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Testimony before the Senate Committee on Armed Services: Manpower and Personnel Subcommittee; by Elmer B. Staats, Comptroller General.

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There is a need for more effective implementation of the OMB Circular A-76 policy, which is a general policy of reliance on private sources for goods and services, by both the Office of Management and Budget and the Department of Defense (DOD). GAO reports have criticized DOD's A-76 program with respect to: unsupported justifications for in-house work, significant in-house functions that were not periodically reviewed as to the possibility of contracting out, required reviews that were behind schedule, areas of significant potential savings that were not being reviewed, incomplete and inaccurate identification of commercial or industrial activities performed in-house, failure to report new commercial or industrial activities initiated in-house, and unreliable contract cost estimates. DOD has devoted considerable time and effort to implementing the A-76 policy, whereas some of the civilian agencies have only recently established implementation programs. Many of the problems and issues that have been identified in the DOD's implementation of the A-76 policy remain unresolved. The Government should continue to pursue its policy of relying on the private sector and encouraging private industry to compete with the executive departments in providing needed commercial or industrial products and services. (SC)

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Statement of

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Comptroller General of the United States

Before the
Subcommittee on Manpower and Personnel
Senate Committee on Armed Services

on

Activities of the United States General Accounting Office
Concerning Office of Management and Budget Circular A-76
and Its Implementation by the Department of Defense

Mr. Chairman and Members of the Subcommittee:

We are here today at the request of your Subcommittee to discuss activities of the U.S. General Accounting Office concerning Office of Management and Budget (OMB) Circular A-76 and its implementation by the Department of Defense (DOD).

Through Bureau of the Budget Bulletin 55-4, dated January 1955, the executive branch issued a policy statement that, with certain exceptions, the Federal Government should obtain needed goods and services from the private sector. Although this bulletin has been revised four times and is presently identified as OMB Circular A-76, the general policy of reliance on private sources has remained unchanged.

02965

The general thrust of this policy is that executive agencies will not start or continue an existing commercial or industrial activity to provide a product or service for their own use if such product or service can be procured through the private enterprise system. Agencies are authorized, however, to provide needed products or services with their own resources when it is in the national interest. The national interest is described as including instances in which (1) procurement of a product or service from a commercial source would disrupt or materially delay an agency's program, (2) the Government needs to conduct a commercial or industrial activity for purposes of combat support, retraining of military personnel or to maintain or strengthen mobilization readiness, (3) a satisfactory commercial source is not available and cannot be developed in time to provide a product or service when it is needed, (4) the product or service is available from another Federal agency, or (5) procurement of a product or service from a commercial source would result in higher costs to the Government.

GAO supports the general policy set forth in the OMB circular and has a long history of working cooperatively with OMB to clarify the policy statement and strengthen implementing guidance. Since January 1, 1972, we have issued 30 reports which directly or indirectly concern OMB's and DOD's implementation of the A-76 policy.

These reports are identified in the exhibit. Four of these reports were addressed to the Congress, 18 were addressed to Subcommittee Chairmen or individual members of Congress, and 8 were addressed to the Director of OMB, the Secretary of Defense, or the Secretary of the Navy.

Many of these reports involve the performance of a specific service or services at an individual military installation. Others have much broader application. Collectively, they cover a wide range of types of support activities including the following: custodial; supply; maintenance of construction equipment, aircraft, and family housing; airfield marking; ocean cargo handling; and food service. The reports generally demonstrate a need for more effective implementation of the A-76 policy by OMB and DOD.

The reports, as you might expect, do not support a broad conclusion that one method of performance (Government or private sector) is always preferred over the other. The circumstances of each situation require individual analysis in light of the exceptions permitted in the circular. Two of the reports are of special significance because they represent fairly comprehensive reviews of DOD's administration of the A-76 program. These are titled "Better Controls Needed in Reviewing Selection of In-House or Contract Performance of Support Activities," B-158685, March 17, 1972, and "How to Improve Procedures for Deciding Between Contractor and In-House Military Base Support Services," LCD-76-347, March 28,

1977. In these reports we criticized DOD's A-76 program with respect to:

- Unsupported justifications for in-house work.
- Significant in-house functions that were not periodically reviewed as to the possibility of contracting out, as required by A-76.
- Required reviews that were behind schedule.
- Areas of significant potential savings that were not being reviewed.
- Incomplete and inaccurate identification of commercial or industrial activities performed in-house.
- Failure to report new commercial or industrial activities initiated in-house.
- Unreliable contract cost estimates.

We would like to point out, however, that DOD has devoted considerable time and effort over the years to implementing the A-76 policy. On the other hand, some of the civilian agencies have only recently established implementation programs. Others have had programs in effect for a number of years but have neither promoted implementation of the A-76 policy nor devoted adequate resources to implementing it. We reported to the Congress in 1973 on the results of our work at several civilian agencies concerning implementation of A-76. ("Better Management Needed in Civil Agencies Over Selection of In-House or Contract Performance of Support Activities," B-158685, July 31, 1973)

Currently we have about 12 assignments in various stages of completion that relate to OMB's and DOD's implementation of

the A-76 policy. Most of these are being performed at congressional request to investigate individual decisions to contract out. The remaining assignments represent part of our effort to monitor executive agencies' performance in carrying out assigned programs and responsibilities. These assignments cover the evaluation of specific types of services, such as automatic data processing. I also have established a task force within GAO to review the overall effectiveness of the executive agencies' policies and program for acquiring commercial or industrial products and services for Government use.

We plan to evaluate the guidance, procedures and management controls of this program. We will also examine the interpretation of guidelines by the executive branch and review their practices and progress. At present, we are initiating work at ten major executive departments and plan to have a report to the Congress early in 1978.

While much attention has been given to the question of contracting out versus performing work in-house, many of the problems and issues that have been identified remain unresolved. For example, the policy was studied by the Commission on Government Procurement and its report of December 1972 recommended five basic changes. We fully support those recommendations, which are as follows:

1. Provide through legislation that it is national policy to rely on private enterprise for needed goods and services, to the maximum extent feasible, within the framework of procurement at reasonable prices.

2. Revise Circular A-76 to provide that Federal agencies should rely on commercial sources for goods and services expected to cost less than \$100,000 per year, without making cost comparisons, provided that adequate competition and reasonable prices can be obtained.
3. Base cost comparisons on (a) fully allocated costs if the work concerned represents a significant element in the total workload of the activity in question, or if discontinuance of an ongoing operation will result in a significant decrease in indirect costs or (b) an incremental basis if the work is not a significant portion of the total workload of an organization, or if it is a significant portion in which the Government has already provided a substantial investment.
4. Increase the Circular A-76 threshold for new starts to \$100,000 for either new capital investment or annual operating cost. These thresholds refer to the dollar size that new starts should be before a cost comparison would have to be made to support make-or-buy decisions. A new start is currently defined by Circular A-76 to mean either (a) a new Government commercial or industrial activity involving additional capital investment of \$25,000 or more, or annual operating costs of \$50,000 or more; or (b) an expansion or renovation of an existing facility with dollar thresholds double the amounts for new activities. This recommendation reflected the majority view of the Commissioners.
5. Increase the minimum cost differential for new starts to justify performing work in-house from the 10 percent presently prescribed to a maximum of 25 percent. Of this figure, 10 percent would be a fixed margin in support of the general policy of reliance on private enterprise and a flexible margin of up to 15 percent would be added to cover various elements of risk, uncertainty, etc.

Although considerable time has passed since these recommendations were made, OMB feels that it has not yet developed enough information on agency implementation of A-76 to set target dates for stating executive branch positions on them.

Some of our more recent work has identified four more issues for consideration.

Cost comparisons

On October 18, 1976, Circular A-76 was amended to include the following policy guidance:

"... the Circular does not require that a cost study be made in every case to support a decision in compliance with the policy preference for reliance on commercial sources. A cost analysis is not needed in circumstances where the Government's economic interests would be protected, such as the existence of a competitive commercial market, unless the agency has some unique economic advantage which would enable it to supply the needed product or service at less than commercial cost. In determining whether a cost study should be undertaken, consideration should be given to the delay and expense involved in a study sufficiently detailed and comprehensive to provide valid results."

In commenting on a draft of this guidance, we advised OMB that this would lead agencies to make far fewer cost comparisons than in the past. As a result, the risk of selecting an uneconomical source would be greatly increased. We further stated that such a step seems highly inadvisable without a careful analysis of the costs of the studies that have been made in the past as compared to potential savings disclosed. While we support the policy of obtaining needed goods and services from commercial sources, we believe that obtaining needed goods and services at the lowest possible cost is also an important policy objective that must be given equal consideration. The effective implementation of both policies requires that complete and accurate cost comparisons be made.

In this regard, on November 14, 1974, we recommended to OMB that cost comparison criteria be revised to require the recognition of the time value of money and State and local taxes forgone. OMB, however, has not implemented these recommendations. We believe that these recommendations should be considered in a new study to be made by OMB and DOD, as discussed later in this statement.

Retirement benefit costs

Another issue is estimating the full annual accrual of retirement benefits earned by employees in both the public and private sectors.

Effective October 18, 1976, OMB announced that the retirement cost of Government employees would be estimated on the basis of 24.7 percent of base pay. We generally concurred with the use of this rate in our November 5, 1976, reports to Representatives Dodd and Udall (PSAD-77-6 and PSAD-77-7). On June 13, 1977, this rate was reduced to 14.1 percent through the issuance of Transmittal Memorandum No. 3 to Circular A-76. On this same date OMB also publicly announced its proposed review of A-76 and its implementation.

Further, as you know, the Department of Defense Appropriation Authorization Bill, 1978, as reported out of the conference committee, would suspend use of any such rate put into effect after June 30, 1976, by prohibiting conversion of in-house commercial or industrial functions to performance by private contractors unless such conversion would have been made under policies and regulations in effect before June 30, 1976.

This provision would remain in effect until March 15, 1978, or until 90 days after the receipt of a required joint DOD/OMB comprehensive review of the criteria used in determining whether commercial or industrial type functions at DOD installations should be conducted by in-house personnel or be contracted out. The Department of Defense Appropriation Bill, 1978, as passed by the House, would prevent funding for fiscal year 1978, with certain exceptions, of base operating support functions which were converted to commercial contract between the date of enactment of the act and September 30, 1978.

We believe that one of the most important factors that should result from the review will be a clear decision on whether employee retirement costs used in determining both in-house and contractor costs should be computed on a dynamic basis. In actuarial terminology, the value of benefit rights earned annually by employees covered under a retirement system is referred to as normal cost. Normal cost can be calculated on either a static or dynamic basis. Under the static basis, no consideration is given to future general pay increases or cost-of-living annuity adjustments while under the dynamic basis consideration is given to such increases. We have strongly supported computing both Government and contractor retirement costs on a dynamic basis. We believe that it is sound procedure to consider the total cost, as well as it can be determined, of various courses of action to provide a basis for informed judgments.

Retirement costs for civil service employees had been taken into account on a dynamic basis when cost comparisons are made.

No similar consideration was given, however, to retirement benefits for employees in the private sector under the social security system.

OMB has taken the position that social security costs should not be considered on a dynamic basis in estimating contract cost because (1) benefits paid are financed by earmarked contributions of employers and employees and (2) presently there are no legal requirements for contributions to the social security trust fund from the general fund of the Treasury.

The Social Security Administration acknowledges that contributions to the trust fund are not adequate to finance future liability for benefits. OMB has stated in response to our November 1976 reports to Representatives Dodd and Udall that if some levy is imposed on the general taxpayer by the Congress to finance social security, OMB would reexamine the cost factors used in A-76.

Because the necessity for Government subsidy of the social security fund is a strong probability--and many believe it a moral if not a legal obligation--we believe that estimates prepared under A-76 of the cost of contracting should include provision for this potential cost. Also, regardless of the eventual source of funding, we believe that the dynamic costs of social security benefits being earned should be reflected in A-76 type decisions.

Another factor in the review required by the Department of Defense Authorization Bill, 1978, is the possible development and use of more accurate factors applicable to civil service

retirement costs. Rates used to date represent a composite computation applicable to the overall work force, including engineers, secretaries, unskilled laborers, etc. In our November 1976 reports to Representatives Dodd and Udall, we stated that we believed OMB should give consideration to developing a series of retirement rates tailored to major occupational categories that are candidates for contracting out, such as guard services, grounds maintenance, and food service. It is improbable that pension cost factors are the same for all occupations.

In responding to this suggestion on December 20, 1976, OMB stated that it would significantly increase the cost and complexity of the administrative burden for the Civil Service Commission, and that it is doubtful that clear distinctions can be made, in terms of retirement experience, among employees in different occupations or activities. OMB further stated:

*** efforts to develop different cost factors for various occupational groups would lead to many questions, problems, and perceived inequities, such as:

Agencies and employees would probably object to making contributions at the present uniform rate if actual costs were shown to be different.

Employees in similar occupations but different activities could be subject to different cost factors.

Comparability studies with industry based on total compensation (salary plus fringe benefits) could be seriously distorted or made prohibitively complex."

OMB concluded that if the Government should subsequently establish different factors for different occupations, it will consider their use; but that until such figures are provided, it believes that use of the composite retirement cost factor is justified.

Since the issue will continue to be a sensitive one, we believe that the development of differential series of retirement rates along the lines suggested would save time in the long run.

Federal blue-collar wage levels

Another issue related to the making of cost comparisons is the fact that blue-collar Federal wages are generally higher than those in the private sector.

In a June 1975 report to the Congress, we discussed legislative provisions which were resulting in Federal blue-collar pay being higher than local prevailing private sector rates ("Improving the Pay Determination Process for Federal Blue-Collar Employees," FPCD-75-122, June 3, 1975). The Federal Wage System was established pursuant to legislation approved in 1972. The law sets forth the policy that pay rates for Federal blue-collar employees be fixed and adjusted from time to time as nearly as is consistent with the public interest in accordance with prevailing private sector rates.

We found that this legislative pay principle of comparability was not being obtained because of the application of certain other provisions of the 1972 Federal Wage System legislation. These include the establishment of (1) a Federal pay schedule that provides for five equal steps in each grade through which employees' pay increases a total of 16 percent over periods of time in service (the second Federal step is set at the prevailing private sector average rate, but in July 1976, 49 percent of the Federal employees were in the fifth step--12 percent more

than the local prevailing rates--and 14 percent were in the fourth step--8 percent above market), (2) conditions under which private sector wage rates of other localities may be used in setting Federal rates, and (3) night differential payments based on a percentage of the employees' wage rates. We suggested that the Congress reconsider these provisions.

An illustration of the effects of this situation is set forth in our June 20, 1977, report "Potential For Contracting Selected Operations at the Air Force Academy Cadet Dining Hall" (FPCD-77-57). We stated that the Academy's cost analysis, which we found was generally performed in accordance with Circular A-76, indicated that the cost for contracting the food service would be 34 percent less than in-house cost. The indicated savings were due primarily to lower wage rates paid by the contractor compared to the rates paid to Federal employees--\$3.27 per hour versus \$5.81 per hour.

Wage rates for Federal employees at the Academy are determined by DOD with concurrence by the Civil Service Commission as provided for in 5 U.S.C. 5341, which established the Federal Wage System. The minimum wage for contractor employees is determined by the Department of Labor in accordance with the Service Contract Act of 1965. The differences between the minimum wages for contractor employees and the wages for Federal employees varies substantially according to industry, geographic areas, selected boundaries, and timing of required wage surveys.

To improve the Federal Wage System's pay determination process we recommended that the Civil Service Commission obtain wage information more representative of the types of services needed.

Because personnel costs are generally an important element in comparing the cost of in-house versus contractor performance, significantly higher Federal wages will increase the likelihood that agencies will contract for needed goods and services.

In summary, we believe that the Federal Government should continue to pursue its policy of relying on the private sector and encouraging private industry to compete with the executive departments in providing needed commercial or industrial products and services.

This completes our formal statement, Mr. Chairman. I will be glad to respond to any questions regarding our comments.

EXHIBIT

EXHIBIT

EXHIBIT

LIST OF GAO REPORTS CONCERNING THE
IMPLEMENTATION OF THE A-76 POLICY

BY OMB AND DOD

(SINCE JANUARY 1, 1972)

| <u>Title</u> | <u>Addressee</u> | <u>Date</u> | <u>Publication Number</u> |
|--|--|-------------|---------------------------|
| Cost of Using Civil Service Versus Contract Labor for Loading Containers at the Military Ocean Terminal, Bayonne, New Jersey | House Subcommittee on Manpower and Civil Service, Committee on Post Office and Civil Service | 1/25/72 | B-171695 (LCD) |
| Better Controls Needed in Reviewing Selection of In-House or Contract Performance of Support Activities | Congress | 3/17/72 | B-158685 (FPCD) |
| Cost of Using Civil Service Versus Contractor Labor for Loading and Unloading the GTS Admiral William M. Callaghan at the Military Ocean Terminal, Bayonne, New Jersey | House Subcommittee on Manpower and Civil Service, Committee on Post Office and Civil Service | 6/21/72 | B-171695 (LCD) |
| Naval Training Command Decisions to Make Instead of Buy Certain Audio/Visual Projection Systems | Representative Broyhill | 2/22/73 | B-176496 (PSAD) |

| <u>Title</u> | <u>Addressee</u> | <u>Date</u> | <u>Publication Number</u> |
|--|--|-------------|---------------------------|
| Study of Military Temporary Lodging Facilities and the Availability of Commercial Motels | House Subcommittee on Small Business Problems in Smaller Towns and Urban Areas of the Select Committee on Small Business | 9/27/73 | B-169926 (LCD) |
| Transfer of Cargo Operations at the Military Ocean Terminal, Oakland, California, from Civil Service to Contract Labor | Representative Dellums | 6/11/74 | B-171695 (LCD) |
| Contract for Food Service Operations at Lackland Air Force Base | Representative Gonzalez | 10/04/74 | B-180966 (LCD) |
| The Air Force Should Review Contracting Out for Services at McGuire Air Force Base | Representative Forsythe | 11/05/74 | B-158685 (FPCD) |
| Improvements Needed in Criteria Used by Executive Agencies in Making Cost Comparisons | Director, OMB and Administrator of General Services | 11/14/74 | B-163762 (OP) |
| Contracting for Base Operations at Army, Navy, and Air Force Training Installations | Secretary of Defense | 11/18/74 | B-158685 (FPCD) |
| Comparing Costs of Marking Airfields: Air Force Versus Contract | Representative Andrews | 12/13/74 | LCD-74-331 |

| <u>Title</u> | <u>Addressee</u> | <u>Date</u> | <u>Publication Number</u> |
|--|--|-------------|-------------------------------|
| Reduction In Force Versus Contracting at Picatinny Arsenal | Senator Williams | 1/07/75 | FPCD-75-127 |
| Financial Operations of the Five Service Academies | Congress | 2/06/75 | FPCD-75-117 |
| Patrick Air Force Base Food Service Cost Comparison Study | Representative Frey | 5/08/75 | LCD-75-438 |
| Improving the Pay Determination Process for Federal Blue-Collar Employees | Congress | 6/03/75 | FPCD-75-122 |
| Savings Available by Contracting for Supply Support Services at the Eastern Test Range | Senator Chiles & Representative Frey | 8/18/75 | FPCD-76-5 |
| Reduction of Civilian Personnel at New London, Connecticut, Naval Installations | Representative Dodd | 11/04/75 | FPCD-76-22 |
| Tugboat Operations in the Navy | Secretary of the Navy | 11/24/75 | LCD-76-419 |

| <u>Title</u> | <u>Addressee</u> | <u>Date</u> | <u>Publication Number</u> |
|--|----------------------|-------------|-------------------------------|
| The Air Force Should Use Both Contract and In-House Services for Maintaining Military Family Housing at Dover Air Force Base | Senator Roth | 1/20/76 | FPCD-76-34 |
| Using Government Versus Commercial Facilities for Storing Military Personnel Household Goods | Secretary of Defense | 1/28/76 | LCD-76-210 |
| Reduction of Civilian Personnel in Research Development, Test and Evaluation Programs in the Department of Defense | Senator Tunney | 4/07/76 | FPCD-76-52 |
| Survey of Maintenance of Construction and Rail Equipment in the Army | Secretary of Defense | 6/03/76 | LCD-76-446 |
| Observations for Improving Depot-Level Maintenance Construction in the Department of Defense | Secretary of Defense | 6/07/76 | LCD-76-432 |
| Should Aircraft Depot Maintenance Be In-House or Contracted? Controls and Revised Criteria Needed | Secretary of Defense | 10/20/76 | FPCD-76-49 |

| <u>Title</u> | <u>Addressee</u> | <u>Date</u> | <u>Publication Number</u> |
|---|----------------------|-------------|---------------------------|
| Letter Report Regarding the Action of OMB Designed to Greatly Expand the Amount of Contracting Out of Functions Now Performed In-House by Civil Service Employees | Representative Dodd | 11/05/76 | PSAD-77-6 |
| Letter Report Regarding the Action of OMB Designed to Greatly Expand the Amount of Contracting Out of Functions Now Performed In-House by Civil Service Employees | Representative Udall | 11/05/76 | PSAD-77-7 |
| Contracting Out of Functions Previously Performed In-House | Representative Brown | 2/16/77 | PSAD-77-79 |
| How to Improve Procedures for Deciding Between Contractor and In-House Military Base Support Services | Secretary of Defense | 3/28/77 | LCD-76-347 |
| Personnel Ceilings--A Barrier to Effective Manpower Management | Congress | 6/02/77 | FPCD-76-88 |
| Potential for Contracting Selected Operations at the Air Force Academy Cadet Dining Hall | Representative Evans | 6/20/77 | FPCD-77-57 |