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May 22, 2003

The Honorable George V. Voinovich
Chairman
The Honorable Richard J. Durbin
Ranking Minority Member
Subcommittee on Oversight of Government Management,
the Federal Workforce, and the District of Columbia
Committee on Governmental Affairs
United States Senate

The Honorable Jo Ann Davis
Chairwoman
The Honorable Danny Davis
Ranking Minority Member
Subcommittee on Civil Service and Agency Organization
Committee on Government Reform
House of Representatives

Subject: *Posthearing Questions Related to Strategic Human Capital Management*

On April 8, I testified before your Subcommittees at a hearing on “The Human Capital Challenge: Offering Solutions and Delivering Results”.¹ This letter responds to requests from Chairman Voinovich, Chairwoman Davis, and Senator Carper that I provide answers to follow-up questions from the hearing. The questions, along with my responses, follow.

Questions from Chairman Voinovich

1. In your testimony, you discuss the need to preserve and share an agency’s institutional knowledge in light of the impending retirement wave by using various means of “phased retirement.” Proposed in my Federal Workforce Flexibility Act are provisions to make it more desirable for individuals to work part-time at the end of their career. What other options might Congress consider to ease this transition?

There are a variety of options that should be considered; however, they all require further analysis to ensure they would be cost-effective in retaining the institutional knowledge of key employees as they approach and become eligible for retirement.

¹U.S. General Accounting Office, *Human Capital: Building on the Current Momentum to Address High-Risk Issues*, GAO-03-637T (Washington, D.C.: Apr. 8, 2003).

For example, one option would be to allow retirement eligibles to continue working after retirement eligibility on a part-time basis and factor in that service when making pension calculations. However, for those employees who are under the Civil Service Retirement System, legislation would be needed to remove the so-called penalty on their retirement annuity for working part time. Another option would be to allow certain employees to retire and receive their annuity and continue to work part time for up to a stated period of time (e.g., 1 – 2 years) without a pension offset. Both of these options would help agencies address succession planning and knowledge transfer challenges. In all cases, however, Congress should consider placing certain criteria along with numerical or percentage of workforce caps on agencies' use of such authorities to prevent abuse.

2. GAO has been successful in implementing personnel reforms that clearly emphasize the importance of human capital. Part of your success has been achieved through GAO-specific legislation, but your agency also has been successful in implementing governmentwide reforms. Unfortunately, other agencies have not been as successful. As agencies begin to consider the governmentwide flexibilities included in last year's homeland security legislation, please discuss in a bit more detail how GAO has been successful in the past.

As noted in my statement for the hearing, we have reported on the capabilities that agencies need to have in place to effectively use the human capital flexibilities and authorities that Congress has provided.² Our own approach to the use of the authorities that Congress has provided us has been consistent with the practices of leading organizations, as shown in figure 1.

²U.S. General Accounting Office, *Human Capital: Effective Use of Flexibilities Can Assist Agencies in Managing Their Workforces*, GAO-03-2 (Washington, D.C.: Dec. 6, 2002).

Figure 1: Key Practices for Effective Use of Human Capital Flexibilities

Plan strategically and make targeted investments	<ul style="list-style-type: none"> • Obtain agency leadership commitment • Determine agency workforce needs using fact-based analysis • Develop strategies that employ appropriate flexibilities to meet workforce needs • Make appropriate funding available
Ensure stakeholder input in developing policies and procedures	<ul style="list-style-type: none"> • Engage the human capital office • Engage agency managers and supervisors • Involve employees and unions • Use input to establish clear, documented, and transparent policies and procedures
Educate managers and employees on the availability and use of flexibilities	<ul style="list-style-type: none"> • Train human capital staff • Educate agency managers and supervisors on existence and use of flexibilities • Inform employees of procedures and rights
Streamline and improve administrative processes	<ul style="list-style-type: none"> • Ascertain the source of existing requirements • Reevaluate administrative approval processes for greater efficiency • Replicate proven successes of others
Build transparency and accountability into the system	<ul style="list-style-type: none"> • Delegate authority to use flexibilities to appropriate levels within the agency • Hold managers and supervisors directly accountable • Apply policies and procedures consistently
Change the organizational culture	<ul style="list-style-type: none"> • Ensure involvement of senior human capital managers in key decision-making processes • Encourage greater acceptance of prudent risk taking and organizational change • Recognize differences in individual job performance and competencies

Source: GAO.

In our specific situation, we developed data-driven business cases to demonstrate the need for the authorities, how they would be used, and took steps to assure that safeguards were in place to ensure their proper and fair use. We also have involved our employees at all levels in the development and implementation of our human capital policies and programs to improve the quality of those policies and programs and build GAO-wide ownership for the changes we are making. Further, we have used our human capital initiatives as part of, and consistent with, broader efforts we have underway to instill a more results-oriented culture throughout GAO. Finally, we monitor and evaluate our efforts and publicly report on our use of the authorities both to assure our own accountability as well as to provide lessons for other agencies.

3. You have recommended the creation of a nonpolitical chief operating officer at federal agencies. While your roundtable discussion did not achieve consensus on the concept, it did lay out three “themes” that should be considered. Would you like to elaborate a bit more on these themes and what more Congress and agencies can do to facilitate this discussion?

GAO convened a roundtable on September 9, 2002, to discuss the Chief Operating Officer (COO) concept and how it might apply within selected federal departments and agencies as one strategy to address certain systemic federal governance and management challenges. We reported that there was general agreement that the following three themes provide a course for action.³

³U.S. General Accounting Office, *Highlights of a GAO Roundtable: The Chief Operating Officer Concept: A Potential Strategy To Address Federal Governance Challenges*, GAO-03-192SP (Washington, D.C.: Oct. 4, 2002).

- Elevate attention on management issues and transformational change.
- Integrate various key management and transformation efforts.
- Institutionalize accountability for addressing management issues and leading transformational change.

The participants also offered a number of ideas to help address agencies' management weaknesses and drive transformational change. First, while there is no "one size fits all" solution to address the challenges agencies face, the critical point is to craft an approach in each case that (1) sets responsibility and accountability for functional management issues and transformational change at an organizational level appropriate for the types of reforms that are needed and (2) creates integrated leadership responsibility in a single organizational position for key management functions such as human capital, financial management, information technology, acquisition sourcing strategies, and performance management as well as for transformational change initiatives, if appropriate.

Second, participants suggested that Congress should make clear in statute the broad responsibilities and qualifications for at least the senior official responsible for management and transformation. Congress has taken this general approach with other important management legislation, such as the Chief Financial Officers Act (CFO), which requires CFOs to "possess demonstrated ability in general management of, and knowledge of and extensive practical experience in financial management practices in large governmental or business entities" and clearly lays out the CFOs' responsibilities. By establishing the broad CFO responsibilities in statute, Congress created a number of important advantages: unambiguous expectations for the position, a professional approach, and an implicit set of qualification standards and expectations.

Third, participants also widely agreed that augmented accountability mechanisms are needed to help assure the success of key management and transformational change efforts. To help provide the continuing focused attention essential to successfully completing multiyear transformational change, the important role that congressional oversight has played and can play in fostering improvements was acknowledged at the forum. Likewise, public reporting, such as the annual performance plans and performance reports required by the Government Performance and Results Act and audited financial statements under the CFO Act, can provide useful information on agencies' progress in meeting goals and addressing mission-critical management challenges. The use of performance contracts for senior leaders was also recognized as being a potentially important mechanism for clarifying expectations, monitoring progress, and assessing accountability.

Questions from Chairwoman Davis

1. Far too often, when agency budgets are short, training is the first item cut. The world's top companies have a commitment to training because training helps ensure the skills and performance necessary for an organization to meet its goals. The Federal Workforce Flexibility Act, which was introduced by both Senator Voinovich and myself, enhances the institutional manner in which employees are trained in the federal government. How critical is

employee training to attract, retain and improve the performance of the federal workforce?

A strategically sound training and development program is critical to both building and retaining an effective federal workforce. Initiatives such as the Federal Workforce Flexibility Act that Chairwoman Davis and Chairman Voinovich have introduced are evidence that this area is beginning to receive the increased emphasis and attention it warrants.

A learning environment, with opportunities to update and enhance an individual's skills and competencies, is an attractive feature for prospective and new employees as well as for current and long-time employees. People want to work where they will be able to continue to learn and grow as they develop their careers. As in the private sector, effective training and development opportunities are an important element in the package that the federal government needs to be able to offer in the "war for talent." Once employees are onboard, strategic training and development efforts can help ensure that, as part of succession planning, new leaders are developed and ready to take on new roles and assume greater responsibilities.

Training and development opportunities are also a tangible example of the need to invest in human capital, both in terms of time and budgetary resources. The Federal Workforce Flexibility Act calls for agencies to evaluate their training programs and plans to ensure that they are linked to strategic and performance goals and contribute to achieving the agency's mission. This is a key step in making a business case and demonstrating that training and development efforts, like other strategic human capital management investments, are a vital and integrated part of agencies' ability to marshal, manage, and maintain the human capital needed to maximize government performance and assure its accountability.

2. At our hearing on April 1, we talked about the crucial importance of performance management improvements by federal agencies before a pay-for-performance system will work well. At the same time, as the Deputy Director of the Office of Personnel Management (OPM) pointed out last week, the current system of lock-step raises provides no incentive for agency managers to devote their attention to the difficult job of improving their performance management. So we have a chicken-and-egg problem here. If we wait for better appraisals before we get to pay for performance, we may never get there. In your own experience at GAO, what amount of time separated the first pay raises under a banded pay system and the first appraisals under the new competency-based performance management system? What approach would you recommend for this problem?

While there is growing agreement on the need to better link individual pay to performance, experience has shown that moving too quickly—and prematurely—significantly raises the risk of doing it wrong, which could severely set back the current momentum. Thus, while it is imperative that we take steps to better link employee pay to performance across 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 or not such efforts are successful. In our own case, we began making significant

changes to our analyst performance management system in 2000 and made more direct links between performance and pay as a result of the 2002 appraisal cycle. It should be noted, that we had over a decade of experience in the use of pay banding before we undertook our recent changes, so much of the needed organizational infrastructure was already in place. With regard to executive branch agencies, the key to progress over the next year is to create performance management systems that are capable of supporting more performance based pay and other personnel decisions. Such performance management systems are based on the practices used by leading organizations to align individual performance with organizational success and have the institutional infrastructures that provide adequate safeguards, reasonable transparency, and appropriate accountability mechanisms.⁴ The critical issue is not so much the length of time needed, but rather the extent to which agency senior leadership is willing to provide the priority attention and targeted investments needed to create and maintain a results-oriented performance management system. Finally, in our view, appropriate systems and safeguards should be in place before any additional pay for performance authority is actually implemented or operationalized under this approach. Congress could authorize such authority while providing that certain conditions must be met before the authority can be implemented or operationalized.

3. Last week, when we asked the Deputy Director of OPM about the desirability of eliminating the General Schedule altogether, he testified that the Administration’s proposal for a \$500 million Human Capital Performance Fund was a “downpayment” on pay reform. Would you agree that the Human Capital Performance Fund is a step in the right direction, if perhaps only a baby step? Do you think the executive branch is capable of doing a good enough job on performance appraisals to experiment on about one half of one percent of pay? Maybe this is a way to get some energy into the agencies when it comes to improving their performance management.

Modern, reliable, effective, and, as appropriate, validated performance management systems with adequate safeguards, including reasonable transparency and appropriate accountability mechanisms, must serve as the fundamental underpinning of any successful results-oriented pay reform. Most executive branch agencies are a long way from meeting this essential test.

To build the necessary performance management systems within agencies and to create incentives for progress, I suggested in my testimony that Congress should consider establishing a governmentwide fund where agencies, based on a sound business case, could apply to OPM for funds to be used to modernize their performance management systems and ensure that those systems have adequate safeguards to prevent abuse. The basic idea is to provide for targeted investments needed to prepare agencies to use their performance management systems as strategic tools to achieve organizational results and drive cultural change. (If successful, this approach to targeted investments could be expanded to foster and support agencies’ related transformation efforts, including other aspects of the High

⁴U.S. General Accounting Office, *Results-Oriented Cultures: Creating a Clear Linkage between Individual Performance and Organizational Success*, GAO-03-488 (Washington, D.C.: Mar. 14, 2003).

Performing Organization (HPO) concept recommended by the Commercial Activities Panel.)

Congress should also consider providing the authority where whole agencies and/or employee groups move to a pay for performance approach only after it has been demonstrated to OPM that a modern, reliable, effective, and, as appropriate, validated performance management system with adequate safeguards, including reasonable transparency and appropriate accountability mechanisms, is in place to support pay and related personnel decisions. In any case, Congress should consider establishing statutory principles for the standards that an agency must have in place before OPM can grant additional pay flexibilities. OPM, working with the Chief Human Capital Officers' Council, would issue guidance implementing legislatively-defined principles.

As a first step, the Senior Executive Service needs to lead the way in the federal government's effort to better link pay to performance. We have reported that there are significant opportunities to strengthen efforts to hold senior executives accountable for results.⁵

4. I notice in your testimony that you believe OPM should play an aggressive leadership role in the area of human capital management. If pay and performance management systems are handed over to individual agencies so they can tailor their systems to their particular needs and objectives, what role in setting compensation policy would you foresee for OPM?

We have reported that OPM leadership is critical to accomplish its mission in a decentralized human capital environment in which direct accountability for strategic human capital management continues to shift to agencies.⁶ In particular, as noted above, OPM should certify that an agency has a modern, effective, credible, and as appropriate, validated performance management system in place before the agency is granted the authority to better link pay to performance for broad-based employee groups. In addition, OPM should gather, assess, and disseminate leading practices from federal organizations on a full range of innovative human capital policies and procedures, such as pay for performance. Further, OPM should build on its White Paper to design and lead a broad research agenda to develop a more market-based approach to federal pay.

5. What legislative changes do you think are most important for us to enact in this Congress to improve the government's human resources management over both the short and long term? Or, if we could only get one change, what should that be?

The need for results-oriented pay reform is one of the most pressing human capital issues facing the federal government today. As implied in our answers above, Congress could provide broad-based authority for broadbanding and pay for performance along with specific statutory standards that would have to be met

⁵U.S. General Accounting Office, *Results-Oriented Cultures: Using Balanced Expectations to Manage Senior Executive Performance*, GAO-02-966, (Washington, D.C.: Sept. 27, 2002).

⁶U.S. General Accounting Office, *Major Management Challenges and Program Risks: Office of Personnel Management*, GAO-03-115 (Washington, D.C.: January 2003).

before such authorities can be operationalized. An agency should have to demonstrate, and OPM should have to certify, that a modern, effective, credible, and, as appropriate, validated performance management system with adequate safeguards, including reasonable transparency and appropriate accountability mechanisms, is in place to support more performance-based pay and related personnel decisions, before the agency could implement a new system. OPM should be required to act on any individual certifications within prescribed time frames (e.g., 30-60 days).

6. Similarly, where do you think we should most focus our oversight attention in the area of human resources management?

Congress has had and will need to continue to have a central role in improving agencies' human capital approaches. First and foremost, congressional oversight is important to ensure that agencies human capital plans and programs are integrated with program missions and goals. Too often in the past, agencies' program initiatives were designed and implemented without due regard to the human capital implications that these program decisions entail. In addition, Congressional oversight is important to ensure that agencies effectively and properly use human capital authorities and flexibilities that Congress has provided, for example those in the Homeland Security Act. While agencies' first priority should be to improve their human capital management by using the authorities already available to them, additional flexibilities may be appropriate where clear business cases have been established.

Questions from Senator Carper

1. In recent years, Congress has granted agencies like the Internal Revenue Service and the Federal Aviation Administration some additional personnel flexibilities aimed at meeting agency-specific problems. Just this year, the National Aeronautics and Space Administration came to this committee with its own set of problems and suggested some reforms aimed at recruiting workers with advanced degrees in math and science. Would it be better for Congress to address human capital issues on an agency-by-agency basis rather than enacting broad reforms that may not be well suited for everyone?

We strongly support the concept of modernizing federal human capital policies, including providing reasonable flexibility to management in this critical area provided adequate safeguards are in place to prevent abuse. In this regard, we believe that Congress should consider both governmentwide and selected agency changes to address the pressing human capital issues confronting the federal government. Agency-specific human capital reforms should be enacted to the extent that the problems being addressed and the solutions offered are specific to a particular agency (e.g., military personnel reforms for the Department of Defense). In addition, targeted reforms should be considered in situations where additional testing or piloting is needed for fundamental governmentwide reform.

In our view, it would be preferable to employ a governmentwide approach to address certain flexibilities that have broad-based application (e.g., broadbanding, pay for performance, part-time employment, reemployment annuities) and serious potential

implications for the civil service system, in general, and OPM, in particular. In these situations, it may be prudent and preferable for Congress to provide such authorities on a governmentwide basis and in a manner that ensures that appropriate performance management systems and safeguards are in place before the new authorities are implemented by the respective agency. This approach is not intended to delay action on any individual agency's efforts, but rather to accelerate needed human capital reform throughout the federal government in a manner that ensures reasonable consistency on key principles within the overall civilian workforce. This approach also would provide agencies with reasonable flexibility while incorporating key safeguards to help maximize the chances of success and minimize the chances of abuse and failure. This approach would also help to maintain a level playing field among federal agencies in competing for talent and avoid a further fragmentation of civil service in key areas.

However, in all cases whether from a governmentwide authority or agency specific legislation, in our view, such additional authorities should be implemented (or operationalized) only when an agency has the institutional infrastructure in place to make effective use of the new authorities. This institutional infrastructure includes, at a minimum, a human capital planning process that integrates the agency's human capital policies, strategies, and programs with its program goals and mission, and desired outcomes; the capabilities to effectively develop and implement a new human capital system; and importantly, the existence of a modern, effective, credible, and validated performance management system that includes adequate safeguards, including reasonable transparency and appropriate accountability mechanisms, to ensure the fair, effective, and nondiscriminatory implementation of the system.

2. In your view, how helpful can the streamlined hiring process authorized through the Homeland Security Act be in helping agencies address their personnel problems? How helpful can the other governmentwide personnel provisions included in the bill be?

Much of the authority agency leaders need to manage human capital strategically is already available under current laws and regulations, especially in connection with modernizing existing performance appraisal and management systems.⁷ In that regard, we believe that the hiring and other central provisions of the Homeland Security Act will serve as important tools for agencies to use to address their hiring and other human capital needs. For example, the Homeland Security Act included significant provisions relating to categorical ranking when considering applicants, direct hire authority, the creation of chief human capital officer (CHCO) positions and a CHCO Council, an expanded voluntary early retirement and "buy-out" authority, a requirement to discuss human capital approaches in Government Performance and Results Act plans and reports, and a provision allowing executives to receive their total performance bonus in the year in which it is awarded.

3. What are the specific safeguards against discrimination and abuse that you believe need to be in place before an agency can implement a "pay for performance" program?

⁷To assist agencies in identifying available human capital flexibilities, OPM has published *Human Resources Flexibilities and Authorities in the Federal Government* (Washington, D.C.: July 2001).

At the request of Representative Danny Davis, we developed an initial list of possible safeguards for Congress to consider to help ensure that any pay for performance systems in the government are fair, effective, and credible:

- Assure that the agency’s performance management systems (1) link to the agency’s strategic plan, related goals, and desired outcomes and (2) result in meaningful distinctions in individual employee performance. This should include consideration of critical competencies and achievement of concrete results.
- Involve employees, their representatives, and other stakeholders in the design of the system, including having employees directly involved in validating any related competencies, as appropriate.
- Assure that certain predecisional internal safeguards exist to help achieve the consistency, equity, nondiscrimination, and nonpoliticization of the performance management process (e.g., independent reasonableness reviews by Human Capital Offices and/or Offices of Opportunity and Inclusiveness or their equivalent in connection with the establishment and implementation of a performance appraisal system, as well as reviews of performance rating decisions, pay determinations, and promotion actions before they are finalized to ensure that they are merit-based; internal grievance processes to address employee complaints; and pay panels whose membership is predominately made up of career officials who would consider the results of the performance appraisal process and other information in connection with final pay decisions).
- Assure 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 individual confidentiality and report periodically on internal assessments and employee survey results).

The above items should help serve as a starting point for Congress to consider in crafting possible statutory safeguards for executive agencies’ performance management systems. OPM would then issue guidance implementing the legislatively defined safeguards.

4. What role should employees play in administering any “pay for performance” initiative tested or put into place at the federal level?

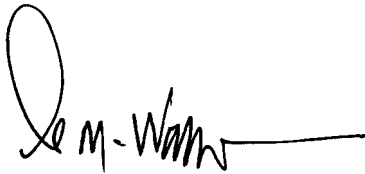
We have reported that the involvement of employees both directly and indirectly is crucial to the success of new initiatives, including implementing a pay for performance system.⁸ Performance management systems are more effective when employees perceive the process to be fair and the criteria to be clearly defined, transparent, and consistently applied. Leading organizations have found that by

⁸U.S. General Accounting Office, *Results-Oriented Cultures: Insights for U.S. Agencies from Other Countries’ Performance Management Initiatives*, GAO-02-862 (Washington, D.C.: Aug. 2, 2002) and *Human Capital: Practices That Empowered and Involved Employees*, GAO-01-1070 (Washington, D.C.: Sept. 14, 2001).

actively involving employees, unions, or other employee associations when developing results-oriented performance management systems, employee confidence and belief in the fairness of incentive programs improves due to an understanding of why certain employees were rewarded. To involve stakeholders and employees when reforming their performance management systems, agencies should:

- Consult a Wide Range of Stakeholders Early in the Process.
- Obtain Feedback Directly from Employees. Directly asking employees to provide feedback on proposed changes in their performance management systems encourages a direct sense of involvement and buy-in, allows employees to express their views, and helps to validate the system to ensure that performance measures are appropriate.
- Engage Employee Unions or Associations. Effective labor-management relations help to achieve consensus on planned changes, avoid misunderstandings, and assist in the expeditious resolution of problems.

For additional information on our work on federal agency transformation efforts and strategic human capital management, please contact me on 512-5500 or J. Christopher Mihm, Director, Strategic Issues, at 512-6806 or at mihmj@gao.gov.

A handwritten signature in black ink, appearing to read "D. M. Walker", with a long horizontal line extending to the right.

David M. Walker
Comptroller General
of the United States

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