



STATEMENT FOR THE RECORD OF THE  
PROFESSIONAL SERVICES COUNCIL

"CONTRACTORS: HOW MUCH ARE THEY COSTING  
THE GOVERNMENT?"

SUBCOMMITTEE ON CONTRACTING OVERSIGHT  
COMMITTEE ON HOMELAND SECURITY AND  
GOVERNMENTAL AFFAIRS  
UNITED STATES SENATE

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The Professional Services Council (PSC) appreciates your invitation to submit our views on the question of how much contractors are costing the government and the degree to which the government is assessing and using accurate and complete data to make appropriate cost-comparison determinations when such comparisons are relevant. Accurate cost comparisons between the public and private sectors have been a contentious issue for many years and we commend the subcommittee for holding this hearing to explore it in detail.

Understanding the cost implications associated with agency sourcing decisions is always important, particularly in today's fiscal environment. While we recognize that there are clear limits to the scope of work that is appropriate for the private sector to perform for the government, it is also true that the innovation, skills, agility, and competitive spirit of the private sector are the engine that drives our economy. Thus, any decision to perform work inside the government that is, under current law and policy, appropriate for performance in the private sector must be accompanied by real analytical rigor. To do otherwise is contrary to both the government's and taxpayers' interests and the broader health of our economy.

PSC is the voice of the government professional and technical services industry. PSC's nearly 350 member companies represent small, medium, and large businesses that provide federal agencies with services of all kinds, including information technology, engineering, logistics, facilities management, operations and maintenance, consulting, international development, scientific, social, environmental services, and more. Together, the trade association's members employ hundreds of thousands of Americans in all 50 states.

In conducting your review and if Congress were to fashion any legislative proposal as a result, we would recommend that you focus on five key points:

I. While cost is a critical factor in most sourcing decisions, in others it is not relevant. The first question that must be asked is not which sector or provider is more cost effective but what is the nature of the work itself? For example, as the Obama administration has made clear, when work is deemed to be "inherently governmental" in nature, it should always be performed by government employees, regardless of cost. The same is generally true for a small subset of work that is sometimes referred to as "closely associated with inherently governmental" or "critical" functions. By the same token, when work is commercial in nature (i.e., engineering, software development, management consulting, etc.); involves skills the government is not generally able to internally hire, retain, or provide essential training capabilities for; or is work for which there may only be a limited need, then cost comparisons may be of less significance in the decision process. In these latter cases, understanding the associated cost comparison is important but the realities of the human capital market or the government's temporal mission means that cost alone should not be the basis for a sourcing decision.

II. The key to getting the "right" answer for the American taxpayer in cases where cost is a factor lies in ensuring that the government is using the best and most complete taxonomy for conducting its cost comparisons. To date, the evidence overwhelmingly suggests that this objective is not being achieved. For work that is contracted, the costs to the government are clear and are detailed in proposals received and in the resulting contract(s). Regrettably, the same is far from true for government cost estimates. Although absolute "apples-to-apples" comparisons of the cost of government versus private-sector performance are elusive, significant improvements to the current process are achievable and much needed.

III. Government in-house cost estimates fail to account for the full cost impacts incurred by other than the requiring agency or true "lifecycle" costs associated with the hiring of federal personnel

(including the full range of post-retirement costs that are not and cannot be "front loaded"). These substantial, often deferred, liabilities must be accounted for in all cost comparison analyses, much as they are accounted for in the balance sheets of any private entity, and must be included in proposals submitted on government solicitations.

IV. Attempts to answer in general the perennial question "who is more expensive?" are off track. Instead, the question should be "who is more cost efficient in this circumstance?" Determining sourcing policy, or preemptively determining the source of performance, on the basis of "averages" or estimates is simply not sound management as it detracts from the specifics and realities of each individual situation and fails to account for the effects of market competition or the dynamics of the competition for talent. The government would never award a contract on the basis of a company's "average" costs on other related work. Federal sourcing actions should not be based on such limited and often misleading analyses, either.

V. The process for making sourcing decisions should be subjected to transparency and accountability. The current moratorium on competitions conducted under OMB Circular A-76 has not only enabled the government to make sole-source, non-competitive, insourcing decisions but also has enabled the government to do so without transparency or accountability. As a matter of practice and policy, government components refuse to share the analytical bases for their decisions, if any, even when requested by members of Congress or through the Freedom of Information Act. Furthermore, while more competition is being required for contracted work, government activities alone are exempt from the rigors of competition and continue to operate in a monopoly environment. While cost analyses are helpful and important, they cannot replace the benefits of competition.

### **Focus on the Taxonomy**

In asking the question of whether the government is effectively using cost data to make its sourcing decisions, it is essential to first start with a focus on the quality of that data and the taxonomy through which it is being analyzed.

Adequate data is available to enable far more analytically sound cost comparisons than are generally being applied by federal departments and agencies today. In some recent cases of government "insourcing" work, the problems have not been with the availability of data but with the data the government chose to use in its assessment. In assessing contractor costs, the task is relatively easy. Contractors submit a proposal or, where insourcing is being considered, contractors are operating pursuant to a contract where all of the contractor's costs are clearly documented. However, the same is not true for government in-house cost estimates.

For example:

- In 2010, a government component insourced more than 200 jobs on the basis of a "cost comparison" which purported to show that the government would save approximately \$400,000 on a contract with a value in excess of \$225 million. Leaving aside the question of whether it is wise or cost efficient to insource (or outsource) work for such negligible savings, there has long been agreement (and also statutory and regulatory requirements) that insourcing or outsourcing should generate a minimum 10 percent or \$10 million in personnel savings to justify the transition and organizational churn involved. Of particular note in this case are the additional facts that emerged upon a review of the cost comparison itself (one of the very few for which information was made available after a Freedom of Information Act request):
  - In its estimate of contractor costs, the government included contract items that the contractor had not been required to execute. Had those elements been excluded from the cost

comparison, as they should have been, any potential savings estimated by the analysis would have been more than wiped out;

--The government assumed that its workforce would be 15 percent smaller than the contractor workforce—the size of which was dictated by the government itself. In addition to this change demonstrating that in-house performance was substantially higher in cost on a per person basis cost, no effort was made to assess the costs of contract performance with a smaller workforce;

--The analysis did not include any assessment of costs that would not be incurred against the agency's own budget. In other words, all post-retirement costs that are assumed by the Office of Personnel Management were excluded. Including just one—identifiable and marginal post-retirement cost (monthly premiums for health insurance)—would have resulted in tens of millions of dollars being added to the government cost estimate. In fact, those costs alone would likely have amounted to nearly 25 percent of the total cost of continued contract performance. Instead, the component claimed a “\$400,000 savings.”

- In 2012, a government component informed a contractor that it was insourcing more than 70 positions on the basis of significant estimated cost savings. However, in reviewing the cost comparison summary documents (made available only after a direct congressional request), it became evident that the cost comparison was based on faulty data.

--The analysis substantially altered the workforce requirements associated with the work and based the government cost estimate on a workforce with significantly less expertise and experience than the government was requiring the contractor to provide.

--The analysis assigned substantial cost to the contractor to account for government contract administration and management requirements. However, because the insourcing involves less than half of the contractor's workforce under the relevant contract, the bulk of current contract administration costs will continue to be incurred whether or not the work was insourced. Moreover, the analysis did not provide for any costs to account for the government's very real and unavoidable management, supervisory or other related costs associated with performance by government personnel.

--The analysis was conducted under outdated cost comparison guidelines that had been more recently updated to better capture the complete costs to the government.

- Many external "analyses" have inappropriately compared fully burdened contractor costs with only direct government personnel costs.

--One good example of this misleading trend is evident in the suggestion that private security contractors in Iraq were substantially more expensive than equivalent military capacity. Such "analyses" compare the reported daily "rate" for some private security personnel with the Army's pay rate. However, as the Congressional Budget Office<sup>1</sup> and Congressional Research Service<sup>2</sup> both concluded, such comparisons ignore the fact that the contractor rate includes a wide range of non-pay overhead, benefits, training, equipment and other costs that were not included in the base pay rate of the uniformed military. Under those circumstances, both CBO and CRS concluded that there is very little, if any, difference in the total immediate costs of using private security contractors versus Army personnel. Both also noted, however, that in peacetime the bulk of the Army personnel would remain in the Army (accruing all costs

<sup>1</sup> “Contractors’ Support of U.S. Operations in Iraq,” Congressional Budget Office, August 2008. Available at: <http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/96xx/doc9688/08-12-iraqcontractors.pdf>

<sup>2</sup> “Private Security Contractors in Iraq: Background, Legal Status, and Other Issues,” Congressional Research Service, August 25, 2008. Available at: <http://www.fas.org/sgp/crs/natsec/RL32419.pdf>

associated with their continued service plus their retirement and benefits) while the contractor workforce would be released as contracts were terminated.

--Similarly, the Government Accountability Office<sup>3</sup> and U.S. Department of State assessed the relative costs of using private security forces versus using State Department Diplomatic Security Service personnel. Their conclusion was that the use of private security was an order of magnitude less expensive than using DSS personnel. In short, while there is general agreement today that cost alone should not determine the circumstances under which the government should use private security, these studies are especially instructive in that they are among the few that sought to assess total lifecycle costs of government performance.

As Congress weighs the question of contractor costs it is also important that members not rely on faulty studies conducted to date. One such study is the Project on Government Oversight's (POGO) September 2011 report titled "Bad Business: Billions of Taxpayer Dollars Wasted on Hiring Contractors." The POGO report purports to prove that contractors are more expensive than federal employees. However, PSC's analysis of the report finds that it contains principal weaknesses and by POGO's own admission, the report is not without gaps.

First, POGO relied on contractor rates included in the GSA's Multiple Award Schedules. However, those rates rarely end up being the final rates that agencies pay and in most cases the costs are substantially lowered through competition. Furthermore, those rates include the fully burdened contractor costs, including overhead, supplies, equipment and rent, whereas POGO ignored the full range of overhead and other non-personnel costs that drive up the cost of federal employee performance. The report also failed to recognize long-term costs associated with public-sector performance, such as post-retirement costs and other expenses naturally associated with creating a permanent infrastructure that do not exist when relying on contractors. Lastly, the POGO report relies on "averages," which provide little basis for making sourcing decisions on a case-by-case basis.

There are many more cost comparison examples that point to the same challenge. All show the government MUST have a clear, complete and consistent taxonomy for assessing the relative costs of performance. Indeed, despite whatever differences might exist between various stakeholders in this debate, we trust that all agree that getting the taxonomy and cost elements right is both the fairest way to move forward and the way in which the interests of the American taxpayer will best be served.

### **A More Accurate and Balanced Taxonomy**

Today, there is a lack of clarity about the extent to which federal civilian agencies are undertaking rigorous cost analyses. Historically, federal agencies had been able to rely on the OMB Circular A-76 cost comparison methodology to conduct public-private competitions. Despite a current moratorium on OMB Circular A-76 public-private competitions, the cost comparison methodology still exists, yet it is unclear if, or how, it is being used by the agencies.

The National Defense Authorization Acts of 2010 and 2011 direct the Defense Department to use the Directive Type Memorandum (09-007), (the "DTM") as the basis for its cost comparisons. While there are many similarities between the DTM and A-76, each has significant weaknesses that bias the outcome

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<sup>3</sup> "Warfighter Support: A Cost Comparison of Using State Department Employees versus Contractors for Security Services in Iraq," Government Accountability Office, March 4, 2010. Available at: <http://www.gao.gov/assets/100/96571.pdf>

in favor of the public sector. In fact, the DTM does not serve as a viable methodology, it is merely a list of factors that should be considered in a cost comparison. Moreover, as explained in the seminal 2011 report by the non-partisan Center for Strategic and International Studies (CSIS), the DTM is a less complete and less analytically rigorous model than that contained in the longstanding OMB-Circular A-76.

#### *Key Analytical Weaknesses of the DTM*

The independent CSIS analysis is the most comprehensive review of the quality and accuracy of government cost-comparison models. It identified numerous, substantial gaps in the DTM which, in CSIS's words, "overlook[s] many cost aspects for the government."

According to CSIS, the DTM specifically:

- Fails to address government-wide costs and, as a result, likely does not account for costs (or even savings) that might be incurred by agencies other than the immediate agency or component.
- Does not take into account the full cost of DoD-owned capital (although such costs are included for contractors) thus ignoring foregone interest, risk premiums and depreciation. These costs are the same or similar for both the public and private sectors and can be calculated for government purposes. Instructively, OMB Circular A-76 does require consideration of these costs on the government side.
- Ignores tax collections foregone by the federal, state or local governments, elements which are incurred by contractors and considered under OMB Circular A-76.
- Assumes cost growth for work that is contracted out but makes no similar assumptions for work performed by the government. As CSIS reported, the evidence is clear that cost growth is not a function of which sector performs the work but of changes in the scope of work, the presence of competition (which is the best guarantor of containing cost growth) and other factors.
- Does not require any assessment of the imputed cost of insuring and indemnifying in-house operations, although it does require such costs be assessed with regard to contractor performance. Here too, OMB Circular A-76 requires such costs to be assessed since it recognizes that while the government self-insures, there are costs associated with its practice of self insurance, and using a market-based model to assess those costs is the most logical means by which to do so.
- Does not take into account the often wide variances in workload requirements and in so doing ignores the tremendous flexibility contractors can provide. The failure to account for this cost element ignores the substantial immediate and lifecycle costs associated with maintaining a workforce "bench" for those periods when workloads are reduced. In a contract environment, the workforce and, thus, the costs are continually adjusted based on immediate workload requirements.
- Does not require the use, for government costing purposes, of a detailed statement of work, which serves as the foundation of any contract, thus making it "impossible to ensure that the full costs of performance are captured in any cost estimate." Once again, the creation of such a detailed statement of work is required under OMB Circular A-76.

### *Cost Analyses Under OMB Circular A-76*

While OMB Circular A-76 has a number of advantages over the less rigorous process required under the DTM, it is not without its flaws. As CSIS correctly notes, much of the debate over A-76 has traditionally focused on the process itself rather than the costing methodology. Yet key weaknesses remain in the A-76 cost methodology, including:

- The A-76 methodology includes a standard 12 percent overhead rate for all government activities. Simply put, and as articulated by CSIS, the figure is "methodologically unsupportable." Although better than the DTM in its coverage of the cost of capital to the government, it remains more notional than analytical and well below all generally accepted norms for "overhead."
- Other problems arise when the government creates the notional "most efficient organization" (MEO) using the A-76 costing model for cost comparison analyses only because there is no requirement that the MEO reflect the actual workforce design or the actual grade levels of the federal employees that will do the work. Finally, once the cost comparison is completed, there is no requirement that the MEO execute the work according to the MEO design that served as the basis for the cost comparison.
- As a result of these evident gaps, prior to the imposition of the current moratorium, the private sector had largely turned away from bidding on competitions conducted under A-76. In fact, during the last few years prior to the moratorium, the vast majority of A-76 competitions had fewer than two bidders and a significant percentage had no private sector bidders at all, thus depriving the government of the benefits of real competition.

### *Misaligned Inputs*

Regardless of whether A-76 or the DTM is used, it is essential that all workforce and workload requirements for both the public and private sector be properly aligned. No comparison can overcome the analytical problems created by shortcomings in these areas. As noted in the examples provided earlier, cost comparisons that fail to align and equalize workforce numbers or skill sets inevitably lead to skewed results. Likewise, as has routinely been seen in competitions conducted under OMB Circular A-76, the notional composition of the government's proposed "Most Efficient Organization" (MEO) may not align with the skills and grades of the government's current workforce. If the foundational data used as the basis for the cost comparison does not reflect the actual workforce involved, the results will be similarly skewed.

### *Addressing the Gaps; Improving the Taxonomy*

The CSIS report is agnostic on the question of which sector should perform any given work. Rather, it provides an objective and improved taxonomy that is likely to result in more accurate cost analyses to be used to guide government sourcing decisions. The detailed explanations for each of its proposals, and the associated cost comparison tools, can be found in the May 2011 report "DoD Workforce Cost Realism Assessment."<sup>4</sup>

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<sup>4</sup> "DoD Workforce Cost Realism Assessment," Center for Strategic and International Studies (CSIS), May 17, 2011. Available at: <https://csis.org/publication/dod-workforce-cost-realism-assessment>

The CSIS recommended taxonomy can be summarized as follows:

- Require a detailed statement of work for both public and private performance;
- Include all, fully burdened costs to the federal government rather than just those that favor the requiring agency or component;
- Recognize and account for the inherent risk of cost growth for both sectors;
- Account for transition costs in both directions: public to private and vice versa;
- Account for oversight and management costs for both sectors;
- Regularly update dynamic personnel cost elements (health, retirement, etc.);
- Account for the full cost of government-owned capital;
- Include tax (revenue) implications;
- Include in the costing model costs associated with varying workload levels;
- Account for costs of insurance/self insurance and indemnity for both sectors; and
- Recognize and account for cost impacts of cumulative sourcing decisions.

### **A Simple, But Focused, Legislative Response**

Finally, Congress must take major steps toward addressing the evident and well documented weaknesses in the government's collection and use of data for sourcing decisions. In order to be successful, the federal government must be able to rely on and access the latest innovation, expertise, and flexibility of the public and private sectors. When determining which sector delivers capabilities in the most cost-effective and efficient manner, it is vital that the government have adequate, reliable tools for assessing the total, respective costs when cost is a factor in the decision-making process. To date, nothing truly approaching an “apples-to-apples” comparison of costs has existed. Hence, federal agencies, and DoD specifically, have continued to rely on faulty cost comparisons to justify sourcing decisions. Given the fiscal challenges faced by our nation, it is critically important that the federal government is able to accurately calculate and comprehend its total workforce costs.

Therefore, PSC recommends that Congress:

1. Rescind the moratorium on public-private competitions under OMB Circular A-76 to enable agencies to gain the full benefit of competition—the engine that drives performance and efficiency.
2. Require OMB to update the current OMB Circular A-76 cost comparison taxonomy to address the shortcomings and process improvements identified in the CSIS report.
3. Require DoD to develop a new methodology, if necessary using its existing Directive-Type Memorandum (DTM) 09-007, to compare costs of in-house with private-sector performance, correct identified shortcomings in the DTM and incorporate the process improvements highlighted by the CSIS report.
4. Require that, in cases where agencies make a decision to insource contracted work, the analysis used in making that decision be shared at a minimum with the affected contractor and that a process for appeal by the contractor be provided. The fiscal year 2012 National Defense Authorization Act requires DoD to develop guidance on providing that notification to affected contractors, but as of March 15 that guidance was not yet developed and no information is being provided except in rare circumstances when requested by a member of Congress.
5. Require that any decision to insource contracted work be accompanied by a government analysis of the impact of its decision on small business. In too many cases, small businesses have been impacted greatly—and some have even gone out of business—as the result of a government insourcing

decision. Legislation favorably reported by the House Small Business Committee in March 2012 would impose this requirement on federal agencies.

## **CONCLUSION**

The debate over whether contractors or federal employees are more expensive is not new and it flares up on the release of reports that claim that one side costs less than the other. While each of these reports needs to be assessed based on its merits and thoroughness, Congress should refrain from focusing on the less relevant and discernible global question and instead focus on the taxonomy that will get the right answer for the government in specific circumstances. Without question, getting to an accurate cost comparison model will be difficult. However, the shortcomings of the current comparison tools must not be overlooked and additional steps must be taken to improve them to help avoid the government making decisions that lead to higher costs to the taxpayer. Additionally, Congress must continue to recognize that cost is not the only factor in determining who is best suited to perform certain functions.

PSC thanks the subcommittee for holding this important hearing, and we look forward to continuing working with the subcommittee and other members of Congress on this issue.