## Post-Hearing Questions for the Record Submitted to

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U.S. Department of Army
From Senator McCaskill
"Contractors: How Much Are They Costing the Government?"

Tuesday, March 29, 2012, 10:00 A.M.

## **United States Senate, Subcommittee on Contracting Oversight, Committee on Homeland Security and Governmental Affairs**

Question: To what extent is the Army sharing any lessons learned on the development of its contractor inventory with the Office of Management and Budget, civilian agencies or other military departments and defense components?

Answer: The Army has shared lessons learned on the development of its contractor inventory extensively with other military departments. Numerous meetings have taken place between the Army and its relevant counterparts in other military departments in order to share the Army's experiences with them. The Army also had the opportunity to meet with representatives from the Office of Management and Budget in January 2010 to discuss lessons learned with them, though it has not otherwise had the opportunity to meet with agencies and components outside the Department of Defense.

Question: To what degree is the contractor inventory data informing or improving the process by which Army personnel are making acquisition decisions?

Answer: To date, contractor inventory data has been primarily used by the Manpower community in its Total Force Management reviews. Beginning in Fiscal Year 2012, however, the Army Acquisition Executive is obtaining Army-wide semi-annual service requirements forecasts and quarterly cost reports for service acquisitions valued at \$10M or more to provide program management and funding visibility for services acquisitions. Additionally, the Panel for Documentation of Contractors has, since 2009, performed a contractor inventory review to identify inherently governmental, closely associated with inherently governmental, critical, and authorized and unauthorized personal services functions.

Question: When the analysis shows that using a federal employee is the best route, is the Army actually able to do this? If not, why? Please provide examples.

Answer: When the analysis shows that using a federal employee is the best route, the Army is able to do this, subject to certain constraints. The Resource Management Decision 703A2 issued by the Secretary of Defense directed the Components to freeze their civilian full-time equivalents (FTE) for Fiscal Year (FY) 2011 through FY 2013 (and later extended through FY 2018) to the levels budgeted in FY 2010. This "civilian cap" has reduced the flexibility of the Army to utilize the types of manpower it sees as most beneficial to the performance of its missions.

Additionally, since the implementation of the Secretary of the Army's in-sourcing policy dated 1 February 2011, individual Commands within the Army have functioned with de facto civilian hiring ceilings in order to keep the Army compliant with the civilian FTE freeze. Since that time, the Secretary of the Army has given permission for the hiring against 640 positions and the creation of 79 new authorizations due to in-sourcing.

Question: Have the current caps on federal employees hiring hampered agencies from actually making cost-analysis based decisions when contracting?

Answer: The current caps on federal employees hiring have hampered agencies from actually making cost-analysis based decisions when contracting. The civilian full time equivalent cap instituted by the Secretary of Defense in Resource Management Decision 703A2 has had the side effect of removing some of the flexibility that the Army and its attendant Commands previously had to manage its workforce to the appropriate manpower mix. In practical terms, if the Army cannot hire civilians, then it must turn to other sources of labor—like contracting—when it needs to execute missions, provided the work is not inherently governmental.

Question: How many exemptions from the civilian caps have been requested? How many have been granted? Please provide a short explanation of the functions at issue and the Department's reasons for granting or denying the exemptions.

Answer: The only Army request to OSD for relief from the civilian cap was made by the Secretary of the Army on 5 April 2012. This exemption was a request regarding 857 positions at the Defense Language Institute Foreign Language Center (DLIFLC). The DLIFLC trains military personnel and civilian employees from across the Department of Defense, and supports the Department's intelligence missions.

The Army is the Executive Agent for the DLIFLC and made this request in order to continue offering instruction and support for students in 23 different languages and two dialects, including strategically vital languages like Arabic and Farsi. OSD has not yet responded to this request for an exemption, so a discussion of the Department's reasons for granting or denying the exemption is not possible at this time.

Question: What further analysis will need be done to fully understand the information collected by the Army regarding overhead costs? When will that work be completed?

Answer: The deadline for the collection of Fiscal Year 2011 data in the Contractor Manpower Reporting Application (CMRA) was May 1, 2012. As such, we are now concluding the closeout for the data collection itself and can proceed to analysis.

Analysis of the collected data has not yet been conducted, as the collection was not, as mentioned, complete. Now that the collection has been finished, analysis on a number of different factors can be initiated on a collaborative basis between the Assistant Secretary of the Army for Acquisition, Logistics, and Technology, and the Assistant Secretary of the Army for Financial Management and Comptroller, and the Assistant Secretary of the Army for Manpower and Reserve Affairs. Analysis will include, among other things, the examination of the effect levels of subcontracting have on overall and overhead costs, as well as the effect that the type of contract vehicle and type of contract service has on overall and overhead costs.

Given the recent completion of the data collection and the need to now begin analysis, it is expected that data examination and synthesis by the aforementioned offices will require around six months to complete.

Question: Please estimate the savings to the Army in the event that the contractor compensation cap is lowered to \$400,000 per year.

Answer: If a \$400K/Full Time Equivalent (FTE) Rate Cap was applied to the Fiscal Year (FY) 2011 Army Inventory of Contract Services, labor costs reported in the Contractor Manpower Reporting Application (CMRA) for FY 2011 would be reduced by \$6B (approximately 15% of the \$41B in invoices reported in FY 2011 for contract services).

This estimate was reached utilizing the following methodology:

- 1. Using the data reported in CMRA for the FY 2011 Inventory of Contract Services, Labor Costs and Labor Rates were computed for the individual services listed within each Contract Task Order, where:
  - a. Labor Cost = Total Amount Invoiced minus Direct Non-Labor Cost; and
  - b. Labor Rate = Labor Cost divided by Number of Contractor FTEs.
- 2. For labor rates greater than \$400K/FTE, the associated labor costs were recomputed using the \$400K maximum. Reductions in labor costs using this method totaled \$6B.
- 3. Total costs reported for contract services in CMRA for FY 2011 amounted to \$41B. The application of the \$6B reduction from the utilization of the \$400,000/FTE cap represents a drop to \$35B, a reduction of approximately 15%.

Question: You stated that contractor costs are not accounted for in the budget process prospectively. What are the challenges with projecting contractor costs forward?

Answer: There are two main challenges associated with projecting contractor costs forward. The first challenge is that many of the services and skills provided by contractors are not necessarily full-time, enduring requirements, but rather provide Army with various services and skills to complete a variety of functional requirements. Although some of the requirements for which Army contracts for services are enduring, using task-based contracts provides Army the flexibility to execute funding on a variety of functional requirements throughout the year of execution whereas programming an enduring requirement for a civilian billet for a specific requirement limits the Army's flexibility to adjust to emerging requirements.

The second main challenge arises from the fact that the budget is built from Object Classes. Contract services, however, are managed and grouped into "portfolios," as directed by USD(ATL) in response to statutory mandate. These budget objects and portfolios are not interchangeable: there is no clear cross-walk between them. Acquisition support managers are supposed to be controlling contract services spending based on these portfolios, but because these portfolios are not interchangeable with the object classes used in the budget and financial accounting systems, this cannot be done effectively. Object Class data itself is also not without

its own flaws; the "Other services" object class includes a disparate variety of functions, like data digitization, chaplain services, intelligence services, and auditing. This kind of problem in budget object classifications only serves to further exacerbate the problem of lack of interchangeability with portfolios, and makes it even more difficult to project contracts costs forward.

Question: In testimony you stated that from FY08 to FY10 the Army was able to reduce expenditures on non-OCO service contracts from \$51B to \$36B. You stated that this reduction stemmed from an insourcing program combined with the contractor inventory review process. In FY11 that amount increased to \$40B.

Answer: The facts presented above are correct and consistent with our written testimony. From Fiscal Years 2008 to 2010, there was indeed a decrease in expenditures on non-Overseas Contingency Operations (OCO) funding for contract services, as a result of the Department of Defense's institution of an active in-sourcing program, as well its service contract pre-award approval process and contractor inventory review process.

Question: Why was there an increase in FY11 service contract expenditures?

Answer: There was an increase in service contract expenditures in Fiscal Year (FY) 2011 due to the confluence of various factors. The voluntary in-sourcing program, as well as the use of preaward analysis via the Panel for Documentation of Contractors, both contributed to the decline in service contract expenditures. In FY 2010, in-sourcing was no longer voluntary and was mandated by budgetary targets. Some viewed these targets as upward limits on in-sourcing, even for inherently governmental functions. In FY 2011, the institution of the civilian full time equivalent cap removed a great deal of the Army's flexibility in determining its manpower mix, but this flexibility was not accompanied by an attendant reduction in mission.

Question: Have you continued to subject contracts for services to the same pre-award analysis?

Answer: Yes, the Army has continued to subject contracts for services to the same pre-award analysis. However, the effect of mandated in-sourcing targets through the budget process starting in Fiscal Year 2010, combined with the subsequent full time equivalent cap, can often override the results of such pre-award analysis, as funding drives behavior.

Question: What impact did this have on Army spending for federal civilians or was there any correlation at all?

Answer: Total pay for Army civilians in Fiscal Years (FY) 2009-2011 is as follows:

FY 2009: \$20,257,579,000

FY 2010: \$21,820,440,000

FY 2011: \$24,154,232,000

The Army's in-sourcing brought 921 civilians onboard in FY 2009, 6039 civilians in FY 2010, and 1126 civilians in FY 2011. The increase in total pay for Army civilians in FY 2009-2011

seen above cannot be solely explained by this in-sourcing. The addition of 921 civilians through in-sourcing in FY 2009 increased Army spending on civilian pay by about \$96.5M; the addition of 6039 in FY 2010 increased spending by about \$636.5M; and the addition of 1126 in FY 2011 increased spending by about \$125.2M. These three years combined amount to about \$858M, but even the combined amount is not enough to account for the spending increase outlined above.

Question: Can the Army distinguish between non-OCO and OCO related service contracting costs?

Answer: Yes, as described in the testimony, the Army can distinguish between non-Overseas Contingency Operations (OCO) and OCO related service contracting costs. The accounting system itself can identify a substantial amount of OCO-funded contractor services, though the accounting is neither perfect nor complete.

Question: Are there functions that could be classified as inherently governmental being performed by contractors at this time in the Army? Please explain why and what is being done to change that.

Answer: Yes, there are functions that could be classified as inherently governmental being performed by contractors at this time in the Army. There are a number of possible reasons for this. When a function being performed by a contractor is identified as being inherently governmental, that function's performance must be divested, shifted to existing workforce if it cannot be divested, or in-sourced, if neither of the previous options is possible. In-sourcing of functions can, at times, be a lengthy process, not the least because of the need to identify offsets as a result of the civilian full time equivalent cap.

Additionally, the realities of actual contract performance are such that inherently governmental functions may be performed by contractors, even if statements of work deliberately exclude such functions. The Army's review of contracted work, both by individual contract and by task order, is an ongoing process, performed at both the pre-award and post-award stages. In practical terms, this review and analysis is iterative, and the longer it goes on, the greater the likelihood that more inherently governmental functions will be identified and appropriately dealt with.

Finally, the Secretary of the Army recently issued guidance on 10 February, 2012, that will withdraw funds by May 2012 from organizations that continue to contract inherently governmental functions or unauthorized personal services contracts and have not submitted packages within 90 days to in-source those functions.

Question: The Government Accountability Office (GAO) released a report (GAO-12-357) on April 6, 2012 that found that the Army inventory review identified 1,935 instances in which contractors were performing inherently governmental functions. According to GAO, in 8 of the 12 Army and Air Force cases GAO reviewed, contractors continued to perform inherently governmental functions because of DOD's decision to cap the number of civilian federal employees at 2010 levels. Is the Army continuing to review functions that are closely associated to inherently governmental or critical?

Answer: Yes, the Army is continuing to review functions that are closely associated with inherently governmental or critical. In a memo dated December 29, 2011, the Acting Under Secretaries of Defense for Acquisition, Technology, and Logistics, and Personnel and Readiness directed the Department components to complete an Inventory of Contracts for Services for Fiscal Year 2011, a part of which is the "identification of contracts under which functions closely associated with inherently governmental functions are being performed." The Army is currently engaged in this review process, and at the moment approximately 11,000 contracts (or, about 10%) still need to be reviewed for closely associated with inherently governmental and critical functions.