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HUMAN CAPITAL

DOD Needs Better Internal Controls and Visibility over Costs for Implementing Its National Security Personnel System





Highlights of [GAO-07-851](#), a report to congressional committees

Why GAO Did This Study

Given a large-scale organizational change initiative, such as the Department of Defense's (DOD) National Security Personnel System (NSPS), is a substantial commitment that will take years to complete, it is important that DOD and Congress be kept informed of the full cost of implementing NSPS. Under the Comptroller General's authority to conduct evaluations on his own initiative, GAO analyzed the extent to which DOD has (1) fully estimated total costs associated with the implementation of NSPS and (2) expended or obligated funds to design and implement NSPS through fiscal year 2006. GAO interviewed department officials and analyzed the NSPS Program Executive Office's (PEO), and the military services' and the Washington Headquarters Services' (hereafter referred to as the components) cost estimates and reports of expended and obligated funds.

What GAO Recommends

GAO recommends that DOD define all costs needed to manage NSPS, prepare a revised estimate of those costs for implementing the system in accordance with federal financial accounting standards, and develop a comprehensive oversight framework to ensure that all funds expended or obligated to design and implement NSPS are fully captured and reported. In reviewing a draft of this report, DOD generally concurred with GAO's recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-07-851.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Derek Stewart at (202) 512-5559 or stewartd@gao.gov.

HUMAN CAPITAL

DOD Needs Better Internal Controls and Visibility over Costs for Implementing Its National Security Personnel System

What GAO Found

DOD's November 2005 estimate that it will cost \$158 million to implement NSPS does not include the full cost that the department expects to incur as a result of implementing the new system. Federal financial accounting standards state that reliable information on the costs of federal programs and activities is crucial for effective management of government operations and recommend that full costs of programs and their outputs be provided to assist Congress and executives in making informed decisions on program resources and to ensure that programs get expected and efficient results. The full cost includes both those costs specifically identifiable to carry out the program, or direct costs, and those costs that are common to multiple programs but cannot be specifically identified with any particular program, or indirect costs. While the standards emphasize that full cost information is essential for managing federal programs, their activities, and outputs, the standards also provide that items may be omitted from cost information if that omission would not change or influence the judgment of a reasonable person relying on the cost information. Based on GAO's review of documentation provided by DOD and discussions with department officials, GAO found that DOD's estimate includes some direct costs, such as the start-up and operation of the NSPS PEO and the development and delivery of new NSPS training courses, but it does not include other direct costs such as the full salary costs of all civilian and military personnel who directly support NSPS activities departmentwide. Before developing its estimate, DOD had not fully defined all the direct and indirect costs needed to manage the program. Without a better estimate, decision makers—within DOD and Congress—will not have complete information about whether adequate resources are being provided for implementing NSPS.

The total amount of funds DOD has expended or obligated to design and implement NSPS during fiscal years 2005 through 2006 cannot be determined because DOD has not established an oversight mechanism to ensure that these costs are fully captured. In May 2005, the NSPS Senior Executive established guidance for tracking and reporting NSPS implementation costs that requires the components to develop mechanisms to capture these costs and to report quarterly their costs to the NSPS PEO. However, this guidance does not define the direct and indirect costs DOD requires that the components capture. DOD's pervasive financial management deficiencies have been the basis for GAO's designation of this as a high-risk area since 1995. GAO's review of submitted reports from the components found that their official accounting systems do not capture the total funds expended or obligated to design and implement NSPS. Without an effective oversight mechanism to ensure that the official accounting systems capture all appropriate costs, DOD and Congress do not have visibility over the actual cost to design and implement NSPS.

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Abbreviations

DOD	Department of Defense
NSPS	National Security Personnel System
OPM	Office of Personnel Management
PEO	Program Executive Office

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United States Government Accountability Office
Washington, DC 20548

July 16, 2007

Congressional Committees

Given a large-scale organizational change initiative, such as the National Security Personnel System (NSPS), is a substantial commitment that will take years to complete, it is important that the Department of Defense (DOD) and Congress be kept informed of the full cost of implementing NSPS. In November 2003, Congress authorized the Secretary of Defense to establish NSPS, a new human resources management system. On November 1, 2005, DOD and the Office of Personnel Management (OPM) jointly released the final regulations on NSPS. Successful implementation of NSPS is essential for DOD because this new human resources management system, if properly designed and effectively implemented, could serve as a model for governmentwide human capital transformation.

We have undertaken a number of human capital engagements to track how DOD began to make use of its new human capital authorities.¹ This body of work highlighted multiple implementation challenges DOD would face in both the early and later stages of NSPS implementation. These challenges include, among other things, providing adequate resources to implement NSPS, especially in times of increased fiscal constraints.

We prepared this report under the Comptroller General's authority to conduct evaluations on his own initiative and are providing it to you because of your continued interest in this issue. This report analyzes the extent to which DOD has (1) fully estimated total costs associated with the implementation of NSPS and (2) expended or obligated funds to design and implement NSPS through fiscal year 2006.

¹ GAO, *Human Capital: Observations on Final Regulations for DOD's National Security Personnel System*, [GAO-06-227T](#) (Washington, D.C.: Nov. 17, 2006); *Human Capital: DOD's National Security Personnel System Faces Implementation Challenges*, [GAO-05-730](#) (Washington, D.C.: July 14, 2005); *Human Capital: Preliminary Observations on Proposed DOD National Security Personnel System Regulations*, [GAO-05-432T](#) (Washington, D.C.: Mar. 15, 2005); *Human Capital: Preliminary Observations on Proposed Department of Defense National Security Personnel System Regulations*, [GAO-05-559T](#) (Washington, D.C.: Apr. 14, 2005); *Human Capital: Preliminary Observations on Proposed Department of Defense National Security Personnel System Regulations*, [GAO-05-517T](#) (Washington, D.C.: Apr. 12, 2005).

To determine the extent to which DOD has fully estimated the total costs associated with the implementation of NSPS, we obtained and analyzed DOD's estimate that was published in the NSPS Final Regulations in November 2005. We interviewed officials from the NSPS Program Executive Office (PEO) and the NSPS Program Management Offices for the Department of the Navy (which is also responsible for the Marine Corps), the Army, the Air Force, and the Washington Headquarters Services² to discuss how they had interpreted PEO guidance on how to estimate NSPS costs. To determine what costs should be included in NSPS estimates, we analyzed DOD guidance, government accounting standards, and other government regulations and manuals. To determine the extent to which DOD expended or obligated funds to design and implement NSPS through fiscal year 2006, we obtained quarterly reports collected by the PEO and consolidated for fiscal years 2005 and 2006. We compared the quarterly reports to data from the components' official accounting systems to determine what NSPS cost data had been captured in these accounting systems. To obtain criteria for tracking and managing the costs of programs, activities, and their outputs, we compared the PEO's management of the reporting of NSPS costs with internal control factors described in *Internal Control Management and Evaluation Tool* and *Standards for Internal Control in the Federal Government*.³ We conducted our review from June 2006 through June 2007 in accordance with generally accepted government auditing standards.

Results in Brief

DOD's November 2005 estimate that it will cost \$158 million to implement NSPS between 2005 and 2008 does not include the full cost that the department expects to incur as a result of implementing the new system. Federal financial accounting standards state that reliable information on the costs of federal programs and activities is crucial for effective management of government operations and recommend that full costs of

² The Washington Headquarters Services is a field activity that reports to the Director of Administration and Management, which has oversight responsibility for DOD's "Fourth Estate" entities. "Fourth Estate" entities are all organizational entities in DOD that are not in the military departments or the combatant commands. These include the Office of the Secretary of Defense, the Joint Staff, the Office of the Inspector General of DOD, the defense agencies, and DOD field activities. In this report, we will use "Washington Headquarters Services" to mean the "Fourth Estate," as defined by DOD.

³ GAO, *Internal Control Management and Evaluation Tool*, [GAO-01-1008G](#) (Washington, D.C.: August 2001) and *Standards for Internal Controls in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

programs be reported to assist Congress and executives in making informed decisions on program resources and to ensure that programs get expected and efficient results.⁴ According to the standards, the full cost of a program includes both those costs specifically identifiable to carry out the program, or direct costs, and those costs which are common to multiple programs but cannot be specifically identified with any particular program, or indirect costs.⁵ While the federal financial accounting standards emphasize that full cost information is essential for managing federal programs, their activities, and outputs, the standards provide that costs may be omitted from cost information if that omission would not change or influence the judgment of a reasonable person relying on the cost information. DOD's \$158 million estimate includes \$51 million for the Program Executive Office and \$107 million for the military services' and the Washington Headquarters Services' NSPS program management offices. However, PEO and component officials could not provide us with complete supporting documentation that identifies the specific costs included in these estimates although internal control standards require such documentation. Based on our review of the documentation provided and discussions with PEO and component officials, however, the estimate does not include all direct costs of implementing the system. For example, PEO and component officials agreed that the estimate does not include the full salary costs of all civilian and military personnel who directly support NSPS activities departmentwide. Furthermore, PEO and component officials acknowledge that the estimate does not include any of the typical indirect costs associated with the design and implementation of NSPS such as general administrative services, general research and technical support, rent, and operating and maintenance costs for buildings, equipment, and utilities. Before developing its estimate, DOD had not fully defined all the direct and indirect costs needed to manage NSPS. Without a cost estimate that includes all costs that the department expects to incur as a result of implementing the new system, decision makers—within DOD and Congress—will not have the complete cost information they need to

⁴ Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, establishes standards for managerial cost accounting information at federal agencies.

⁵ Typical direct costs include salaries and benefits for employees who work directly on NSPS activities; materials and supplies used in the work; various costs associated with office space, equipment, facilities, and utilities that are used exclusively to produce the output; and the costs of goods and services received from other segments or entities that are used to produce the output. Typical indirect costs include, among other things, general administrative services, general research, and technical support.

make decisions about whether adequate resources are being provided for implementing NSPS. Moreover, component officials told us that certain categories of the estimated costs provided by the components do not contain comparable cost elements. One of DOD's key financial management regulation principles—comparability—requires the reporting of financial management data in the same manner throughout DOD, using common definitions when necessary.⁶ The PEO did not provide detailed instructions to the components on the specific types of costs to be included in the estimate and appropriate costing methodologies. The PEO required the components to estimate costs in several broad cost categories.⁷ As a result, the Departments of the Army, Navy, and Air Force and the Washington Headquarters Services used different approaches to estimate their NSPS funding requirements. For example, Army and Navy officials told us that they estimated civilian personnel costs under the category of “Program Office Operations”; Air Force officials noted that they estimated civilian personnel costs under four other categories; and Washington Headquarters Services said that they did not estimate their NSPS costs in any of the cost categories. Without comparable cost estimates, DOD and congressional decision makers cannot contrast and compare or otherwise evaluate implementation costs across the various DOD components.

The total funds DOD has expended or obligated to design and implement NSPS during fiscal years 2005 through 2006 cannot be determined because DOD has not established an effective oversight mechanism to ensure that all these costs are fully captured in the components' official accounting systems. In May 2005, the NSPS Senior Executive established a requirement for tracking and reporting NSPS implementation costs that requires the components to develop appropriate mechanisms to capture these costs and send them to the NSPS PEO on a quarterly basis. Components were given flexibility to establish the desired level of specificity to track NSPS costs, provided the established mechanism allowed complete visibility of all costs. However, this guidance does not define the direct and indirect costs DOD requires that the components capture. DOD's pervasive financial management deficiencies have been

⁶ DOD Financial Management Regulation 7000.14-R, vol. 1, chapter 2, *Conceptual Framework* (December 1998).

⁷ (1) NSPS Design Support, (2) Training Development and Support, (3) Training Execution, (4) Communications/Website, (5) General Implementation Support, (6) NSPS Evaluation, (7) Conversion Cost, (8) HR Automated Systems, and (9) Program Office Operations.

the basis for GAO's designation of this as a high-risk area since 1995. GAO's review of the components' submitted quarterly NSPS cost reports in fiscal years 2005 and 2006 found that their official appropriation accounting systems do not capture the total amount of funds they reported that they had expended or obligated to design and implement NSPS. While the quarterly reports are intended to provide DOD with visibility over NSPS implementation costs, the PEO does not have an effective oversight mechanism or internal controls in place to ensure that the information contained in the reports is complete and accurate. The PEO relies on the components to follow the guidance for capturing NSPS costs in their official accounting systems, but it does not conduct an independent verification of the completeness or accuracy of financial data reported by the component. Without an effective oversight and quality control mechanism and internal controls to ensure that the official accounting systems capture all appropriate costs, DOD and Congress do not have adequate visibility over the actual cost to design and implement NSPS.

We are recommending that DOD define all direct and indirect costs needed to manage NSPS, prepare a revised estimate of these costs for implementing NSPS in accordance with the established definitions and federal financial accounting standards, and develop a comprehensive oversight framework to ensure that all funds expended or obligated to design and implement NSPS are fully captured and reported. In written comments on a draft of this report, DOD generally concurred with our recommendations. DOD's comments are reprinted in appendix II.

Background

The National Defense Authorization Act for Fiscal Year 2004 provided DOD with the authority to establish (1) a pay-for-performance management system, (2) an appeals process, and (3) a labor relations system—which together comprise the major components of NSPS.⁸ The legislation permits DOD significant flexibility in designing NSPS, allowing for a new framework of rules, regulations, and processes to govern how defense civilian employees are hired, compensated, promoted, and disciplined. The law grants DOD certain exemptions from laws governing federal civilian personnel management found in Title 5 of the U.S. Code.⁹

⁸ Pub. L. No. 108-136, section 1101 (2003) (codified at 5 U.S.C. sections 9901-9904).

⁹ Congress did not exempt DOD from provisions of Title 5, U.S. Code, pertaining to veterans' preference, merit systems principles, prohibited personnel practices, and equal employment opportunity.

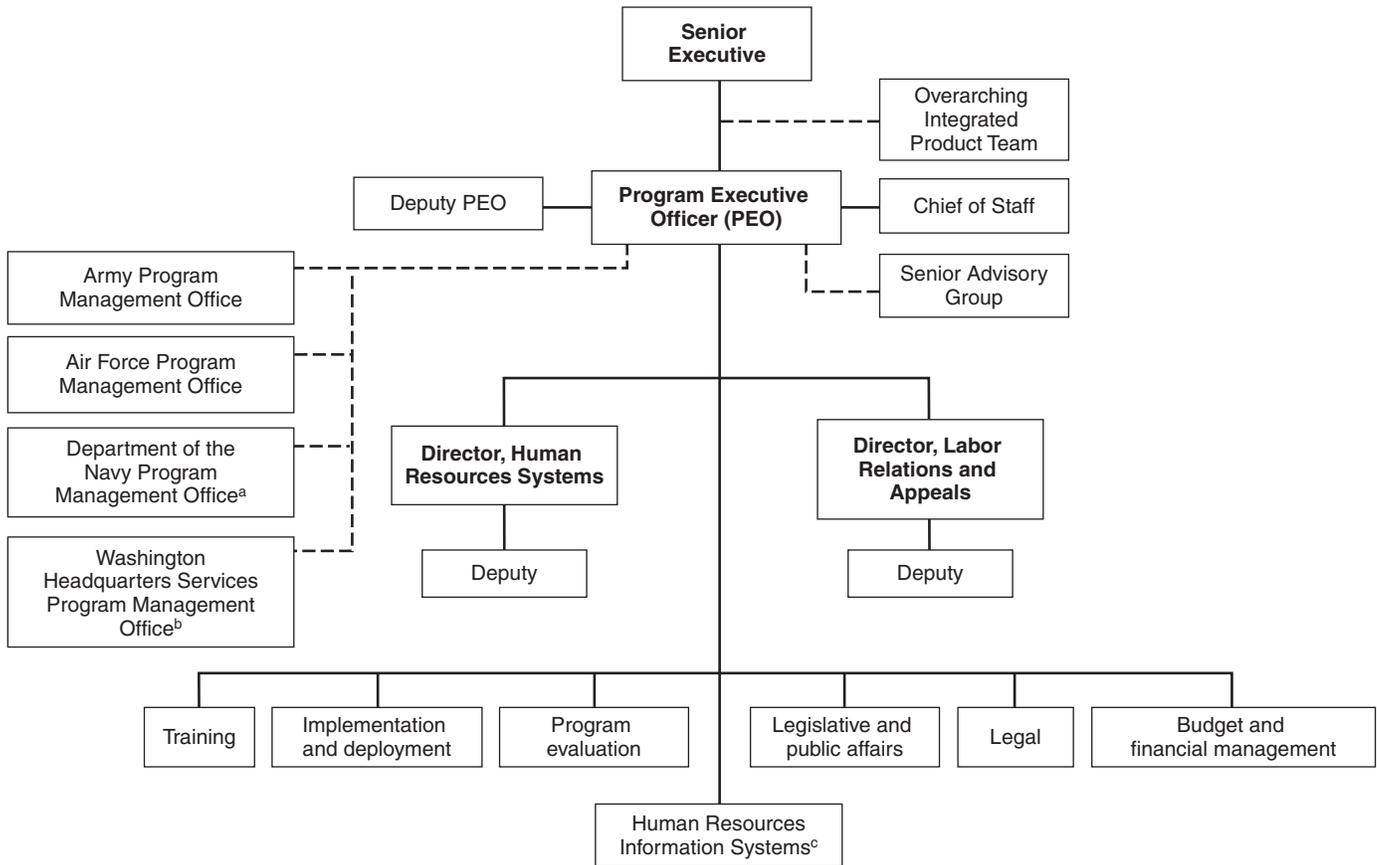
Congress provided these flexibilities in response to DOD's position that the inflexibility of federal personnel systems was one of the most important constraints to the department's ability to attract, retain, reward, and develop a civilian workforce to meet the national security mission of the 21st century.

On November 1, 2005, DOD and OPM jointly developed and issued the final NSPS regulations in the *Federal Register*.¹⁰ In the *Federal Register*, DOD estimated the overall costs associated with implementing NSPS to be approximately \$158 million through 2008. The components' estimates projected that over 700,000 civilian employees would be converted to the new system over a period of 4 years. By component, the Army projected converting 235,000 civilian employees between fiscal years 2005 and 2008; the Navy, 185,985; the Air Force, 128,408; and the Washington Headquarters Services, 156,454.

DOD established a team to design and implement NSPS and manage the transformation process. In April 2004, the Secretary of Defense appointed an NSPS Senior Executive to, among other things, design, develop, and establish NSPS. Under the Senior Executive's authority, the PEO was established as the central policy and program office to design, plan, develop, deploy, assess, and fully implement NSPS. Specifically, the PEO's responsibilities include designing the labor relations, appeals, and human resource/pay-for-performance systems; developing communication and training strategies; modifying personnel information technology; and drafting joint enabling regulations and internal DOD implementing regulations. As the central DOD-wide program office, the PEO directs and oversees the components' NSPS program managers, who report to their parent components and the NSPS PEO. These program managers also serve as their components' NSPS action officers and participate in the development, planning, implementation, and deployment of NSPS. Figure 1 shows the organization of the NSPS design and implementation team.

¹⁰ Department of Defense Human Resources Management and Labor Relations System, 70 *Fed. Reg.* 66,116 (Nov. 1, 2005) (codified at 5 C.F.R. pt. 9901).

Figure 1: NSPS Design and Implementation Team Organization



— Direct reporting authority

- - - Indirect reporting authority

Source: DOD.

^aIncludes the U.S. Navy and the U.S. Marine Corps.

^bThe Washington Headquarters Services is a field activity that reports to the Director of Administration and Management, which has oversight responsibility for DOD's "Fourth Estate" entities. "Fourth Estate" entities are all organizational entities in DOD that are not in the military departments or the combatant commands. These include the Office of the Secretary of Defense, the Joint Staff, the Office of the Inspector General of DOD, the defense agencies, and DOD field activities.

^cThis group is responsible for satisfying human resources information technology (and related) system requirements and integrating the resulting systems.

DOD's Estimated Costs to Implement NSPS Do Not Fully Represent Its Total Resource Needs

DOD's estimate that it will cost \$158 million to implement NSPS between 2005 and 2008 does not include the full cost that the department expects to incur as a result of implementing the new system.

Federal financial accounting standards state that reliable information on the costs of federal programs and activities is crucial for effective management of government operations and recommend that full costs of programs be reported so that decision makers have information necessary to make informed decisions on resources for programs, activities, and outputs, and to ensure that they get expected and efficient results. According to the standards, the full cost of a program or activity includes both those costs that are specifically identifiable to carry them out, or direct costs, and those costs that are common to multiple programs or activities but cannot be specifically identified with any particular program or activity, or indirect costs. While the standards emphasize that cost information is essential for managing federal programs, their activities, and outputs, the standards also provide that items may be omitted from cost information if that omission would not change or influence the judgment of a reasonable person relying on the cost information.

To implement NSPS, the PEO estimated costs of about \$51 million for the start-up and operation of its office and the start-up of the National Security Labor Relations Board. The components estimated costs of about \$23 million in fiscal year 2005, about \$27 million in fiscal year 2006, about \$35 million in fiscal year 2007, and \$22 million in fiscal year 2008, as shown in table 1. Typical direct costs include salaries and benefits for employees who work directly on NSPS activities; materials and supplies used in the work; various costs associated with office space, equipment, facilities, and utilities that are used exclusively to produce the output; and the costs of goods and services received from other segments or entities that are used to produce the output.

Table 1: DOD Fiscal Year 2005-2008 Estimate of Cost to Implement NSPS

Dollars in thousands

DOD component	Fiscal year 2005	Fiscal year 2006	Fiscal year 2007	Fiscal year 2008	Total
Army	\$6,627	\$9,897	\$17,199	\$10,213	\$43,936
Navy	4,161	5,597	5,430	4,552	19,740
Air Force	7,300	5,731	4,704	2,070	19,805
Washington Headquarters Services	5,230	5,943	7,845	4,755	23,773
NSPS Program Executive Office	0	0	0	0	51,000^a
Total	\$23,318	\$27,168	35,178	21,590	\$158,000

Source: NSPS PEO.

Note: Numbers may not total due to rounding.

^aThe NSPS Program Executive Office estimated \$38 million for the start-up and operation of its office and \$13 million for the start-up of the National Security Labor Relations Board.

DOD's estimate included several broad cost categories. These categories are (1) design and implementation, (2) training, (3) evaluation, (4) human resources automated systems, and (5) program office operations. DOD's estimate contained some examples of the types of costs included in each of these broad categories. However, before calculating its estimate, DOD had not fully defined what direct and indirect costs should be included for it to effectively manage NSPS. Neither could DOD provide us with complete supporting documentation that identifies the specific types of costs included in its estimate. The *Standards for Internal Controls in the Federal Government* require that all transactions and other significant events, such as cost estimates, be clearly documented.¹¹

Based on our review of the documentation provided by DOD and discussions with PEO and component officials, however, the estimate does not include all direct costs of implementing the system. For example, PEO and component officials stated that the estimate includes direct costs for the start-up and operation of the Program Executive Office and the National Security Labor Relations Board; development and delivery of training materials, Web-based courses, and classroom sessions by DOD contractor and civilian instructors; modification of existing automated personnel and payroll transaction processing systems—the Defense Civilian Personnel Data System and the Defense Civilian Pay System—to accommodate changes brought about by NSPS; travel costs for NSPS

¹¹ GAO-01-1008G and GAO/AIMD-00-21.3.1.

trainers and training participants; outreach with employees and other parties; and collaboration activities with employee representatives. However, PEO and component officials agreed that the estimate does not include all direct costs of implementing the system. For example, PEO and component officials agreed that the estimate does not include the full salary costs of all civilian and military personnel who directly support NSPS activities departmentwide and any of the direct costs that the various organizations and defense agencies expect to incur to implement the system, such as salaries and benefits for employees who work directly on NSPS activities and materials and supplies used in NSPS activities. Furthermore, PEO and component officials acknowledge that the estimate did not include any of the typical indirect costs associated with the design and implementation of NSPS such as costs of general administrative services, general research, and technical support. Without a cost estimate that includes all costs that the department expects to incur as a result of implementing the new system, decision makers—within DOD and Congress—will not have the complete cost information they need to make decisions about whether adequate resources are being provided for implementing NSPS.

Moreover, component officials told us that certain categories of the estimated costs provided by the components do not contain comparable cost elements. One of DOD's key financial management regulation principles—comparability—requires the reporting of financial management data in the same manner throughout DOD, using common definitions when necessary.¹² However, officials from the Departments of the Army, Navy, and Air Force and the Washington Headquarters Services told us that they used different approaches to estimate NSPS funding requirements when calculating this cost estimate. While the PEO issued general instructions to the military services and the Washington Headquarters Services for estimating the costs associated with the design and implementation of NSPS, this office did not provide a description of the specific types of direct and indirect costs to be included in the estimate or a cost-estimating methodology containing assumptions and approaches. The PEO guidance provided a general reporting template with broad cost categories but did not contain detailed instructions for ensuring comprehensive and comparable cost estimates. Army and Navy officials told us that they estimated civilian personnel costs under the

¹² DOD Financial Management Regulation 7000.14-R, vol. 1, chapter 2, *Conceptual Framework* (December 1998).

category of “Program Office Operations”; the Air Force officials noted that they estimated civilian personnel costs under four other categories; and Washington Headquarters Services officials stated that they did not estimate their NSPS design and implementation costs in any of the eight categories. Without comparable cost estimates, DOD and congressional decision makers cannot contrast and compare or otherwise evaluate NSPS implementation costs across the various DOD components.

Total Funds Expended or Obligated to Design and Implement NSPS Cannot Be Determined

The total amount of funds DOD has expended or obligated to design and implement NSPS during fiscal years 2005 through 2006 cannot be determined because DOD has not established an effective oversight mechanism to ensure that all these costs are fully captured. In May 2005, the NSPS Senior Executive established guidance intended to provide the PEO with visibility over NSPS expenditures. The guidance requires the components to develop appropriate mechanisms to capture these costs within their official appropriation accounting systems and allows them flexibility to establish the desired level of specificity to track NSPS costs—such as a job order number and cost account code—provided the established mechanism allows complete visibility of all costs. In addition, the guidance requires the components to submit reports quarterly of their NSPS obligations to the NSPS PEO. This guidance does not, however, define the direct and indirect costs that DOD requires the components to capture. Our prior work on DOD’s financial and related business management and systems has revealed pervasive deficiencies that affect its ability to control costs; ensure basic accountability; anticipate future costs and claims on the budget; measure performance; maintain funds control; prevent and detect fraud, waste, and abuse; and address pressing management issues. GAO first designated DOD financial management as high risk in 1995.

Based on discussions with PEO and component officials and our review of the quarterly reports of NSPS implementation costs submitted for fiscal years 2005 and 2006, the components’ official appropriation accounting systems do not capture the total amount of funds reported expended or obligated to design and implement NSPS. By component, the Army’s quarterly reports indicated that \$9.8 million had been obligated to implement NSPS; however, just \$6.0 million of these costs were captured in the Army’s official accounting system. The remaining \$3.8 million was not captured in the Army’s official accounting system, and Army officials could not provide sufficient evidence supporting the amount. The Air Force’s quarterly reports indicated that \$21.7 million had been obligated to implement NSPS, of which \$3.8 million was captured in its official

accounting system. According to Air Force officials, the remaining reported amount, \$17.9 million, was an estimate of expended and obligated funds Air Force-wide. The Navy and the Washington Headquarters Services reported \$21.6 million and \$13.1 million, respectively, but neither component was able to provide any evidence that these obligated funds had been captured in their official accounting systems.

While the quarterly NSPS cost reports are intended to provide DOD with visibility over NSPS implementation costs, the PEO does not have an effective oversight mechanism or internal controls in place to ensure that the information contained in the reports is complete and accurate. The *Standards for Internal Controls in the Federal Government* sets out management controls for all aspects of an agency's operations. The *Standards* emphasize the importance of management oversight and review to ensure that programs, their activities, and outputs continue to meet their intended goals and comply with the law and policies and recommend that agencies establish internal controls to monitor and review operations and programs to provide reasonable assurance that they meet their goals. Moreover, although the PEO relies on the components to follow its guidance for capturing NSPS costs in their official accounting systems, it does not conduct an independent verification of the completeness or accuracy of financial data reported by the components. Although independent verification is an important internal control activity under segregation of duties designed to reduce the risk of errors, PEO officials told us that none of the reports submitted by the components are reviewed by an independent or second reviewer to ensure that the information reported is accurate or complete. Federal internal control standards require that data control activities, such as verification and reconciliation, be conducted and documented to help provide reasonable assurance that the objectives of a program and its activities are being met.¹³ Moreover, we consider establishing such controls, including policies and oversight mechanisms, a best practice that can ensure greater visibility over the total costs associated with the design and implementation of NSPS. Without an effective oversight mechanism and internal controls, DOD and Congress do not have adequate visibility over the actual cost to design and implement NSPS.

¹³ [GAO-01-1008G](#) and [GAO/AIMD-00-21.3.1](#).

Conclusions

At a time when DOD is competing for resources in an increasingly fiscally constrained environment, it is critically important that DOD and Congress know the full cost to design and implement NSPS. Defining what direct and indirect costs are needed to effectively manage NSPS is a crucial first step for the department and Congress to lay a foundation for future decisions. Without a full cost estimate, decision makers within DOD and Congress will not have the complete cost information they need to make decisions about whether adequate resources are being provided for implementing NSPS. Moreover, the cost information that makes up the components' portion of the overall DOD cost estimate was prepared using different approaches and is therefore not comparable. Without comparable cost estimates, DOD and congressional decision makers cannot contrast and compare or otherwise evaluate NSPS implementation costs across the various DOD components.

Although the components are reporting NSPS implementation costs, the total amount of funds DOD has expended or obligated to design and implement the system cannot be determined. Until the PEO establishes an effective oversight mechanism with reporting requirements and independent verification processes, DOD cannot ensure that the components track and report cost information that includes funds that they have expended or obligated to design and implement NSPS. Without an effective oversight mechanism, DOD and Congress do not have adequate visibility over the actual cost to design and implement NSPS.

Recommendations for Executive Action

To provide decision makers in DOD and Congress with improved visibility and internal controls over the costs of NSPS, we recommend that the Secretary of Defense direct the National Security Personnel System Senior Executive to take the following three actions:

- Direct the NSPS Program Executive Office to define all direct and indirect costs necessary to effectively manage NSPS, in accordance with internal control standards, federal financial accounting standards, and DOD's financial management regulation principle related to comparability.
- Direct the NSPS Program Executive Office to prepare a revised estimate of the full costs of implementing NSPS in accordance with the established definitions, internal control standards, federal financial accounting standards, and DOD's financial management regulation principle related to comparability.

-
- Develop a comprehensive oversight framework to ensure that all funds expended or obligated to design and implement NSPS are fully captured and reported. Such a framework should establish quality controls, including independent reviews of the data being reported by the components in the quarterly reports, to ensure the accuracy and completeness of the reported information.

Agency Comments and Our Evaluation

DOD provided written comments on a draft of this report and generally agreed with our recommendations. In an overall comment, DOD noted that NSPS is not a program; however, it also noted that DOD modeled the development and implementation of NSPS on the acquisition model. Also, the department noted that costing and accounting requirements for NSPS were never intended to be the same as those for the acquisition model. We believe DOD raises this point because we used the federal financial accounting standards to analyze DOD's costs associated with the implementation of NSPS. We note in our report that federal financial accounting standards not only apply to the cost of *programs*, but also to the cost of *activities* such as NSPS. Therefore, we believe that the same costing and accounting rigor and discipline that are applied to major acquisition programs should apply to NSPS.

DOD partially concurred with our recommendation to define all direct and indirect costs necessary to effectively manage the program, its activities, and outputs, in accordance with internal control standards, federal financial accounting standards, and DOD's financial management regulation principle related to comparability. DOD stated that the PEO is reconstituting the Financial Integrated Product Team (IPT) to define all direct and indirect costs necessary to effectively manage the program; relook at the original cost categories to determine if they are still appropriate and change if appropriate; and stipulate the costs included in each category. If the PEO follows through with its effort, we believe that it will be responsive to our recommendation. Regarding indirect costs, DOD stated that a test of reasonableness was applied. The department explained that the components were allowed to weigh the cost/benefit of collecting, tracking, and reporting indirect costs. While we agree that it is indeed appropriate for the components to apply a test of reasonableness to weigh the cost/benefit of collecting, tracking, and reporting indirect costs, it is important to note that a crucial first step for the department to lay a foundation for such decisions about reasonableness is to define what direct and indirect costs are needed to effectively manage NSPS. It is also important to note that we cannot verify DOD's statement that the components applied a reasonableness test because DOD did not provide

documentation to reflect this during our review. DOD further stated that the PEO had tracked both direct and indirect costs. While the PEO does capture funds it expended or obligated to design and implement NSPS, we continue to believe that the total amount of funds DOD has expended or obligated to design and implement NSPS cannot be determined because DOD has not established an effective oversight mechanism to ensure that the cost information reported is accurate and complete.

Regarding our recommendation to prepare a revised estimate of the full costs of implementing NSPS in accordance with established definitions, internal control standards, federal financial accounting standards, and DOD's financial management regulation principle related to comparability, the department concurred, noting that the PEO will develop an estimate covering fiscal years 2008 through 2011.

DOD concurred with our recommendation that the NSPS Senior Executive develop a comprehensive oversight framework to ensure that NSPS funds that are expended or obligated are fully captured and reported, noting that the department should leverage existing policies and procedures to ensure oversight of these costs. However, in the absence of more specific details on its planned actions to leverage existing policies and procedures to ensure oversight of NSPS costs, we continue to emphasize the department's need for a comprehensive oversight framework because without it DOD and Congress do not have adequate visibility over the actual cost to design and implement NSPS.

We are sending copies of this report to the appropriate congressional committees. We will make copies available to others upon request. This report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-5559 or by e-mail at stewartd@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to the report are listed in appendix III.



Derek B. Stewart
Director, Defense Capabilities and Management

List of Congressional Committees

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

The Honorable Daniel Inouye
Chairman
The Honorable Ted Stevens
Ranking Member
Subcommittee on Defense
Committee on Appropriations
United States Senate

The Honorable Joseph I. Lieberman
Chairman
The Honorable Susan M. Collins
Ranking Member
Committee on Homeland Security
and Governmental Affairs
United States Senate

The Honorable Daniel K. Akaka
Chairman
The Honorable George V. Voinovich
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

The Honorable Ike Skelton
Chairman
The Honorable Duncan Hunter
Ranking Member
Committee on Armed Services
House of Representatives

The Honorable John P. Murtha
Chairman
The Honorable C.W. Bill Young
Ranking Member
Subcommittee on Defense
Committee on Appropriations
House of Representatives

Appendix I: Scope and Methodology

To determine the extent to which the Department of Defense (DOD) has estimated the current and future total costs associated with the implementation of the National Security Personnel System (NSPS), we reviewed the estimate that was published in the NSPS Final Regulations.¹ We also analyzed guidance the NSPS Program Executive Office (PEO) provided to the components that would be providing input to this estimate. We interviewed officials from the PEO and the NSPS Program Management Offices for the Navy (which is also responsible for the Marine Corps), the Army, the Air Force, and the Washington Headquarters Services to discuss how they had interpreted the guidance directing them to estimate NSPS costs, and we obtained and reviewed documents of the estimates provided by the NSPS Program Management Offices to the PEO. To determine what costs should be included in NSPS estimates, we analyzed government accounting standards defined in the following documents: DOD Financial Management Regulation 7000.14-R, vol. 1, chapter 2, Conceptual Framework, December 1998, and “Managerial Cost Accounting Concepts and Standards for the Federal Government,” Number 4, July 31, 1995.

To determine the extent to which DOD expended or obligated funds to design and implement NSPS through fiscal year 2006, we obtained quarterly reports collected by the PEO and consolidated for fiscal years 2005 and 2006. To gain an understanding of the roles and responsibilities of the various organizations in tracking NSPS cost data, we reviewed pertinent NSPS documents, including the NSPS Requirements Document, the Charter for the PEO, and the memorandum sent out by the PEO directing that the components report their NSPS costs on a quarterly basis. We reviewed quarterly reports provided by the components and the PEO for the 2-year period and interviewed officials from each of the component PMO offices to gather documentation showing how the reported data had been captured. We compared the quarterly reports to data from the components’ official accounting systems to determine what NSPS cost data had been captured in these accounting systems. To obtain criteria for tracking and managing the costs of programs, activities, and outputs, we compared the PEO’s management of the reporting of NSPS costs with internal control factors described in *Internal Control Management and Evaluation Tool and Standards for Internal Control in the Federal Government*.

¹ 70 *Fed. Reg.* 66,187 (Nov. 1, 2005).

We conducted our review from June 2006 through June 2007 in accordance with generally accepted government auditing standards.

Appendix II: Comments from the Department of Defense



DEPARTMENT OF DEFENSE
NATIONAL SECURITY PERSONNEL SYSTEM
PROGRAM EXECUTIVE OFFICE
1400 KEY BOULEVARD SUITE B200
ARLINGTON, VA 22209-5144



June 18, 2007

Mr. Derek B. Stewart
Director, Defense Capabilities and Management
U.S. Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Stewart:

Enclosed is the Department of Defense (DoD) response to the GAO draft report, "HUMAN CAPITAL: DoD Needs Better Internal Controls and Visibility over Costs for Implementing Its National Security Personnel System," dated June 7, 2007, (GAO Code GAO-07-851). I thank you for the opportunity to review and comment on the draft report.

Generally, we believe that the report adequately portrays our efforts to capture costs for the design and implementation of the National Security Personnel System (NSPS). Responses to specific recommendations include comments on items in the report we would like to clarify or correct.

NSPS is not a program but a personnel system that, when fully implemented, will replace the current General Schedule (GS) personnel system for a majority of the Department's civilian employees. While the Department decided to model the development and implementation of this system based on the acquisition model, the costing and accounting requirements were never intended to be the same.

Again, thank you for the opportunity to comment and respond. We appreciate the thorough and professional job performed by you and your team and your recognition of the challenges faced in implementing NSPS. If you have any questions regarding this response, please do not hesitate to contact me.

Sincerely,

A handwritten signature in cursive script that reads "Mary E. Lacey".
Mary E. Lacey
Program Executive Officer

ENCLOSURE

GAO DRAFT REPORT – DATED June 7, 2007
GAO CODE GAO-07-851

**“HUMAN CAPITAL: DoD Needs Better Internal Controls and Visibility over
Costs for Implementing the National Security Personnel System”**

DOD RESPONSES TO RECOMMENDATIONS

RECOMMENDATION 1: The GAO recommends that the Secretary of Defense direct the National Security Personnel System (NSPS) Senior Executive to direct the NSPS Program Executive Office to define all direct and indirect costs necessary to effectively manage the program, its activities, and outputs, in accordance with internal control standards, federal financial accounting standards, and DoD’s financial management regulation principle related to comparability.

DOD RESPONSE: Partially Concur. The NSPS Senior Executive, in a May 4, 2005 memorandum, communicated the requirement to establish internal procedures for tracking and reporting NSPS design and implementation costs to include capturing the costs within their official appropriate accounting system. Significant effort was expended to identify and collect costs that could assist management officials with making good business decisions regarding the design and implementation of NSPS.

The following categories were determined critical:

- Design and Implementation
- Training Development, Support and Execution
- HR Automated Systems
- Program Evaluation
- Program Office Operations

In regard to indirect costs, a test of reasonableness was applied. If a cost already existed to support prescribed Departmental business, such as a training facility used to conduct a wide variety of training, and NSPS utilized some of the rooms for training purposes, the Department did not capture a portion of the utility or facility maintenance cost and report it as a NSPS cost. However, Components were allowed to weigh the cost/benefit of collecting, tracking, and reporting indirect costs and although not reflected in the GAO Draft Report, the PEO NSPS did track both direct and indirect costs.

The Program Executive Officer is reconstituting the Financial IPT to: define all direct and indirect costs necessary to effectively manage the program; relook the original cost categories to determine if they are still appropriate and change if appropriate; and stipulate the costs included in each category to eliminate ambiguity.

RECOMMENDATION 2: The GAO recommends that the Secretary of Defense direct the NSPS Senior Executive to direct the NSPS Program Executive Office to prepare a revised estimate of the full costs of implementing NSPS in accordance with the established definitions, internal control standards, federal financial accounting standards, and DoD's financial management regulation principle related to comparability.

DOD RESPONSE: Concur. The Program Executive Office will develop a revised estimate of applicable costs for implementing NSPS covering fiscal years 2008 through 2011, the year the NSPS Program Executive Office sunsets. As is true for the first estimate for the costs of implementing NSPS, the revised estimate could be affected by Congressional changes to the authorities that govern the system, and any changes to the NSPS implementation schedule.

RECOMMENDATION 3: The GAO recommends that the Secretary of Defense direct the NSPS Senior Executive to develop a comprehensive oversight framework to ensure that all funds expended or obligated to design and implement NSPS are fully captured and reported. Such a framework should establish quality controls, including independent reviews of the data being reported by the components in the quarterly reports, to ensure the accuracy and completeness of the reported information.

DOD RESPONSE: Concur. The Department should leverage existing policies and procedures to ensure oversight of those costs that assist management officials with making good business decisions regarding the design and implementation of NSPS.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Derek B. Stewart, (202) 512-5559 or stewartd@gao.gov

Acknowledgments

In addition to the contact named above, John Needham, Acting Director; Sandra Burrell, Assistant Director; Margaret Braley; Renee Brown; Nicolaas Cornelisse; William Doherty; Cara Kochheiser; Julia Matta; Donald Neff; Charles Perdue; Beverly Schladt; Rebecca Shea; and John Warner made key contributions to this report.

Related GAO Products

Human Capital: Observations on Final Regulations for DOD's National Security Personnel System. [GAO-06-227T](#). Washington, D.C.: November 17, 2005.

Human Capital: DOD's National Security Personnel System Faces Implementation Challenges. [GAO-05-730](#). Washington, D.C.: July 14, 2005.

Questions for the Record Related to the Department of Defense's National Security Personnel System. [GAO-05-771R](#). Washington, D.C.: June 14, 2005.

Questions for the Record Regarding the Department of Defense's National Security Personnel System. [GAO-05-770R](#): Washington, D.C.: May 31, 2005.

Post-hearing Questions Related to the Department of Defense's National Security Personnel System. [GAO-05-641R](#). Washington, D.C.: April 29, 2005.

Defense Management: Key Elements Needed to Successfully Transform DOD Business Operations. [GAO-05-629T](#). Washington, D.C.: April 28, 2005.

Human Capital: Preliminary Observations on Proposed Department of Defense National Security Personnel System Regulations. [GAO-05-559T](#). Washington, D.C.: April 14, 2005.

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

Human Capital: Preliminary Observations on Proposed DOD National Security Personnel System Regulations. [GAO-05-432T](#). Washington, D.C.: March 15, 2005.

Department of Defense: Further Actions Are Needed to Effectively Address Business Management Problems and Overcome Key Business Transformation Challenges. [GAO-05-140T](#). Washington, D.C.: November 18, 2004.

DOD Civilian Personnel: Comprehensive Strategic Workforce Plans Needed. [GAO-04-753](#). Washington, D.C.: June 30, 2004.

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

Human Capital: Building on DOD's Reform Efforts to Foster Governmentwide Improvements. [GAO-03-851T](#). Washington, D.C.: June 4, 2003.

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

DOD Personnel: DOD Actions Needed to Strengthen Civilian Human Capital Strategic Planning and Integration with Military Personnel and Sourcing Decisions. [GAO-03-475](#). Washington, D.C.: March 28, 2003.

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