

TESTIMONY

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Mr. Chairman and Members of the Committee:

I am pleased to be here today to participate in the committee's hearing on competition and accountability in the federal and service contract workforce with a particular focus on the use of Office of Management and Budget (OMB) Circular A-76. That circular established federal policy for the performance of recurring commercial activities. Issued in 1966, OMB supplemented it in 1979 with a handbook of procedures for conducting cost comparison studies to determine whether commercial activities should be performed by the government or by the private sector. OMB updated the handbook in 1983, 1996, and 1999. Cost comparisons completed under Circular A-76 are variously referred to as public-private competitions, outsourcing, or competitive sourcing.

Emphasis on use of the A-76 process has varied over the years. The Department of Defense (DOD), which began giving strong emphasis to the program in the mid- to late-1990's, has been the primary user of the process. Greater focus on the potential for expanded use of competitive sourcing governmentwide began with passage of the Federal Activities Inventory Reform (FAIR) Act legislation in 1998 requiring agencies to compile annual inventories of commercial activities. Then, in 2001, OMB began directing federal agencies to conduct public-private competitions or convert work involving specified percentages of commercial positions on their FAIR Act inventories directly to the private sector.

My comments today are largely based on our work in recent years tracking DOD's progress in implementing its A-76 program with the goal of saving billions of dollars to apply to other priority needs (see list of related products at the end of this statement). In response to questions you have asked me to address, my testimony will highlight (1) DOD's progress under the A-76 program, (2) challenges faced by DOD that may also be faced by other government agencies as they pursue A-76 studies, and (3) concerns that gave rise to the creation of the Commercial Activities Panel to study sourcing policies and procedures under section 832 of the National Defense Authorization Act for Fiscal Year 2001. Chaired by Comptroller General David Walker, the Commercial Activities Panel is required to report its findings and recommendations to the Congress by May 1, 2002. Given the ongoing nature of the panel's work, I hope you will appreciate limitations on my ability to discuss panel deliberations and their potential outcome.

SUMMARY

DOD has been at the forefront of federal agencies in using the A-76 process in recent years. In 1995, DOD made the process a priority so as to reduce operating costs and free funds for other priorities. DOD has also augmented the A-76 program with what it terms strategic sourcing—a broader array of reinvention and reengineering options that may not necessarily involve A-76 competitions. Over the years, the number of positions—at one point 229,000—that DOD planned to study and the timeframes for the studies have varied. Current plans are to study approximately 143,000 positions between fiscal years 1997 and 2007. Changes in the inventory of commercial activities and the current administration's sourcing initiatives could have the potential to change the number of positions studied in the future. However, we have not evaluated the extent to which these changes might occur.

DOD has faced a number of challenges with its A-76 program that may produce valuable lessons learned for other federal agencies that use the A-76 process. The challenges include the following: (1) studies took longer than initially projected, (2) costs and resources required for the studies were underestimated, (3) selecting and grouping functions to compete can be difficult, and (4) determining and maintaining reliable estimates of savings were difficult.

Federal managers, government workers, and private sector representatives have expressed concern about the A-76 study process. As required by legislation in 2001, the Commercial Activities Panel is studying and has held public hearings about the policies and procedures, including the A-76 process, that concern the transfer of commercial activities from government personnel to contractors. The panel, comprised of federal and private sector experts, is required to report its findings and recommendations to the congress by May 1, 2002.

BACKGROUND

Under A-76, commercial activities may be converted to or from contractor performance either by direct conversion or by cost comparison. Under direct conversion, specific conditions allow commercial activities to be moved from government or contract performance without a cost comparison study (for example, for activities involving 10 or fewer civilians).^[1] Generally, however, commercial functions are to be converted to or from contract performance by cost comparison, whereby the estimated cost of government performance of a commercial activity is compared to the cost of contractor performance in accordance with the principles and procedures set forth in Circular A-76 and the revised supplemental handbook. As part of this process, the government identifies the work to be performed (described in the performance work statement), prepares an in-house cost estimate based on its most efficient organization, and compares it with the winning offer from the private sector.

According to A-76 guidance, an activity currently performed in-house is converted to performance by the private sector if the private sector offer is either 10 percent lower than the direct personnel costs of the in-house cost estimate or is \$10 million less (over the performance period) than the in-house cost estimate. OMB established this minimum cost differential to ensure that the government would not convert performance for marginal savings.

The handbook also provides an administrative appeals process. An eligible appellant^[2] must submit an appeal to the agency in writing within 20 days of the date that all supporting documentation is made publicly available. Appeals are supposed to be adjudicated within 30 days after they are received. Private sector offerors who believe that the agency has not complied with applicable procedures have additional avenues of appeal. They may file a bid protest with the General Accounting Office or file an action in a court of competent jurisdiction.^[3]

Circular A-76 requires agencies to maintain annual inventories of commercial activities performed in-house. A similar requirement was included in the 1998 FAIR Act, which directs agencies to develop annual inventories of their positions that are not inherently governmental.^[4] The fiscal year 2000 inventory identified approximately 850,000 full-time equivalent commercial-type positions, of which approximately 450,000 were in DOD.^[5] OMB has not yet released DOD's inventory for 2001.

DOD has been the leader among federal agencies in recent years in its use of OMB Circular A-76, with very limited use occurring in other agencies. However, in 2001, OMB signaled its intention to direct greater use of the circular on a government-wide basis. In a March 9, 2001, memorandum to the heads and acting heads of departments and agencies, the OMB Deputy Director directed agencies to take action in Fiscal Year

2002 to directly convert or complete public-private competitions of not less than 5 percent of the full-time equivalent positions listed in their FAIR Act inventories. Subsequent guidance expanded the requirement by 10 percent in 2003, with the ultimate goal of competing at least 50 percent.

In 1999, DOD began to augment its A-76 program with what it terms strategic sourcing.^[6] Strategic sourcing may encompass consolidation, restructuring, or reengineering activities; privatization; joint ventures with the private sector; or the termination of obsolete services. Strategic sourcing can involve functions or activities regardless of whether they are considered inherently governmental, military essential, or commercial. I should add that these actions are recognized in the introduction to the A-76 handbook as being part of a larger body of options, in addition to A-76, that agencies must consider as they contemplate reinventing government operations.

Strategic sourcing initially does not involve A-76 competitions between the public and the private sector, and the Office of the Secretary of Defense and service officials have stressed that strategic sourcing may provide smarter decisions because it determines whether an activity should be performed before deciding who should perform it. However, these officials also emphasized that strategic sourcing is not intended to take the place of A-76 studies and that positions examined under the broader umbrella of strategic sourcing may be subsequently considered for study under A-76.

DOD'S AMBITIOUS GOALS FOR USING A-76 HAVE VARIED OVER TIME

After several years of limited use of Circular A-76, the deputy secretary of defense gave renewed emphasis to the A-76 program in August 1995 when he directed the services to make outsourcing of support activities a priority in an effort to reduce operating costs and free up funds to meet other priority needs. The effort was subsequently incorporated as a major initiative under the then secretary's Defense Reform Initiative, and the program became known as competitive sourcing—in recognition of the fact that either the public or the private sector could win competitions. A-76 goals for the number of positions to be studied have changed over time, and out-year study targets are fewer than in previous years. However, future study targets could be impacted by the current administration's emphasis on reliance on the private sector for commercial activities.

The number of positions planned for study and the timeframes for accomplishing those studies have changed over time in response to difficulties in identifying activities to be studied. In 1997, DOD's plans called for about 171,000 positions to be studied by the end of fiscal year 2003. In February 1999, we reported that DOD had increased this number to 229,000 but had reduced the number of positions to be studied in the initial years of the program. In August 2000, DOD decreased the number of positions to be studied under A-76 to about 203,000, added about 42,000 Navy positions for consideration under strategic sourcing, and extended the program to fiscal year 2005. Last year we noted that DOD had reduced the planned number to study to approximately 160,000 positions under an expanded timeframe extending from 1997 to 2007. It also planned to study about 120,000 positions under strategic sourcing during that timeframe.

More recently, DOD officials told us that the A-76 study goal for fiscal years 1997-2007 is now approximately 143,000 positions—95,000 between fiscal years 1997-2001, and 48,000 between fiscal years 2002-2007. It projects a comparable number of positions to be studied under strategic sourcing. To what extent the A-76 study goals are likely to change in the future could be a function of changes in inventories of commercial activities and continuing management emphasis on competitive sourcing.

Although DOD's fiscal year 2001 inventory of commercial activities has not been publicly released, we have noted some reductions between previous inventories as the department has gained experience in completing them. In reporting on our analysis of DOD's initial FAIR Act inventory, we cited the need for more consistency in identifying

commercial activities.^[7] We found that the military services and defense agencies did not always consistently categorize similar activities. We have not had an opportunity to analyze more recent inventories to determine to what extent improved guidance may have helped to increase consistency in categorizing activities. At the same time, we also previously reported that a number of factors could reduce the number of additional functions studied under A-76. For example, we noted that factors such as geographic dispersion of positions and the inability to separate commercial activities from inherently governmental activities could limit the number of inventory positions studied. Likewise, the inventory already makes provision for reducing the number of positions eligible for competition such as where performance by federal employees was needed because of national security or operational risk concerns.

On the other hand, *The President's Management Agenda*, Fiscal Year 2002, notes "Agencies are developing specific performance plans to meet the 2002 goal of completing public-private or direct conversion competition on not less than five percent of the full-time equivalent employees listed on the FAIR Act inventories. The performance target will increase by 10 percent in 2003." Additionally, DOD's *Quadrennial Defense Review Report*, September 30, 2001, states that the department should "*Focus DOD 'owned' resources on excellence in those areas that contribute directly to warfighting.* [Original emphasis] Only those functions that must be performed by DOD should be kept by DOD. Any function that can be provided by the private sector is not a core government function. Traditionally, 'core' has been very loosely and imprecisely defined and too often used as a way of protecting existing arrangements." We have not assessed to what extent efforts in this area are likely to strengthen emphasis on A-76.

CHALLENGES FACED BY DOD THAT MAY BE APPLICABLE TO OTHER FEDERAL AGENCIES

As we tracked DOD's progress in implementing its A-76 program since the mid- to late-1990s, we identified a number of challenges and concerns that have surrounded the program—issues that other agencies may encounter as they seek to respond to the administration's emphasis on competitive sourcing. They include (1) the time required to complete the studies, (2) cost and resources to conduct and implement the studies, (3) selecting and grouping positions to compete, and (4) developing and maintaining reliable estimates of projected savings expected from the competitions. These need not be reasons to avoid A-76 studies but are factors that need to be taken into consideration in planning for the studies.

Studies Took Longer to Complete Than Initially Expected

Individual A-76 studies in DOD have taken longer than initially projected. In launching its A-76 program, some DOD components made overly optimistic assumptions about the amount of time needed to complete the competitions. For example, the Army initially projected that it would take 13-21 months to complete studies, depending on their size. The Navy initially projected completing its studies in 12 months. The numbers were subsequently adjusted upward, and the most recent available data indicate that the studies take on average about 24 months for single-function and 27 months for multifunction studies. Agencies need to keep these timeframes in mind when projecting resources required to support the studies and timeframes for when savings are expected to be realized—and may need to revisit these projections as they gain experience under the program.

Costs and Resources to Conduct and Implement Studies Were Underestimated

Once DOD components found that the studies were taking longer than initially projected,

they realized that a greater investment of resources would be needed than originally planned to conduct the studies. For example, the 2001 president's budget showed a wide range of projected study costs, from about \$1,300 per position studied in the Army to about \$3,700 in the Navy. Yet, various officials expressed concern that these figures underestimated the costs of performing the studies. While the costs they cited varied, some ranged up to several thousand dollars per position. One factor raising costs was the extent to which the services used contractors to facilitate completion of the studies. Given differences in experience levels between DOD and other agencies in conducting A-76 studies, these other agencies may need to devote greater resources to training or otherwise obtaining outside assistance in completing their studies.

In addition to study costs, significant costs can be incurred in implementing the results of the competitions. Transition costs include the separation costs for civilian employees who lose their jobs as a result of competitions won by the private sector or when in-house organizations require a smaller civilian workforce. Such separation costs include the costs of voluntary early retirement, voluntary separation incentives, and involuntary separations through reduction-in-force procedures. Initially, we found that DOD budget documents had not fully accounted for such costs in estimating savings that were likely to result from their A-76 studies. More recently, we found that the Department had improved its inclusion of study and transition costs in its budget documents.

Selecting and Grouping Functions to Compete Can Be Difficult

Selecting and grouping functions and positions to compete can be difficult. Because most services faced growing difficulties in or resistance to finding enough study candidates to meet their A-76 study goals, the goals and timeframes for completing studies changed over time; and DOD ultimately approved strategic sourcing as a way to complement its A-76 program and help achieve its savings goals.

Guidelines implementing the FAIR Act permit agencies to exclude certain commercial activities from being deemed eligible for competition such as patient care in government hospitals. Additionally, as experienced by DOD, factors such as geographic dispersion of positions and the inability to separate commercial activities from inherently governmental activities could limit the number of inventory positions studied. It becomes important to consider such factors in determining what portions of the FAIR inventories are expected to be subject to competition.

Developing and Maintaining Reliable Estimates of Savings Were Difficult

Considerable questions have been raised concerning to what extent DOD has realized savings from its A-76 studies. In part, these concerns were exacerbated by the lack of a reliable system for capturing initial net savings estimates and updating them as needed and by other difficulties associated with the lack of precision often associated with savings estimates. Our work has shown that while significant savings are being achieved by DOD's A-76 program, it has been difficult to determine precisely the magnitude of those savings. Savings may be limited in the short-term because up-front investment costs associated with conducting and implementing the studies must be absorbed before long-term savings begin to accrue. Several of our reports in recent years have highlighted these issues.

For example, we reported in March 2001 that A-76 competitions had reduced estimated costs of Defense activities primarily by reducing the number of positions needed to perform those activities under study.^[8] This is true regardless of whether the government's in-house organization or the private sector wins the competition. Both government and private sector officials with experience in such studies have stated that, in order to be successful in an A-76 competition, they must seek to reduce the number of positions required to perform the function being studied. Related actions may include

restructuring and reclassifying positions and using multiskill and multirole employees to complete required tasks.

In December 2000, we reported on DOD's savings estimates from a number of completed A-76 studies.^[9] We noted that DOD had reported cost reductions of about 39 percent, yielding an estimated \$290 million savings in fiscal year 1999. We also agreed that individual A-76 studies were producing savings but stressed difficulty in quantifying the savings precisely for a number of reasons

- Because of an initial lack of DOD guidance on calculating costs, baseline costs were sometimes calculated on the basis of average salaries and authorized personnel levels rather than on actual numbers.
- DOD's savings estimates did not take into consideration the costs of conducting the studies and implementing the results, which of course must be offset before net savings begin to accrue.
- There were significant limitations in the database DOD used to calculate savings.
- Savings become more difficult to assess over time as workload requirements or missions change, affecting program costs and the baseline from which savings were initially calculated.

Our August 2000 report assessed the extent to which there were cost savings from nine A-76 studies conducted by DOD activities.^[10] The data showed that DOD realized savings from seven of the cases, but overall less than Defense components had initially projected. Each of the cases presented unique circumstances that limited our ability to precisely calculate savings. Some suggested lower savings. Others suggested higher savings than initially identified. In two cases, DOD components had included cost reductions unrelated to the A-76 studies as part of their projected savings. Additionally, baseline cost estimates used to project savings were usually calculated using an average cost of salary and benefits for the number of authorized positions, rather than the actual costs of the positions. The latter calculation would have been more precise. In four of the nine cases, actual personnel levels were less than authorized. While most baseline costs estimates were based largely on personnel costs, up to 15 percent of the costs associated with the government's most efficient organizations' plans or the contractors' offers were not personnel costs. Because these types of costs were not included in the baseline, a comparison of the baseline with the government's most efficient organization or contractor costs may have resulted in understating cost savings. On the other hand, savings estimates did not reflect study and implementation costs, which reduced savings in the short term.

DOD has revised its information systems to better track the estimated and actual costs of activities studied but not to revise previous savings estimates. DOD is also emphasizing the development of standardized baseline cost data to determine initial savings estimates. In practice, however, many of the cost elements that are used in A-76 studies will continue to be estimated because DOD lacks a cost accounting system to measure actual costs. Further, reported savings from A-76 studies will continue to have some element of uncertainty and imprecision and will be difficult to track in the out-years because workload requirements and missions change, affecting program costs and the baseline from which savings are calculated.

COMMERCIAL ACTIVITIES PANEL IS STUDYING

SOURCING POLICIES AND PROCEDURES

Although comprising a relatively small portion of the government's overall service contracting activity, competitive sourcing under Circular A-76 has been the subject of much controversy because of concerns about the process raised both by the public and private sectors. Federal managers and others have been concerned about organizational turbulence that typically follows the announcement of A-76 studies. Government workers have been concerned about the impact of competition on their jobs, their opportunity for input into the competitive process, and the lack of parity with industry offerors to protest A-76 decisions. Industry representatives have complained about the fairness of the process and the lack of a "level playing field" between the government and the private sector in accounting for costs. Concerns also have been registered about the adequacy of oversight of the competition winners' subsequent performance, whether won by the public or private sector.

Amid these concerns over the A-76 process, the congress enacted section 832 of the National Defense Authorization Act for Fiscal Year 2001. The legislation required the comptroller general to convene a panel of experts to study the policies and procedures governing the transfer of commercial activities for the federal government from government to contractor personnel. The panel, which Comptroller General David Walker chairs, includes senior officials from DOD, OMB, the Office of Personnel Management, private industry, federal labor organizations, and academia. The Commercial Activities Panel, as it is known, is required to report its findings and recommendations to the congress by May 1, 2002.

The panel had its first meeting on May 8, 2001, at which time it adopted a mission statement calling for improving the current framework and processes so that they reflect a balance among taxpayer interests, government needs, employee rights, and contractor concerns. Subsequently, the panel held three public hearings. At the first hearing on June 11, in Washington, D.C., over 40 individuals representing a wide spectrum of perspectives presented their views. The panel subsequently held two additional hearings, on August 8 in Indianapolis, Indiana, and on August 15 in San Antonio, Texas. The hearing in San Antonio specifically addressed OMB Circular A-76, focusing on what works and what does not in the use of that process. The hearing in Indianapolis explored various alternatives to the use of A-76 in making sourcing decisions at the federal, and local levels.

Since completion of the field hearings, the panel members have met in executive session several times, augmented between meetings by work of staff to help them (1) gather background information on sourcing trends and challenges, (2) identify sourcing principles and criteria, (3) consider A-76 and other sourcing processes to assess what's working and what's not, and (4) assess alternatives to the current sourcing processes. Panel deliberations continue with the goal of meeting the May 1 date for a report to the congress.

This concludes my statement. I would be pleased to answer any questions you or other members of the committee may have at this time.

Contacts and Acknowledgement

For further contacts regarding this statement, please contact Barry W. Holman at (202) 512-8412 or Marilyn Wasleski at (202) 512-8436. Other individuals making key contributions to this statement include Jane Hunt, Debra McKinney, Donald Bumgardner, Nancy Lively, Stephanie May, and Judith Williams.

[1] For functions performed by DOD employees, a number of additional requirements, reports and certifications are addressed in Chapter 146 of title 10 U.S. Code and in recurring provisions in DOD's annual appropriation acts.

[2] An eligible appellant is defined as (a) federal employees (or their representatives) and existing federal contractors

affected by a tentative decision to waive a cost comparison; (b) federal employees (or their representatives) and contractors who have submitted formal bids or offers who would be affected by a tentative decision; or (c) agencies that have submitted formal offers to compete for the right to provide services through an interservice support agreement.

[3] Federal employees do not have standing to file a protest with GAO and have generally been denied standing to sue in court.

[4] Section 5 of P.L. 105-270, codified at 31 U.S.C. 501 note (1998) defines an inherently governmental function as a "function that is so intimately related to the public interest as to require performance by Federal Government employees."

[5] Guidance implementing the FAIR Act permitted agencies to exempt many commercial activities from competitive sourcing consideration on the basis of legislative restrictions, national security considerations, and other factors. Accordingly, DOD's fiscal year 2000 inventory of positions it considers to be potentially subject to competitions was reduced to approximately 260,000.

[6] While strategic sourcing includes A-76 studies, the Department has commonly used the term to refer to all reinvention efforts other than A-76. For purposes of this testimony, our reference to strategic sourcing will not include A-76 studies.

[7] U.S. General Accounting Office, *DOD Competitive Sourcing: More Consistency Needed in Identifying Commercial Activities*, GAO/NSIAD-00-198 (Washington D.C.: Aug. 11, 2000).

[8] U.S. General Accounting Office, *DOD Competitive Sourcing: Effects of A-76 Studies on Federal Employees' Employment, Pay, and Benefits Vary*, GAO-01-388 (Washington, D.C.: Mar. 16, 2001).

[9] U.S. General Accounting Office, *DOD Competitive Sourcing: Results of A-76 Studies Over the Past 5 Years*, GAO-01-20, (Washington, D.C.: Dec. 7, 2000).

[10] U.S. General Accounting Office, *DOD Competitive Sourcing: Savings Are Occurring, but Actions Are Needed to Improve Accuracy of Savings Estimates*, GAO/NSIAD-00-107, (Washington, D.C.: Aug. 8, 2000).

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