GAO

United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-279861

April 27, 1998

The Honorable Stephen Horn
Chairman
The Honorable Dennis J. Kucinich
Ranking Minority Member
Subcommittee on Government Management,
Information and Technology,
Committee on Government Reform and Oversight
House of Representatives

Subject: Competitive Contracting: Information Related to the Redrafts of the Freedom From Government Competition Act

This letter responds to your requests for information related to the Subcommittee's consideration of redrafts of H.R. 716 and S. 314, the Freedom From Government Competition Act. Enclosure 1 contains our responses to questions received on March 18, 1998, from Chairman Horn; and enclosure 2 contains our responses to questions received on March 18, 1998, from Ranking Minority Member Kucinich.

As agreed with your staff, our responses are based on our prior work and other information readily available from the Office of Management and Budget (OMB); the General Services Administration's (GSA) Federal Procurement Data Service (FPDS); and the Offices of the Inspectors General of the Department of Defense (DOD), Department of Energy (DOE), and the National Aeronautics and Space Administration (NASA).

We did not obtain agency comments on a draft of this correspondence because our responses were based primarily on previously issued work on which agencies have previously commented. Also, we did not independently verify the accuracy of information provided by OMB and GSA.

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We are sending copies of this letter to the Chairman and Ranking Minority Member of the Subcommittee on Oversight of Government Management, Restructuring and the District of Columbia, Senate Committee on Governmental Affairs; the Director, Office of Management and Budget; the Secretary of Defense; the Secretary of Energy; and the Administrator of NASA. We will also make copies available to others upon request. If you have any questions concerning this letter, please contact either J. Christopher Mihm on (202) 512-8676, or Barry Holman on (202) 512-5581.

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GAO RESPONSES TO QUESTIONS FROM CHAIRMAN HORN CONCERNING THE REDRAFT OF H.R. 716, THE FREEDOM FROM GOVERNMENT COMPETITION ACT

The following represent responses to the questions received from the Honorable Stephen Horn, Chairman, Subcommittee on Government Management, Information and Technology, House Committee on Government Reform and Oversight, dated March 18, 1998.

Question #1: Competition and its Effect on Performance and Costs. GAO should briefly discuss recent work in this area and general results found.

We have noted that competition is the key to realizing savings in consideration of outsourcing, whether functions are eventually performed by private sector sources or remain in-house.[1] We found that savings achieved through the A-76 competitive process were largely personnel savings, the result of closely examining the work to be done and reengineering the activities in order to perform them with fewer personnel, whether in-house or with contractors.[2] The Office of Management and Budget (OMB) has reported that savings from reviewing an agency's operations and making changes to implement the Most Efficient Organization (MEO) have averaged 20 percent from original costs. However, OMB's savings data are based on estimates rather than on actual savings information.

Although we believe there are savings from outsourcing competitions, we have urged caution regarding the magnitude of savings projections cited in various studies. Statements about savings have often been heavily premised on initial savings estimates

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[1]Base Operations: Challenges Confronting DOD as It Renews Emphasis on Outsourcing (GAO/NSIAD-97-86, Mar. 11, 1997); and Privatization: Lessons Learned by State and Local Governments (GAO/GGD-97-48, Mar. 14, 1997).

[2]Outsourcing DOD Logistics: Savings Achievable But Defense Science Board's Projections Are Overstated (GAO/NSIAD-98-48, Dec. 8, 1997); Base Operations: Challenges Confronting DOD as It Renews Emphasis on Outsourcing (GAO/NSIAD-97-86, Mar. 11, 1997); and Defense Outsourcing: Challenges Facing DOD as It Attempts to Save Billions in Infrastructure Costs (GAO/T-NSIAD-97-110, Mar. 12, 1997).

that were not later adjusted to reflect actual savings. Our work concerning the Department of Defense (DOD) illustrates three potential problems with this approach. First, actual costs change as the scope of the work, wages, and technology change, but savings estimates are not updated accordingly. Second, the savings rates used in DOD's estimates are based on outsourcing competitions conducted before the onset of significant personnel reductions in DOD. Therefore, the projected savings rates in the future may not be as high as those achieved during the 1980s, because some inefficiencies associated with personnel have already been reduced. Third, mission and programmatic changes that occur after A-76 competitions are completed make it difficult to effectively track over time the costs and savings changes that result from the A-76 competitions themselves.

Question #2: Comment upon the management capacity needed to implement the competition requirements of H.R. 716 and compare that which was needed to implement the Chief Financial Officers Act. Are agencies and the Office of Management and Budget capable of implementing H.R. 716 and performing the tasks they are being asked to accomplish?

The Chief Financial Officers Act (CFO Act) has been a significant undertaking for all of the 24 agencies required to comply with the act as well as for OMB. Agencies have had to develop new training requirements for their staff; and develop new, or revise existing, systems and procedures to maintain the required data. In addition, the Inspectors General (IGs) at the agencies have had to devote significant resources to the financial audits required under the Government Management Reform Act (GMRA), which expanded the requirements of the CFO Act.

The CFO Act requires agencies to have integrated accounting and financial systems that, among other things: (1) comply with applicable accounting principles, standards, and requirements; (2) provide for the systematic measurement of performance; and (3) provide for the development of cost information. The Federal Financial Management Improvement Act (FFMIA) of 1996 complemented the CFO Act by requiring the 24 CFO Act agencies to implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. Among the applicable accounting standards developed in response to the CFO Act are the Managerial Cost Accounting Standards,[3] which are to be implemented in the current fiscal year. These standards include requirements for agencies to (1) accumulate

[3]Statement of Federal Financial Accounting Standards No. 4, Managerial Cost Accounting Standards.

and report costs on a regular basis for management information purposes; and (2) measure the full cost of outputs, including both direct and indirect costs. The standards state that one of the purposes of having cost information is to make economic choice decisions, such as whether to do a project in-house or contract it out. Thus, the CFO Act and FFMIA require agencies to have the capability to identify the cost information that would be needed under H.R. 716.

Most agencies are still in various stages of implementing the CFO Act, as expanded by GMRA and FFMIA, and are not expected to fully comply with all applicable federal accounting standards for a number of years. For example, as of March 31, 1998, 17 of the 24 largest agencies had received audit opinions on their financial statements for fiscal year 1997. Of those 17 agencies, only 8 had received unqualified opinions. The administration has stated that its goal is to have unqualified audit opinions for 23 of the 24 agencies by fiscal year 2000. Additionally, four agencies have thus far proven to be in compliance with the federal financial systems requirements.

Despite the difficulties and continuing challenges in implementing the CFO Act, the efforts have already resulted in marked improvements in federal financial management. Once the act is fully implemented, agencies will be able to produce complete, reliable, timely, and consistent financial information. Agencies should have the necessary cost information readily available to satisfy the competition requirements of H.R. 716. For activities that are subject to competition, the bill requires that the offer of a federal government source in the competition reflect all of the source's direct and indirect costs that are relevant to the performance of the activity. The bill further states that the costs in the offer of a federal government source are to be adjusted, if necessary, to be comparable with offers from private sector sources.

Even when agencies have the systems in place to develop the necessary cost information, the task of competitively examining all nonexempt government activities should not be underestimated. The government's experience with the OMB Circular A-76 inventory of commercial activities provides some evidence that it is difficult, time consuming, and resource intensive to develop and translate a list of commercial functions into specific procurement actions. Also, soliciting offers and awarding contracts takes time--sometimes over a year between the original procurement request and the final approval of a contract and notice to proceed. We have also expressed concern that the use of contracting requires considerable contract management capability that may currently be lacking.[4]

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[4]Federal Contracting: Comments on S. 1724, the Freedom From Government Competition Act (GAO/T-GGD-96-169, Sept. 19, 1996).

As part of our ongoing work on A-76, officials in some agencies, including DOD, Interior, and Commerce, have told us that the number of staff with expertise in the A-76 process have dwindled in the past decade. Some officials have indicated that at the current staffing levels, they would not be able to competitively examine more than a handful of commercial activities. Some agencies, such as DOD, have recently increased efforts to train staff in the skills needed to conduct cost comparisons. However, training sufficient numbers of staff can take time and could make it difficult for agencies to meet the time frames specified by the draft bill.

Question #3: Contract Management. GAO should address the challenges faced by agencies in the area of contract management if commercial activities are subject to competition. Comment on the contract management situation at NASA and DOE, and any improvements in those agencies since they were placed on GAO's high risk list.

Contracting out can be considered one form of privatization. In our report on privatization lessons from state and local governments, we noted that when a government's direct role in the delivery of services is reduced through privatization, the need for monitoring and oversight grew. Oversight was needed not only to evaluate compliance with the terms of the contract, but also to evaluate performance in delivering goods and services in order to ensure that the government's interests were fully protected. Officials from most state and local governments said that monitoring contractors' performance was the weakest link in their privatization processes.

In past reports on governmentwide contract management, we identified major problem areas, such as ineffective contract administration; insufficient oversight of contract auditing; and lack of high-level management attention to, and accountability for, contract management.[5] Our high-risk reports have also pointed out longstanding contractor oversight problems at several agencies, including the Department of Energy (DOE) and the National Aeronautics and Space Administration (NASA), which are the two civilian agencies that do the most contracting. Specific information on progress made and remaining problems for DOE and NASA contracting are noted below. We also included some information on contracting problems and progress at DOD, because it spends more

[5]Government Earns Low Marks on Proper Use of Consultants (GAO/FPCD-80-48, June 16, 1980); Civilian Agency Procurement: Improvements Needed in Contracting and Contract Administration (GAO/GGD-89-109, Sept. 5, 1989); and Federal Contracting: Cost-Effective Contract Management Requires Sustained Commitment (GAO/T-RCED-93-2, Dec. 3, 1992).

on contracting than any other federal agency. When combined, DOE, NASA, and DOD represent nearly 83 percent of the federal government's reported contract expenditures. Although these agencies have taken actions to improve their contractor oversight and monitoring functions, their contracting functions remain high-risk areas that we will continue to monitor closely.

DOE

In our 1992 high-risk report on DOE contract management, we noted that DOE continued to enter into noncompetitive contracts, reimbursed virtually any cost to the contractor, and had inadequate contractor oversight.[6] Since then, DOE has taken steps to address its contracting weaknesses. In February 1994, a DOE contract reform team made nearly 50 recommendations that included, among other things, increasing competition for contracts, using alternatives such as performance-based contracts, and improving DOE's management and control of certain costs.

In September 1997, DOE reported on its assessment of the overall implementation of the 1994 contract reforms. The report concluded that although the reforms are being implemented across the DOE complex and examples of improved performance and cost savings have been documented, important issues and challenges remain. For example, the report noted that DOE needed (1) skilled contracting employees and (2) realignment of management and financial systems to meet the needs of performance-based contracting.

In October 1997, DOE reported on its assessment of performance-based incentive contracts, one of the key reform initiatives. Although the report indicated positive benefits from the use of performance-based incentive contracts, it also raised a number of concerns. For example, the report indicated that formal guidance for developing and administering performance objectives/incentives was limited and did not address establishing baselines to measure performance.

The Department's IG has also issued three reports since February 1997 that were critical of DOE's implementation of performance-based incentive contracts. For example, in March 1997 the IG reported that at DOE's Richland (WA) site, officials had not always made the best use of incentive dollars paid to the management and operating contractor.

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[6]High-Risk Series: Department of Energy Contract Management (GAO/RCED-92-244, Apr. 14, 1992).

As another example of recent contracting problems, DOE has had various problems with its privatized efforts to clean up radioactive wastes at the Pit 9 project at the Idaho National Engineering and Environmental Laboratory. As we reported in July 1997, estimated completion of the project is at least 26 months behind the original schedule, has resulted in nearly $1 million in fines by state and federal regulators, and the total estimated completion price has risen to over twice its original $200 million cost estimate. Overall, in January 1998, we reported that although DOE has made some progress in implementing its contract reform initiatives, recent internal reviews and IG reports disclosed problems with reform implementation and identified some of the same significant underlying problems also identified in the 1994 report.[7]

NASA

Since the early 1990s, we have identified NASA contract management activities as "high risk" for fraud, waste, abuse, and mismanagement, principally because of unrealistic budget expectations, inadequate systems and information for monitoring contractors' activities, and inadequate compliance with contract management requirements.[8] Since then, NASA has taken a number of steps to address these weaknesses. For example, NASA significantly reduced its budget expectations and, by the end of 1994, almost all of the $20 billion gap between its likely budgets and its 5-year program plans that had existed in 1991 was gone. However, because of continuing budget cutbacks, there is still potential for future program slowdowns that could extend schedules and increase contract costs. Moreover, NASA's efforts to partly close its remaining budget gap by reducing the cost of its infrastructure through improved use of aerospace test facilities in cooperation with the Department of Defense has made slow and uneven progress.

In addition to significantly reducing its budget gap, NASA has also improved its ability to influence contractors' performance and to oversee procurement activities. For example, NASA restructured its contract award fee policies to emphasize cost control and end product performance, tightened its rules on providing equipment to contractors, and improved its management of contract audit services.

Although NASA has made considerable progress on a variety of contract management issues and effectively addressed many problems throughout the procurement cycle as they have been identified, as of early 1997, one key contract management area still had not yet

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[7]Federal Management Issues (GAO/OCG-98-1R, Jan. 9, 1998).

[8]Federal Management Issues (GAO/OCG-98-1R, Jan. 9, 1998).

received adequate attention; namely, NASA's approach to routinely monitoring and measuring its procurement activities. NASA has, however, made commitments and taken actions to improve its abilities to identify contract management problems.

NASA also continues to work on other difficult issues that directly or indirectly affect contract management. For example, the cost control performance of the space station's prime contractor has significantly worsened over the past 2 years. Both NASA and the prime contractor have made commitments and taken actions to get costs under control. Additionally, NASA continues to develop an integrated agencywide financial management system and to implement full cost accounting practices throughout the agency.

DOD:

In our high-risk report on DOD contracting, we noted that increased contracting, coupled with reduced contract oversight staff, is a cause for concern at DOD.[9] We also reported that DOD's contract payment process is error prone and costly and that improving and simplifying the process is imperative. We also noted that poor cost-estimating remains a problem at some contractors' locations and requires attention by contractors and government contracting officials. Further, DOD's Voluntary Disclosure Program has the potential to contribute to identifying potential contractor fraud, but improvements in the administration of the program are needed. We have noted that as DOD plans to increase procurement budgets, increase outsourcing, and reduce contract administration resources, DOD will need to be creative in finding ways to meet an expected increase in demand for contract oversight and be more efficient in using its existing resources. Recent acquisition reform initiatives may create opportunities for DOD to redeploy oversight resources.[10]

The areas identified in our February 1997 high-risk report remain a concern. For example, in April and October 1997, we reported that DOD had made hundreds of millions of dollars in overpayments to contractors, many undetected for years, because it used inadequate computer systems requiring manual entry of often erroneous or incomplete data and a burdensome document-matching process.[11] In addition, concerns

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[9]High-Risk Series: Defense Contract Management (GAO/HR-97-4, Feb. 1997).

[10]Federal Management Issues (GAO/OCG-98-1R, Jan. 9, 1998).

[11]Contract Management: Fixing DOD's Payment Problems is Imperative (GAO/NSIAD-97-37, Apr. 10, 1997); and DOD Procurement: Funds Returned by Defense Contractors (GAO/NSIAD-98-46R, Oct. 28, 1997).

have recently been raised about the pricing of commercial spare parts purchased by DOD. We, along with the DOD IG, have started work to assess the reasonableness of the prices DOD pays for its commercial spare parts.

Question #4: Cost Data. GAO should address the role that cost information plays in the decision making process, and discuss the role of FASAB managerial cost accounting rules, and any adjustments which may be needed to the FASAB rules to accommodate the process envisioned by this Act.

The government's lack of complete cost data, particularly for indirect costs, has increased the difficulty of carrying out the competitive process, because the government is not able to accurately determine the cost of the function or activity it plans to compete. The cost data needed to develop indirect costs or standard cost factors that represent these costs, such as overhead rates, are not readily available. Also, without knowing current costs it is difficult to determine savings that are realized from competitions.

OMB has recognized the need to improve the process for public/private competitions. In March 1996, it revised its A-76 supplemental handbook to improve the administration of the process and the way government cost estimates are developed. The revisions were aimed at addressing private sector concerns about government cost estimates and improving the fairness of the competition. As a result, numerous changes were made to the process. The changes included revising or establishing several standard cost factors, such as requiring that government overhead costs be calculated on the basis of a standard rate of 12 percent of direct labor costs. In past competitions, the government cost estimates often did not include any overhead costs. However, as we recently reported, the 12-percent rate adopted by OMB lacked an analytical basis, and its use could lead to overstating or understating overhead costs and savings.[12]

Other longer term efforts are under way to improve government cost data and supporting systems. Recent legislative and management reform initiatives have emphasized the need for better information, including cost data, to support federal decisionmaking and measure the results of program operations. Continuing efforts to implement the CFO Act are central to ensuring that agencies resolve their long-standing problems in generating vital information for decisionmakers. In that regard, the Federal Accounting Standards Advisory Board (FASAB) has developed a new set of accounting concepts and standards that underpin OMB's guidance to agencies on the form and content of their agencywide

[12]Defense Outsourcing: Better Data Needed to Support Overhead Rates for A-76 Studies (GAO/NSIAD-98-62, Feb. 27, 1998).

financial statements.[13] As part of that effort, FASAB developed managerial cost accounting standards, which were referred to in our answer to question 2.[14]

These managerial cost accounting concepts and standards require that federal agencies provide reliable and timely information on the full cost of federal programs, their activities, and outputs. Specifically identified in the standards is the need for information to help guide decisions involving economic choices, such as whether to do a project in-house or contract it out. Such information would allow agencies to develop appropriate overhead rates for specific operations. These cost accounting standards became effective for fiscal year 1998.

In addition, as discussed in our answer to question 2, in 1996 Congress passed FFMIA requiring that agency financial management systems comply with, among other things, federal accounting standards and federal financial management system requirements. The federal financial management system requirements cited by FFMIA are developed by the Joint Financial Management Improvement Program (JFMIP).[15] Included are the Managerial Cost Accounting System Requirements, which were issued in February 1998 and are intended to guide federal agencies in defining their cost accounting software

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[13]FASAB was created in October 1990 by the Secretary of the Treasury, the Director of OMB, and the Comptroller General to consider and recommend accounting principles for the federal government. If accepted by Treasury, OMB, and GAO, the standards are adopted and issued by OMB and GAO.

[14]Statement of Federal Financial Accounting Standards No. 4, Managerial Cost Accounting Standards (July 31, 1995).

[15]JFMIP is a joint cooperative undertaking of OMB, GAO, the Department of the Treasury, and the Office of Personnel Management, who work together and with operating agencies to improve financial management throughout the government. JFMIP was given statutory authorization in the Budget and Accounting Procedures Act of 1950.

requirements. In addition, in February 1998, the CFO Council,[16] which was established by the CFO Act, and JFMIP issued the Managerial Cost Accounting Implementation Guide.[17]

These are all positive steps that will eventually lead to better cost data throughout the federal government. Unfortunately, cost accounting systems that would provide reliable cost information to support public-private competitions are typically not yet in place and may be years away. In our audit of the consolidated financial statements of the U.S. government for fiscal year 1997, we noted significant financial management deficiencies.[18] We found that financial systems weaknesses; problems with fundamental recordkeeping; incomplete documentation; and weak internal controls, including computer controls, prevent the government from accurately reporting a large portion of its assets, liabilities, and costs. These deficiencies affect the government's ability to accurately measure the full cost and financial performance of programs and to efficiently manage its operations. Overcoming these deficiencies presents a difficult challenge. As we pointed out in our February 1998 report on the A-76 overhead rates, it will likely be many years before FASAB cost accounting standards are fully implemented in DOD and DOD is capable of providing accurate and reliable cost data.[19]

One feature of the draft legislation is the provision describing the criteria that are to be used in contracting for goods and services. The legislation prescribes standards and procedures that are to include the analyses of all direct and indirect costs and that are to be performed in a manner consistent with generally accepted cost accounting principles. We have found in the past that the widespread absence of this type of information has compromised effective public-private comparisons. Given the current limitations of government accounting systems, significant time will be required to implement improvements.

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[16]The members of the CFO council--the CFOs and the deputy CFOs of the 24 largest federal agencies and senior officials of OMB and the Department of the Treasury--work collaboratively to improve the financial management of the U.S. government.

[17]The Managerial Cost Accounting Implementation Guide is a technical practice aid to assist federal entities in implementing cost accounting practices.

[18]Audit of the Consolidated Financial Statements of the U.S. Government for Fiscal Year 1997 (GAO/AIMD-98-127, Mar. 31, 1998).

[19]Defense Outsourcing: Better Data Needed to Support Overhead Rates for A-76 Studies (GAO/NSIAD-98-62, Feb. 27, 1998).

Question #5: What are the benefits and risks associated with judicial review of agency decisions as to which functions are inherently governmental?

In our report on inherently governmental functions we noted that inherently governmental functions are difficult to define and are therefore subject to varying interpretations.[20] There are very few constitutional and statutory restrictions on those activities that may or may not be contracted out by the federal government, and the courts have provided little additional insight. Also, identifying the governmental functions to be reserved for government officials depends on the agency's relationship to its contractors and the technical and management capacity of the agency. Therefore, each situation must be examined separately on the basis of how a function is carried out by an agency. This concept is mirrored in OMB policy letter 92-1, which provides guidance to help agencies make determinations of what functions are inherently governmental. The guidance provides some general direction but maintains broad discretion for agencies to consider their specific circumstances.

A primary benefit of providing for judicial review of agency decisions would be to provide some limits on what would otherwise be very broad agency discretion to determine what functions were inherently governmental. Knowing that their decisions in this area would be subject to court review should encourage agencies to take care in deciding what is an inherently governmental function. If an agency makes a decision that a particular activity is inherently governmental without adequate support, the decision could be reversed by the courts. It is more likely that the statutory goal of contracting out for all but inherently governmental and a few other specifically listed functions could be achieved.

The primary risk of providing judicial review is that every decision of an agency as to what is inherently governmental could be challenged. The judicial review process could be both costly and time consuming and could interfere with the government's ability to take appropriate and timely action in the challenged areas, particularly if each inherently governmental function is challenged on a case-by-case basis. A strong argument can be made that it is preferable for the executive branch to decide whether a particular activity is or is not an inherently governmental function. Such decisions entail policy trade-offs, and the executive branch would have to implement such decisions. Moreover, there is a chance that court decisions themselves may produce divergent results. Judicial review

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[20]Government Contractors: Are Service Contractors Performing Inherently Governmental Functions? (GAO/GGD-92-11, Nov. 18, 1991).

would not therefore provide the consistent governmentwide policy oversight that OMB could provide to the Executive Branch.

Question #6: Role of Best Value In Procurement. Briefly discuss whether increased attention to best value contracting, as opposed to the traditional cost comparison approach used in the A-76 process, improves the competition process.

A "best value" offer is the private sector offer that is considered to be most advantageous to the government, considering past performance and other noncost factors as well as cost--it is not necessarily the lowest-priced, acceptable offer. In the past, A-76 competitions rarely used best value criteria in any portion of the selection process. However, the March 1996 revision to the A-76 supplemental handbook has resulted in heightened attention to the consideration of "best overall value to the government" in competitions.

In accordance with the March 1996 supplement, once the best value private offer is selected, a cost comparison is made between the private offer and the in-house estimate. To ensure that the cost comparison is fair, the March 1996 revision specifically requires the government to submit a technical proposal along with its other proposal data. This allows the source selection authority[21] to determine whether the government's technical proposal is based on the same scope of work and performance levels as the private sector's best value contract offer. If the in-house proposal does not include the same level of performance, the government is required to change its technical proposal and cost estimate before the final cost comparison is made to determine the winner of the competition.

To date, best value criteria have received limited use by government agencies, but their use could grow in the future--particularly at DOD with its increased emphasis on outsourcing competitions. On the basis of our recent work involving outsourcing in DOD, we found that best value criteria are considered most appropriate when work to be competed involves high levels of complexity, significant technical expertise, and risk.[22] In these situations, the government is normally able to obtain a better value by comparing the

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[21]The source selection authority is the government official responsible for selecting the private sector offer that provides the best overall value to the government and determining whether the in-house proposal offers the same level of performance as the private sector offer.

[22]Defense Outsourcing: Better Data Needed to Support Overhead Rates for A-76 Studies (GAO/NSIAD-98-62, Feb. 27, 1998).

private sector's technical proposals and making trade-offs among various technical and nontechnical factors, such as past performance and costs.

To get an indication of how the best value criteria were affecting A-76 competitions, we recently reviewed the outcome of three Air Force competitions. Air Force officials told us that because the use of best value criteria now requires the government to submit a technical proposal, they were better able to compare the contractor's winning proposal with the government's. In one of the studies, for example, the government was required to adjust its proposal to match the same level of performance offered in the best private offer. Although the private offeror still won the competition, the contracting officer said she had greater confidence that the competition was fair. In the other two studies, the Air Force determined that the contractor and government proposed the same levels of performance. Consequently, the government did not have to adjust its proposals. The government won one of the competitions, and the private offeror won the other.

Question #7: Based on GAO's past work, please discuss the capacity issues (skills and expertise) that the Inspectors General may need in overseeing agencies' implementation of this Act. Also, please be prepared to discuss GAO's capacity to monitor and evaluate agency responsibilities outlined in this Act as well as other similar businesslike reform efforts.

We have not undertaken any work related to the capacity of the Offices of the Inspectors General to oversee the implementation of H.R. 716. Consequently, the IGs are probably in the best position to identify the capacity and skill levels needed to address any increased workload resulting from a heightened emphasis on outsourcing.

In recent years we have undertaken a wide range of work for a number of congressional committees on agencies' efforts to become more businesslike. For example, we recently completed several reviews pertaining to implementation of A-76 within DOD, and we currently have work under way monitoring DOD's progress in its efforts to study over 220,000 Full-time Equivalent (FTE) positions under the A-76 process over the next several years. We also have work under way to examine implementation of A-76 in the Departments of Commerce and the Interior and to determine OMB's role in supporting the efforts of these agencies. Additionally, we are currently studying the federal government's use of public-private partnerships at the request of Chairman Horn. We look forward to continuing to provide Congress with needed information and analysis as it seeks to improve the effectiveness and efficiency of the federal government.

GAO RESPONSES TO QUESTIONS FROM RANKING MINORITY MEMBER KUCINICH CONCERNING THE REDRAFTS OF H.R. 716 AND S. 314, THE FREEDOM FROM GOVERNMENT COMPETITION ACT

The following represent responses to the questions received from the Honorable Dennis J. Kucinich, Ranking Minority Member, Subcommittee on Government Management, Information and Technology, House Committee on Government Reform and Oversight, dated March 18, 1998.

Question #1: . . . To what extent are FTE ceilings on the federal government's civilian workforce, either implicit or explicit, forcing agencies to contract out services? Has contracting out ever cost more than if the work had been performed in-house?

In the past, OMB used FTE reductions to encourage agencies to outsource a gradually rising proportion of their activities. Recently, however, the federal government's downsizing efforts have been driven more by lower appropriations levels than by specific FTE ceilings, which are now somewhat less of an integral part of the budget process. In an effort to operate within lower appropriations levels, agencies have used a range of management strategies, including contracting out. For example, DOD is now increasing its emphasis on outsourcing competitions because of its need to reduce the costs of its operations and free up money for modernization. To what extent outsourcing may still be occurring because of personnel ceilings is uncertain. However, as noted in our March 1997 report on DOD outsourcing, various installation officials noted that one way of achieving across-the-board personnel reductions mandated by DOD was to outsource activities.[23] This would free remaining employees for use in other critically understaffed activities. Also, personnel ceilings can limit bringing work back in-house after it has been outsourced.

We are aware of some instances where contracting out has cost more than if the work had been performed in-house. However, these instances are not generalizable to all work that has been contracted out. For example, in August 1991, we reported that based on our estimates, DOE could have achieved savings by performing work in-house for 11 of the

[23]Base Operations: Challenges Confronting DOD as It Renews Emphasis on Outsourcing (GAO/NSIAD-97-86, Mar. 11, 1997).

12 support service contracts that we reviewed.[24] However, in that report we noted that the results were not generalizable because the selection methodology favored contracts that agency officials suggested could be performed less expensively by federal personnel. In March 1994, we reported on our review of nine reports and testimonies that compared the cost of using contractors versus federal employees to perform services.[25] Although the nine studies indicated that savings may have been available in certain situations if services were performed by federal employees rather than by contractors, all of the studies had limitations. For example, none were sufficiently large or comprehensive to permit generalization to other situations in the government as a whole, or even within specific agencies.

Question #2: What differences are there in pay, health care benefits, and retirement benefits between contractor employees and federal employees who used to perform their work? What percentage of the federal government's service contractor workforce is organized? What differences are there between organized and unorganized federal service contractor employees with respect to pay and benefits?

Governmentwide data are not available that would identify the differences between compensation and benefits of contractors and federal employees who used to perform their work. Data are also not available on union organization of contractor employees. In an effort to answer the question on this topic, we contacted OMB, DOD, and Office of Personnel Management (OPM) officials knowledgeable about contractor workforces. The officials noted that the information would be difficult, if not impossible, to collect because of the large number of contractors and subcontractors employed by the federal government and the wide variety of benefits packages available to private sector employees or those who work under personal services contracts. Regarding union organization of the contractor workforces, none of the officials had any relevant information, because there are no requirements for contractors to report this type of information.

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[24]Energy Management: Using DOE Employees Can Reduce Costs for Some Support Services (GAO/RCED-91-186, Aug. 16, 1991).

[25]Government Contractors: Measuring Costs of Service Contractors Versus Federal Employees (GAO/GGD-94-95, Mar. 10, 1994).

Question #3: How much has the federal government spent annually on commercial activities contracting over the past 10 years? How much is spent on commercial activities contracting that is not included in OMB's calculations, like construction and Medicare payments to health care providers? How many contract employees currently make up the federal government's commercial activities contracting workforce? What has been the growth of this workforce over the past 10 years? How much has been spent annually on goods contracting over the past 10 years?

Table 2.1 shows how much the federal government spent on commercial activities contracting over the past 10 years. The data are drawn from the Federal Procurement Data System, which includes only contracts valued at $25,000 or more as reported to GSA by federal agencies. These amounts include contracting for construction but do not include Medicare payments to healthcare providers. Neither OMB nor OPM were able to provide any information on how many contract employees make up the federal government's contracting workforce. Contractors are generally not required to report on the workforces they apply to government contracts, and many employees work on nongovernmental as well as governmental contracts. Table 2.2 shows how much has been spent annually on goods contracting over the past 10 years.

Table 2.1: Commercial Activities Contracting

	Reported amount spent on R&D and services	
Fiscal year	Current dollars in thousands	Constant dollars (FY 1997) in thousands
1988	$88,602,034	$116,323,743
1989	88,807,051	111,901,632
1990	91,149,895	110,232,297
1991	104,295,779	120,975,053
1992	107,073,104	120,652,707
1993	107,347,479	117,842,502
1994	111,834,794	119,868,344
1995	116,285,275	121,523,431
1996	113,816,224	116,262,598
1997	109,924,784	109,924,784

Note: Current dollar amounts converted to constant (FY 1997) dollars using the GDP price index. We did not independently verify the accuracy of the data reported to GSA.

Source: Federal Procurement Data System Annual Reports (GSA). Current dollars converted to constant dollars by GAO.

Table 2.2: Reported Supplies and Equipment Contracting

Fiscal year	Current dollars in thousands	Constant dollars (FY 1997) in thousands
1988	$85,495,551	$112,245,307
1989	79,887,930	100,663,063
1990	80,150,995	96,930,756
1991	85,306,441	98,948,887
1992	70,713,277	79,681,525
1993	71,019,500	77,962,851
1994	62,853,157	67,368,156
1995	64,566,700	67,475,155
1996	64,795,620	66,188,342
1997	62,796,130	62,796,130

Note: Current dollar amounts converted to constant (FY 1997) dollars using the GDP price index. We did not independently verify the accuracy of the data reported to GSA.

Source: Federal Procurement Data System Annual Reports (GSA). Current dollars converted to constant dollars by GAO.

Question 3 Continued: What percentage of commercial activities contracting monies are competed under A-76? What percentage of those monies is competed under an informal competitive framework? What percentage is not competed at all?

What is the number of A-76 studies initiated, and the number of federal employees covered by such studies, over the past 10 years? What have been the savings generated by competitions mandated by A-76?

OMB is not able to provide data on the percentage of commercial activities contracting funds (1) competed under A-76, (2) competed under an informal competitive framework, and (3) not competed at all. OMB did, however, provide data on the number of FTEs studied over the past 10 years, including information on estimated savings. (See table 2.3)

As noted previously, actual cost information is not available. It is difficult to determine actual savings, because after the contract is awarded, changes frequently occur in the scope of the work to be performed and the wage rates paid. Although we believe there are savings from outsourcing competitions, we have urged caution regarding the magnitude of savings projections cited in various studies.

Table 2.3: Reported A-76 Cost Comparisons Initiated During the Past 10 Years

Fiscal year	FTEs studied	Estimated FTE savings	Estimated dollar savings (000)
1988	17,249	10,288	$129,684
1989	8,469	5,128	85,095
1990	9,547	4,121	73,806
1991	2,026	1,194	37,390
1992	921	1,301	325,255
1993	921	1,301	325,255
1994	921	1,301	325,255
1995	2,386	1,301	325,255
1996	5,267	1,479	355,697
1997	25,255	1,245	412,000

Note: Data for 1992-1995 are based on annual averages for that time period. Not all agencies are included, but OMB stated that the amount excluded is insignificant. Dollar amounts are not adjusted for inflation, and we did not independently verify the accuracy of the data provided by OMB.

Source: OMB

Question #4: The latest A-76 supplement allows work to be contracted-in in the event of poor contractor performance. Have any federal agencies used this provision, and if not, why not? What problems have federal agencies encountered in contracting-in work? Have any steps been taken to deal with such problems, to the extent that they genuinely exist?

We have not done work to fully answer this question. However, we did discuss the issue of contracting-in with OMB officials. They said they were aware of some cases where work has been contracted-in as a result of poor contractor performance, but they do not collect data to quantify the number of cases where this has occurred. They said that there may be many possible reasons why agencies are not more active in contracting-in work. For example, agencies may be satisfied with contractors' performance or may not feel that they are currently competitive with contractors. Personnel reductions that have occurred throughout the government could make it difficult to bring work back in-house.

We have not done work that addresses governmentwide contracting-in due to poor contractor performance. However, in 1995, we reported on contracting decisions for GSA's real property management services, such as building maintenance and custodial services.[26] We reviewed post-decision analyses and evaluations by GSA for 54 activities that showed that the agency generally obtained services at a reasonable cost and at an acceptable level of performance and that it made relatively few reversals from its original decisions to contract out the activities. We found no evidence of performance problems in the case files for a majority (29) of the 54 sample activities. For 11 activities, however, we found serious problems, such as defaults or terminations for unsatisfactory performance. All but one of these activities involved maintenance services.

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[26]Public-Private Mix: Effectiveness and Performance of GSA's In-House and Contracted Services (GAO/GGD-95-204, Sept. 29, 1995).

Questions #5: To what extent do problems continue to plague the federal government's contract administration? What steps should the federal government take to resolve these problems? To what extent will the contemplated downsizing of the Pentagon's contract administration workforce complicate these problems? To what extent would an even greater reliance by federal agencies on contractors, as is contemplated by H.R. 716/S. 314, complicate these problems? How much is lost annually as a result of waste, fraud, and abuse from service contracting and poor contract administration?

In numerous past reports on governmentwide contract management, we identified major problem areas, such as ineffective contract administration, insufficient oversight of contract auditing, and lack of high-level management attention to and accountability for contract management. Our high-risk reports have also pointed out long-standing contractor oversight problems at several agencies, including DOD, DOE, and NASA.[27] In our high-risk report on DOD contracting, we noted that increased contracting, coupled with reduced contract oversight staff, is a cause for concern at DOD. Although these agencies have taken actions to improve their contractor oversight and monitoring functions, they remain high-risk areas that we will continue to closely monitor.

As the federal government does more contracting, as would be expected under H.R. 716/S. 314, proper contract oversight becomes more important. Increased contracting requires considerable contract management capability. An agency must have adequate capacity and expertise to successfully carry out the solicitation process and effectively administer, monitor, and audit contracts once they are awarded. Similarly, in our report on privatization lessons from state and local governments, we noted that when a government's direct role in the delivery of services is reduced through privatization, the need for aggressive monitoring and oversight grew. Oversight was needed not only to evaluate compliance with the terms of the privatization agreement, but also to evaluate performance in delivering goods and services to help ensure that the government's interests were fully protected. Officials from most state and local governments said that monitoring contractors' performance was the weakest link in their privatization processes.

It is not possible to determine the total amount of losses as a result of waste, fraud, and abuse from service contracting and poor contract administration. However, the most recent Annual Report of the President's Council on Integrity and Efficiency (PCIE) and

[27]High-Risk Series: An Overview (GAO/HR-97-1, Feb. 1997).

the Executive Council on Integrity and Efficiency (ECIE)[28] provides governmentwide summary information from federal IGs during fiscal year 1996 that may give some perspective.[29] The report notes that federal agencies' managers agreed to cancel or seek reimbursement of over $5.5 billion in questioned costs. In addition, IG investigations in fiscal year 1996 resulted in the reported recovery of more than $1.1 billion from companies and people who defrauded the federal government. Further, IG investigative work resulted in a reported 4,633 debarments, exclusions, and suspensions of firms or individuals doing business with the government.

Question #6: . . . In 1994, GAO reported that almost $75 million in government property had been lost by a single contractor at one DOE facility. GAO reported that "this amount represents only what the contractor reported to DOE as missing. We believe that figure probably understates the actual amount of missing property . . ." To what extent do these problems still exist at federal agencies? What steps have been taken to address them?

In our audit of the consolidated financial statements of the U.S. government for fiscal year 1997, we noted that the federal government does not have accurate information about the amount of assets held to support its domestic and global operations.[30] Hundreds of billions of dollars of the more than $1.2 trillion of these reported assets are not adequately supported by financial and/or logistical records. Some portions of these assets include buildings, military equipment, and various government-owned assets in the hands of private sector contractors.

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[28]PCIE and ECIE are interagency councils established by executive order to coordinate and enhance governmental efforts to promote integrity and effectiveness in federal programs. PCIE principally consists of the presidentially appointed/Senate confirmed IGs. ECIE principally consists of the IGs appointed by the agency heads at designated federal entities.

[29]Fiscal Year 1996 Annual Report of the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency.

[30]Audit of the Consolidated Financial Statements of the U.S. Government for Fiscal Year 1997 (GAO/AIMD-98-127, Mar. 31, 1998).

Regarding specific problems at DOE, we reported in 1994 on the management of DOE-owned property by the 20 major contractors involved in defense-related activities.[31] These 20 contractors reported missing property totaling about $74.2 million in their property inventory reports to DOE. DOE IG reports show that property management continues to be an issue at DOE. For example, in February 1996, the Office of the Inspector General was unable to form an opinion on DOE's Fiscal Year 1995 Statement of Financial Position because, among other things, DOE did not have adequate controls over its property and equipment to ensure accountability for these assets. More recently, in April 1998, the IG reported on inadequate safeguards or accounting for property in the care of contractors at the Oak Ridge (TN) facility, indicating that property records were inaccurate and incomplete.

Question #7: H.R. 716/S. 314 and their successor drafts invest considerable power in OMB with respect to determining which are inherently governmental functions and whether or not to contract out functions which are not inherently governmental. This power would be exercised at the expense of the discretion currently exercised by agency managers, who in many cases are closest to the function and may be best qualified to make such decisions.

Is it wise to invest such decision making power in officials so far removed from the customer-service level? What are the possible drawbacks/benefits of such an approach?

Currents drafts of the bill have reduced the role of OMB in determining which functions are inherently governmental. Instead, they require the agencies to make these determinations, subject to judicial review. In our response to question 5 in enclosure 1, we noted that there would be advantages and disadvantages to this strategy. We said that the main benefit of allowing judicial review of agency decisions would be to provide some limits on what would otherwise be very broad agency discretion to determine what functions were inherently governmental. We said the primary risk is that the judicial review process could be both costly and time consuming and could interfere with the government's ability to take appropriate and timely action in the challenged areas, particularly if each inherently governmental function is challenged on a case-by-case basis. It might be important to have consistent governmentwide oversight over determining what

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[31]Department of Energy: Status of DOE's Property Management Program (GAO/RCED-94-154FS, April 7, 1994).

is or is not an inherently governmental function. Providing for judicial review would not ensure consistent governmentwide policy oversight.

Question #8: What impact would litigation have on the integrity of public-private competitions? What impact would litigation have on any savings which might occur as a result of enactment of H.R. 716/S. 314?

We do not have a basis to predict the possibility or likely effect of increased litigation.

Question #9: What post-contract audit provision do agencies have in place to determine whether or not projected outsourcing costs and/or savings are being realized? Are there any policies in place which compel managers to revisit or reverse a decision to outsource in the event of contractor defaults, overruns, or non-performance? If such measures are not in place, should they be?

The March 1996 revision to OMB Circular A-76 requires a formal review and inspection of the in-house (or government MEO) winner typically following the first full year of performance. Reviews are to be conducted on not less than 20 percent of the functions performed by the government as the result of a cost comparison. When a contract default or an in-house failure to perform is identified, including failure to implement the MEO as required, the contracting officer is to award the work to the next lowest offeror who participated in the cost comparison, if feasible. If award to the next lowest offeror is not feasible, the contracting officer is to immediately resolicit to conduct a revised and updated cost comparison.

Our ongoing and completed work at DOD has shown that post-contact reviews of activities outsourced by the military services have been limited; as a result, we have questioned whether they provide a basis for projecting with reliability the magnitude of savings achieved over time. Further, such assessments are extremely difficult to do, because a baseline for comparison between the government and a contractor is increasingly limited as time passes from the point of initial comparison. Nevertheless, the Defense Authorization Act for Fiscal Year 1998 (P.L. 105-85, Section 385) requires that DOD maintain cost data on contracted out functions for a period of 5 years. The act also requires DOD to collect cost information on certain functions brought back in-house for a period of 5 years. This information is to be compared with the estimated costs of continued performance of such activity by private contractor employees.

DOD does not effectively track costs and savings in its A-76 competition databases. These databases contain only partial information on the actual costs of the government or

contractors' performance. In addition, the military services calculate savings estimates in different ways, making meaningful comparison difficult. Several studies by DOD and others, including our prior reviews, have found numerous problems with the Commercial Activity Management Information System databases used by DOD and the services. DOD has recognized the problems and has undertaken efforts to improve these systems. As part of our future work, we intend to obtain information on DOD's plans for improvement and schedules for implementation.

Question #10: How much service contracting in the federal government is sole-sourced, both as a percentage of contracts and a percentage of dollars? Would the recent drafts of H.R. 716/S. 314 increase the probable use of sole-sourced contracts?

As shown in table 2.4, for contracts valued at $25,000 or more, the Federal Procurement Data System reported that there was a total of 286,735 procurement actions for services in fiscal year 1997. Of these, 23,055 (about 8 percent) were sole-source procurement actions. In terms of dollar value, there was a total of about $109.9 billion in federal procurement actions for services, of which about $18.7 billion, or about 17 percent, were sole-source actions.

Table 2.4: Sole-Source Procurements for Services and R&D as a Percentage of Total Federal Procurements for Services and R&D for Fiscal Year 1997

	Actions	Percentage of total	Dollars (000)	Percentage of total
Total federal procurement for services and R&D	286,735		$109,924,784	
Sole-source procurements for services and R&D	23,055	8.04%	$18,707,264	17.01%

Note: We did not independently verify the accuracy of the data provided by GSA

Source: GSA, Federal Procurement Data Center.

We have no information to suggest how the draft legislation would affect the use of sole-source procurements.

Question #11: Are you aware of any recent developments which would cause you to question whether contracting out decisions have been beneficial and cost effective?

In 1995, we testified that evaluating the overall effectiveness of A-76 decisions and verifying the estimated savings reported by agencies are extremely difficult.[32] At that time we said that we could not prove or disprove that the results of federal agencies' A-76 decisions have been beneficial and cost effective. We still are unable to verify the savings reported by agencies on a macro basis. We have, however, recently stated that savings can occur regardless of who wins the competitions, because the process forces a competitive examination of the work to be done and the most efficient way of doing it.[33] Therefore, we believe that the process of identifying the most efficient organization as part of the A-76 study process can be beneficial to agencies, regardless of who wins the competitions. We have found that savings achieved through the A-76 competitive process have been largely personnel savings, the result of closely examining the work to be done and reengineering the activities in order to perform them with fewer personnel, whether in-house or by contractors. OMB has reported that savings from reviewing an agency's MEO have averaged 20 percent from original costs. However, OMB's savings data are based on estimates rather than on actual savings information. It is difficult to determine actual savings, because after the contract is awarded, changes frequently occur in the scope of the work to be performed and the wage rates paid.

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[32]Government Contractors: An Overview of the Federal Contracting-Out Program (GAO/T-GGD-95-131, Mar. 29, 1995).

[33]Outsourcing DOD Logistics: Savings Achievable But Defense Science Board's Projections Are Overstated (GAO/NSIAD-98-48, Dec. 8, 1997); Base Operations: Challenges Confronting DOD as It Renews Emphasis on Outsourcing (GAO/NSIAD-97-86, Mar. 11, 1997); and Defense Outsourcing: Challenges Facing DOD as It Attempts to Save Billions in Infrastructure Costs (GAO/T-NSIAD-97-110, Mar. 12, 1997).

Question #12: Recent drafts of H.R. 716/S. 314 envision subjecting every "commercial activity" performed by federal agencies to a public-private competition within five years and at least once every five years thereafter.

How costly and disruptive would this process be? Do the agencies have sufficient personnel and money to perform such a massive undertaking with their current budgets?

We believe that efforts to increase an emphasis on public-private competitions could produce important benefits to the government in terms of ensuring that functions are being performed in an economical and efficient manner. Such is the benefit from the process of identifying "most efficient organizations" as part of the A-76 process, regardless of whether the competitions are won by the private sector or the in-house workforce. However, our ongoing work suggests that DOD has a sizeable task ahead of it as it prepares to study over 220,000 FTE positions under the A-76 process between 1997 and 2001. Whether DOD and other agencies could realistically and effectively study positions encompassing all commercial activities within 5 years is uncertain.

We also cannot be certain about the possible costs associated with conducting additional outsourcing studies. Currently, some of the services and defense agencies within DOD are performing these studies with in-house personnel, and others are relying on contractors. A variety of costs has been tentatively identified by the services for conducting these studies; however, the wide range in cost estimates provided leads to questions about their accuracy and completeness. Total study costs historically have not been tracked or reported within DOD.

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