenge in involving its employees, employee representatives, and other stakeholders in implementing the National Security Personnel System (NSPS).<sup>4</sup> In the design process for NSPS, DOD involved employees through many mechanisms, including focus groups, town hall meetings, an NSPS Web site for employee comments, and meetings with employee representatives, but it did not include employee representatives on the working groups that drafted the design options. The working groups covered program areas, such as compensation (classification and pay banding), performance management, employee engagement, and labor relations. The composition of these working groups is important because it helps employees see that they are being represented and that their views are being considered in the decision-making process. Subsequently, we found that DOD's final regulations to implement NSPS provide for the involvement of employee representatives throughout the implementation process, such as having opportunities to participate in developing the implementing issuances that will outline detailed policies and procedures for the new system.<sup>5</sup> In addition, designated employee representatives will have an opportunity to be briefed and to comment on the design and results of NSPS's implementation. However, the final regulations do not identify a process for the continuing involvement of individual employees in the implementation of NSPS. In this regard, it is my understanding that approximately 40 percent of civilian employees within DOD are not represented by a union. These employees also need to be involved in the design, implementation, and evaluation process of NSPS as well.

<sup>2</sup>GAO, *Human Capital: DHS Personnel System Design Effort Provides for Collaboration and Employee Participation*, GAO-03-1099 (Washington, D.C.: Sept. 30, 2003).

<sup>3</sup>GAO, *Human Capital: Observations on Final DHS Human Capital Regulations*, GAO-05-391T (Washington, D.C.: Mar. 2, 2005).

<sup>4</sup>GAO, *Human Capital: DOD's National Security Personnel System Faces Implementation Challenges*, GAO-05-730 (Washington, D.C.: July 14, 2005).

<sup>5</sup>GAO, *Human Capital: Observations on Final Regulations for DOD's National Security Personnel System*, GAO-06-227T (Washington, D.C.: Nov. 17, 2005).

**2. Employees at GAO have no guarantee of a pay increase as a result of the change to pay-for-performance at GAO, even if an employee meets performance expectations. How are employees at GAO reacting to this change?**

Let me reiterate that GAO employees who perform at a satisfactory level during the year (e.g., “meets expectations” or higher in all applicable competencies) and are paid within applicable competitive compensation ranges can expect to receive, at a minimum, some pay adjustment designed to recognize changes in market-based pay ranges, absent extraordinary economic conditions or serious budgetary constraints. In addition, these employees will be eligible for additional performance-based merit pay increases, performance bonuses, and incentive awards. In 2005, during the transition period to this new pay system, employees who performed at this satisfactory level received the equivalent of the across the board base pay increase and locality pay provided to the executive branch.

It is important to note that, even in the best of circumstances, it is difficult to garner a broad-based consensus of employee support for any major pay system changes. We did not take a vote on whether we were going to move to more performance-oriented and market-based pay and there were differences of opinion among employees. It is my impression based on employee feedback that we have made significant strides in allaying the significant initial concerns expressed by employees. We were able to do so through extensive employee involvement and active and ongoing communication efforts. However, I believe that some employees will continue to have concerns. It is necessary to make the case for change from the top, have consistent communication, and involve all employees throughout the process. We involve employees through informal focus groups, task teams, town hall meetings, and issuing proposed regulations for employee comment before final decisions are made. This involvement needs to be meaningful, and not pro forma. In this regard, all constructive employee comments should be considered and acted on, as appropriate. While there are going to be employees who do not agree with the decision, they should not be able to argue about the integrity of the process.

**3. Many argue that the current General Schedule pay system is “broken.” However, I believe the current system has not been used as intended because of a lack of funding and the unease of managers in making distinctions in performance. Given the continuing budget deficit, how can we ensure that any new pay system does not suffer from the same problems?**

I believe that the current General Schedule system is broken for a number of reasons. For example, approximately 85 percent of annual pay increases under the General Schedule system are tenure based. Furthermore, as you observed, the federal government must address a long-term, structural fiscal imbalance.<sup>6</sup> Our nation is on an imprudent and unsustainable fiscal path driven by known demographic trends and rising health care costs, and relatively low revenues as a percentage of the economy. Unless we take effective and timely action, we will face large and growing structural deficit shortfalls, eroding our ability to address current and emerging national needs.

<sup>6</sup>GAO, *21<sup>st</sup> Century Challenges: Reexamining the Base of the Federal Government*, GAO-05-325SP (Washington, D.C.: February 2005).

Further, the federal government has not transformed, in many cases, how it recruits, motivates, develops, and compensates its employees to achieve maximum results within available resources and existing authorities. A key question to consider is how the federal government can make an increasing percentage of employee compensation dependent on achieving individual and organizational results.

Among the criteria that agencies should have in place as they plan for and manage their new human capital reforms is adequate resources for planning, implementation, training, and evaluation.<sup>7</sup> If people are the government's most important asset—and I certainly believe they are—we must be willing to make the investments needed in their recruitment, development, support, and retention. Providing more compensation as one-time bonuses rather than as permanent salary increases 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. For example, we found that some of the Office of Personnel Management's (OPM) demonstration projects intended to manage salary costs by providing a mix of one-time awards and permanent pay increases.<sup>8</sup>

**4. You testified that organizations must base pay increases on an employee's contribution to an organization's mission and goals. How is contribution measured, and would you please provide an example?**

Many high-performing organizations use validated core competencies as a key part of evaluating individual contributions to organizational results. Competencies define the skills and supporting behaviors that individuals are expected to demonstrate and can provide a fuller picture of an individual's performance. Organizations can take different approaches to evaluating employee performance. For example, at GAO, we use a set of validated core competencies as part of our performance management system for all employees with specific performance standards for each competency describing the behaviors required. At the end of the appraisal cycle, employees receive a performance rating—"below expectations," "meets expectations," "exceeds expectations," or "role model"—for each competency that translates into an overall performance appraisal average. To help ensure consistency in employee ratings within and across GAO's teams, we recently implemented standardized ratings scores (SRS) that indicate the employee's position relative to the average rating of that employee's team. Employees in different teams with the same SRS have the same relative performance and if they are paid within applicable competitive compensation ranges, they receive the same percentage of performance-based compensation. Employees' SRS and the midpoint for their pay range are key factors in calculating their performance-based compensation for that year.

On the other hand, we reported that at the Navy Demonstration Project at China Lake, employees and their supervisors are to develop individual performance plans that include competencies tailored to the individual's responsibilities and expected

<sup>7</sup>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).

<sup>8</sup>GAO, *Human Capital: Implementing Pay for Performance at Selected Personnel Demonstration Projects*, GAO-04-83 (Washington, D.C.: Jan. 23, 2004).

results.<sup>9</sup> Employees are rated in one of three assessment categories—“less than fully successful,” “fully successful,” and “highly successful”—and supervisors recommend numerical ratings, based on employees’ performance and their salaries, among other factors. The numerical rating determines how many “increments” the employee will receive. An increment is a permanent pay increase of about 1.5 percent of an employee’s base salary. For example, employees that receive a rating of less than fully successful and a numerical rating of “5” receive zero increments and no annual across the board increase. In comparison, employees that receive a rating of highly successful and a numerical rating of “1” receive three or four increments plus the annual across the board increase.

**5. In granting DOD and DHS flexibility with how employees are paid, Congress required both to have safeguards in place to ensure fairness, as recommended by GAO. Would you please elaborate on the safeguards that are needed to ensure fairness in any pay-for-performance system?**

Agencies need to have modern, effective, credible, and, as appropriate, validated performance management systems in place with adequate safeguards to ensure fairness and prevent politicization and abuse. DOD and DHS, like all agencies, will need to constantly and fully assure that the management of their pay for performance systems are fair and equitable and based on employee performance. 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 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. We believe that the following safeguards could guide agencies as they develop and implement their systems:

- 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.
- 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.
- 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, as well as reviews of performance rating decisions, pay determinations, and promotion actions by human capital offices and offices of opportunity and inclusiveness or their equivalent before they are finalized to ensure that they are merit-based; internal grievance processes to address employee complaints; and pay panels whose membership predominately consists of career officials who would consider the results of the performance appraisal process and other information in connection with final pay decisions).
- Assure reasonable transparency and appropriate accountability mechanisms in connection with the results of the performance management process (e.g., publish overall results of performance management and pay decisions while protecting

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<sup>9</sup>GAO-04-83.

individual confidentiality, and report periodically on internal assessments and employee survey results).

**6. Are automation and new data systems required to successfully implement a pay-for-performance system, and if so, how much should agencies expect to spend on such systems?**

The direct costs associated with automation and data systems was a major cost driver for OPM's personnel demonstration projects in implementing their pay for performance systems.<sup>10</sup> To manage data system costs, we reported that some demonstration projects modified existing data systems rather than designing completely new systems to meet their information needs. For example, the Naval Sea Systems Command Warfare Center's divisions modified DOD's existing Defense Civilian Personnel Data System to meet their needs for a revised performance appraisal system. Similarly, the Department of Commerce imported the performance appraisal system developed by the National Institute of Standards and Technology and converted the payout system to a web-based system. The exact costs any given agency will incur are determined by its needs, size, and current capacities.

**7. GAO has worked on its compensation system for 13 years, and according to the testimony submitted at the hearing, the alternative personnel system at the Federal Deposit Insurance Corporation is constantly changing. How much lead time do you believe is needed to ensure implementation of a governmentwide pay-for-performance system?**

The lead time for an agency's implementation of more market-based and performance-oriented pay depends on how long it would take to build the necessary infrastructure to help ensure the pay reform's effective and credible implementation. As I recently testified on the administration's draft proposal for governmentwide pay for performance, a condition-based approach should be required before agencies can begin implementing pay reforms.<sup>11</sup> Specifically, 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. OPM should also independently certify that such infrastructure meets specified statutory standards before the agency could implement such reforms. 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, credible, and nondiscriminatory implementation of the system.

<sup>10</sup>GAO-04-83.

<sup>11</sup>GAO, *Human Capital: Preliminary Observations on the Administration's Draft Proposed "Working for America Act,"* GAO-06-142T (Washington, D.C.: Oct. 5, 2005).

Even after implementing their pay for performance systems, high-performing organizations continuously review and revise their systems based on data-driven lessons learned and changing needs in the environment.<sup>12</sup> At a recent symposium on designing and managing market-based and more performance-oriented pay systems, organizations said they monitored their pay systems by listening to employees' and stakeholders' views—informally and formally—on the pay systems and using metrics, such as employee grievance rates, to track the effectiveness of the pay systems over time.<sup>13</sup> Still, while the need for refining pay systems is inevitable, especially when new initiatives are introduced, the organizations found that there is value in stabilizing their pay systems for a period of time to let employees get accustomed to the new initiative and see how it works.

**8. At GAO, are performance expectations communicated to employees orally or in writing? If oral, how do you hold employees accountable for those performance expectations?**

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. At GAO, we have a set of validated core competencies with detailed performance standards that are documented in writing. The performance standards for each competency describe the behaviors required to merit a rating of "meets expectations" or "role model."

Supervisors are to refer to these competencies and standards when setting performance expectations for each of their staff members, and employees are responsible for seeking any clarification. In addition, each employee is to be provided specific information on his or her role and the engagement's objective, scope and method, anticipated product, and time frame, and is responsible for seeking clarification for any of these matters. The level of detail appropriate for an expectation-setting discussion will depend on the employee's prior knowledge related to the work and his or her experience level, as well as the nature and timing of the engagement. Initial expectations are to be amplified and clarified as needed. Supplemental written expectations are encouraged but not required, and the date the expectations were set and communicated to the employee is recorded. Likewise, at least at the midpoint and end of a rating year, supervisors are to provide employees feedback on how well they are meeting the expectations, performance standards, and competencies. This feedback is especially important for employees who are not performing at a "meets expectations" level or better. In addition, supervisors are encouraged to provide such feedback throughout the year. This communication further provides for transparency and clarity.

For additional information on our work on strategic human capital management, please contact me at 512-5500 or J. Christopher Mihm, Managing Director, Strategic Issues, at 512-6806 or mihmj@gao.gov.



David M. Walker  
Comptroller General  
of the United States

<sup>12</sup>GAO-05-69SP.

<sup>13</sup>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).



## Enclosure I

**GAO Expenditures for the Competency-Based Performance Management and Performance-Based Compensation Systems**

A sound implementation plan and involvement of GAO's management team, Employee Advisory Council, and employees were the keys to rolling out GAO's new appraisal and performance-based compensation systems. GAO used Personnel Decision Research Institutes, Inc. (PDRI) to help develop its competency-based appraisal and promotion system for its analysts, specialists, attorneys, and administrative professional and support staff. Specifically, PDRI worked with GAO's management team to determine the technical, practical, and cultural challenges associated with the implementation of a new performance management system and develop migration strategies to address these challenges, as well as develop and revise the appraisal competencies, appraisal standards, initial performance management training, and conduct train-the-trainer systems.

Upon implementation of the new competency-based performance management system, GAO initiated an effort to improve its current process for making pay for performance decisions for analysts and specialists within the context of a total compensation approach that considered both fixed and variable components. GAO contracted with Watson Wyatt Worldwide for assistance in assessing the strengths and weaknesses of three performance-based compensation proposals developed by a GAO project team. On the basis of their assessment and knowledge of best practices in the private sector, they recommended performance-based compensation options, one of which was implemented this year.

The expenditures by fiscal year for the development and implementation of GAO's competency-based performance management and performance-based compensation systems follow.

<b>Fiscal Year</b>	<b>Description of Key Tasks</b>	<b>Expenditures</b>
2001	<u>For analysts and specialists</u> <ul style="list-style-type: none"> <li>Developed the initial design for competency-based performance appraisal, pay, and promotion system.</li> <li>Developed and delivered appraisal system overview briefings.</li> </ul> <u>For attorneys</u> <ul style="list-style-type: none"> <li>Began work to develop initial design for competency-based performance appraisal systems.</li> </ul>	\$593,299
2002	<u>For analysts and specialists</u> <ul style="list-style-type: none"> <li>Conducted training sessions.</li> <li>Redesigned and revised training materials.</li> <li>Adjusted performance standards for specialist staff.</li> <li>Developed a system evaluation plan.</li> </ul>	\$376,043

## Enclosure I

	<u>For mission support staff</u> <ul style="list-style-type: none"> <li>Developed a position management workshop, base resource requirements, grade clusters, and customized competencies.</li> </ul>	
2003	<u>For analysts and specialists</u> <ul style="list-style-type: none"> <li>Developed targeted workshops on applying appraisal standards for staff, designated performance managers, and managing directors.</li> <li>Combined and streamlined the analyst and specialist performance standards.</li> <li>Rewrote and revalidated performance standards.</li> </ul> <u>For mission support staff</u> <ul style="list-style-type: none"> <li>Developed additional competency models, and appraisal standards for all mission support job families.</li> </ul>	\$232,400
2004	<u>For analysts and specialists</u> <ul style="list-style-type: none"> <li>Provided advice, guidance, and support to develop a team human capital management strategy and a foundation for human capital management processes within a team.</li> </ul> <u>For attorneys</u> <ul style="list-style-type: none"> <li>Revised and validated performance standards.</li> </ul> <u>For analysts, specialists, and attorneys</u> <ul style="list-style-type: none"> <li>Provided assistance in developing a performance-based compensation system.</li> </ul>	\$159,594
2005	<u>For mission support staff</u> <ul style="list-style-type: none"> <li>Identified, developed, and conducted training on understanding and applying appraisal standards.</li> <li>Planned and conducted training for the managing directors and designated performance managers on (1) understanding and applying the appraisal standards and (2) learning about self-assessments and writing achievement statements.</li> </ul> <u>For attorneys</u> <ul style="list-style-type: none"> <li>Revised and validated competencies and performance standards.</li> </ul> <u>For analysts, specialists, and attorneys</u> <ul style="list-style-type: none"> <li>Developed market-based pay ranges for the performance-based compensation system.</li> </ul>	\$423,881
<b>Total</b>		<b>\$1,785,217</b>

Enclosure I

**GAO Expenditures for Employee Learning**

GAO's Learning Center did a comprehensive assessment of employees' learning and developmental needs, which resulted in the development of a competency-based learning curriculum and several approaches to deliver these learning opportunities. Our Learning Center expenditures to develop the curriculum and design the courses by fiscal year follow.

<b>Fiscal Year</b>	<b>Description of Key Tasks</b>	<b>Expenditures</b>
2004	Strategic curriculum development services	\$607,000
	Learning design services	\$58,482
2005	Strategic curriculum development services	\$400,000

On occasion, it is more cost-effective for staff to attend training conferences offered by other training sponsors to meet developmental needs or develop/enhance their skills/technical knowledge. Further, government auditing standards require that GAO employees who work on an engagement earn 80 continuing professional education credits every two years, of which at least 24 must be government-related and a minimum of 20 earned each year. In fiscal years 2004 and 2005, GAO spent \$1,298,255 and \$1,725,483 respectively for external training.

(450453)

Senator Daniel K. Akaka  
Alternative Personnel Systems:  
Assessing Progress in the Federal Government  
Oversight of Government Management Subcommittee  
September 27, 2005

Questions for Mr. Jeffery Nulf, Deputy Assistant Secretary for Administration,  
Department of Commerce

1. The 2003 Booz Allen Hamilton report on the fourth year of the Commerce demonstration project said that the proportion of new veteran hires was lower for the demonstration project group of employees as compared to the general employment population at the Department of Commerce. To what do you attribute this adverse impact on veterans, and what have you done to address it?

Answer: The 2003 Demonstration Project Evaluation Report prepared by Booz Allen Hamilton to which you refer is a summative report that covers the demonstration project as a whole. It studied veteran employment in terms of veterans hired into the demonstration project and veteran representation in the demonstration project population. Looking at the demonstration project as a whole, the report states, "across all five years of the demonstration project, objective and subjective data indicate that the demonstration project has not had a negative impact based on race, gender or veteran status." Specifically, veteran representation among new hires under the demonstration project was slightly higher than in the demonstration population as a whole in Years 2 and 3, and slightly lower in Years 3 and 4.

When considering veteran hiring, it is also helpful to compare the rate at which veterans were recruited under the demonstration project to the rate across government. For Years 2 through 5, the demonstration project was on par with or significantly outpaced the government as a whole with one exception. During Year 4, veterans represented 8 percent of all demonstration project hires compared with 9.2 percent across government. Years 3, 4, and 5 indicate that the demonstration veterans' population was at par with the Commerce veterans' population.

Demonstration Project Period	Veterans Hired in Demo Project	Total Veterans in Demo Project	Total Veterans in Commerce (OPM Statistics) <sup>1</sup>		Veterans Hired Government wide (OPM Statistics) <sup>2</sup>	
Year 2 (04/99 – 03/00)	12%	9%	(9/30/99)	14.1%	(FY00)	9.5%
Year 3 (04/00 – 03/01)	16%	15%	(9/30/00)	14%	(FY01)	10.1%
Year 4 (04/01 – 03/02)	8%	13%	(9/30/01)	13.6%	(FY02)	9.2%
Year 5 (04/02 – 03/03)	11%	13%	(9/30/02)	13%	(FY03)	11.2%

Demo Data Source: First two columns of data from Booz Allen reports

<sup>1</sup> This column of OPM statistics is compiled for the specific date indicated.

<sup>2</sup> As noted, this column of OPM statistics is compiled for fiscal years, which differ from the twelve-month year used for the demonstration project.

As recommended in the report, we are continuing to monitor hiring and retention of veterans as part of our annual evaluation to ensure that employment for this group is not adversely impacted under the demonstration.

2. The same report also noted that on average demonstration project employee participants received larger salary increases than other employees. Given the increase in pay, how was the project funded and how much did it cost?

Answer: The demonstration project is funded within normal operating budget parameters. The pool of money available for performance bonuses and pay level adjustments does not change as a result of implementing the demonstration project. Funds are simply distributed differently, i.e., they are used to recognize high performers, not to reward longevity. Budget discipline is ensured by limiting the amount available for salary increases and bonuses to historical spending for a three-year period under the General Schedule.

In addition to those costs associated with pay level adjustments and performance bonuses, there are administrative – or overhead – costs. For the first five years of the Commerce demonstration project, these costs totaled nearly \$5 million and included start-up costs related to early implementation. For example, 29 percent of this amount involved one-time lump sum payments to employees associated with the time they had served toward the next step increase they would have received under the General Schedule. Over the span of five years, Commerce has also expended approximately \$1 million on annual evaluations required by statute (5 U.S.C. 47) and in compliance with OPM regulations. Other significant overhead costs include development and maintenance of the information technology systems needed to support the demonstration project.

3. The 2003 report also noted that performance scores for new hires in the demonstration group were lower than the overall average performance scores. Have you examined the cause of these low scores and determined why the demonstration project goal of hiring more highly qualified candidates was not being met?

Answer: The performance scores to which you refer relate to demonstration project employees hired in Year Five, and do not include new employees hired during Years One through Four. In looking at the demonstration project over its five-year history, the 2003 report states that “employees hired during the demonstration project years have slightly outperformed the more tenured employees.”

Additionally, in Year Five, a new analysis was conducted to examine whether new hires to the demonstration project outperform employees who were hired prior to the demonstration project. The results suggest that, on average, new hires are of a higher

quality than “tenured” employees. Furthermore, survey and focus group results indicate that the demonstration project does attract high quality candidates.

4. As you know, while General Schedule (GS) federal workers in the 48 contiguous states receive locality-based salary adjustments determined by a federal wage board, GS federal employees in Hawaii, Alaska, Guam, the Northern Mariana Islands, Puerto Rico, and the Virgin Islands receive what is known as non-foreign COLA (cost-of-living allowance). I understand there are over 100 employees in Hawaii participating in the demonstration project at the Department of Commerce. Can you explain how non-foreign COLA is impacted in a pay-for-performance system? Does the non-foreign COLA increase or decrease based on an employee’s performance?

Answer: The COLA rate is not impacted by an employee’s performance under the Commerce demonstration project. Demonstration project employees living outside the 48 contiguous states receive the same COLA rate that they would receive under the General Schedule.

5. According to a January 2004 Government Accountability Office (GAO) report, the Commerce demonstration project increased the probationary period from one year to three years for scientist and engineers. However, GAO also noted that it was difficult to assess the utility of this change. This finding is troubling because employees who are serving their probationary period have limited employment rights and protections. Why was the probationary period extended for these individuals and have you been able to determine whether this change is useful?

Answer: The maximum three-year probationary period for scientists and engineers involved in research and development (R&D) projects was designed to provide supervisors with the time needed to adequately evaluate employee performance during a full R&D cycle and, thereby, make better informed hiring decisions.

In Years One, Two, Three, Four and Five the Department hired 10, 15, 8, 22 and 20 new employees, respectively, using this expanded probationary period. Many supervisors have reported anecdotally that it has been useful in determining the suitability of these new employees to perform R&D work. Of those supervisors surveyed in Year Five, 75 percent thought the length of the probationary period was about right, 4 percent thought it was too long, and 21 percent thought it was too short.

6. Employees at the Department of Homeland Security (DHS) and the Department of Defense (DOD) have expressed concern as to whether their performance expectations will be written or oral. How are performance expectations communicated to employees at your agency? If oral, how do you hold employees accountable for those expectations?

Answer: As with the General Schedule, performance expectations under the Commerce demonstration project are established in a written performance plan developed for each employee, which is discussed between the employee and

supervisor during a formal meeting at the beginning of the performance period. Based on input from the employee, the performance plan may be revised. At the conclusion of the meeting, both the employee and supervisor sign the plan. Throughout the course of the year, performance plans may be adjusted in order to reflect any changes in work responsibilities. Verbal feedback occurs between employees and supervisors throughout the year.

7. Many employees are concerned about the impact artificial quotas on performance decisions could have on their pay increases. Would you comment on how performance ratings are distributed at your agency to ensure that meaningful distinctions are made in rewarding employees?

Answer: There is no preset distribution of scores or artificial quotas. Each employee is rated on the basis of established point ranges for each performance element using performance benchmark standards. Although the range of scores may vary from one pay pool to another based on the performance of the individual employees that they include, the standards to which all managers must adhere ultimately result in higher rewards for higher performers, and lower or, in some cases, no rewards for lower performers.

8. One issue of concern in any pay-for-performance system is how to ensure a collegial working environment and avoid pitting employees against one another. One solution to this problem is to reward teamwork. Does Commerce reward performance based on team efforts, and if so, how do you handle situations when one member of the team noticeably contributes more – or less – than others on the team?

Answer: The benchmark standards used to evaluate performance include an element relating to team participation. An employee's contribution to the team effort affects the score that they receive for this element, which impacts the recognition that they receive in terms of performance bonuses and pay level adjustments.

9. The proposed DOD regulations do not guarantee that employees will be made whole and given pro-rated amounts toward their next step or career ladder promotion once they are converted to the proposed National Security Personnel System (NSPS). Did employees in your agency receive pro-rated amounts or a pay increase upon conversion to the new pay system?

Answer: Commerce employees who have been converted to the demonstration project received a lump sum payment that was pro-rated based on their length of service within grade. We refer questions regarding the proposed DOD regulations and NSPS to the Department of Defense.

10. You testified that there was an increase in the number of discrimination and unfair treatment complaints following the implementation of a pay-for-performance system at Commerce. What redress options are available for employees to challenge performance and pay decisions?

Answer: Commerce demonstration project employees have the same rights as those afforded to General Schedule employees. Demonstration project employees may grieve their rating, performance score, and/or payout under a negotiated grievance procedure or the Department of Commerce Administrative Grievance procedure. Bonus decisions are not grievable. In addition, demonstration project employees enjoy the same right as other employees to file grievances or appeals to the Merit Systems Protection Board concerning actions based on unacceptable performance, such as removal or demotion.

11. How have you ensured sufficient resources, such as for training, in implementing your pay-for-performance system?

Answer: The Departmental Personnel Management Board (Board) serves as the oversight body for managing the overall Commerce demonstration project. It comprises senior managers from each operating unit participating in the demonstration project. Each year, the Board develops and adopts a budget to cover expenditures such as information technology support and the annual program evaluation. Funds are provided by each participating unit based on the number of employees it has in the demonstration project.

Operational costs such as training are determined by each operating unit based on their specific needs. Much of the demonstration project training is conducted in-house by human resources professionals. However, Commerce does contract for certain training, as needed. For example, supervisory training was provided through a contract at the time the demonstration project was expanded to include Office of the Secretary. During the last two years, Commerce has also contracted for training to strengthen supervisory skills in performance feedback.

12. GAO recommends training on leadership, management, and interpersonal skills to make these alternative personnel systems succeed. What training programs do you offer on your personnel system?

Answer: The Commerce demonstration project, through its participating bureaus, provides a variety of training to employees and managers, including:

- briefings for new employees and newly converted employees;
- routine performance feedback training for employees and managers;
- quarterly management training for new managers;
- refresher courses for supervisors and managers;
- training on the automated system that supports the demonstration project, as needed; and
- routine pay pool manager training.



**Arleas Upton Kea, Director  
Federal Deposit Insurance Corporation's Division of Administration :  
Response to Questions from  
The Honorable Daniel Akaka**

**Q1. The FDIC is exempt from the prohibited personnel practices outlined in Title 5, United States Code, other than the prohibition on retaliation for whistleblowing. What redress options are available for employees who find themselves subject to a prohibited personnel practice as defined in Title 5?**

A1. Although the Federal Deposit Insurance Corporation, like other government corporations, is not covered by the statutorily prohibited personnel practices described in 5 USC 2302 (other than the prohibition on whistleblower retaliation), the FDIC *is* subject to the merit system principles described in 5 USC 2301 and other antidiscrimination statutes. The FDIC also is a certified participant in the Office of Special Counsel's 2302(c) certification program for compliance with the whistleblower laws. In addition, as a matter of written policy and practice, the FDIC prohibits all forms of discriminatory or non-merit-based personnel actions. Employees who believe they have been subjected to a prohibited personnel practice are entitled to pursue their grievances through either the FDIC's negotiated collective bargaining agreement with its employee union, the National Treasury Employees Union (NTEU), or through the agency's internal grievance process. These processes guarantee and afford all employees reasonable standards of due process, including notice, opportunity to be heard, fair and impartial decision-making, and appeal rights.

**Q2. You testified that FDIC managers received training on how to make meaningful distinctions in performance. Please describe how much was spent on training, the number of employees trained, and the type of training received by managers. Do you offer training on leadership, management, and interpersonal skills as recommended by the General Accountability Office (GAO) to make this alternative personnel system succeed?**

A2. Following the negotiated agreement on the Corporate Success Award program in March 2003, training sessions were held for the managers and supervisors in each of the FDIC's divisions and offices at our headquarters locations to discuss the implementation of the program, the nomination criteria, and the process for comparing employee contributions under the new pay for performance system. The training consisted of a presentation by members of the human resources staff, with a segment for addressing questions. The training was developed and presented using internal staff; thus, there were no outside costs to the training. The training was provided to all manager levels, from first line supervisors to the division and office directors. The divisions with supervisory staff outside of the headquarters location provided a rollout of the training to their field managers. One video teleconference training session was provided by the human resources staff for managers and supervisors in the largest field division. Approximately 350 supervisors and managers received training from the human resources staff. Following these training sessions, supervisors met with their subordinate employees as a group to discuss the goals of their work unit during the contribution period in relation to the nomination criteria so that all eligible employees were aware of the process that would be used in making pay for performance distinctions.

The FDIC values and understands the importance of leadership training and development. Through its Corporate University's College of Leadership Development, the FDIC provides a comprehensive program for leaders – from team leaders up through levels of management to the Executive ranks. Program elements include:

- The Foundation for Supervisors Curriculum is mandatory for all new supervisors and provides management training about FDIC policies and procedures related to the supervision of employees as well as skill practice in various interpersonal skills required for effective leadership. The curriculum includes computer based courses that are available at the employee's computer on the following topics: Communication and Feedback; Corrective Actions: Conduct and Performance; EEO for Supervisors; Handling Employee Grievances; Managing in a Unionized Environment; Reasonable Accommodation; and Preventing Workplace Violence. Skills training classes include Interpersonal Skills for Leaders, Reaching Agreement, and Preventing and Dealing with Conduct and Performance Problems. Participants receive credible and constructive feedback on the interpersonal communication skills demonstrated in class role play activities.
- Mandatory Leadership Core Programs address critical leadership competencies at all levels of management. Each core program includes a 360-degree leadership assessment based on the Office of Personnel Management's Executive Core Qualifications and individual consultation to provide participants with feedback on their mastery of the leadership competencies critical to their level of management. The Leadership Core Programs also provide tools and strategies to enhance effectiveness in creating and leading high performance teams, setting expectations and providing feedback for improved results, and leading in a changing environment. The courses include experiential activities, in-depth discussion of management and leadership topics, and assessments, such as the Myers-Briggs Type Indicator and the Emotional Intelligence Quotient, that enable participants to complete action plans for incorporating their learning on the job.

**Q3. You testified that agencies need money to reward good performers to have a successful pay-for-performance system. How much additional money did the pay-for-performance system cost (including funding for rewards and training), and where did you find the extra money?**

A3. The FDIC has budgeted approximately \$24 million, or slightly more than 2 percent of its 2005 annual operating budget (approximately 4.66 percent of total salaries), for pay increases under its various pay-for-performance programs. It is important to note that this is the total funding set aside for salary increases for employees. As noted in my written testimony, the FDIC does not operate with appropriated funds. The FDIC is funded by insurance assessments on the deposits held by insured institutions and by interest earned on the deposit insurance funds.

**Q4. In your opinion, has collective bargaining had an impact on the ability of the FDIC to meet its mission and implement a successful pay-for-performance system?**

A4. In my opinion, successful collective bargaining results in both sides taking from the bargaining table some features in the agreement that are not ideal from their individual perspectives. The NTEU has been a participant at every step of the efforts by the FDIC to create a pay-for-performance system. When collective bargaining results in an agreement that everyone can support, it can play an important role in ensuring the success of a pay-for-performance system. However, if parties do not bargain in good faith or do not support the agreement when it becomes effective, collective bargaining does little to provide positive benefits in developing a pay-for-performance system.

**Q5. Employees at the Department of Homeland Security (DHS) and the Department of Defense (DOD) have expressed concern as to whether their performance expectations will be written or oral. How are performance expectations communicated to employees at your agency? If oral, how do you hold employees accountable for those expectations?**

A5. At the FDIC, performance expectations are both written and oral. At the beginning of each performance cycle of the FDIC's Performance Management Program (PMP), employees receive a personal Performance Plan that includes written Performance Criteria. These PMP criteria are standardized across each major occupational grouping (e.g., executives, supervisors, examiners, analysts, etc.). Supervisors discuss the performance plans with employees at the beginning of the cycle. The supervisor meets with each employee during the performance cycle to provide feedback, at a minimum, at least once for a mid-point review. Further, if an employee is experiencing performance problems at any time during the cycle, he/she is formally counseled in writing. At the end of the cycle, employees receive a rating of either *Meets Expectations* or *Does Not Meet Expectations*.

In addition, Corporate Performance Goals are developed annually, communicated to employees in writing by senior leadership, discussed in organizational meetings and remain available on the internal website for reference. Pay increases may be linked to job performance or employees' contributions that support these annual goals.

Employees must receive a *Meets Expectations* rating under the PMP to be considered for any annual pay increase. For 2005 pay decisions (based on 2004 contributions), bargaining unit employees participated in the Corporate Success Award (CSA) system and non-bargaining unit employees participated in the Contribution-based Compensation (CBC) system. Each system used the same four criteria to assess contributions, which were provided both orally and in writing to employees. Those criteria are: business results, competency, working relationships, and learning and development. At the end of the annual contribution cycle, employees were encouraged to provide input on their accomplishments and contributions to their rating/nominating officials. There are standard agency forms that are used to document the contributions under the CSA and CBC programs – these forms have the four criteria noted above documented at the top of the form.

**Q6. Many employees are concerned about the impact artificial quotas on performance decisions could have on their pay increases. Would you comment on how performance ratings are distributed at your agency to ensure that meaningful distinctions are made in rewarding employees?**

A6. Because the Performance Management Program (PMP) is a two-level system, every employee who fully meets the performance criteria in the performance plan receives a *Meets Expectations* rating. There are no quotas imposed on the PMP system. Employees with a *Meets Expectations* rating also are eligible for a pay increase based on their contributions toward organizational goals in one or more of the four CSA/CBC criteria.

For 2005, all bargaining unit employees (with a *Meets Expectations* rating) automatically received a basic pay increase of 3.2 percent. Additionally, one third of eligible employees received a CSA, and thus an additional 3 percent increase in basic pay – for a total increase of 6.2 percent.

For 2005, non-bargaining unit employees did not automatically receive the basic pay increase of 3.2 percent. Based on their level of contributions in one or more of the CBC criteria, they were assigned to one of five groups, and their pay was determined by their group assignment. In determining 2005 pay increases, non-bargaining unit employees received the following:

- Group I (10 percent of eligible employees) a 5.5 percent increase and a 2.0 percent lump sum;
- Group II (15 percent of eligible employees) a 4.5 percent increase and a 1.5 percent lump sum;
- Group III (25 percent of eligible employees) a 3.5 percent increase and 1 percent lump sum;
- Group IV (45 percent of eligible employees) a 3.2 percent increase (and no lump sum); and
- Group V (5 percent of those eligible) no pay increase.

For 2005, the actual pay increases under both the CSA and CBC programs cut across all demographic, occupational, and grade groupings.

**Q7. One issue of concern in any pay-for-performance system is how to ensure a collegial working environment and avoid pitting employees against one another. One solution to this problem is to reward teamwork. Does FDIC reward performance based on team efforts, and if so, how do you handle situations when one member of the team noticeably contributes more – or less – than others on the team?**

A7. The CSA and CBC pay programs include a criterion entitled *Working Relationships* against which employees are evaluated. This criterion recognizes productive working relationships and collaborative efforts built on mutual respect, with individuals inside and outside of the FDIC.

In addition, the FDIC has another program that rewards teamwork and that is the FDIC's Corporate Rewards and Recognition Program. Teams can be recognized for their efforts through a Mission Achievement Award or a Chairman's Excellence Award. Members of the team can receive different cash award amounts based on their level of contributions to the team.

**Q8. The proposed DOD regulations do not guarantee that employees will be made whole and given pro-rated amounts toward their next step or career ladder promotion once they are converted to the proposed National Security Personnel System (NSPS). Did employees in your agency receive pro-rated amounts or a pay increase upon conversion to the new pay system?**

A8. Yes. When FDIC transitioned from its GS-like system (with 19 within-grade steps) in 1997 to a pay-for-performance pay system, employees received roughly pro-rated step adjustments to their pay to address any loss of accrued increases based on the date of implementation. The eligibility criteria and amounts of these adjustments were determined through negotiations with the NTEU.

When implementing the current three year compensation agreement in January 2003, all employees who received a rating of *Meets Expectations* were given a basic pay adjustment of 3.2 percent, along with a 1.2 percent increase as a transitional pay adjustment, for a total increase of 4.4 percent. This allowed the agency to implement and communicate the criteria for the Corporate Success Award program and provide employees a reasonable period to make contributions before receiving pay adjustments in 2004 under this new pay system.

Additionally, FDIC continues to use a grade structure. When employees are promoted to the next grade, they receive the standard grade increase of 10 percent in base pay or the minimum of the grade range, whichever is greater.

**Q9. Ms. Kelley, President of the National Treasury Employees Union (NTEU) testified that while the FDIC has stated that, "more graduated levels of rewards are better than fewer levels," the FDIC has dropped a multi-level performance evaluation system and moved to a pass fail system. Please explain your performance evaluation system and why you have moved to a pass fail system?**

A9. The FDIC has had extensive experience with multi-tiered systems that did not achieve the desired result. From 1996 to 2002, the FDIC used a multi-tiered performance appraisal system that required our supervisors to produce voluminous amounts of documentation to support their performance ratings; however, the final results showed very little distinction in employee performance. The majority of employees were rated in the same numerical range, which translated to very little meaningful distinctions in pay raises. Both employees and managers found the system cumbersome and unhelpful. In 2000, management adopted a Pass/Fail system without objection from NTEU.

**Q10. Ms. Kelley also said that employees who receive a passing performance rating are eligible to be nominated by their supervisor for a pay increase known as a Corporate**

**Success Award. These awards are limited to one-third of the eligible employees and the standards for who gets these increases are vague, subjective, and not apparent to those covered by the system. Moreover, Ms. Kelley states that the system is demoralizing and sends the message that two-thirds of the work force is not contributing.**

**Q10(a). Please explain the standards for receiving Corporate Success Awards and how employees are informed about the standards.**

A10(a) The Corporate Success Award Program is the result of compensation negotiations with NTEU in 2002 with an agreed upon delayed implementation date in 2003 to allow for management training and employee awareness. The criteria were developed to link not only to job performance but to the annual corporate performance goals.

The Corporate Success Awards are based on four criteria:

1. **Business Results:** Consistently displays a high level of initiative, creativity, and innovation to produce results that reflect important contributions to the Corporation and/or its organizational components.
2. **Competency:** Demonstrates an exceptional degree of competency within his/her position, and is frequently relied upon by others for advice, assistance, and/or judgment that reflect important contributions to the Corporation and/or its organizational components.
3. **Working Relationships:** Builds extremely productive working relationships with co-workers, other Divisions/Offices, or other public or private sector agencies based on mutual respect that reflect important contributions to the Corporation and/or its organizational components.
4. **Learning and Development:** Takes an active part in developing personal skills and competencies and applies newly acquired skills and competencies that reflect important contributions to the Corporation and/or its organizational components.

The purpose of this award is to recognize an employee's individual initiative, exceptional effort and/or achievements that reflect important contributions to the Corporation and/or its organizational components during the annual contribution cycle. An employee recognized with this award will have made important contributions that are within or outside of the scope of his/her job; however, when within the scope of the employee's job, such contributions must reflect initiative, effort, or achievement beyond that normally expected from an employee in that position and grade.

Supervisors conduct a group meeting with employees during each annual contribution period (generally within the first 90 days) to explain the Corporate Success Award criteria and to discuss how the criteria apply to the work of their organization and unit. In addition, during the first year of implementation, employees received two global electronic mail messages that specified the criteria along with guidance on the Corporate Success Awards. Further, a

question and answer section was included on the FDIC's internal website to address questions raised by employees in regard to the Corporate Success Awards.

**Q10(b). What safeguards are built into the system to provide transparency and credibility?**

A10(b). Each Division and Office utilizes at least a three-step process for nomination, review, and approval of Corporate Success Awards. Specifically, first-level supervisors prepare nominations for those employees the supervisors themselves have identified as top contributors based on the four criteria. These nominations are then reviewed by higher-level managers to ensure consistency and that the correct employees have been nominated and assess whether any employees have been overlooked. Additional nominations may be submitted as a result of this review. The division and office directors conduct another level of review for their respective organization, and make final decisions to approve the percentage of nominations set by the Chairman. This process provides for a comprehensive check and balance system to support the approved Corporate Success Award nominations. The fact that the overwhelming number of arbitration decisions issued on the CSA grievances lodged in 2004 have been favorable to the FDIC's position indicates that our multi-layered review process ensures fairness and was equitably applied.

**Q10(c). What steps are you taking to address the morale of employees under this pay system?**

A10(c). As noted during my testimony, we do not agree with Ms. Kelly that the pay for performance programs at the FDIC have demoralized employees. It is important to recognize that employees under this pay system are among the highest paid employees in the Federal government. During the two years the Corporate Success Award program has been in place, all eligible bargaining unit employees who met performance expectations were granted a pay increase of 3.2 percent. Employees who were recognized as the top contributors received an additional 3 percent pay increase – for a total pay increase of 6.2 percent. Employees are reminded that the Corporation's rewards and recognition program includes other forms of awards, including monetary and time-off awards. Thus, the Corporate Success Award program is not the only means by which an employee can receive recognition for their demonstrated performance and contributions to the FDIC. Managers and supervisors are encouraged to make full use of the rewards and recognition program each year. In both 2003 and 2004, the FDIC issued approximately 5,000 awards to employees each year. These awards are separate and apart from the Corporate Success Awards.

**The following answer to the question posed by Senator Carper  
is provided by Arleas Upton Kea, Director of the  
Federal Deposit Insurance Corporation's Division of Administration**

**Question:** Is the Federal Deposit Insurance Corporation aware of the availability and use of programs within the federal government that give agencies the ability to quickly reemploy qualified annuitants to handle critical, short term work?

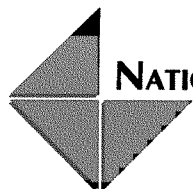
**Response:** U.S. Office of Personnel Management (USOPM) regulations permit agencies to request (on a case-by-case basis) a waiver to the restriction on dual compensation to current and former federal employees. This restriction is a barrier to annuitants being willing to return to the workforce since their pay is offset, dollar for dollar, by the amount of their retirement annuity.

The FDIC just received a six year delegation of authority from USOPM to waive this restriction as necessary in emergency situations where the FDIC would need to supplement its current workforce of bank examiners, resolutions specialists, and other critical occupations. The FDIC Chairman will have the authority to make such waiver decisions under the terms of this delegation. The multi-year delegation provides a useful additional line of defense for the Corporation in times of stress to the banking system.

Such multi-year delegations are rare in the federal government. According to USOPM, agencies that have received dual compensation delegation waivers in the past include: the Department of Defense, the Federal Aviation Administration, the Department of Transportation, the Department of the Treasury, the Federal Emergency Management Administration, the National Security Council, the Department of Commerce, the Social Security Administration, the U.S. Department of Agriculture, the Department of Health and Human Services, the Department of Justice and the Veterans Administration.

None of the above agencies received a delegation that was as broad as the delegation sent to the FDIC on September 30, 2005 for approval by the Chairman. Generally, the proposed FDIC agreement is broader and more complex in terms of occupations/grades covered, duration of delegation, shortened timeframes for conditions of re-employment, and conditions for declaring or reporting an "emergency" that would invoke the proper use of the authority if agreed to by both sides.





## NATIONAL ACADEMY OF PUBLIC ADMINISTRATION

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November 7, 2005

The Honorable Daniel K. Akaka  
Ranking Member  
Subcommittee on Oversight of Government Management,  
the Federal Workforce and the District of Columbia  
Committee on Homeland Security and Governmental Affairs  
U.S. Senate  
Washington, DC 20510

Dear Senator Akaka:

I am writing in response to your question in follow-up to the Subcommittee's September 27, 2005 hearing on Alternative Personnel Systems.

Your question was: "In your testimony you stress the importance of leadership development and succession planning. I strongly agree with you. As the impending retirement wave approaches, it is more important than ever for agencies to have mechanisms in place to pass along institutional knowledge. What are some best practices agencies can use to improve leadership development and succession planning?"

I think I can most fully respond to your question by referring to the conclusions we drew from an Academy Symposium that I moderated last June on the topic "Can Government Grow Great Leaders?" Our panelists included Ambassador Prudence Bushnell, an Academy Fellow and former Dean of the School of Foreign Service, James Colvard, an Academy Fellow and former Deputy Director of OPM, DOD NSPS Program Officer Mary Lacey, Office of National Intelligence CHCO Ronald Sanders, and Comptroller General David Walker, who is also an Academy Fellow.

We have been able to draw the following lessons from the panel presentations and follow-up discussion with our audience of federal executives and policy experts:

AN INDEPENDENT, NONPARTISAN ORGANIZATION CHARTERED BY CONGRESS

A. Government is in transformation. Successful leaders will emphasize and reward:

- Measuring results, focusing on clients and customers, engaging employee involvement, working partnerships and informed stakeholder relationships
- Developing human capital strategies and training programs that match business goals
- Building leadership succession and fluid development linked to performance

B. Leadership requires global thinking and the modernization of today's OPM leadership competencies. Some examples:

- The definition of 'who' leads must include all who contribute, not just 'managers'
- Mastering diverse cultural and multi-sector workforce challenges
- Dealing with ambiguity and working the 'gray' areas across organizations
- Balancing management and leadership strategies to have immediate impact

C. The DNA of our organizations must be revitalized; this includes:

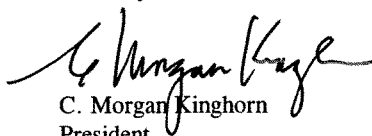
- Linking leadership competencies to performance management systems
- Reward and recognition systems that hold leaders accountable
- Flat organizations that demand leadership at all levels
- Imbedding leadership values in organizational culture
- Personnel authorities consistent with new organizational models and workforces.

D. "Stewardship" for growing great government leaders of the future means:

- Building capacity for leadership at all levels
- Sharing power with many to identify the few who will excel... moving from a controlling to an empowering culture while managing the risks
- Changing the people to Change the People. Move people around, not just up.

The full report on this Symposium is in final draft and I will share it with you and the Subcommittee as soon as it is finalized. Thank you again for inviting me to contribute to the Subcommittee's work in this important area.

Sincerely,



C. Morgan Kinghorn  
President  
National Academy of Public Administration

Senator Daniel K. Akaka  
Alternative Personnel Systems: Assessing Progress in the Federal  
Government  
Oversight of Government Management Subcommittee  
September 27, 2005

Questions for Ms. Colleen Kelley, President, National Treasury Employees  
Union (NTEU)

1. You testified as to the importance of ensuring an adequate pool of funds to reward and train employees in any pay-for-performance system.
  - A. Could you provide examples of alternative pay systems where agencies did not provide sufficient funds for training and employee rewards?
  - B. For those agencies that provided adequate funding, where did the agencies obtain the extra money? How much extra funding was required?
  - C. In your opinion, for those agencies with successful pay-for-performance systems, how much was spent on training for the new system? Did agencies also have adequate funds for other training programs unrelated to the new compensation system?
  - D. Please describe in general terms the type of training that would be most beneficial to managers and employees in implementing a pay-for-performance system and the best method of delivering this type of training.

**RESPONSE BY COLLEEN M. KELLEY, NTEU NATIONAL PRESIDENT,  
TO QUESTIONS FROM SENATOR DANIEL AKAKA,  
RANKING DEMOCRATIC MEMBER HOMELAND SECURITY AND  
GOVERNMENTAL AFFAIRS SUBCOMMITTEE ON OVERSIGHT OF  
GOVERNMENTAL MANAGEMENT AND THE FEDERAL WORKFORCE**

You asked about the importance of ensuring an adequate pool of funds to reward and train employees in a pay for performance system. NTEU believes this is an important concern. As for particular agencies that either failed or were successful in this, a comprehensive level of budget detail is not available to NTEU for agencies where we do not represent the employees. We can provide some commentary as to those agencies whose employees are represented by NTEU. However, I would refer you to the GAO Report presented at the hearing (GAO-05-1048T) and the Symposium GAO sponsored on alternative pay systems (GAO-05-832SP). GAO studied five organizations including the Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), Commonwealth of Virginia, IBM Corporation, and American Red Cross.

NTEU represents the bargaining unit employees at FDIC. We also represent the employees at OCC but are in the process of negotiating our first contract, so cannot speak as to long term issues at OCC.

FDIC is not funded through the appropriations process but by the agency's own authority assesses a fee on member banks. Compensation at FDIC is negotiated with NTEU. These two features separate FDIC from the situation of most federal employees, who work under Title V. While NTEU would not characterize FDIC as an agency that has fully provided adequate funding for performance pay and training, the level that has been provided relates to the distinct features of compensation negotiation and fee funding. Agencies that have these two features are in a better position to have the money to reward good performance and provide proper training. Those subject to the appropriations process and dependent on general revenue are in a much more precarious position.

Senator Daniel K. Akaka  
Alternative Personnel Systems: Assessing Progress in the Federal  
Government  
Oversight of Government Management Subcommittee  
September 27, 2005

Questions for Dr. Hratch Semerjian, Deputy Director, National Institute of  
Standards and Technology (NIST)

1. Employees at the Department of Homeland Security (DHS) and the Department of Defense (DOD) have expressed concern as to whether their performance expectations will be written or oral. How are performance expectations communicated to employees at your agency? If oral, how do you hold employees accountable for those expectations?

Performance expectations are communicated in writing as part of an employee's annual performance plan and discussed when the performance plan is issued. Progress reviews are conducted at mid-year and throughout the rating cycle, as needed.

2. Many employees are concerned about the impact artificial quotas on performance decisions could have on their pay increases. Would you comment on how performance ratings are distributed at your agency to ensure that meaningful distinctions are made in rewarding employees?

**At NIST, there are no quotas on performance decisions. Meaningful distinctions in performance are made based upon employee accomplishments as compared to benchmark performance standards. Senior managers review all pay-for-performance decisions. In addition, aggregate pay-for-performance data is posted annually on the NIST internal website for viewing by all NIST staff.**

3. One issue of concern in any pay-for-performance system is how to ensure a collegial working environment and avoid pitting employees against one another. One solution to this problem is to reward teamwork. Does NIST reward performance based on team efforts,

and if so, how do you handle situations when one member of the team noticeably contributes more – or less– than others on the team?

The NIST pay-for-performance system evaluates and rewards employees based on their individual contribution to the team, compared to benchmark performance standards. This avoids pitting employees against one another. Other award mechanisms are used to reward group or team accomplishments.

4. The proposed DOD regulations do not guarantee that employees will be made whole and given pro-rated amounts toward their next step or career ladder promotion once they are converted to the proposed National Security Personnel System (NSPS). Did employees in your agency receive pro-rated amounts or a pay increase upon conversion to the new pay system?

Yes, on the date of conversion to the demonstration project, employees received a lump sum pro rata share of an equivalent within-grade increase or merit increase they would have been due.

5. You testified that there was an increase in the number of discrimination and unfair treatment complaints following the implementation of a pay-for-performance system at NIST. What redress options are available for employees to challenge performance and pay decisions?

Dr. Semerjian testified that there was no increase in the number of discrimination and unfair treatment complaints following the implementation of a pay-for-performance system at NIST. This is credited to well written, well communicated performance plans. Employees who are dissatisfied with their performance ratings may file grievances under established grievance procedures.

6. How have you ensured sufficient resources, such as for training, in implementing your pay for performance system?

NIST used internal resources (funds and personnel) to develop and implement the pay-for-performance system. Several NIST personnel were involved in designing the system and training staff on the new system.

7. The Government Accountability Office (GAO) recommends training on leadership, management, and interpersonal skills to make these alternative personnel systems succeed. What training programs do you offer on your personnel system?

NIST offers ongoing training on the alternative personnel system which includes training for new supervisors and workshops on writing effective performance plans. NIST also offers leadership training for emerging leaders, and new and experienced supervisors and managers. These include courses on performance management and communication. In addition, briefings on the pay-for-performance system are held annually for all NIST staff.

Responses to Questions for the Record from Senator Daniel K. Akaka to John Gage, President, American Federation of Government Employees (AFGE)

Question #1: "Could you provide examples of alternative pay systems where agencies did not provide sufficient funds for training and employee rewards?"

*Answer: Although we do not have specific information about agencies' funding of training and employee rewards in the context of existing demonstration projects, the Congress has recently cut \$23 million from the proposed funding for the new alternative personnel system at the Department of Homeland Security (DHS). Although AFGE strongly opposed the award of a \$175 million contract to a private firm to design and administer the new DHS personnel system, we do recognize that if the system is to avoid becoming a hugely expensive exercise in corruption, discrimination, and mismanagement, substantial funding will be required not only for training and rewards, but also to make sure that supervisors are relieved of other operational duties so that they can devote the time necessary to evaluate each and every employee on the numerous performance criteria on which the system is supposed to rest. No supervisor will be able to do a fair or accurate job of rating each employee under him on the basis of five to seven "core competencies" and three to five "job-specific" goals, and any number of "work behaviors" without begin given permission to stop doing his other work. Further, more supervisors will need to be hired, again because of the enormously time-consuming nature of continuous, individualized employee evaluation.*

Question #2: "For those agencies that provided adequate funding, where did the agencies obtain the extra money? How much extra funding was required?"

*Answer: The NAVSEA laboratories are non-appropriated fund entities that generate their own income from "customers." These labs were able to expand the scope of collective bargaining with their unionized workers in order to determine an actual percentage of payroll that would be placed in the performance "pay pool." At Fort Monmouth, management reports that "other operational funds" have been utilized to finance the performance raises distributed to workers in the various alternative personnel systems in operation there. No details of this funding source have been released to the union. In fact, management at Ft. Monmouth is clear that performance raises are contingent on the availability of funds.*

Question #3 "In your opinion, for those agencies with successful pay-for-performance systems, how much was spent on training for the new system? Did agencies also have adequate funds for other training programs unrelated to the new compensation system?"

*Answer: It is difficult to characterize any "pay for performance" system in the federal government as successful, unless one counts the General Schedule, which awards periodic step increases on the basis of successful performance, as a pay for performance system. If "success" is defined as a system outside the General Schedule that can be fairly credited as having produced either improved agency performance or improved employee satisfaction, then we cannot identify a successful system. We have no*



*information on expenditures for training in alternative personnel systems. At Ft. Monmouth, there has been internal training for the union and for management, however, no one has been able to specify the amount of money spent on that training.*

Question #4: "Please describe in general terms the type of training that would be most beneficial to managers and employees in implementing a pay-for-performance system and the best method of delivering this type of training."

*Answer: AFGE believes that the most beneficial training program for any pay-for-performance system would be both ongoing and performed by in-house federal personnel rather than training contractors. For the system to have any legitimacy or credibility among rank-and-file federal employees, it needs to be designed and administered by federal employees, not contract Human Resources consultants. Outside consultant contractors have a financial incentive different from those of agencies, not only in terms of complexity, but also in terms of flexibility. A system designed internally, in the context of collective bargaining between an agency's operational managers and the union representing its workforce is by definition more attuned to the particular needs and culture of the agency. As such, those who design and implement training for those who will participate in the system should also be agency employees who have an ongoing connection with the entire workforce. This has been the case at Fort Monmouth, where training, design, administration, and the collective bargaining relationship are all connected and accountable. AFGE local representatives at Fort Monmouth have stressed that the most important reason that the training there has been so well-accepted, so accessible, and of such high quality is that it is carried out on an ongoing basis by in-house people from the personnel department who really know how the system works because they administer the system right on site. Further, they maintain that everyone in-house has an incentive to keep costs down because money spent on outside consultant and contractors would be money unavailable to fund performance raises.*



Questions for the Record  
 Senate Committee on Homeland Security and Governmental Affairs  
 Subcommittee on the Oversight of Government Management  
 September 27, 2005  
 Alternative Personnel Systems: Assessing Progress in the Federal Government

Questions from Senator Akaka to Mr. Michael B. Styles, National President, Federal Managers Association

***1. You testified that of major importance to the implementation of any pay-for-performance system is ensuring an adequate pool of funds to reward and train employees.***

***Could you provide examples of alternative pay systems where agencies did not provide enough money for training and employee rewards?***

A: Training for the Navy Warfare Center Divisions Personnel Demonstration (DEMO) Project was funded through the activity's overhead. The Navy did not provide any additional funding to support implementation or maintenance of these projects. Since overhead dollars were spent to accomplish DEMO training, no additional overhead funding was authorized and as such, other overhead expenses suffered. This was a substantial cost that prolonged implementation and continuation of the new WC DEMO Project. The project is currently underway at eight divisions: Keyport, WA; Newport RI; Dahlgren, VA; Indian Head, MD; Carderock, MD; Crane, IN; Corona, CA; and Port Hueneme, CA.

Employee rewards in the WC DEMO project are provided in two categories – Continuing Pay and Bonus Pay. The Continuing Pay pool was determined by historical spending for General Schedule (GS) Within-Grade Increases (WGs), the Quality Salary Step Increases (QSI), in-level career promotions and labor market conditions. The Bonus Pay pool was determined by historical spending on Performance Awards, Special Achievement Awards, Division Fiscal Condition and Financial Strategies. Each WC Division established the Continuing Pay pool and the Bonus Pay pool at the beginning of the performance year. On average, these two pay pools are approximately 3% of the base salary of the personnel in the DEMO project. Based on the above, each Division struggled to adequately reward high performing employees. And given financial hard times, the above pay pools can rapidly shrink to meet end-of-year fiscal conditions.

It is worth noting that the WC DEMO Project Pay Pool does not include the congressionally approved salary increases in January of each year. Adding this money to the pay pool would increase funding to be distributed for pay for performance, but would also make distributing the funds very difficult. Everyone in a given area is affected by the changes in cost of living. If one employee's cost of living January pay increase was distributed to another, it would destroy the employees' confidence in pay for performance.



**2. For those agencies that provided adequate funding, where did the agencies obtain the sufficient funds? How much extra funding was required?**

A: We at FMA are not aware of any agency that provided direct funding to support implementation and maintenance of a new personnel system within its agency.

**3. In your opinion, for those agencies with successful pay-for-performance systems, how much was spent on training for the new system? Did agencies also have adequate funds for other training programs unrelated to the new compensation system?**

A: At the WC DEMO Project at Keyport, WA, a minimum of 20 hours of training per supervisor and 4 hours of training per employee was needed to understand the new system. Follow-up training is available for new employees entering the DEMO Project and additional training is also available to refresh supervisors' training at the end of the performance year. It was imperative that this training take place face-to-face, as it could not have been done as self-paced on-line training. In order to buy-in to the principles of a new pay for performance system, supervisors and employees will undoubtedly need questions addressed and those questions will need to be answered face-to-face with a knowledgeable instructor. The lack of buy-in by both supervisors and employees will implode any new personnel system. However, I must mention again that all of this training was paid for by activities overhead; direct funding was not provided. As a result, other overhead functions suffered.

Historically, agencies in general, have not had enough funding for required mandatory training functions. Safety, security, supervisory, managerial and employee training is always conducted on a shoestring. Since this kind of training tends to be an overhead expense, even the best intentions of providing adequate training falls short when the realities of other overhead expenses vie for the few leftover overhead dollars available. Fencing off overhead money to support training would suffer the same fate. Instead we at FMA believe agencies should directly budget and fund the minimum training required.

**4. Please describe in general terms the type of training that would be most beneficial to managers and employees in implementing a pay-for-performance system and the best method of delivering this type of training.**

A: Training for any new pay-for performance system *must* include adequate information to understand the new system and the need to switch to a new system. It must also include enough details to answer questions and develop a mutual buy-in of supervisors, managers, and employees. A big weakness of the WC DEMO Project is the lack of pay incentives for an employee to become a supervisor or manager, especially when non-management employees may make more money than their supervisor or manager. Pay differentials for managers and supervisors taking on added duties and responsibilities must be carefully implemented in any new system.

The critical element of training is understanding the pay incentive system and making sure that an adequate appraisal system is in place to ensure true pay for performance. This training cannot successfully be delivered on-line. Buy-in of everyone in the project is required -- which requires group



training in addition to individual training.

***5. Were managers consulted in the creation and implementation of pay-for-performance systems, and if so, do you believe your input was valued? Generally, when were managers first consulted about these new systems?***

A: In the WC DEMO Project, managers were consulted in the creation of the system and in the implementation at the local activities. We at FMA believe manager and supervisor inputs are critical to the success of any new personnel system. As they will be the ones implementing the new system, managers and supervisors need to be convinced of the need to transition to a system. In the draft of the current NSPS regulations, little feedback has been available showing that the inputs received from managers, supervisors, and employees have been included in the final regulation. I have exceptional concern that the lessons learned from existing Personnel Demonstration Projects (like the WC DEMO Projects) have not adequately been incorporated into the regulations for the new NSPS. Just like in the China Lake DEMO Project, the WC DEMO Project has evolved over the past few years, and we believe that the NSPS should build upon a system already working. Ignoring the need for adequate training and funding is one good example of how NSPS could relive the mistakes made in earlier Personnel Demonstration Projects. Not accounting for the increased responsibilities of managers and supervisors is yet another potential mistake. In addition, adding the January congressional pay raise into the pay for performance pool would be a devastating blow to having a new personnel system that would be embraced by employees and supervisors/manages alike.