



Improving the Sourcing Decisions of the Government

Final Report



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Commercial Activities Panel

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Section I

Executive Summary

Introduction

The federal government is one of the world's largest users of services. Because of the large dollar value and the number of private and public sector jobs involved, deciding whether the public or the private sector would be the most appropriate provider of the services the government needs is an important, and often highly charged, question. These sourcing decisions are frequently controversial, both when the government decides to outsource work to the private sector directly, and when it makes a sourcing decision by comparing the costs of public- versus private-sector performance of the work.

In order to address the many and complex challenges it faces, the federal government must be able to attract and rely on employees and contractors that are highly skilled, high-performing, and competitive.

In particular, the execution of public-private cost comparison studies conducted under rules set out in the Office of Management and Budget (OMB) Circular A-76 and its Supplemental Handbook has been under fire from all sides. Federal managers and others have been concerned about the organizational turbulence that typically follows the announcement of A-76 studies. Government workers have been concerned about the impact of competition on their jobs, the opportunity for input into the process, and the lack of parity with industry offerors to protest A-76 decisions. Industry representatives have complained about unfairness in 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 raised about the adequacy of oversight of subsequent performance, whether by the public or private sector.

The government's goal is and always should be to obtain high-quality services at a reasonable cost. Stated differently, the government should strive to achieve outcomes that represent the best deal for the taxpayer. Achieving this goal is a significant challenge. But there can be little doubt that identifying the right processes that will lead to results consistent with this goal is critical.

Today, the federal government faces a number of significant and evolving challenges, some of which are directly related to its ability to achieve this goal. The public rightfully expects that the government will obtain and deliver high-quality services. Many federal agencies face serious management and personnel challenges, especially as the workforce ages and heads towards retirement. For example, in the acquisition area, the workforce has been downsized significantly in recent years, and some of those who remain have not been trained sufficiently to perform their functions in an increasingly complex environment. Similarly, the government faces continued and significant management, human resource, and professional development challenges, which affect the government's ability to manage the cost, schedule, and performance of in-house and contracted activities.

In order to address the many and complex challenges it faces, the federal government must be able to attract and rely on employees and contractors that are highly skilled, high-performing, and competitive. But in many cases, the processes designed

to help identify the best sources to deliver services have proved difficult for agencies to implement. The government continues to be saddled with systems, budgeting practices, and processes that do not adequately account for total costs and inhibit the government's ability to manage its activities in the most effective manner possible. For many agencies, choosing the most effective source for services in support of their missions has become increasingly problematic.

The Commercial Activities Panel

Against this backdrop, and in response to a requirement in the National Defense Authorization Act for Fiscal Year 2001, the Comptroller General of the United States convened a panel of experts to study the current process used by the government to make sourcing decisions. The Commercial Activities Panel (the Panel) consisted of representatives from agencies, federal labor unions, and private industry, as well as other individuals with expertise in this area. Early in its review, the Panel adopted the following mission statement:

Mission of the Commercial Activities Panel

The mission of the Commercial Activities Panel is to improve the current sourcing framework and processes so that they reflect a balance among taxpayer interests, government needs, employee rights, and contractor concerns.

The Panel decided that all of its findings and recommendations would require the agreement of at least a two-thirds

supermajority of the Panel in order to be adopted. The Panel also decided that each Panel member would have the option of having a brief statement included in the report explaining the member's position on the matters considered by the Panel.

During its year-long study, the Panel heard from a variety of sources. The Panel held three public hearings to hear first-hand both about the current process, primarily the cost comparison process conducted under OMB Circular A-76, as well as alternatives to that process. The Panel also reviewed existing literature on sourcing issues faced by governments as well as by commercial firms. In the private sector, outsourcing has grown dramatically and been used primarily for what are seen as non-core services, such as information technology, and is typically integrated with a firm's strategic vision. For the federal government, however, determining the appropriate sourcing strategy has been a challenge.

The Panel heard repeatedly about the importance of competition and its central role in fostering economy, efficiency, high performance, and continuous performance improvement. The means by which the government utilizes competition for sourcing its commercial functions was at the center of the Panel's discussions and work. The Panel strongly supports continued emphasis on competition, and believes that whenever the government is considering converting work from one sector to another, public-private competitions should be the norm. Direct conversions (a decision to convert one or more positions from performance in one sector to the other without a public-private competition, although private-private competition may well exist) generally should occur only where

the number of affected positions is so small that the costs of conducting a public-private competition clearly would outweigh any expected savings (i.e., a *de minimis* number, no more than 10 positions). There should be adequate safeguards to ensure that activities, entities, or functions are not improperly unbundled as a means to come under the ceiling to avoid competition. Any exception to the *de minimis* rule, based on clear, transparent, and consistently applied criteria, would need to be approved by the head of the agency. If that approval is obtained, any subsequent private-private competition should include as an evaluation criterion the favorable treatment of incumbent employees, in terms of retention, wages, and benefits.

The Panel also heard about several successful undertakings involving public-private partnerships, as well as about the importance of labor-management cooperation in accomplishing agency missions. A consistent theme at the hearings was the need for a strategic approach to sourcing decisions, rather than an approach that relies on the use of arbitrary quotas or that is unduly constrained by personnel ceilings. Critical to adopting a strategic approach is having an enterprisewide perspective on service contract expenditures, yet the federal government lacks timely and reliable information about exactly how, where, and for what purposes, in the aggregate, taxpayer dollars are spent for both in-house and contracted services. The Panel was consistently reminded about, and fully agrees with, the importance of ensuring accountability throughout the sourcing process, providing adequate training and technical support to the workforce in developing proposals for improving performance,

and assisting those workers who may be adversely affected by sourcing decisions.

Sourcing policy is inextricably linked to human resource and human capital policies. This linkage has many levels, each of which is important. It is particularly important that sourcing strategies support, not inhibit, the government's efforts to recruit and retain a high-performing in-house workforce, as well as support its efforts to access and collaborate with high-performance, private-sector providers. Properly addressed, these policies should be complementary, not conflicting.

The Panel fully agrees with the importance of ensuring accountability throughout the sourcing process, and of providing adequate training and technical support to the workforce.

Sourcing Principles

Based on public input, review of previous studies and other relevant literature, and many hours of deliberation, the Panel developed and unanimously adopted a set of principles that it believes should guide sourcing policy for the federal government. While each principle is important, no single principle stands alone. As such, the Panel adopted the principles as a package. The Panel believes that federal sourcing policy should:

1. **Support agency missions, goals, and objectives.**

Commentary: This principle highlights the need for a link between the missions, goals, and objectives of

federal agencies and related sourcing policies.

2. **Be consistent with human capital practices designed to attract, motivate, retain, and reward a high-performing federal workforce.**

Commentary: This principle underscores the importance of considering human capital concerns in connection with the sourcing process. While it does not mean that agencies should refrain from outsourcing due to its impact on the affected employees, it does mean that the federal government's sourcing policies and practices should consider the potential impact on the government's ability to attract, motivate, retain, and reward a high-performing workforce both now and in the future. Regardless of the result of specific sourcing decisions, it is important for the workforce to know and believe that they will be viewed and treated as valuable assets. It is also important that the workforce receive adequate training to be effective in their current jobs and to be a valuable resource in the future.

3. **Recognize that inherently governmental and certain other functions should be performed by federal workers.**

Commentary: Recognizing the difficulty of precisely defining "inherently governmental" and "certain other functions," there is widespread consensus that federal employees should perform certain types of work. OMB Directive 92-1 provides a framework for defining work that is clearly "inherently governmental," and the Federal

Activities Inventory Reform (FAIR) Act has helped to identify commercial work currently being performed by the government. It is clear that government workers need to perform certain warfighting, judicial, enforcement, regulatory, and policymaking functions, and the government may need to retain an in-house capability even in functions that are largely outsourced. Certain other capabilities, such as adequate acquisition skills to manage costs, quality, and performance and to be smart buyers of products and services, or other competencies such as those directly linked to national security, also must be retained in-house to help ensure effective mission execution.

4. **Create incentives and processes to foster high-performing, efficient, and effective organizations throughout the federal government.**

Commentary: This principle recognizes that historically it has primarily been when a government entity goes through a public-private competition that the government creates a "most efficient organization" (MEO). Since such efforts can lead to significant savings and improved performance, they should not be limited to public-private competitions. Instead, the federal government needs to provide incentives for its employees, its managers, and its contractors to constantly seek to improve the economy, efficiency, and effectiveness of the delivery of government services through a variety of means, including competition, public-private partnerships, and enhanced worker-management cooperation.

5. Be based on a clear, transparent, and consistently applied process.

Commentary: The use of a clear, transparent, and consistently applied process is key to ensuring the integrity of the process as well as to creating trust in the process on the part of those it most affects: federal managers, users of the services, federal employees, the private sector, and the taxpayers.

6. Avoid arbitrary full-time equivalent (FTE) or other arbitrary numerical goals.

Commentary: This principle reflects an overall concern about arbitrary numbers driving sourcing policy or specific sourcing decisions. The success of government programs should be measured by the results achieved in terms of providing value to the taxpayer, not the size of the in-house or contractor workforce. Any FTE or other numerical goals should be based on considered research and analysis. The use of arbitrary percentage or numerical targets can be counterproductive.

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7. Establish a process that, for activities that may be performed by either the public or the private sector, would permit public and private sources to participate in competitions for work currently performed in-house, work currently

contracted to the private sector, and new work, consistent with these guiding principles.

Commentary: Competitions, including public-private competitions, have been shown to produce significant cost savings for the government, regardless of whether a public or a private entity is selected. Competition also may encourage innovation and is key to improving the quality of service delivery. While the government should not be required to conduct a competition open to both sectors merely because a service could be performed by either public or private sources, federal sourcing policies should reflect the potential benefits of competition, including competition between and within sectors. Criteria would need to be developed, consistent with these principles, to determine when sources in either sector will participate in competitions.

8. Ensure that, when competitions are held, they are conducted as fairly, effectively, and efficiently as possible.

Commentary: This principle addresses key criteria for conducting competitions. Ineffective or inefficient competitions can undermine trust in the process. The result may be, for private firms (especially smaller businesses), an unwillingness to participate in expensive, drawn-out competitions; for federal workers, harm to morale from overly long competitions; for federal managers, reluctance to compete functions under their control; and for the users of services, lower performance levels and higher costs than necessary.

Fairness is critical to protecting the integrity of the process and to creating and maintaining the trust of those most affected. Fairness requires that competing parties, both public and private, or their representatives, receive comparable treatment throughout the competition regarding, for example, access to relevant information and legal standing to challenge the way a competition has been conducted at all appropriate forums, including the General Accounting Office (GAO) and the United States Court of Federal Claims.

Public-private competitions should be structured to take into account the government's need for high-quality, reliable, and sustained performance, as well as cost efficiencies.

9. **Ensure that competitions involve a process that considers both quality and cost factors.**

Commentary: In making source selection decisions in public-private competitions: (a) cost must always be considered; (b) selection should be based on cost if offers are equivalent in terms of non-cost factors (for example, if they offer the same level of performance and quality); but (c) the government should not buy whatever services are least expensive, regardless of quality. Instead, public-private competitions should be structured to take into account the government's need for high-quality, reliable, and sustained performance, as well as cost efficiencies.

10. **Provide for accountability in connection with all sourcing decisions.**

Commentary: Accountability serves to assure federal workers, the private sector, and the taxpayers that the sourcing process is efficient and effective. Accountability also protects the government's interest by ensuring that agencies receive what they are promised, in terms of both quality and cost, whether the work is performed by federal employees or by contractors. Accountability requires defined objectives, processes and controls for achieving those objectives, methods to track success or deviation from objectives, feedback to affected parties, and enforcement mechanisms to align desired objectives with actual performance. For example, accountability requires that all service providers, irrespective of whether the functions are performed by federal workers or by contractors, adhere to procedures designed to track and control costs, including, where applicable, the Cost Accounting Standards. Accountability also would require strict enforcement of the Service Contract Act, including timely updates to wage determinations.

The Panel used these principles to assess the government's existing sourcing system and concluded that there are some advantages to the current system. First, A-76 cost comparisons are conducted under an established set of rules, the purpose of which is to ensure that sourcing decisions are based on uniform, transparent, and consistently applied criteria. Second, the A-76 process has enabled federal managers to make cost comparisons between sectors that have

vastly different approaches to cost accounting. Third, the current A-76 process has been used to achieve significant savings and efficiencies for the government. Regardless of whether the public or the private-sector wins the cost comparison, Department of Defense (DOD) officials have noted that savings of 20 percent or more are not uncommon. This is because competitive pressures promote efficiency and improve the performance of the activity studied.

But despite these advantages, the Panel heard frequent criticism of the A-76 process as being slow, too complicated, unfair to either or both sectors, and causing needless distress to federal workers. In the Panel's view, however, the most serious shortcoming of the A-76 process is that it has been stretched beyond its original purpose, which was to determine the low-cost provider of a defined set of services. Circular A-76 has not worked well as the basis for competitions that seek to identify the best provider in terms of quality, innovation, flexibility, and reliability. This is particularly true in an era where solutions are increasingly driven by technology — even for what have traditionally been considered “low-tech” requirements, particularly those that require investment. Furthermore, since A-76 is designed to compare direct functional costs, it ignores overall long-term benefits to the enterprise, in addition to cost savings. As the federal procurement system has moved in the decades since the Circular was first issued from a low-price approach

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toward consideration of non-price factors in making source selections, the A-76 process may no longer be an effective tool for conducting competitions to identify the most efficient and effective service provider. In the federal procurement system today, there is a common recognition that a cost-only focus does not necessarily deliver the best quality or performance for the government. Thus, while cost is always a factor, and often the most important factor, it is not the only factor. In this sense, the competitive process under the Circular is now an anomaly in the federal procurement process in that it effectively inhibits consideration of important non-cost factors. The Panel concludes that the current sourcing system, including the A-76 process, is not consistent with its recommended principles.

The government has an established mechanism that has been shown to work as a means to identify high-value service providers: the negotiated procurement process of the Federal Acquisition Regulation (FAR). The Panel believes that in order to promote a more level playing field on which to conduct public-private competitions, the government needs to shift, as rapidly as possible, to a FAR-type process under which all parties compete under the same set of rules. Appropriate modifications would be needed to accommodate a public-sector competitor, and the competition approach would need to be consistent with the ten principles noted above. The Panel recognizes that implementing such a shift may take some time, and therefore

has developed a set of recommendations to improve A-76 for competitions conducted in the interim. The Panel also has developed a proposed implementation strategy.

Summary of Recommendations:

(Details in Section V)

A. Adoption of Sourcing Principles.

The Panel unanimously recommends that all sourcing decisions be guided by the sourcing principles and commentary listed above.

A supermajority of the Panel adopts the following package of three additional recommendations:

B. Integrated Competition Process.

The Panel believes that all parties – taxpayers, agencies, employees, and contractors – would be better served by conducting public-private competitions under the framework of the FAR, while using appropriate elements of the current A-76 process. In essence, a public-sector proposal (which could provide for process improvements, as with MEOs under A-76) could be submitted in response to a broad range of agency solicitations, including in appropriate cases, work currently contracted out and new work, and have the proposal evaluated under the same rules that apply to proposals from private-sector offerors. Although some changes in the process will be necessary to accommodate the public-sector proposal, the same basic rights and responsibilities would apply to both the private and the public sectors, including accountability for perfor-

mance and the right to protest. This and perhaps other aspects of the integrated competition process would require changes to current law or regulation, and the Panel urges the Congress and the administration to begin work immediately toward that end.

C. Limited Changes to Circular A-76.

Development of an integrated FAR-type process will require some time to be implemented. In the meantime, the Panel expects current A-76 activities to continue, and therefore believes some modifications to the existing process can and should be made. Accordingly, the Panel recommends a number of limited changes to OMB Circular A-76. These changes would, among other things, strengthen conflict of interest rules, improve auditing and cost accounting, and provide for binding performance agreements.

D. High-Performing Organizations.

The Panel recommends that the government take steps to encourage high-performing organizations (HPOs) and continuous improvement throughout the federal government, independent of the use of public-private competitions. In particular, the Panel recommends that the Administration develop a process to be used to select a limited number of functions currently performed by federal employees to become HPOs, and then evaluate their performance. As to those functions, authorized HPOs would be exempt from competitive sourcing studies for a designated period of time. Overall, however, the HPO

process is intended to be used in conjunction with, not in lieu of, public-private competitions.

Successful implementation of the HPO concept will require a high degree of cooperation between labor and management, as well as a firm commitment by agencies to provide sufficient resources for training and technical assistance. In addition, a portion of any savings realized by the HPO should be available to reinvest in continuing reengineering efforts and for the HPO to use for further training and/or for incentive purposes. There are a variety of approaches for implementing the HPO concept. While the Panel is not recommending the use of any particular approach, Appendix B outlines one possibility.

Implementation Strategy

Many of the Panel's recommendations can be accomplished administratively under existing law, and the Panel recommends that they be implemented as soon as it is practical to do so. The Panel recognizes, however, that some of its recommendations would require changes in statutes or regulations, and that making the necessary changes could take some time. Moreover, although the Panel views the use of a FAR-type process for conducting public-private competitions as the end state, the Panel also recognizes that some elements of its recommendations represent a shift in current procedures for the

federal government, and therefore need to be demonstrated and then refined based upon experience. For these reasons, the Panel recommends a phased implementation strategy as follows.

A-76 studies currently underway or initiated during the near term should continue under the current framework. Subsequent studies should be conducted in accordance with the improvements listed in Section V, Recommendations.

OMB should develop and oversee the implementation of a FAR-type, integrated competition process. In order to permit this to move forward expeditiously, it may be advisable to limit the new process initially to agencies where, except for allowing protests by federal employees, its use would not require legislation, that is, civilian agencies. Statutory provisions applying only to defense agencies may require repeal or amendment before the new process could be used effectively at DOD, and the Panel recommends that any legislation needed to accommodate the integrated process in DOD be enacted as soon as possible. As part of a phased implementation and evaluation process,

The Panel recommends that the integrated competition process be used in a variety of agencies and in meaningful numbers across a broad range of activities, including those currently performed by federal employees, work currently performed by contractors, and new work.

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Based on the results generated during the demonstration period, and on the reports submitted by OMB and GAO, Congress will then be in a position to determine the need for any additional legislation.

Within 1 year of initial implementation of the new process, and again 1 year later, the Director of OMB should submit a detailed report to the Congress identifying the costs of implementing the new process, any savings expected to be achieved,

expected gains in efficiency or effectiveness of agency programs, the impact on affected federal employees, and any lessons learned as a result of the use of this process, together with any recommendations for appropriate legislation. The GAO would review each of these OMB reports and provide its independent assessment to the Congress. The Panel anticipates that OMB would use the results of its reviews to make any needed “mid-course corrections.” Based on the results generated during the demonstration period, and on the reports submitted by OMB and GAO, Congress will then be in a position to determine the need for any additional legislation.