

CONTRACTORS: HOW MUCH ARE THEY COSTING THE GOVERNMENT?

HEARING

BEFORE THE

AD HOC SUBCOMMITTEE ON CONTRACTING
OVERSIGHT

OF THE

COMMITTEE ON
HOMELAND SECURITY AND
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

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CONTRACTORS: HOW MUCH ARE THEY COSTING THE GOVERNMENT?

THURSDAY, MARCH 29, 2012

U.S. SENATE,
AD HOC SUBCOMMITTEE ON CONTRACTING OVERSIGHT,
OF THE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:06 a.m., in Room SD-342, Dirksen Senate Office Building, Hon. Claire McCaskill, Chairwoman of the Subcommittee, presiding.

Present: Senators McCaskill, Tester, and Portman.

OPENING STATEMENT OF SENATOR MCCASKILL

Senator MCCASKILL. This hearing will come to order. The Subcommittee on Contracting Oversight (SCO) is having a hearing today about contractors, and the question of the hearing is, how much are contractors costing the government?

As we have discussed many times in this Subcommittee, and also in the Armed Services Committee where I chair the Readiness Subcommittee, government agencies are increasingly reliant on contractors to perform services, and today we are talking about service contracts, not buying things, contracts to actually ask people to work at a service on behalf of the government.

Contractors now perform many of the duties which most Americans would assume are done by government employees, from managing and overseeing contracts and programs to developing policies and writing regulations. Contractors sit side-by-side with Federal employees and perform many of the same tasks.

Spending on service contractors has outpaced spending on Federal employees. The cost of service contracts has increased by 79 percent over the last 10 years from \$181 billion to \$324 billion, while in the same time period, spending on Federal employees has only increased by 34 percent, \$170 billion to \$229 billion.

As with any expense of taxpayer dollars, we have to ask whether the government is getting the most effective use out of these dollars. It would seem intuitive that when deciding whether to contract out a function, the government would figure out how much it will cost, and whether it would be cheaper for Federal employees to do it instead.

For too many years now, the Federal Government has relied on assumptions and flawed studies to support those assumptions. Without good data about the cost of using contractors instead of

Federal employees, the government simply does not have the information it needs to make smart choices.

For those of us who track these issues closely, we have seen many studies over the years that compare the costs of Federal employees to the private sector and conclude that the private sector is more efficient. However, contractors are not quite comparable to the private sector. Contractors do work for the government, and some of that work does not exist in the private sector.

The overhead cost for contractors may not be the same as in the private sector, and this includes situations where contractor employees work alongside Federal employees using government provided equipment and infrastructure. If we are going to honestly assess whether contractors are more or less expensive for the Federal Government than using Federal employees, then we need to look at the cost of contractors, not just the cost within the private sector.

A report issued by the Project on Government Oversight (POGO) in September 2011 was the first study I am aware of to actually attempt to compare the cost of Federal employees versus Federal contractors. It found that in some instances, contractors may be paid, on average, more than 1.83 times what Federal employees are paid to perform the same work. I think this report was a worthwhile and needed effort, but as the authors of the report concede, it is hampered by inadequate and inaccurate data.

For the government to make smart contracting decisions, it needs more than assumptions. If the government is going to have the best and most efficient mix of Federal employees and contractors to perform its work, it needs to be able to assess the true cost of both outsourcing and insourcing. This analysis should include overhead costs, how contractor compensation should be reimbursed, and when some government functions are inherently governmental or critically impact an agency's core mission.

I am concerned that one agency charged with management in the Federal Government does not seem to be providing enough guidance on this issue. The Subcommittee did extend an invitation to the Office of Management and Budget (OMB) to be here today, but unfortunately, OMB declined to attend.

They did not have Senate-confirmed personnel to testify today since Jeffrey Zients has been elevated to Acting Director of OMB, and the Director of OMB, as my Ranking Member is well-aware, had a long-standing policy that they do not testify in front of subcommittees. And it is a long-standing policy that agencies only send Senate-confirmed personnel to testify at these hearings.

It would seem that OMB is in the best position to provide governmentwide guidance on how agencies should look at cost and, most importantly, how agencies can gather the data to do that analysis. I understand that OMB is planning to issue some cost guidance within the next 60 days. If this is the case, I look forward to seeing it and hope it will take into account the issues we discuss today. We will be directing a number of questions to OMB for the record and those will be available to the public in connection with this hearing.

I want to say that two of the agencies represented here today, the Army and the Department of Homeland Security (DHS), are

making strides on cost and data issues. The work that the Army has done on contractor inventory is setting a standard for the rest of the Department of Defense (DOD), and the Department of Homeland Security's Balanced Workforce Strategy tool is a promising approach to making contracting decisions. I think both of these efforts deserve further discussion by both Congress and the Administration.

Today's hearing is an opportunity to discuss these efforts and to consider other possible tools that the government can use to make smart, cost-effective contracting decisions. We need to develop a best practices model to help determine when contracting will save taxpayer dollars. We also need to start collecting data that will help us make those determinations. Assuming that contractors cost less and that the Federal employees cost more does not help this discussion because, frankly, we do not have any idea whether that assumption is true or false. Assumptions are especially costly in our current budget climate and could undermine efforts to save taxpayer dollars.

I thank the witnesses for being here today and look forward to their testimony. I would just add as a note to my opening remarks that as we have spent a lot of time in Congress talking about freezing the number of Federal employees and freezing the pay of Federal employees, there has not been enough talk about freezing the size of the contracting force and freezing the pay of contractors.

And, frankly, if people understand that we are spending more money on service-related contractors in many agencies than we are spending on Federal employees, that is why I have been frustrated with these efforts, because it is like saying, you have a problem, but we are going to shut one eye and only look at part of it.

This is an attempt today, this hearing, to make sure that the efforts to freeze the size of Federal employees does not go on without us taking a hard look at this contracting workforce, its efficiencies, and whether or not the taxpayers are getting a bang for their buck in this regard. I will now turn to my colleague, Senator Portman, for his opening remarks.

OPENING STATEMENT BY SENATOR PORTMAN

Senator PORTMAN. I thank you, Madam Chairman, and it is good to have the witnesses here with some expertise from some agencies and departments that actually are making some progress in this area. It is also good to have your grandsons watching over us here. After all, they are the ones who are going to have to solve these problems in the future, so it is good they are hearing it now.

And it is an important hearing. It is about an important challenge I think the Chair has laid out well. And, frankly, I think we need a lot of work right now on how to be sure that we do have the ability to evaluate the cost effectiveness of using private contractors. I appreciate, again, the fact we are going to have some folks here who can give us some examples of how that can be done better than it is being done governmentwide.

We spend about \$320 billion a year now on service contracts and about \$200 billion to compensate Federal employees. Both of those are major expenditures and both have to be looked at in this ongo-

ing effort to strike the right balance between the Federal workforce and government contractors.

Evaluating the cost effectiveness of insourcing versus contracting sounds like a very technical discussion and it is, as we will hear from these witnesses, but is an extremely important process to go through because it has huge consequences, multi-billion dollar consequences. So simply put, I think what we are examining here today is how agencies should evaluate which option, public option or the privately contracted option, makes the most sense for taxpayers. Where can we get the best value for the dollar?

Those who have followed this insourcing versus out-sourcing debate know that sometimes this issue has been politicized. In fact, during this political campaign, we will probably hear more about it. We have to be careful that it does not become political because at a time of \$15 trillion debts and trillion dollar deficits, Federal agencies are going to be under a lot of pressure, as we are all spending, and we need to be sure that we are adhering to a neutral and an analytically sound cost comparison methodology.

The decision to insource or contract out any government activity, existing, new, or expanded, should be data-driven. And, frankly, I think we do not have the methods and data available right now to do that. We need to be sure that we do not end up producing cost savings projections that need to be reworked.

This all starts with a fundamental threshold question. Chair McCaskill just talked about it. It is the question, is this job suitable for contractors to perform or is it inherently a governmental or a critical function that should remain in-house? OMB and individual agencies have provided guidance on that question over the years, including the current Administration's 2009 OMB Memorandum entitled, *Managing the Multi-Sector Workforce*.

Once it is determined whether it is public or private, the decision where to place the work, again, should be primarily cost-driven, in my view. We get a better value as taxpayers when commercial activities are paid for by the Federal Government are the subject of competition. This is an interesting point because just by having competition, we are going to see savings.

As the Center for Strategic and International Studies reported last year, research demonstrates that 65 percent of savings achieved from public-private competition is derived from the competition itself, not any intrinsic advantage of public versus private. So competition does work and that should be part of the analysis.

In-sourcing or contracting decisions based on costs depend on the ability, of course, to accurately project these comparative costs, and guesswork does not work, it will not suffice, and that is one of the overriding concerns for me, is that there is an apparent lack of uniform guidance on cost comparison methodologies. I will be interested to hear from our witnesses on that and see what they think.

But from 1996 to 2009, of course, you had the OMB guidance document, Circular A-76, which every OMB employee is very familiar with, and that basically governed contracting out of commercial activities in various forms. Congress told agencies to stop conducting Circular A-76 competitions, and that is a mistake. I think whatever its strengths and weaknesses, A-76 provided detailed guidance that is needed on cost comparison.

Since A-76 was suspended, it appears that agencies have been left largely on their own with little oversight or guidance. The current Administration has stated that agencies faced with sourcing decisions should still, quote, perform a cost analysis that addresses the full cost of government and private sector performance. That is fine, but again, OMB has provided little if no guidance on how to perform that analysis.

The Government Accountability Office (GAO) recently found that OMB's new policies have created, and I quote, confusion as to when a cost analysis is needed and the appropriate procedures to conduct one. As Chair McCaskill said, we need to hear from OMB on this. When I was OMB Director, I thought that Subcommittee rule made a lot of sense. I am now wondering. But seriously, we do need to hear directly from OMB, although we appreciate the agency input today and their view of it.

But this lack of guidance is problematic for a lot of agencies because the apples-to-apples comparisons between contract work and in-house functions are often very complex, and the guidance is needed and needs to be uniform.

On the government side, the analysis is particularly difficult and requires a fine grained analysis. An agency has to evaluate the fully burdened cost of using or adding Federal employees, overhead costs, equipment use, other expenses. Multiple reports have indicated we are not getting that right. The contractor side is generally easier to price out with the exception of cost-plus contracts, which are difficult.

An important dimension of this problem that agencies appear to be overlooking is that insourcing can reduce flexibility, and as a result, increase long-term costs. And this is, again, something that ought to be considered. The point is, it is difficult to eliminate or downsize an agency program.

GAO, the Center for Strategic International Studies, and others have looked at this problem and have noted that terminating a contract is far easier than adjusting the size of the Federal workforce. Again, agencies have no guidance on how to evaluate that cost of lost flexibility. Whoever is doing the government work, Job 1, of course, is ensuring that American taxpayers get the best possible value and that is what this hearing is all about.

Informed sourcing decisions are key to achieving that goal. And again, with that, Madam Chairman, appreciate you holding this hearing. I look forward to hearing from our witnesses on this complex but important issue.

Senator MCCASKILL. Thank you, Senator Portman. Would you like a minute, Senator Tester.

Senator TESTER. Yes, I would.

OPENING STATEMENT BY SENATOR TESTER

Senator TESTER. Thank you, Madam Chairman. Thank you, Ranking Member Portman, and thank you to the witnesses who are here today. I look forward to your testimony. I think we can all say there is probably a lot of contractors out there that are doing a job and doing it well. I think we can also acknowledge that I think there are a number of contractors who are out there that are overeating at the taxpayer trough.

I think that I appreciate this hearing, it has been one of many that Chairman McCaskill has done, because there are certain things that, since I have been in the U.S. Senate, have been brought to my attention that is somewhat disturbing. The concept of no-bid contracts is an amazing concept to me.

The concepts of the Federal Government using somebody else as basically their contractor to contract is something that is pretty amazing to me. And with the wars in Iraq and Afghanistan and the number of contractors we are utilizing in those, and I have been over there. I have been protected by some of those contractors and I will tell you that they did a good job because I made it back here in one piece.

But the amount of money that we are paying for those contractors versus what we are paying our active military and if we are actually getting, as Senator Portman said, the taxpayers' best value really brings a lot of what is going on here into question.

I do not want to take a lot more time, but I just want to state that I do not know if there was a move some time ago to say we are going to downsize government and we are going to replace those with contractors so we can try to dupe the American taxpayer, or if there was a real effort that somebody thought this was really going to save money.

But I can tell you that when we talk about \$60 billion being gone up in air—and \$60 billion is a lot of change, I mean, that is a lot of Montana budgets for a lot of years—we are doing something wrong and it is unacceptable. I look forward to your statements. I look forward to hearing what you have seen.

In the meantime, in my notes here for my opening statement, it says, Tell them you are confident that the Federal Government can bring accountability to the process. I cannot say that. I have not seen that. And when we are talking about deficits—by the way, this is inappropriate at any time, but especially when we are talking about deficits like we have now—we have to get our arms around this situation. I want to thank the Chairman once again.

Senator MCCASKILL. Thank you, Senator Tester. Let me introduce our witnesses. Jay Aronowitz—am I saying it correctly?

Mr. ARONOWITZ. Yes, ma'am.

Senator MCCASKILL [continuing]. Is Deputy Assistant Secretary of Force Management, Manpower and Resources for the U.S. Army. In this position, he advises the Army's Assistant Secretary of Manpower and Reserve Affairs on all matters pertaining to total force structure and associated military, civilian, and contractor manpower in the active and reserve components, program objective memorandum resources for programs under Manpower and Reserve Affairs oversight, and all manpower and personnel issues associated with force structure requirements of new weapons systems. Mr. Aronowitz also provides direct oversight for the U.S.A. Manpower Analysis Agency.

Debra Tomchek is the Executive Director of the Balanced Workforce Program Management Office in the Office of Chief Human Capital Officer at the Department of Homeland Security. Ms. Tomchek began her government career as a civilian Army intern. Since then, she has held several executive positions including Director for Human Resources at the Department of Commerce and

the Department of Justice (DOJ), Deputy Director for Program Support at the Department of Defense, and as Associate Director for Workforce Solutions at the United States Mint.

Chuck Grimes is the Chief Operating Officer at the Office of Personnel Management (OPM), where he is responsible for managing OPM's human, financial, and other resources. He is also responsible for improving the agency's performance and achieving the agency's goals through strategic planning, measurement, analysis, and progress assessment. Prior to joining OPM, Mr. Grimes served as the Assistant Director of Compensation Policy in the Strategic Human Resources Division at the Internal Revenue Service (IRS) and as Director of the Wage and Salary Division for the Department of Defense's Civilian Personnel Management Service.

Thank you all for being here. It is the custom of this Subcommittee to swear all witnesses, so if you do not mind, I would ask you to stand.

Do you swear that the testimony that you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. ARONOWITZ. I do.

Ms. TOMCHEK. I do.

Mr. GRIMES. I do.

Senator MCCASKILL. Thank you all very much. We will begin your testimony, Mr. Aronowitz.

TESTIMONY OF JAY D. ARONOWITZ,¹ DEPUTY ASSISTANT SECRETARY, FORCE MANAGEMENT, MANPOWER AND RESOURCES, U.S. ARMY

Mr. ARONOWITZ. Chairman McCaskill, Ranking Member Portman, distinguished Members of this Subcommittee, thank you for the opportunity to appear before you today. I am honored to have the opportunity to discuss the Army's contractor inventory and how we use this information for the strategic human capital planning for our total force, military, civilian, and contractors.

To serve as effective stewards of public funds, the Army must ensure that we are managing our workforce in the most effective and cost-efficient manner possible. To that end, we developed our Contractor Manpower Reporting Application tool (CMRA), in January 2005 to increase the visibility of the Army's contract workforce, both in terms of labor, hours, and costs.

As part of the development process and in order to gain approval under the Paperwork Reduction Act (PRA), we met with over 50 corporations and worked with them in designing a system that would minimize the reporting burden on them and the cost to the government.

The reporting process is so streamlined that most contractors do not even separately bill the government for reporting this data. Today we have over 20,000 contractors entering data into CMRA. CMRA was developed at a cost of approximately \$1 million using commercial off-the-shelf software and it is government owned.

A staff of five individuals manage the program for the entire Army, providing help desk capability, interpreting policies, running

¹The prepared statement of Mr. Aronowitz appears in the appendix on page 27.

reports, and coordinating actions across our acquisition, manpower, and financial management staffs. The Army uses CMRA to collect the direct labor hours and labor dollars associated with each service contract, as well as the function, location of performance, requiring activity, funding source, and type of contract vehicle.

In fiscal year (FY) 2001, we began collecting data on other direct non-labor costs which includes supply cost and travel expenses, as well as a variety of other expenses charged directly to the government. By collecting this data, the Army can now see direct labor and direct non-labor costs, and thus, infer overhead costs, though we have just begun to analyze these overhead costs.

The inventory compiled in the CMRA today is primarily used to fulfill the statutory requirement to identify inherently governmental functions and closely associated with inherently governmental functions, authorized personal service contracts, and functions appropriate for contract performance.

Beginning in fiscal year 2011, the Department of Defense was required to submit a budget exhibit of service contract manpower and costs. The Department of Defense Comptroller recently issued guidance that the services inventory of contract services would be used to inform the budget process, and we have started to work with the Army Comptroller to ensure Congress will have the most accurate data on contract services in the future, and that our program and budget for fiscal year 2014 for contract services is built on data from CMRA.

CMRA, our inventory of contract services, has helped us to improve management of our total force by identifying inappropriately contracted functions and by collecting cost information to help us make informed decisions on the most appropriate workforce mix.

In addition to service contract data, CMRA allows us the ability to ensure adequate oversight of service contracts by our organic workforce, a statutory requirement, and ensure there are no redundancies between the contracted functions and the organic government workforce.

In December 2011, in response to the House Armed Services Committee concerns over lack of visibility as to what DOD spends on contract services, Secretary of Defense responded that he was, quote, committed to enable the efforts of the rest of the Department of Defense to quickly implement the Army's Contract and Manpower Reporting Application tool this fiscal year, while also leveraging Army processes, lessons learned, and best practices to comply with the law in the most cost-efficient and effective manner.

In closing, we believe that the Army's contractor inventory process has potential benefits, not only for the rest of the Department of Defense, but also for governmentwide application. Chairman McCaskill and Members of the Subcommittee, thank you for your support and I look forward to your questions.

Senator MCCASKILL. Thank you very much, Mr. Aronowitz. Ms. Tomchek.

**TESTIMONY OF DEBRA M. TOMCHEK,¹ EXECUTIVE DIRECTOR,
BALANCED WORKFORCE PROGRAM MANAGEMENT OFFICE,
U.S. DEPARTMENT OF HOMELAND SECURITY**

Ms. TOMCHEK. Chairman McCaskill, Ranking Member Portman, and distinguished Members of the Subcommittee. I appreciate the opportunity to speak to you today about the Department of Homeland Security's efforts to balance our Federal and contractor workforce.

During the Department's stand-up in 2003, contractors played a significant role as leadership worked quickly to obtain the capabilities necessary to accomplish our mission. By 2007, concerns surfaced about possible over-reliance on contractors at DHS. At the request of Congress, the Government Accountability Office recommended that DHS take action to improve its ability to manage risk and to ensure governmental control and accountability.

To comply with GAO's recommendations, statutory requirements, guidance from the President and the Office of Management and Budget Policy, DHS established our balanced workforce strategy in mid-2010. The strategy has three aims.

First, to ensure compliance with applicable statutes, regulations, and policies through a repeatable, documented, decisionmaking process. Second, to determine the proper balance of Federal and contractor employees for programs and functions. And third, reduce mission risk and, as practicable, reduce or control cost.

The Balanced Workforce Program Management Office was established within the Office of the Chief Human Capital Officer with an understanding that rebalancing the workforce would have to rely on sound workforce planning. Given the complexity of decisions related to properly sourcing programs and functions, we simultaneously created a departmental working group with senior representatives from the Office of the Chief Financial Officer, the Office of the Chief Procurement Officer, and the Office of the General Counsel.

The departmental working group uses its multidisciplinary expertise to oversee the execution of the balanced workforce strategy by components. We also created the Balanced Workforce Executive Steering Group comprised of representatives from components to provide input and direction concerning the strategy.

In 2010, DHS components began reviewing current service contracts using the three-step balanced workforce strategy process. The first step, identify the work, involves looking at a service contract's statement of work (SOW) to isolate and accurately describe each discrete function that should be analyzed.

The second step, analyze the work, relies on an electronic questionnaire entitled, The Balanced Workforce Strategy Tool. The tool leads components through a series of questions about a function to ensure compliance with law, regulations, and relevant policy.

The tool also includes a method for assessing sufficient internal or Federal capability and uses questions such as, What is the relationship of a function to the Department's core mission? What is the risk to a function if all contractors were to leave suddenly? And

¹The prepared statement of Ms. Tomchek appears in the appendix on page 44.

what is the likelihood that a function might evolve into one that is inherently governmental?

The Balanced Workforce Strategy Tool produces a suggested ratio of Federal to contractor employees for components to use in considering mission control and the sourcing of a function. If concerns about mission control are identified, components may seek to rebalance the workforce for a function. However, components may alternatively provide a risk mitigation strategy such as enhancing contract oversight or increasing reporting requirements.

If a component's responses to the questionnaire indicate that a function can be performed by either the public or private sector, the component must then consider the cost to DHS. The DHS Balanced Workforce Strategy guidance mandates that components perform cost comparison analysis to determine the most efficient sourcing solution.

First, components calculate the cost of Federal workers using the OMB-approved, DHS Modular Cost Model. This model incorporates a variety of factors to describe the fully loaded cost for Federal employee to DHS. On the contract side, the cost of the current contract is used, including the cost of contract oversight. If a new requirement is being reviewed, an independent government cost estimate serves as the basis for comparison.

The third step in the Balanced Workforce Strategy process is to implement the sourcing decision. If the workforce for a function requires rebalancing, numerous stakeholders must collaborate to make the change. The Department's workforce is responsible for executing our complex and important Homeland Security mission to protect the American public and the American homeland.

To meet our mission objectives, we need the expertise of both Federal workers and contractor employees. The Balanced Workforce Strategy contributes to DHS mission readiness through its focus on mission control, accountability, and oversight for business decisions and cost containment.

I look forward to answering any questions you might have.

Senator MCCASKILL. Thank you so much, Ms. Tomchek. Mr. Grimes.

TESTIMONY OF CHARLES D. GRIMES III,¹ CHIEF OPERATING OFFICER, U.S. OFFICE OF PERSONNEL MANAGEMENT

Mr. GRIMES. Madam Chairman, Ranking Member Portman, and Members of the Subcommittee, thank you for the opportunity to testify before you today on contracting and the multi-sector workforce. The U.S. Office of Personnel Management is the central human resources agency for the Federal Government, providing leadership and guidance to Federal agencies on governmentwide policies for strategic management of the Federal workforce.

The American people expect and deserve a high-performing government that can efficiently and effectively carry out its missions, such as defending our homeland, providing care to our veterans, and ensuring the safety of our air and water. Performing this highly challenging and complex work depends on an engaged and well-

¹The prepared statement of Mr. Grimes appears in the appendix on page 48.

prepared workforce with the right mix of knowledge, skills, and abilities.

One of OPM's roles is to set standards for effective management of human capital and to assist agencies in meeting those standards. OPM evaluates agency performance in meeting those standards through an annual reporting, evaluation, and feedback process. One of these standards is strategic management alignment, that is, having a human capital strategy aligned with mission goals and organizational objectives.

Effective workforce planning is critical to meeting the strategic alignment standard. Workforce planning is the systematic process to identify and document mission-critical occupations and associated current or anticipated competency gaps, then to address those gaps using strategies and techniques such as restructuring, recruitment, redeployment, retraining, retention, or technology solutions.

OPM, however, does not get involved in specific agency workforce planning decisions, nor does it get involved in agency-specific decisions such as whether or not to competitively source or contract particular functions. OPM does analyze non-Federal and Federal pay for the purposes of comparisons required for setting Federal employee pay under the General Schedule pay system, but it does not determine whether Federal employees or private contractors are more cost-effective in the performance of government operations.

Agencies have that responsibility in their specific areas of operation. For instance, as agencies consider the appropriate size and composition of the workforce necessary to carry out their missions, the determination on whether to use private sector contractors is best informed by application of sound planning principles, such as the level of specialization needed for a specific task, the duration of need for that specialization, and cost comparisons. Other considerations include the availability of expertise, the time needed to train new employees thoroughly, the urgency of the need, the resultant opportunity costs, and the need for institutional memory.

It is worth emphasizing that a simple comparison of labor costs alone is not likely to answer the question of which sector would be more cost-effective and efficient in performing a given task in a specific circumstance. For example, a cost comparison to consider in-house performance as an alternative to continued contract performance might be beneficial if requirements tend to be managed best through an employer-employee relationship, the agency has experience in performing the work in-house, the ability to recruit for the skill is high, and the government has historically had challenges with contractor performance.

By contrast, the benefit of a cost comparison may be lower if the agency is looking to meet a short-term surge that would be costly to address through long-term hiring, the agency currently lacks an in-house capability to do the work, and the agency has had considerable success in getting good performance at a reasonable cost from its contractors.

All of these factors have a role in determining when a cost comparison is likely to be most effective in achieving best value for the taxpayer. OPM provides guidance and training to assist agencies in identifying workforce requirements and conducting training ses-

sions on multi-sector workforce planning. OPM has focused on the way our human capital management standards apply to multi-sector planning.

OPM has not delivered training on how agencies should appropriately compare the cost of a contracted versus employed workforce. Agencies may refer to OMB publications such as Memorandum M-09-26, which requires agencies to begin the process of developing and implementing policies, practices, and tools for managing the multi-sector workforce for guidance in making such comparisons.

Additionally, on September 12, 2011, OMB's Office of Federal Procurement Policy published a policy letter, *Performance of Inherently Governmental and Critical Functions*, in order to provide guidance to agencies on governmental and critical function management.

OPM is also co-chairing an interagency working group with the Department of Defense to implement the Administration's Cross-Agency Priority Goal to close skill gaps to more effectively achieve agency missions, an important workforce planning effort that will require agencies to look at recruitment, training, and business processes, as well as the use of technology and contractor support.

OPM's support and coordination of effective management practice sharing among agencies will be essential to achieving this goal. Thank you again for this opportunity to testify before you and I look forward to any questions you may have.

Senator MCCASKILL. Thank you very much, Mr. Grimes. I would like to start by looking at the chart,¹ Mr. Aronowitz, the total force mix, military, civilian, and contractor, and I wish we had it large, but we do not. But you can see, looking at this chart, that the civilian personnel has stayed very stable and really has not changed; military personnel, while we have had a slow growth, but really the real growth has been in this contractor category.

Senator MCCASKILL. The Department has called these contracts increasingly unaffordable and says savings are here. And I fundamentally believe that, as somebody who has had really a 50-yard line seat on contracting for 5 years in the Department of Defense. Anybody, including my friends I work with to bring down the cost of Federal Government, anybody who believes we cannot find savings in the Department of Defense around contracting does not know the issue.

And so, everyone who says we cannot cut one dime from the Department of Defense and that, in fact, we need to continue to grow that budget is really not taking the time to understand how contracting has gone wild. And I do think the Army is working very hard to get a handle on this, but I find it astonishing that agencies do not consider whether it is cheaper to use contractors or Federal employees before deciding whether to award a contract.

Ms. Tomchek, if DHS developed a similar graph, do you think the results would be the same?

Ms. TOMCHEK. Well, first, our active duty military is pretty small because it is in the—

¹The chart referenced by Senator McCaskill appears in the appendix on page 51.

Senator MCCASKILL. I mean the comparison between civilian and contractors.

Ms. TOMCHEK. I do not have specific information, but I tend to doubt that it would be as stark as this.

Senator MCCASKILL. Well, I would bet that if—it may be coming down now, but when I got here, I will never forget speaking to Secretary Chertoff in one of the very first hearings I had in the Committee, and when I asked the question, How many contractors work at the Department of Homeland Security, it was like I was speaking a different language. No one had any idea.

And I think people are envisioning contractors differently out there than what we know they are. If I go to the Department of Homeland Security, as you well know, and I go down carrels, everybody is doing the same function, everyone having the same job, it is likely to be employee, contractor, contractor, employee, contractor, contractor, contractor, employee, employee, contractor. Is that not accurate?

Ms. TOMCHEK. I do believe that when GAO did its report in 2007, that was probably very likely accurate. Since that time, we have been working diligently to address issues of mission risk that were raised by GAO, along those same lines, as to why we had so many contractors in place to accomplish the mission of the Department.

The primary purpose of the Balanced Workforce Strategy is first to comply with the law. But second, it is to ensure that we have control of our mission. And I believe that GAO pointed out that given that situation, as you described it, which I believe was definitely the case in 2007, that we have tried very hard to make progress to reduce that as a result of the Balanced Workforce Strategy.

Senator MCCASKILL. Let me also ask DHS, you have identified 3,500 contractor positions for insourcing and at least 2,600 Federal positions were filled as of the end of 2011. How much as the Department saved by converting contractors to government positions?

Ms. TOMCHEK. That effort was the very first effort that we had underway. It was done prior to the Balanced Workforce Strategy. We did a data call last year and we are getting ready to implement our second data call to determine what savings there might have been. But information from our components as of the data call last year was approximately \$28 million.

Senator MCCASKILL. So by converting contractor positions to Federal employees, you saved \$28 million?

Ms. TOMCHEK. That is what our components reported to us, yes, ma'am.

Senator MCCASKILL. What methodology, including assumptions, have you all used to come up with those numbers? How are you doing that?

Ms. TOMCHEK. When we sent the data call last year, we asked the components to use the same costing methodology that I previously described, which is, what was the total cost of the contract, and then what is the total cost of the Federal workers that have been hired, using the OMB-approved DHS modular cost model. It is our understanding that this was applied in that fashion and those were the savings that were documented.

Senator MCCASKILL. Mr. Aronowitz, in the past several years, both the Administration and the Secretary of Defense have announced initiatives to reduce on the amount spent on contractors. Do you know to what extent the Army has reduced the total amount spent on contracts over the last 2 years?

Mr. ARONOWITZ. Yes, ma'am. I can give you a figure and then I can tell you some of the challenges that we have and how I think that we can address those going forward. For base budget contracts in fiscal year 2009, we spent \$32 billion, in fiscal year 2010 \$36 billion, and in fiscal year 2011 \$40 billion. If you want, I can also give you the figure for the civilian pay. For civilians in fiscal year 2010, it was \$20 billion as compared to the \$32 billion spent on service contracts.

In fiscal year 2010, it was \$22 billion for civilian pay—and when I say pay, it is really the fully burdened pay of civilians—\$22 billion in relation to \$36 billion spent on service contracts. And in fiscal year 2011, \$24 billion on civilian pay and \$40 billion on service contracts.

The real challenge that we have, ma'am, in terms of managing service contracts is that we do not have it very well integrated into our program and budget. They tend to be executed in the year of execution of the budget, and so it is kind of a rear-looking event in terms of how much have we executed last year.

In my written testimony, there is a chart¹ that shows service contract dollars going down significantly in the period of fiscal year 2008 to 2009, and then starting to go back up. And interestingly enough, that period of 2008 to 2009 was when we first implemented our inventory of contract services where we had—requiring activities having to fill out a checklist that tracked back to statute in law to ensure that they were not going to implement a service contract involving inherently government work or an unauthorized personal service contract, and whether or not if it was closely associated, that one, that there was enough organic government capability to oversee the execution and performance of that contract, and enough contracting officers representatives (CORs), and that the workforce was adequately trained and capable to oversee the performance of the contractors.

That was a period when this was totally voluntary. The Secretary of the Army sent out a memo and said that the first general officer, or the Senior Executive Service (SES), in the chain of command would have to certify the checklist so that, again, we were not having contractors to perform inherently governmental functions.

And during that period, we saw service contract dollars go down significantly. It went from \$51 billion in 2008 down to \$32 billion in 2009. It was the first time that the Department seriously looked—

Senator MCCASKILL. That is \$20 billion. That is some significant change.

Mr. ARONOWITZ. Yes, ma'am.

Senator MCCASKILL. So what happened? Why did it start going back up again?

¹The chart referenced by Mr. Aronowitz appears in the appendix on page 52.

Mr. ARONOWITZ. Well, the challenges were, again, we do not program and budget for the service contracts. They are not integrated into our budget and there are year of execution issues that we see. And so, the Army's intent going forward is to ensure that we integrate these service contracts in our program and budget.

The Army acquisition executive, following DOD guidance, has set up a governance structure and a portfolio of management structure for service contracts, six portfolios. We have mapped our inventory of contract services to these portfolios. And we are trying to integrate both our inventory and the portfolios into the budget process. And I think if we can achieve that, then we will have much better control over the budgets for service contracts.

Senator MCCASKILL. Thank you very much. Senator Portman.

Senator PORTMAN. Thank you, Madam Chairman. If I may followup a little with DOD because it is an interesting story. In 2009, you guys started an insourcing initiative and the goal, as I understand it, was to replace 30,000 contractors with DOD civilians between 2010 and 2015. And DOD planned at the time to achieve budgetary savings equal to 40 percent of the cost of the contracts replaced.

More recent DOD statements have claimed the savings could be not 40 percent, but 25 percent. In 2010, August, before he left, Secretary Gates said in a speech that Defense agencies, quote, were not seeing the savings we had hoped for from insourcing, and DOD shifted the policy to try to eliminate unnecessary jobs rather than trying to simply trade contract workers for Federal employees.

It is my understanding that the Army suspended insourcing altogether in late 2010. What happened? What are the lessons that you learned from your insourcing initiative?

Mr. ARONOWITZ. Sir, if I can go back to again the period of 2008 to 2009 when we saw the initial drop, it was a voluntary insourcing program that had no undue outside controls or influence pressurizing another component of our total force. As you mentioned, Secretary Gates directed to the Army a savings of \$400 million with the assumption that we could save 40 percent if we insourced.

That money was taken off of the Army's top line and so we were driven to insource approximately 9,000 to 10,000 contractor man-year equivalence without really having done the due diligence, workload analysis up-front. And so, you have—

Senator PORTMAN. Projections really were not based on a thorough analysis. The projections were more of a budget decision and then you tried to achieve those budget savings.

Mr. ARONOWITZ. Yes, sir, absolutely. In this case, we had the budget trying to drive workforce mix decisions. Our experience at the Army is that 40 percent was a very aggressive goal to meet. We had two instances over different periods of time where we achieved anywhere from about 16 to 30 percent savings. And really, the percentage savings are really dependent upon the function that is being insourced and the location of where that is occurring.

Senator PORTMAN. Well, let me just say, as a general matter as we are going through the current downsizing because of the cuts and the Budget Control Act and now the potential sequestration at the end of the year, I have some of the same concerns that you are, establishing budget numbers without backing them up with good

analysis. And certainly that goes to what we talked about today in general, which is that we do not have the kind of data-driven analysis that we need to be able to make these decisions wisely.

I talked earlier about this Circular A-76, which is the long-standing circular people relied on for years through Administrations, Republican and Democrat alike. That is now being used since 2009, really because of Congress. And I just—I am very concerned that we do not have the kinds of careful analysis being done because the guidance is not there.

The Administration has maintained that for jobs that can be done by contractors, agencies should, and I quote, evaluate the full cost and perform like comparisons. The trouble is that unlike A-76 it does not say how you do that. And there is not much guidance on how to implement this revised approach.

GAO has found this new policy has created confusion and noted that OMB's criteria do not specify the procedures for conducting a cost analysis or define what constitutes the full cost of performance. So I guess to all of you, and, Mr. Grimes, you talked a little about this, with OMB issuing guidance governing everything from the quality of science that has to be used by your agencies to the cost/benefit analysis of regulations, do you believe that OMB should step in here and take a more central role in creating a uniform and a consistent credible cost comparison methodology for making these insourcing and outsourcing decisions?

Mr. GRIMES. I think OMB would be the central management agency that would be best positioned to do that. I would just like to point out that there are a number of difficulties with cost comparisons that would have to be sort of addressed and taken into account.

As you know, we compare Federal salaries against private sector salaries in setting pay for General Schedule employees, and we find one thing with the way that we do it and others find different answers when they study that issue using other assumptions. So to the extent that those assumptions could be laid out and followed and considered appropriately, then I do agree OMB is the right place to go.

Senator PORTMAN. And you think there is a need for it, to have a uniform standard that is established to provide additional guidance?

Mr. GRIMES. I think if you have a need—if you are going to make these comparisons across agencies, then uniform standards would be helpful.

Senator PORTMAN. Do you agree, Ms. Tomchek?

Ms. TOMCHEK. Yes, sir. The Department of Homeland Security would definitely welcome additional guidance on this issue. We try very hard to ensure that all of our work adheres to the guidance issued by the Congress and by OMB, and this would be extremely helpful for us.

Senator PORTMAN. Mr. Aronowitz.

Mr. ARONOWITZ. Sir, in DOD, there is a directive-type memorandum (DTM), which is entitled, *Estimating the Cost of Military and Civilian Manpower and Service Contracts*. So within DOD, we basically have a cost/benefit analysis tool to ensure we have the fully burdened cost of our workforce.

I would say that before I signed up to a one-size-fits-all for the government, that there are some nuances to DOD that would have to be considered going forward.

Senator PORTMAN. Thank you, Madam Chairman.

Senator MCCASKILL. Thank you, Senator Portman. Senator Tester.

Senator TESTER. Thank you, Madam Chairman. I think we will approach this from two different ways, looking backward and looking forward. First of all, I do want to say thank you all for being here. I appreciate your testimony. I appreciate what I have heard today.

Mr. Aronowitz, you said that in 2009 there was a 40 percent savings when it went from contractors to civilians. And you also had said there was some elimination of unnecessary jobs—I do not want to paraphrase, if that is not what you said, tell me—that helped contribute to that 40 percent.

And I guess it brings up an interesting point to me in that when the military, I think, has more control, I think it would be fair to say and you can correct me if I am wrong, that they have more control with the civilian workforce than they do the contractors. Would you agree with that?

Mr. ARONOWITZ. Yes, sir.

Senator TESTER. I think it gives them an opportunity to get rid of some of the driftwood that was in the staff. As you guys make your assessments and your evaluations and make your transfers, the ones that are appropriate, what kind of—I mean, are you seeing some potential savings from folks who really have no function, but just kind of were along for the ride for whatever reason?

Mr. ARONOWITZ. Sir, I would not subscribe to that writ large. First of all, when the Army again did the insourcing in 2008 and 2009, we achieved about a 30 percent cost savings. When DOD directed and took \$400 million out of our budget, their assumption was that there would be a 40 percent savings, and this was in about the fiscal year timeframe.

Senator TESTER. Thirty percent is not chump change. I mean, that is pretty incredible.

Mr. ARONOWITZ. I would agree, sir.

Senator TESTER. And you need to be applauded for that and I would hope that you would move forward. And by the way, when I am critical of the contractors, I am not critical of the active military. I just want to make that very clear. You guys do an incredible job and I want to thank you for your service. I have never been around a more professional workforce than I am when I was in Iraq and Afghanistan.

Ms. Tomchek, I remember when Madam Chairman asked a question about contractors at Homeland Security. And correct me if I am wrong, Claire, but I do not believe that they could answer the question as to how many contractors they had.

Senator MCCASKILL. And I do not think the Department of Defense thinks they can get us that number until 2016 at the earliest, I believe, is the date we have been given. Is that correct, Mr. Aronowitz?

Mr. ARONOWITZ. Well, ma'am, I cannot speak for DOD. I can speak for the Army.

Senator McCASKILL. Right. That is right. I am sorry.

Mr. ARONOWITZ. During or through our inventory process, the Army is very confident in the number of contractors or contract man-year equivalence that we capture, which is about 217,000 today.

Senator TESTER. In this day of computers that basically can run processes that are incredible, I think it is amazing that—everybody should be able to tell us that number just like that. I mean, I think that if they cannot, it tells me that the system is broken. OK?

I just want to move on just a little bit. There were \$60 billion that was lost to waste, fraud, and abuse in Iraq and Afghanistan for the entire contracting process. This was done by the Commission on Wartime Contracting. Occasionally I get to sit on the floor and do some presiding, and I hear folks continually get up and talk about Solandra 500 and \$35 billion wasted, and by the way, that is totally unacceptable. We are talking about \$60 billion here.

Can any of you answer the question as to, if there is any possibility of recouping that money and what percentage of that money might possibly be recouped?

Mr. ARONOWITZ. Sir, since I believe that is a DOD figure, I would like to take that for the record and get it back to the Subcommittee.

Senator TESTER. I would love to see what is going on. I mean, it is an amazing figure for me. I recently joined Senator McCaskill on legislation that would implement many of the recommendations for the Commission on Wartime Contracting. Your perspective, Mr. Aronowitz, or any of you for that matter. Do you think the recommendations would have a positive effect on the way that the Army, Department of Defense—I know you cannot speak for both, but maybe you can—would do business with contractors? Or would it hurt your ability to achieve a savings?

Mr. ARONOWITZ. I know that the legislation is now being reviewed back in the Pentagon and we will get a response back through DOD on that. The Secretary of the Army takes this very serious and he has directed the Army's staff to basically expedite the hiring initiative we had to grow the acquisition workforce and also to increase the military by about 1,000 soldiers in the acquisition field to build an expeditionary acquisition capability.

And again, I know this is reaction to the Commission on Wartime Contracting, but again, we take it very serious in the Department.

Senator TESTER. One last question, and I would direct it to Mr. Aronowitz, but any of you can answer the question because I think it applies to the government across the board, whether it is DOD, Department of State, or Homeland or any others as far as that goes. I know that in Iraq and Afghanistan, we have awarded and re-awarded non-compete contracts. Can you give me any idea to what extent this still happens, that folks are awarded non-compete government contracts?

Mr. ARONOWITZ. Again, sir, I would have to take that for the record and get you a better fidelity on the numbers and get back to the Subcommittee.

Senator TESTER. We would love to get that. Would you two want to respond to that at all?

Ms. TOMCHEK. I do not have those numbers, but would be happy, also, to get them for you. I would add that the law that we follow, which is Section 736 of the Fiscal Year Appropriations Act, specifically asked us to look at sole source non-competed contracts when we do these reviews, and it is something that is captured on our questionnaire, to make sure that we could sort those out and look at those separately if we needed to do so.

Senator TESTER. And have you?

Ms. TOMCHEK. Our questionnaire process has a database in the back and we have not yet derived much information from it.

Senator TESTER. Chuck.

Mr. GRIMES. I know that we do look at that, but to give you specific figures, I would have to get back to you for the record.

INFORMATION FOR THE RECORD

OPM does award non-competitive contracts, on an exception basis. In FY 2011, 25 percent of the total dollars awarded by OPM were through non-competitive actions. These awards are merit-based, justified in accordance with long-standing statutes that authorize the use of non-competitive contracting in certain prescribed situations, such as urgency, the availability of only one responsible source, or the protection of national security. Justifications must be approved.

Senator TESTER. I would like that. And thanks for the latitude, Madam Chairman. I would just say that I think everybody in this room gets it and I know you guys get it. When you have non-compete contracts, you are not getting best value. I would say I dare somebody to show me how you get best value out of a non-compete contract. And when the average taxpayer looks at that, they are saying to themselves, What is going on?

When I go buy a car, I do not walk into the auto dealer and look at the list price and say, Write up the papers. You go to several auto dealers and then you negotiate on the price. And it is the same thought process, for my mind anyway. So I really think it is a non-starter. And I know a lot of these contracts come out and they are so doggone big that you might only get one person to bid on it, and that is another problem, by the way. We need to break those down so that they are available to be bid on companies, because quite honestly, if you get more bidders, you are going to get better value for your dollar.

So I want to thank the Chair for holding this hearing and I want to thank the people who have testified today. I appreciate your straight-forwardness.

Senator MCCASKILL. Thank you, Senator Tester. One of the things that has happened a lot, and frankly, it has been a head-scratcher for me, is that there have been people beaten up on people who work for the government. And all of you are great examples and I have been blessed to be surrounded by, and for many years, people who have decided government service is honorable work.

And I have never met anybody who has gone into a government job looking for big money. I think most people who take government jobs know that while it does offer stability, I do not think that most people who seek public sector employment are looking for a big payday. It just has not been my experience.

And so, I have been disappointed at some of my colleagues who think that they can get to a leaner, meaner Federal Government

just by beating up on the level of pay of Federal employees, and that brings me to contractor compensation. I have never seen anyone give a speech on the floor that we need to do something about the high rate of salaries with contractors.

And as you may well know, there have been attempts to put in legislation, to put a cap on contractor salaries. I think most Americans would be shocked to know that we have one now and it is \$693,000 a year. So right now, the Federal Government can pay contractors up to almost 700 grand a year.

And my colleagues, Senators Boxer and Grassley, have proposed changing this cap to \$400,000 a year for all contractor and subcontractor employees. Others have even proposed lowering the cap even further. And for civilian contracts, the cap only applies to senior executives. I believe the cap should be extended to all contractor and subcontractor employees.

I understand the Department of Defense has conducted a survey of its nine top contractors and found that changing the cap from \$693,000 to \$400,000 could save the agency \$421 million. That is a big number. Let me ask you, do you at the Army, Mr. Aronowitz, or you, Ms. Tomchek, have any idea how much money you could save by lowering the cap that we would pay in terms of contractor salaries?

Mr. ARONOWITZ. Ma'am, my office does not track that information, but again, I would like to have the opportunity to come back to the Subcommittee with that information.

Senator MCCASKILL. Ms. Tomchek.

Ms. TOMCHEK. I would say something similar. I am in the Chief of Human Capital Office and I would be happy to coordinate with my colleagues as we have our interdisciplinary group and try to see if I could answer that question for you.

Senator MCCASKILL. And, Mr. Grimes, is there any data available through your office that would get to this issue of how many very well-paid executives are we paying for on some of these service contracts?

Mr. GRIMES. We do not collect that information, so we would not have any idea really what people make in the service contracts. I am sorry.

Senator MCCASKILL. I think that is something—I will tell you this. I am not voting for—I do not support anymore freezing of the salaries for Federal workers until we freeze some salaries for contractors, particularly at that high level. I think—and by the way, we are not telling private companies what they can pay their people.

They can pay them whatever they want. If they want to pay them more, they are welcome to do so. This is not about the government telling private companies how much people should make. It is about telling private companies how much the government will pay. And there is a big difference there. If they want to supplement someone's salaries with revenue streams from other sources, that certainly is up to them. And this is not, I think, a matter of government getting in the way of the private sector.

But if you are going to do business with the Federal Government, I think it is reasonable that you would assume that we are not going to pay somebody 700 grand a year. I just think that is rea-

sonable and I hope that we can get that cap in place and realize those savings.

The same thing with overhead costs. Looking at the data that the Army collected in 2011, there are a few figures that jumped out at me that I would like to look at a little closely. If you look at the portfolio Knowledge-Based Services Contracts, the total invoices were for \$13 million.

Overhead costs accounted for \$6.7 million of that, almost 50 percent of the overall costs. In that same portfolio, Federal workspace was provided for 82 percent of the contracts, and 71 percent of them had government issued equipment. So I am trying to reconcile those numbers. You have a \$13 million contract. More than half of it, or just at half of it, is overhead, but we are providing workspace for 82 percent of them and we are issuing our equipment for 71 percent of them.

Is that the kind of thing that would jump out at you, Mr. Aronowitz?

Mr. ARONOWITZ. Well, ma'am, let me, if I can, walk you through the numbers and I can tell you how the Army is beginning to analyze this data and how we are integrating with the acquisition community. As you mentioned, for the Knowledge-Based portfolio, about \$13 billion total invoiced amount is what the government paid. The direct labor costs, in other words, what was paid or charged for direct labor hours, about \$4.8 billion.

About \$1.5 billion for direct non-labor costs, and again, this would be for packaging, special equipment, travel, and then the amount, the overhead that you mentioned, the \$6.7 billion, that is overhead and profit. And when we start to talk about comparing Federal civilian employees' benefits versus contractors and whether we use A-76 or the Department of Defense's directive-type memorandum, the health and benefits cost for the contract employees is in that \$6.7 billion amount, that overhead amount.

And so again, it is about 50, 51 percent, and again, that includes the profit for the contractor as well as expenses that he or she has for their employees for their health, benefits, leave, and things of that nature, as well as their retirement.

Senator MCCASKILL. So that was a "B" not an "M" which means I really want to get into it. Do we do apples-to-apples on benefits?

Mr. ARONOWITZ. Again, within the DOD, by using the DTM, we do have a fully burdened cost for our civilian and military manpower. It is a very expensive tool.

Senator MCCASKILL. Especially because that also includes all the pensions for active, right?

Mr. ARONOWITZ. Yes, ma'am. It is pensions, child care costs, all the subsidies for groceries; for civilians, it is the unpaid accrued retirement, so for both our military and civilians fully burdened. For the contractors, the only figures we use are what is invoiced to the government and what we pay.

Senator MCCASKILL. Well, I would really like to take a look at that because I think that this has been the assumption that we have been working on without data, which this hearing is all about, is how can we get guidance from OMB so that there is government-wide assistance in the kind of decision tree that you are trying to implement, Ms. Tomchek.

But second, this assumption that if you hire—and I have told this story a million times. My dad peeled potatoes in World War II. We are never going to have a soldier peel potatoes again in theater, in a contingency. That will never happen. So contracting is here to stay.

So the question is, the assumption has been—and I think this is how we got way ahead of ourselves in contracting and contingency, especially around the Logistics Civil Augmentation Program (LOGCAP). The assumption was, our benefits are so significant, that our overhead is so high that contractors just intuitively are going to be cheaper. And I am not sure that we ever held contractors' feet to the fire about what they were billing us in that regard.

So I would love to see, on a typical contract, if you can pull out the data for me what the benefit costs are versus the benefit costs of our employees, and to make sure that the underlying assumption that I think has driven a lot of these decisions without good data, is even actually correct, especially if you factor in some of these guys are making 600 grand a year, 700 grand a year. That takes up a lot of overhead as it relates to benefits.

Mr. ARONOWITZ. Absolutely, ma'am.

Senator MCCASKILL. If the salaries are so much higher, then pretty soon you are under water, even considering all the overhead that we have as it relates to benefits, pensions, and so forth, health care in our system. So if you could do that for me, I would like to take a look at that.

Mr. ARONOWITZ. Yes, ma'am.

Senator MCCASKILL. But I did not understand until you explained it that also was profit, so that also makes sense. I thought it was just overhead. Thank you for walking through the figures.

We have a number of more questions. There is a vote that is being called right now, so I will adjourn this hearing. I want to thank all three of you. And by the way, I know in the contracting community I am not a popular person because of the work I do in this area, but I do understand there are great people that work for these companies and that do good work for the Army and do good work for the Department of Homeland Security.

It is not that they are the enemy. It is just that I do not think our government has been very good at tracking the costs and making sure that we are making the kind of analysis that taxpayers have a right to expect. So I will look forward to OMB's guidance. I will look forward to your input after that guidance comes out.

If all three of you would make a note that we will be following up with you to get your take on the guidance, once it is issued, if you think it is workable, if you think it is going to make a difference, and we will direct a number of questions that we have that we still have not had answered yet today to you in writing. I thank all three of you for being here today and for the hard work you are doing on behalf of our government.

[Whereupon, at 11:14 a.m., the subcommittee was adjourned.]

A P P E N D I X

CONTRACTORS: HOW MUCH ARE THEY COSTING THE GOVERNMENT?

March 29, 2012

Senator Claire McCaskill

Opening Statement

This hearing will now come to order.

The title of this hearing is "Contractors: How Much Are They Costing the Government?"

As we've discussed many times in this Committee and also in the Armed Services Committee, where I chair the Readiness Subcommittee, government agencies are increasingly reliant on contractors to perform services. Contractors now perform many of the duties which most Americans would assume are done by government employees, from managing and overseeing contracts and programs to developing policies and writing regulations. Contractors sit side by side with federal employees and perform many of the same tasks.

Spending on service contractors has outpaced spending on federal employees. The cost of service contracts has increased by 79% over the last ten years, from \$181 billion to \$324 billion, while in the same time period, spending on federal employees has increased by 34%, from \$170 billion to \$229 billion.

As with any expense of taxpayer dollars, we have to ask whether the government is getting the most effective use out of those dollars. It would seem intuitive then that when deciding whether to contract out a function, the government would figure out how much it will cost, and whether it might be cheaper for federal employees to do it instead.

For too many years now, the federal government has relied on assumptions and flawed studies to support those assumptions. Without good data about the costs of using contractors

instead of federal employees, the government simply doesn't have the information it needs to make smart choices.

For those of us who track these issues closely, we've seen many studies over the years that compare the costs of federal employees to the private sector and concluded that the private sector is more efficient. However, contractors are not quite comparable to the private sector. Contractors do work for the government, and some of that work does not exist in the private sector. The overhead costs for contractors may not be the same as in the private sector, and this includes situations where contractor employees work alongside federal employees using government-provided equipment.

If we're going to honestly assess whether contractors are more or less expensive for the federal government than using federal employees, then we need to look at the costs of contractors, not just the costs within the private sector. A report issued by the Project on Government Oversight in September 2011 was the first study to actually attempt to compare the costs of federal employees and contractors. It found that in some instances, contractors may be paid, on average, more than 1.83 times what federal employees are paid to perform the same work. I think this report was a worthwhile and needed effort, but, as the authors of the report concede, it is hampered by inadequate and inaccurate data.

For the government to make smart contracting decisions it needs more than assumptions. If the government is going to have the best and most efficient mix of federal employees and contractors to perform its work, it needs to be able to assess the true costs of both outsourcing and insourcing. This analysis should include overhead costs, how contractor compensation

should be reimbursed, and when some government functions are inherently governmental or critically impact an agency's core mission.

I am concerned that the one agency charged with management in the federal government doesn't seem to be providing enough guidance on this issue. The Subcommittee did extend an invitation to the Office of Management and Budget to be here today, but unfortunately OMB declined to attend. It would seem that OMB is in the best position to provide government-wide guidance on how agencies should look at cost and, most importantly, how agencies can gather the data to do that analysis. I understand that OMB is planning to issue some cost guidance within the next 60 days. If this is the case, I look forward to seeing it and hope that it will take into account the issues we discuss today. I also plan to address questions for the record to OMB and will make those answers public.

I want to say that two of the agencies represented here today, the Army and the Department of Homeland Security, are making commendable strides on cost and data issues. The work that Army has done on its contractor inventory is setting a standard for the rest of the Department of Defense, and the Department of Homeland Security's Balanced Workforce Strategy tool is a promising approach to making contracting decisions. I think both of these efforts deserve further discussion by both Congress and the Administration.

Today's hearing is an opportunity to discuss these efforts and to consider other possible tools that the government can use to make smart, cost-effective contracting decisions. We need to develop a best practices model to help determine when contracting will save taxpayer dollars. We also need to start collecting the data that will help us make those determinations. Assuming that contractors cost less and that federal employees cost more doesn't help this discussion because frankly we don't have any idea whether that assumption is true or false. Assumptions

are especially costly in our current budget climate and could undermine efforts to save taxpayer dollars.

I thank the witnesses for being here today and I look forward to their testimony.

RECORD VERSION

STATEMENT BY

MR. JAY D. ARONOWITZ

DEPUTY ASSISTANT SECRETARY OF THE ARMY

(FORCE MANAGEMENT, MANPOWER AND RESOURCES)

BEFORE THE

SUBCOMMITTEE ON CONTRACTING OVERSIGHT

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

SECOND SESSION, 112TH CONGRESS

ON CONTRACTORS: HOW MUCH ARE THEY COSTING THE GOVERNMENT?

MARCH 29, 2012

NOT FOR PUBLICATION UNTIL RELEASED BY THE

SENATE COMMITTEE ON HOMELAND SECURITY

AND GOVERNMENTAL AFFAIRS

Introduction

Chairwoman McCaskill, Senator Portman, Distinguished Members of this Committee, thank you for the opportunity to appear before you to discuss: 1) the Army's contractor inventory and what information the Army maintains regarding the costs of contractors to perform different types of services; 2) how the Army is using this data to inform the budget process and acquisition planning; 3) how the Army is addressing the comparison of the actual cost of contractors with the actual cost of federal civilian employees; and 4) proposed government-wide solutions for determining contractor cost effectiveness. Before moving to those topics, it is important to note at the outset that the contractor inventory is one of many efforts to buy smarter and drive down contract prices. Implementation of DoD's "Better Buying Power" acquisition reform initiative is directed towards decreasing the use of high-risk contracts, reducing spending on management support services and low-priority acquisitions, increasing use of vehicles that leverage the Government's buying power through strategic sourcing, and increasing small business participation.

Contractor Inventory

The Army began collecting contractor cost information in the Contractor Manpower Reporting Application (CMRA) initiative established by the Secretary of the Army in January 7, 2005, after obtaining approval of the Department of Defense Business Initiatives Council (BIC) on September 13, 2002 and Office of Management and Budget Approval in a Paperwork Reduction Act (PRA) filing on November 24, 2003. (The PRA has been renewed on three occasions and is currently effective through December, 15, 2014.) At that time, the CMRA was sponsored and supported by the Assistant Secretary of the Army (Financial Management and Comptroller), the Assistant Secretary of the Army (Acquisition, Logistics and Technology), the Vice Chief of Staff of the Army and led by the Assistant Secretary of the Army (Manpower and Reserve Affairs), with the stated purpose captured in a memorandum co-signed by these sponsors: "The initiative is the only process that would capture information on funding source, contracting vehicle, organization supported, mission and function performed, and labor hours and costs for contracted efforts. Existing financial management and

procurement systems do not clearly distinguish between goods and services, nor do they identify the organization for which the work is being performed. This initiative will enable us to (a) fully understand the composition of the total Army workforce – military, civilian, and contractor, and allow for more informed workforce staffing and funding decisions; (b) provide better oversight of our workforce, avoid duplication of effort, or shifting of in-house reductions to contract; (c) ensure the Army is getting full value from our contractor workforce; and (d) better account for and explain our total Army workforce.”

The initiative placed the responsibility for reporting the information on the “requiring activity,” which is the Army organizational customer requesting the work to be performed. Reporting was effectuated through a requirement/deliverable in every contract statement of work, with a help desk to minimize reporting burdens on contractors. The labor hour and labor dollar data associated with contractor performance within the prior fiscal year is reported annually to a secure web site. This data collected is treated as proprietary when associated with specific contractor names and contract vehicles. The web-based reporting was implemented prospectively as options were exercised or contracts initiated and included numerous features to minimize industry reporting burdens resulting from meetings and input from industry representatives (in 2003, over fifty senior executives from large defense contractors and small businesses) and informal feedback during help desk sessions with industry users throughout the course of implementation of the reporting. These include a bulk-loader or Excel drop down feature allowing contractors to upload data from their own internal payroll systems in a single spreadsheet rather than making individual entries on the web site; as well as various edit features and pop-ups to assist users in completing data fields. Reporting burdens were so de minimis that most users did not separately bill for reporting once they understood the reporting requirement and how it was collected. Subsequently, when the contractor inventory requirement was codified in Title 10, United States Code section 2330a (enacted in the Fiscal Year 2008 National Defense Authorization Act section 806), the Army has submitted the required reports through the Office of the Secretary of Defense to Congress and published the inventory as required by law on a public web site in an electronic format that may be downloaded, screening

out contract numbers and contractor names to make the data publicly accessible. Enforcement of this reporting requirement was strengthened in a Secretary of the Army policy issued in July 10, 2009 and related Army Federal Acquisition Regulation Supplement (AFARS) Subpart 5107.503 requirement that required Commanders and HQDA Principals to be responsible for ensuring that an accountable senior official reviewed the contracted requirement and certifying various issues related to inherently governmental functions, personal services, validation of the requirement and its priority, appointment of sufficient number of Contracting Office Representatives, and that the reporting requirement for CMRA was included in the Statement of Work and contract. No Army contracting office may process a contract action from an Army requiring activity without this certification. There are no exceptions to this requirement and no thresholds that limit its application because of the magnitude of contracted services that could go unreported if such a threshold were in place. However, the accountable Senior Executive Service or General Officer can delegate to a GS-15 or O-6 the certification for contracts valued at \$100,000 or less over the life of the contract.

The Army has reported contracted services cost and labor data by function, location, Army command, funding source and types of contract vehicles for Fiscal Year 2009, 2010 and has completed the compilation of Fiscal Year 2011 data. Until Fiscal Year 2011, the Army collected the invoiced amount, direct labor costs and direct labor hours by function, location where performed, and other data, all of which are linked to contract information in the Federal Procurement Data System-Next Generation (FPDS-NG) and accounting data on funding source through pre-loading of the data base on the web site so contractors can look up their contract vehicle after authenticating their status. In Fiscal Year 2011, the Army also collected "other direct non-labor costs". These are defined as supply costs plus Other Direct Costs (ODCs) for the fiscal year. ODCs are charged directly to the Government and include but are not limited to special tooling, travel expenses, relocation expenses, pre-production and start-up costs, packaging and transportation cost, royalties, spoilage and rework, computer expenses, federal excise taxes and reproduction costs. Direct labor dollars are the total unburdened salary/wage (not including goods, overhead, retirement or benefits) dollar amount for direct labor performed. The overhead costs are inferred from subtracting the

direct labor costs and other direct non-labor costs reported by contractors from their invoiced amount for the fiscal year. The overhead costs include profit, management and administrative support structure within the contractor, the leave, benefits and retirement costs of the contracted direct labor hours. The direct labor hours reported are converted to a full time equivalent by dividing them by 2,080 or 2,088 hours for a forty hour work week for 52 weeks per year. The different factor depends on whether or not a leap year is involved. These results are summarized by service portfolio at Table 1.

FY 2011 Army Contract Services Inventory (Contractor Manpower Reporting Application)							
Knowledge Based	\$13,174,041,487	\$ 8,750,200,903	\$1,554,721,748	\$4,869,118,815	50,910	82.5%	71.1%
Equipment Related	\$5,541,488,412	\$ 4,030,104,914	\$403,436,965	\$1,098,954,533	16,963	66.6%	85.5%
Electronics & Communication	\$2,279,806,794	\$61,958,726	\$54,807,233	\$1,042,842,835	8,928	83.9%	77.3%
Medical	\$368,845,920	\$59,310,779	\$8,444,247	\$300,890,894	2,353	76.3%	78.1%
Transportation	\$150,348,172	\$62,043,944	\$18,365,042	\$69,937,186	874	64.8%	47.8%
Facility Related	\$4,347,515,339	\$2,089,402,528	\$96,749,207	\$1,562,363,804	28,103	87.3%	81.9%
PSC Not Assigned to Portfolio Group	\$5,680,000,402	\$2,953,230,350	\$816,687,112	\$1,890,102,941	16,878	47.4%	45.5%
Total	\$31,521,652,505	\$16,835,250,145	\$4,052,191,553	\$10,834,210,807	125,010		

* Overhead Total Invoices - (Direct Labor Costs + Direct Non Labor Costs)
 OCO: \$9,782,993,982 Total Invoices / 99,537 Contractor FTEs
 ** Contractor FTEs = Direct Labor Hours + 2088 (2088 is the number of compensable hours in FY 2011)
 *** PSCs that are not assigned to a portfolio group include R&D, quality control, testing, inspection, operation of government owned facilities, and lease / rental of facilities / equipment

Table 1

As this is the first year all this information has been collected, we are just beginning to analyze the implications of this data. However, we plan to evaluate it in

terms of the function, location, type of contract vehicle and the impact of different buying practices.

We also plan to start assessing this data for overlap and duplication with other contracted work, as well as between the contract workforce and organic workforce. At this stage, our primary use of the inventory has been to fulfill the statutory requirement to identify inherently governmental functions, closely associated with inherently governmental functions, ensure that personal services contracts are entered into under proper statutory authority, and to evaluate whether sufficient organic capacity exists to oversee the contracted workforce as required by Title 10 United States Code section 2330a and 2383. The elements of section 2383 that we evaluate with the aid of the inventory and additional information provided by commands in our Panel for Documenting Contractors (PDC) process established by the Secretary of the Army in July 10, 2009 are as follows: 1) Evaluating the span of control and sufficiency of the number of contracting officer representatives; 2) the capacity of the organic workforce to make informed and independent judgments of the work performed; 3) the impact of tiers of sub-contractors; and 4) the potential for organizational conflicts of interests when looking holistically at the work provided by contractors to an organization. Our review is within the framework of "Total Force Management," the Title 10 and Department of Defense term for multi-sector workforce planning and considers not just the appropriate mix between civilian employees and contractors but also evaluated the military, civilian and contractor mix. Our review evaluates contracted work both by individual contract and task order on a pre-award basis but also on a functional basis in the post award review conducted by the PDC. The risk of inherently governmental contractor performance of closely associated with inherently governmental functions is more visible in the post-award review required by section 2330a because statements of work can be written to avoid expressly mentioning inherently governmental work. However, the realities of actual contract performance may be another matter when one holistically evaluates all the contracts performing a function in support of an organization. We are working to improve compliance with what we find in the course of these reviews. The Secretary of the Army recently issued guidance on February 10, 2012, that will withdraw funds by May 2012 from organizations that continue to contract inherently governmental

functions or unauthorized personal services contracts within a 90 day period (See Table 2 below).

Panel Review of Contract Service Inventory Manpower Mix Determination / Budget Projections		
Inherently Governmental	615	\$ 143,986,733
Closely Associated w/ Inherently Governmental	25,788	\$ 4,327,663,614
Unauthorized Personal Services	254	\$ 60,470,107
Critical Functions	39	\$ 7,865,662
Divest	218	\$ 42,159,730
Authorized Personal Services	1,718	\$ 240,686,288
Appropriate to Contract	56,326	\$ 9,728,224,441
Not Reviewed	29,905	\$ 7,056,598,197

Table 2

The Army has established a steady reporting baseline of around \$31B in invoiced amounts in the Generating Force and \$7.5B to \$9.6B in the Operating Force in this inventory as depicted in Table 3 below for Fiscal Year 2009 through 2011. Based on the Object Classes/Element of Resources and Product Service Code categories that the original SecArmy policy required to be reported, we believe we have covered at least 78 percent of the contracted services required to be reported in the Generating Force and 28 percent in the Operating Force. This is a conservative estimate that errs on the low side because we are a large organization and we anecdotally learn of particular contracts that have not complied with the requirement from time to time.

Fiscal Year	Generating Force (BASE)			Contingency Operations (SUPP)		
	CMRA Total Invoices	Accounting System Obligations*	CMRA Report %	CMRA Total Invoices	Accounting System Obligations*	CMRA Report %**
2009	\$33.7B	\$31.5B	107%	\$9.6B	\$24.4B	39%
2010	\$31.9B	\$35.6B	90%	\$7.5B	\$28.2B	28%
2011	\$31.5B	\$40.4B	78%	\$8.7B	\$26.9B	32%

* Includes all appropriations except military personnel (MPA) and military construction (MCA)

* Includes all contract service elements of resource that were excluded in the PB 2012 contract service budget request (Table 4). CMRA reported in base climbs above 90% if all exclusions in table 4 are applied

** CMRA reporting shortfall of contingency operations contractors is due to: 1) limited electronic reporting capability of contractors in the theater of operations; and 2) misidentification of OCO funds in obligation lines of accounting

Table 3

We derive this estimate by comparing the obligated dollars in the accounting system for a fiscal year to the invoiced amounts reported in CMRA, and filtering for Overseas Contingency Operations funds from base funded contracted services. There is no perfect comparison because an invoiced amount will differ from an obligated amount, and while a substantial amount of OCO-funded contracted services can be identified in the accounting system, the accounting is not perfect or complete. That said, the original metric approved by the BIC and Secretary of the Army at the time CMRA was established recognized that there were no other viable metrics for assessing reporting coverage, given the constraints of the accounting and procurement systems.

Uses of Contractor Inventory In Budget and Acquisition

The contractor inventory has not yet been fully used in the budget and acquisition processes, as it has been primarily used by the Manpower community in its Total Force Management reviews to identify inherently governmental, closely associated with inherently governmental, critical functions and authorized and unauthorized personal services contracted functions. Beginning in FY12, the Army Acquisition Executive is obtaining Army-wide semi-annual services requirements forecasts and quarterly cost reports for services acquisitions valued at \$10M and above to provide program management and funding visibility for services acquisitions. This initiative implements part of the Army's 2011 Services Optimization Implementation Plan to increase effectiveness, efficiency and promote cost savings as the Army acquires essential services to support our Soldiers and their families. The amount of contracted services covered in CMRA that fall below this threshold are about 27% percent or \$10B of services. As mentioned above, the Panel for Documenting Contractors started this contractor inventory review in 2009 in the midst of Secretary Gates's in-sourcing initiative that was budgeted with an assumed 40 percent savings assumption. During the course of this budget-driven in-sourcing, and long after, the PDC evaluated command in-sourcing plans developed in response to these budgetary targets, as well as inherently governmental functions on the contractor inventory that had not been identified for in-sourcing in the budget. The review found that most of the in-sourcing plans were for inherently governmental, closely associated with inherently governmental or critical functions, exempt by DoD policy and Title 10, United States Code section 2463 from cost analysis. The review did find, however, that about 1,091 of the 7,215 programmed for in-sourcing required cost analysis. Although, the DTM 09-007 fully-burdened costing rules were not promulgated until January 29, 2010 (nine months after the budget decisions to in-source were made), the principles in the DTM were consistent with the largely cost-based in-sourcing used by the Army in its concept plan process in effect prior to Secretary Gates' in-sourcing initiative reflected in the budget.

When the Department of Defense civilian FTE cap was instituted in the January 2011 budget, this resulted in suspending the in-sourcing of inherently governmental acquisition and law enforcement functions that had been identified by the PDC in the

contractor inventory review process. However, Secretary of the Army policy dated 10 February 2012 directs Commanders to submit for approval in-sourcing actions for inherently governmental functions and unauthorized personal services contracts within 90 days or lose funding.

After Title 10 United States Code section 235 was enacted, the PDC started working with Army commands to project their future contract services requirements based on the contractor inventory review. The budget exhibits submitted since the President's Budget for Fiscal Year 2012 pursuant to section 235 have not been based on the contractor inventory or review process. The Army's contractor inventory includes OCO and base funded contracts and included all appropriations except for Military Personnel and Construction. The Army's contractor inventory includes more object classes and element of resources than included for these budget exhibits which were also limited to the Operations and Maintenance Appropriations. The Table 4 below summarizes the differences:

Service Element of Resource (EOR) 2500	Excluded Service EORs
251* Consulting Services	
252* Other Services (Not from US Government Accounts)	252C Civilian and Military Tuition and Training Costs 252D Scholarships 252E Study Contract Awarded in Accordance w/OMB Circular A-76 252F Demilitarization Ammunition
253* Purchases of Goods and Services from US Government Accounts	253C Training Courses 253D Civilian Retirement Costs
254* Total Operation and Maintenance of Facilities	
255* Research and Development Contracts (RD&E) Only	
256* Medical Care	256B Other Purchased Medical Support Services
257* O&M of Equipment by Contract	257B Temporary Storage
258* Subsistence and Support of Persons	258A Subsistence and Support of Persons
25A Defense Working Capital Fund (DWCF) of Other Revolving Funds	25AB Depot Maintenance
25B Total Industrial Fund Purchases - Navy/USMC	25BK MSC Other Purchases
25C Total Industrial Fund Purchases - USAF	
25D Total Industrial Fund Purchases - Defense Agencies	25DY Defense Finance and Accounting Services
25E Total Industrial Fund Purchases - Other	25EA Cost Reimbursable Purchases
25F* Other Intra-Army Purchases (Not Revolving Fund)	25FB Intra-Army Non-IT Purchases
25G Other Intra-Governmental (Non Army) Purchases (Non Revolving Fund)	25GX Non Army IT Purchases
25H* Other-Tact Equip Maint (Below Depot-LVL) by Contract	

EORs In RED excluded for the PB 2012 Contract Services Budget Request

Table 4

Reliability of Civilian Cost Data and Comparing Costs of Government Workforce to Contractors

Under the revised Office of Management Budget Circular A-76 (2003-2009), the Department of Defense reported completing 107 public-private competitions encompassing 12,117 positions (military and civilian). Of these completed competitions, 64 competitions (5,757 positions) favored government performance and 43 competitions (6,360 positions) favored contract performance. Public-private competitions conducted between 1997 and 2003 (under the previous Circular) are reported by the Department of Defense to have reduced the annual operating cost of commercial activities by \$1B during the period from Fiscal Year 1997 to Fiscal Year 2009. Combined with competitions conducted under the revised Circular (those competitions conducted between 2005 and 2009), a total of more than \$9B in cumulative cost reductions were reported by the Department of Defense, compared to the pre-competition operating costs of these same activities. In 2009, Congress began limiting the Federal government's use of the public-private competition process under A-76 through appropriation and authorization language. The Department is prohibited from using the A-76 process pursuant to Public Law 111-84, National Defense Authorization Act for Fiscal Year 2010, Section 325, so competitive sourcing cannot be done at this time. Three recurring issues pertaining to A-76 competitions within the Army included: (1) the growth of requirements after the competition and savings were computed resulting in questions whether the pressures to compete captured the real requirement, whether the government or contractor won the bid; (2) the Panel for Documenting Contractors subsequently identified issues with the adequacy of government oversight of contracted work because of the inclusion of "closely associated with inherently governmental" function within the Performance Work Statements; and

(3) the failure to account for the full costs of military when military end strength was not adjusted from competitions because of reapplication of the military structure to other requirements within the Army.

When the Department started in-sourcing pursuant to Title 10, United States Code Section 2463, it developed fully-burdened costing rules (similar to A-76 costing rules) which were eventually issued as Defense Technical Memorandum 09-007 by the Director for Cost Analysis and Program Evaluation on January 29, 2010, with further revisions issued on September 2, 2011. In fiscal years 2008-2009, the Army in-sourced 921 positions with an average reported savings of 30 percent, with caveats that savings in a specific in-sourcing action cannot be extrapolated to other situations without performing appropriate cost analysis. Most of the in-sourcing actions resulting from Secretary Gates's in-sourcing (initiated in April 2009 within the Army) involved critical or closely associated with inherently governmental functions that are exempt by law and policy from cost analysis when necessary to mitigate the risks of contract performance of such functions with insufficient government oversight. Nonetheless, Secretary Gates's in-sourcing initiative realigned \$400M in savings from contract spending in Fiscal Year 2010 to other priorities in the budget. In the four in-sourcing actions approved involving cost analyses since the imposition of the civilian full time equivalent cap in January 2011, the estimated cost savings have been 16.5 percent. However, these were for critical or closely associated with inherently governmental functions where risk considerations exempted them from being based on cost alone pursuant to Title 10 United States Code section 2463. During the much smaller period from Fiscal Year 2008 to 2010 when the Department instituted an active in-sourcing program in conjunction with its service contract pre-award approval process and contractor inventory review process, contract services obligations not identified to Overseas Contingency Operations funding decreased from \$51B in Fiscal Year 2008 to \$36B in Fiscal Year 2010. However, spending has increased to \$40B in Fiscal Year 2011, as depicted in the Chart 1 below.

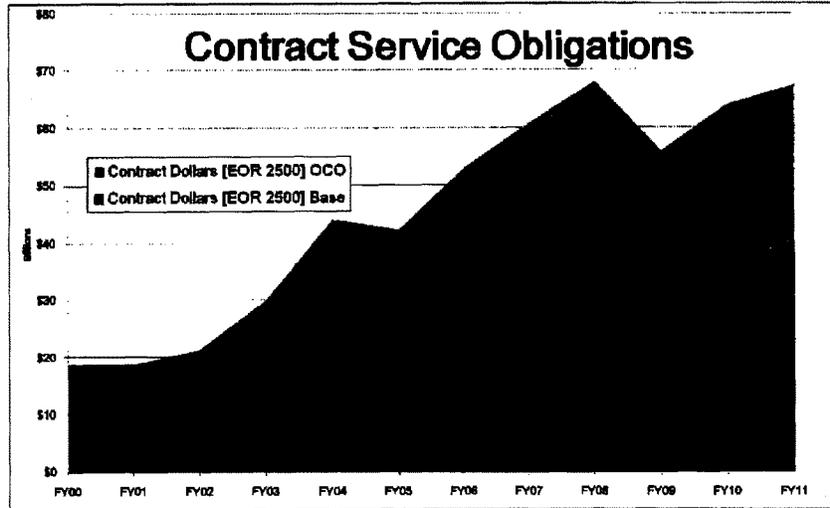


Chart 1

Through the history of public-private competitions and in-sourcing, there is broad consensus on the need for making "apples to apples" comparisons. Cost comparisons are made of "functions" in a public-private competition, whereas in-sourcing actions may involve comparing the costs of individual positions when in-sourcing inappropriately contracted personal services. Cost comparisons of a function include the cost of the military performing the function and not just the civilian employee workforce when comparing the costs to contract performance. Some earlier A-76 competitions did not properly account for the cost of military performance when a military component did not adjust its end strength based on an A-76 competition, but instead reapplied the military to higher priority force structure. Likewise, when in-sourcing a function, the term is not simply limited to converting from contractor to civilian employee performance but also must account for the costs of military performance when this occurs as well. Accordingly, the DTM 09-007 is consistent with the Total Force Management principles that apply to the Department in Title 10, United States Code Section 129a which

requires the Department to holistically consider both the costs and risks of military, civilian employee and contractor performance, rather than simply making a comparison of contractor to civilian employee performance.

Because there has been some confusion regarding the costs to be considered under the DTM 09-007, Table 4 below summarizes the various costs included for both civilian employees and military to ensure a fully burdened "apples to apples" comparison. Within the Army, these cost factors have been developed specific to location, occupational series for civilian and military occupational specialty and grade level in the Army Manpower Cost System (AMCOS) model. The results of a valid cost comparison are very sensitive to the grade level, skill set and local labor market used for comparison, as well as the number of manpower requirements validated for government performance. Just as occurred in the context of A-76 competitions, a key issue often exists as to whether the same requirement is being compared between the function described in a statement of work and the position description of the government workforce.

Civilian Cost Factors by Grade Skill and Location

FTE = 1740 hours / year

Basic Pay/Locality Pay/Title 38 Special Salary Rates
 Title 38 Medical Premium Pay
 Overtime/Holiday/Other Pays
 Incentive/Performance Awards
 Retention Allowance
 Social Security & Medicare (Employer's contribution)
 Specialty Pays (e.g. medical)
 Discount Groceries (OCONUS only)
 Child Development
 Recruitment/Relocation Bonuses
 Health Care (Employer's share FEHBP)
 Personal Travel/PCS
 Federal Employee Group Life Insurance (FGLI)
 Transportation Subsidies
 Worker's Compensation payments
 Education Assistance
 Severance Pay/Separation Incentive
 Retirement Accrual (Employer's contribution)
 Federal Retirement Thrift Investment Board payments (TSP matching)
 Unemployment Insurance payments (FUTA)
 Severance Health Benefit
 Training
 Recruitment, Advertising, Etc.
 Unfunded Civilian Retirement (CBRS only)
 Postretirement Health Benefit (Government's share FEHBP)
 Postretirement Life Insurance (Government's share FGLI)

Contractor Cost Factors
 FTE = 2088 hours / year (Note: leave is covered in overhead not in direct labor hours)
 Overall Contract Costs for the Specific Contract
 Cost to Administer the Contract

Military Cost Factors by Grade, Skill and Location

FTE = 1740 hours / year

Basic Pay
 Basic Allowance for Housing (BAH) / for Subsistence (BAS)
 Special Pay - Board Certification / Incentive / Multi-Year / Other Allowance - Uniform Clothing / OCONUS stationing / CONUS COLA / Family Separation
 Other Pays and Allowances - Family Subsistence / Adoption / Partial Detachment
 Social Security & Medicare (Employer's Contribution)
 Health Care (AD and AD FM)
 Personal Travel/PCS
 Education Assistance
 Discount Groceries
 Child Development (Day Care Facilities)
 Family Support Services
 Transportation Subsidies
 Retired Pay Accrual
 Separation Pay
 Unemployment Benefits
 Death Gratuities
 Survivor Benefits
 Health Care (RET and RET FM < 65)
 Health Care Accrual (MERHCF)
 Health Care (Transitional Assistance Management Program (TAMP))
 Health Care (Continued Health Care Benefit Program (CHCBP))
 Discount Groceries
 Separation Travel
 Education Assistance (e.g., portion of GI Bill)
 Training
 Recruitment, Advertising, Etc.
 Child Education
 Manpower Management
 Other Personal Support
 Other Costs
 Child Education (Impact Aid)
 Employment Training
 Income Tax Benefits (Non-Taxed Income)
 Concurrent Receipts
 Veterans' Benefits, Cash / In-Kind

Table 5

Conclusion / Potential for Government-Wide Solution

The "multi-sector workforce" for DoD and the Army is called Total Force Management in Title 10 and is a more complex issue than simply comparisons of costs between civilian employees and contractors. It includes the costs of military across all three components (Active, Guard and Reserve). It requires an assessment of operational risk associated with the use of contractors in the operating force which our DCS, G-3, G-4 and Joint Staff are reviewing, taking into account the recommendations of the War Time Commission on Contracting. It requires an assessment of the impact on readiness and the viability of the all volunteer force if Soldiers are pulled from units to replace contractors or civilian employees in the generating force.

The Army initiated its contractor inventory reporting because it could not wait for the "perfect" solution for managing this growing percentage of our obligation authority, which has increased from \$19B in FY2000 to \$67B in FY2011. The Department of Defense and Full Year Continuing Appropriations Act, 2011, Public Law 112-10, section 8108 directed "leveraging the Army's Contractor Manpower Reporting Application" to meet the contractor inventory statutory requirements in Title 10, United States Code sections 235 and 2330a. In a December 20, 2011 communication to the House Armed Services Committee, the Secretary of Defense stated that he was "committed to making the Department's information technology and business enterprise systems available to support and enable the efforts of the rest of the Department to quickly implement the Army's 'Contractor Manpower Reporting Application' tool this fiscal year, while also leveraging the Army processes, lessons learned, and best practices to comply with the law in the most cost efficient and effective manner." Within the Army, the web-based reporting application and data base was designed for less than \$1 million and is currently maintained by a five person cell that performs help desk, data base administration, software design updates, policy oversight and Panel for Documenting Contractors functional reviews for the entire Army. The blending of policy with data management, analysis and help desk functions helps improve data quality, reduce burdens on industry reporting, and make the system responsive to needed changes to accommodate users. The Army's inventory has helped us to improve Total Force

Management by identifying functions at risk of inherently governmental performance, and collected cost information that we plan to use to assess our buying practices for contracted services, particularly when we examine the issues of overhead costs and potential redundancies between contracted functions and the organic workforce. Successful implementation of what the Army has done so far over the past few years can be more quickly implemented in smaller, less complex organizations, but will take longer in larger executive agencies. As occurred within the Army, cooperation across functional stovepipes of manpower (or personnel in other agencies), financial management, and acquisition is critical. While the budget process currently is not yet informed by information compiled in the contractor inventory and related analysis, we fully intend to expeditiously move in that direction to fully comply with statutory mandates to do so. As stewards of public monies, we are obligated to do no less.

Thank you for the opportunity to appear before you. I look forward to answering your questions.

TESTIMONY OF

Debra M. Tomchek

Executive Director

Balanced Workforce Program Management Office

U.S. Department of Homeland Security

Before the

U.S. Senate Committee on Homeland Security

and Governmental Affairs

Subcommittee on Contracting Oversight

March 29, 2012

Dirksen Senate Office Building

Chairwoman McCaskill, Ranking Member Portman, and Members of the Subcommittee, I appreciate the opportunity to speak to you about the Department of Homeland Security's (DHS) efforts to appropriately balance its federal and contractor workforce. DHS has devoted significant attention to achieving the correct mix of public and private sector resources, and I look forward to providing details on the approach and implementation of our Balanced Workforce Program.

The Balanced Workforce Strategy (BWS)

In response to GAO recommendations and language in the 2009 Omnibus Appropriations Act, DHS formulated the formal Balanced Workforce Strategy (BWS or the Strategy) in mid-2010 to ensure that the Department could achieve three goals:

- Comply with applicable statutes, regulations, and policies, through a repeatable, documented decision-making process;
- Determine the proper balance of federal employees and contractors for programs and functions; and
- Reduce mission risk while, as practicable, reducing or controlling cost.

The Balanced Workforce Program Management Office was established within the Office of the Chief Human Capital Officer, with an understanding that any effort to balance the workforce would need to be anchored in strategic workforce planning practices. However, recognizing that we would need expertise from other disciplines, we established the Departmental Working Group consisting of representatives from Finance, Human Capital, Procurement, and the Office of the General Counsel to oversee Components' execution of the Strategy.

To launch the Strategy, DHS Components began reviewing current service contract work (that is, contracts already in place) using the following three-step process.

The first step, *Identify the Work*, involves looking at a service contract's Statement of Work to isolate and accurately describe each discrete function that will be analyzed.

The second step, *Analyze the Work*, relies on an electronic questionnaire entitled the BWS Tool. The Department selected the questionnaire method to ensure contract reviews were consistent and repeatable, and an electronic format was chosen to make it easier for Components to respond and to create a central database for future analysis. Six hundred seventy-six contracts or contract actions have been analyzed using the electronic BWS Tool. In FY 2013 the BWS Tool will be upgraded in order to be more user-friendly and add the following new functions: routing of analyses for review, improved user interface, and increased data management capability.

The BWS Tool leads the respondent through a series of items to ensure compliance with law, regulations, and relevant policy. Questions directly address the issue of inherently governmental and follow section 736 of the 2009 Omnibus Appropriations Act, covering whether a function is closely associated with inherently governmental work. The respondent then completes a test to

determine if the Component possesses “Sufficient Internal Capability,” by answering questions related to issues such as:

- The relationship of a function to the Department’s core missions;
- The risk to a function if all contractors were to leave suddenly; and
- The likelihood that a function might evolve into one that is inherently governmental.

The BWS Tool produces a suggested ratio of federal workers to contract workers. This information is used by Components to consider the issue of mission control. Frequently, Components will seek to rebalance the workforce for a function if concerns about mission control are identified; however, Components may alternatively provide a risk mitigation strategy such as substantially enhanced oversight, absorption of work by existing federal employees, or increased reporting requirements to ensure mission control while contracting for the function.

As prescribed in section 736, if a function can be performed by either the public or private sector, Components move to a Cost Comparison Analysis.

The final step of the BWS process, *Implement the Sourcing Decision*, requires the full involvement of finance, human capital, procurement, and the other management lines-of- business. If the determination is made to rebalance the workforce by adding federal employees to attain better control of the mission, a contract must be permitted to expire or the work must be de-scoped while the federal workforce is hired.

All Departmental components have implemented the Balanced Workforce Strategy to assess contracts in place as of 2010. We have also recently launched a pilot to apply the Balanced Workforce Strategy to pending contract requirements, for a limited number of special interest functions. To date, 44 positions have been insourced via the Balanced Workforce initiative and an additional 241 positions have been identified for insourcing in the remainder of FY 2012 and FY 2013.

Cost Comparison Analysis

While adhering to law and regulation and minimizing potential risk to DHS mission requirements are the Department’s paramount considerations, cost is an important element when analyzing work that can be performed by either the public or private sector.

When a Component determines that either federal employees or contractors would be suitable to perform a function, they must consider and compare the costs of each, which informs the final decision on the most cost-effective and efficient source of support.

Within the BWS guidance, Components first calculate the cost of federal workers using the OMB-approved DHS Modular Cost Model, the same tool utilized in formulating annual budget requests and expenditure plans. This method incorporates a variety of factors to describe the fully-loaded cost for a federal worker, including one-time and recurring costs associated with establishing new positions. On the contract side, the cost of the current contract is used; if a new requirement is being procured, an Independent Government Cost Estimate serves as the

basis for the comparison. When applicable, we also include other costs related to the contract, such as the cost for contract oversight and the cost of space and similar administrative factors. Although cost is not the primary driver of the Balanced Workforce Program, the Department has identified an estimated \$2.3 million in savings as a result of BWS implementation, as of January 2012.

It is important to note that concurrent with all of these efforts, the Department continues to make great strides to buy smarter and drive down what we pay for our contracted services. As part of Secretary Napolitano's Efficiency Review Initiative to improve performance and efficiency by working to reduce costs, streamline processes, eliminate duplication, and improve customer service, DHS has placed a renewed emphasis on guarding against inefficiency and waste and improving its ability to obtain high quality services from contractors on time and within budget. For example, between FY 2010 and 2011, information in the Federal Procurement Data System (FPDS) shows that the Department reduced its spending on management support services by roughly 6.5 percent, or approximately \$160 million. This category of spending includes services where spending has grown significantly across the government since 2000, including at DHS, and where agencies have become over-reliant on contractors. In short, we have achieved, and will continue to maintain greater fiscal responsibility in our contract spending.

Conclusion

We will continue to work to have a federal workforce that allows maximum flexibility to accomplish our homeland security mission. Again, I thank you for the opportunity to appear before you today, and I welcome your questions on the Department's Balanced Workforce Program.



UNITED STATES OFFICE OF PERSONNEL MANAGEMENT

STATEMENT OF

**CHARLES D. GRIMES III
CHIEF OPERATING OFFICER
U.S. OFFICE OF PERSONNEL MANAGEMENT**

before the

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

on

CONTRACTORS: HOW MUCH ARE THEY COSTING THE GOVERNMENT?

MARCH 29, 2012

Chairwoman McCaskill, Ranking Member Portman and Members of the Subcommittee:

Thank you for the opportunity to testify before you today on contracting and the multi-sector workforce.

The U.S. Office of Personnel Management (OPM) is the central human resources agency for the Federal Government, providing leadership and guidance to Federal agencies on government-wide policies for strategic management of the Federal workforce. The American people expect and deserve a high-performing government that can efficiently and effectively carry out its missions, such as defending our homeland, providing care to our veterans, and ensuring the safety of our air and water. Performing this highly challenging and complex work depends on an engaged and well-prepared workforce with the right mix of knowledge, skills, and abilities.

One of OPM's roles is to set standards for effective management of human capital, and to assist agencies in meeting those standards. OPM evaluates agency performance in meeting the standards through an annual reporting, evaluation and feedback process. One of these standards is Strategic Alignment – having a human capital strategy aligned with mission, goals, and organizational objectives.

Effective workforce planning is critical to meeting the Strategic Alignment standard. Workforce planning is the systematic process to identify and document mission-critical occupations and

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**Statement of Charles D. Grimes III
Chief Operating Officer
U.S. Office of Personnel Management**

March 29, 2012

associated current or anticipated competency gaps, then to address those gaps using strategies and techniques such as restructuring, recruitment, redeployment, retraining, retention, or technology solutions.

OPM, however, does not get involved in specific agency workforce planning decisions, nor does it get involved in agency-specific decisions such as whether or not to competitively source or contract particular functions. OPM does analyze non-Federal and Federal sector pay for the purposes of comparisons required for setting Federal employee pay under the General Schedule pay system, but it does not determine whether Federal employees or private contractors are more cost-effective in the performance of government operations. Agencies have that responsibility in their specific areas of operation. For instance, as agencies consider the appropriate size and composition of the workforce necessary to carry out their missions, the determination on whether to use private sector contractors is best informed by application of sound planning principles, such as the level of specialization needed for specific tasks, the duration of need for that specialization, and cost comparisons. Other considerations include the availability of expertise, the time needed to train new employees thoroughly, the urgency of the need, the resultant opportunity costs, and the need for institutional memory.

It is worth emphasizing that a simple comparison of labor costs alone is not likely to answer the question of which sector would be more cost-effective and efficient in performing a given task in a specific circumstance. For example, a cost comparison to consider in-house performance as an alternative to continued contract performance might be beneficial if requirements tend to be managed best through an employer-employee relationship, the agency has experience performing the work in-house, the ability to recruit for the skill is high, and the government has historically had challenges with contractor performance. By contrast, the benefit of a cost comparison may be lower if the agency is looking to meet a surge, short term, capacity that would be costly to address through a long-term hiring, the agency currently lacks an in-house capability to perform the work, and the agency has had considerable success in getting good performance at a reasonable cost from its contractors. All of these factors may have a role in determining when a cost comparison is likely to be most effective in achieving best value for the taxpayer.

OPM provides guidance and training to assist agencies in identifying workforce requirements. For example, we have provided such guidance on forecasting and determining the workforce agencies will need, and as well as assistance in identifying agencies' staffing and competency gaps. Additionally, agencies should be mindful in their workforce planning to ensure their long-term needs are being considered and that institutional knowledge is appropriately valued.

In conducting training sessions on multi-sector workforce planning, OPM has focused on the way our human capital management standards apply to multi-sector planning. OPM has not delivered training on how agencies should appropriately compare the costs of a contracted versus employed workforce. This analysis falls under the purview of individual agencies. Agencies may refer to OMB publications such as Memorandum M-09-26, July 29, 2009, which requires agencies to begin the process of developing and implementing policies, practices, and tools for managing the multi-sector workforce, for guidance in making such comparisons. Additionally, on September 12, 2011, OMB's Office of Federal Procurement Policy published a policy letter,

**Statement of Charles D. Grimes III
Chief Operating Officer
U.S. Office of Personnel Management**

March 29, 2012

“Performance of Inherently Governmental and Critical Functions,” in order to provide guidance to agencies on governmental and critical function management.

OPM has provided technical assistance and training to agencies regarding human capital planning concerns associated with potential recruiting and hiring needs. For example, during FY-10 and FY-11, OPM provided one-on-one technical guidance to assist agencies on the fundamental principles of the Human Capital Accountability and Assessment Framework (HCAAF) and how the HCAAF supports sound workforce planning. During FY-11 and FY-12, OPM continued to provide extensive agency-specific technical guidance on how to implement strategic workforce planning. OPM will continue to assist and support agencies in this capacity.

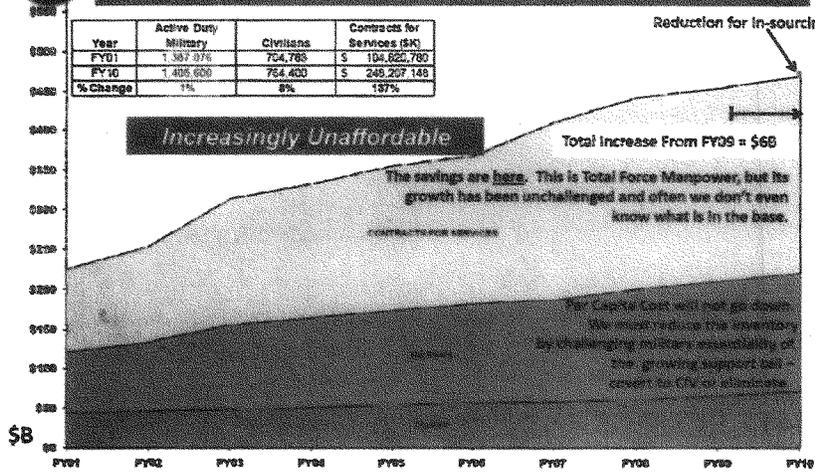
OPM is also co-chairing an interagency working group with the Department of Defense to implement the Administration’s Cross-Agency Priority Goal to close skill gaps to more effectively achieve agency missions, an important workforce planning effort that will require agencies to look at recruitment, training, and business processes, as well as the use of technology and contractor support. OPM’s support and coordination of effective management practice-sharing among agencies will be essential to achieving the goal.

Conclusion

Thank you again for the opportunity to be here today to discuss this important issue with you. I will be happy to respond to any questions you may have.

Unclassified

Total Force Mix - Military, Civilian, Contractor



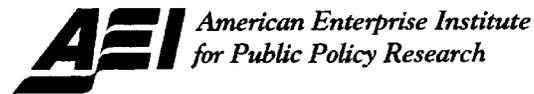
National Defense Budget Estimates for FY2011 ("Current Dollars") – BASE and OCO \$\$
 OUSD(P&R) – Requirements and Program and Budget Coordination Directorate

FY 2011 Contract Services Inventory (Contractor Manpower Reporting Application)

PORTFOLIO GROUP	Total Invoices	Overhead	Direct Non-Labor Costs	Direct Labor Costs	Contractor FTEs	Work Space Provided	Equipment Provided
Knowledge Based Services	\$ 13,174,041,467	\$ 6,750,200,903	\$ 1,554,721,748	\$ 4,869,118,815	50,910	82.5%	71.1%
Equipment Related Services	\$ 5,541,496,412	\$ 4,039,104,914	\$ 403,436,965	\$ 1,098,954,533	16,963	68.6%	85.5%
Electronics & Communication Services	\$ 2,279,606,794	\$ 681,956,726	\$ 554,807,233	\$ 1,042,842,835	8,928	83.9%	77.3%
Medical Services	\$ 368,645,920	\$ 59,310,779	\$ 8,444,247	\$ 300,890,894	2,353	76.3%	76.1%
Transportation Services	\$ 150,346,172	\$ 62,043,944	\$ 18,365,042	\$ 69,937,186	874	64.8%	47.8%
Facility Related Services	\$ 4,347,515,339	\$ 2,089,402,528	\$ 695,749,207	\$ 1,562,363,604	28,103	87.3%	61.9%
PSC Not Assigned to Portfolio Group *	\$ 5,680,000,402	\$ 2,953,230,360	\$ 816,867,112	\$ 1,890,102,941	16,878	47.4%	45.5%
Total:	\$ 31,521,652,505	\$ 16,635,250,145	\$ 4,052,181,553	\$ 10,834,210,807	125,010		

*** Overhead = Total Invoices - (Direct Labor Costs + Direct Non-Labor Costs)**

OCC: \$8,782,993,082 Total Invoices / 90,537 Contractor FTEs
 ** Contractor FTEs = Direct Labor Hours + 2088 [2088 is the number of compensable hours in FY 2011]
 *** PSCs that are not assigned to a portfolio group include R&D, quality control, testing, inspection, operation of government owned facilities, and lease / rental of facilities / equipment



Statement before the United States Senate

Committee on Homeland Security & Governmental Affairs

Subcommittee on Contracting Oversight

Contractors: How Much Are They Costing the Government?

Andrew G. Biggs, Ph.D.
Resident Scholar
American Enterprise Institute

Jason Richwine, Ph.D.
Senior Policy Analyst
The Heritage Foundation

March 13, 2012

The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.

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Chairwoman McCaskill, Ranking Member Portman, and Members of the Committee:

Thank you for the opportunity to submit written testimony regarding the compensation of federal employees and contractors. Please note that the views we express in this testimony are our own, and should not be construed as representing any official position of The American Enterprise Institute or The Heritage Foundation.

In our testimony we will restrict ourselves, as requested, to the more limited question of the costs of federal employees relative to the costs of equivalent private sector workers. We have written extensively on public-sector compensation in the past and will use this opportunity to review recent research in the area. Tight budgets and a perception that public employees have more favorable salaries, benefits, or job security have prompted research regarding compensation for public sector workers at the federal, state, and local levels. Considerable research on federal employee compensation has been conducted since the mid-1970s, with a resurgence of such work in the past several years.

Comparing Federal Salaries

Public-private pay comparisons are generally conducted using what is known as the “human capital model,” which uses regression analysis to compare pay in government and the private sector, while controlling for differences in worker characteristics that influence earnings, such as education, experience, and a range of other factors. In the human capital model, differences in individual worker productivity are the primary drivers for differences in compensation. Characteristics of the job itself enter the model principally to the degree that they create “compensating differentials” for nonfinancial characteristics of the job that make it particularly desirable or undesirable, such as physical risk, unpleasantness of the work involved, differing levels of job security, and so on. The human capital model is the dominant method by which labor economists analyze public-sector pay.

Our own work begins with an analysis of salaries using the Census Bureau's Current Population Survey.¹ Using the standard approach found in the economic literature, we found that federal employees receive salaries about 14 percent higher than those of private sector workers with similar earnings-related characteristics. Consistent with other studies, we found that federal salaries were most generous (relative to private sector levels) for employees with lower levels of education and greater job tenure.

¹ See Andrew G. Biggs and Jason Richwine, “Comparing Federal and Private Sector Compensation.” American Enterprise Institute Working Paper 2011-2, June 2011.

The Congressional Budget Office recently released an analysis of federal compensation that found that federal employees receive salaries on average 2 percent higher than those of similar private sector workers.² Like us, the CBO utilized the human capital model in assessing federal salaries. But the CBO used a different statistical method that generated a smaller federal salary premium. Our approach is consistent with several decades of academic research, but the CBO's approach utilizes new methods designed to address shortcomings in the past literature.

But regardless of whether the federal salary premium is small or large, what is important here is that both our research and that of the CBO strongly contradict the President's Pay Agent, a bureaucratic body charged with conducting official federal-private salary comparisons each year. The Pay Agent concludes that federal *jobs* (not workers) pay on average 26 percent lower salaries than similar private sector *jobs*. This raises a key question: Why do the Pay Agent and the CBO disagree so strongly?

The Pay Agent's methodology starts with data from the Bureau of Labor Statistics (BLS). As part of the National Compensation Survey, the BLS assigns General Schedule (GS) grade levels to occupations in the private sector and in state and local government. The BLS does not assign GS grade levels to federal jobs based upon its analysis of the job's work requirements, but instead relies upon the existing GS level assigned by the Office of the Personnel Management (OPM). Using these grade level assignments, and the salaries received by different occupations, the Pay Agent compares federal employee pay to that of supposedly comparable private sector positions. In other words, an actual GS-9 in the federal government is compared to a private-sector job deemed to be equivalent to a GS-9. Based on such comparisons, the Pay Agent concludes that federal jobs pay salaries significantly lower than comparable private sector positions.

There are several reasons to doubt this conclusion, however. Remember that the BLS relies on existing GS grades for federal positions. It is not uncommon for federal jobs to be "overgraded," meaning assigned a GS level higher than the work requirements of the job merit.³ A 1995 Government Accountability Office study of 1,358 federal positions found that only 230 were correctly graded. Of the remainder, a federal job was over twice as likely to be overgraded than to be undergraded. Moreover, overgrading was significantly more likely at higher GS levels. Overgrading effectively means that federal

² Justin Falk, "Comparing the Compensation of Federal and Private-Sector Employees," Congressional Budget Office, January 2012.

³ Government Accountability Office, "Comparison of Job Content With Grades Assigned in Selected Occupations," GGD-96-20, Nov 6, 1995.

jobs would be compared to private sector jobs with greater workloads or responsibilities, thus creating or embellishing a federal pay penalty.

Similarly, both the CBO and academic research have found that federal government employees have less education and experience than private sector workers who are performing similar job duties.⁴ This could be due in part to the overgrading of federal jobs, but it could also happen independently of it. Putting less experienced or educated workers in federal jobs explains how the human capital model might find that a federal worker is “overpaid” even as the Pay Agent concludes that the job itself is “underpaid.” Of course, the government should pay workers for their actual skills, not merely the skills that their job would normally require.

The Pay Agent’s approach is further undermined by a recent analysis in the *Journal of Economic Perspectives* written by two BLS economists.⁵ The paper compared salaries for state and local government positions to those of private sector positions with similar job requirements, as measured by the GS grade level that BLS had assigned. The authors found that state governments paid salaries about even with private sector levels, while local governments paid salaries around 9 percent above the private sector.

It is difficult to reconcile what the BLS data say about state and local government salaries with the Pay Agent’s conclusions regarding federal salaries, for the simple reason that virtually all studies show that federal government workers are *better* paid than public employees at the state and local level. For instance, our analysis of Current Population Survey data found that federal employees receive salaries 29 percent higher than state and local government workers with similar education and experience.

In summary, the Pay Agent’s salary results are inconsistent with academic research and with analyses published by other federal agencies. The Pay Agent’s methodology is flawed because federal government jobs are overgraded, and federal employees have less experience and education than private sector workers who hold similar positions.

⁴ Congressional Budget Office, “Reducing Grades of the General Schedule Workforce,” September, 1984; Melissa Famulari, “Maintaining a Labor Force Under Wage Controls: The Case of the Federal Government,” Working paper, University of Texas at Austin, 1997.

⁵ This paper is not an official BLS analysis, but its scholarly contribution comes from applying BLS data. Maury Gittleman and Brooks Pierce, “Compensation for State and Local Government Workers,” *Journal of Economic Perspectives*, Vol. 26, No. 1 (Winter 2011), pp. 217-242.

Fringe Benefits

The Pay Agent’s analysis of federal employee compensation critically omits fringe benefits.

Table 1. Average benefits by type and sector, as percent of average wages. (Source: CBO)

	Federal government	Private sector
Retirement Income		
Defined benefit	16.2	4.2
Defined contribution	4.5	3.6
Health insurance		
Current coverage	8.3	11.4
Coverage in retirement	6.5	2.2
Paid leave	17.8	12.3
Legally mandated benefits	10.5	10.2
Total benefits	63.9	43.9

Benefits can have a significant effect on pay comparisons, since public employee benefits tend to be more generous than those paid to similar workers in the private sector. Table 1 summarizes the results of the CBO’s recent analysis, showing that federal benefits are considerably greater than in the private sector. Based on our own work, the CBO’s figures are, if anything, an underestimate of federal benefits.⁶

Because of the Pay Agent’s inaccurate comparison of salaries and total exclusion of benefits, Congress should not be guided by the Pay Agent’s work as it re-evaluates federal employee compensation. The CBO’s analysis is a much more useful starting point.

Implications for Federal Government Contracting

In comparing federal and private-sector compensation, we have considered only direct employees of the federal government, not independent contractors hired by the government, for whom

⁶ The CBO did not include a subsidy to the Thrift Savings Plan’s G Fund that allows it to pay interest rates about 0.77 percentage points higher than similar government bonds available to private investors. Given the \$129 billion size of the G Fund, this subsidy to federal employees totals almost \$2.2 billion annually, equal to roughly 2 percent of federal salaries.

We also used a lower discount rate to value future retirement benefits paid to federal employees, which include both DB pensions and retiree health coverage. The interest rate used to value a future benefit amount depends upon the risk of the benefit itself; if the benefit is secure a low interest rate should be used, while if it is risky a higher rate is appropriate. Consistent with the academic literature regarding state and local government pensions, we assumed that accrued federal retirement benefits are effectively guaranteed. This does not mean that Congress could not change the terms under which future benefits are earned, or even fundamentally change benefits for newly hired federal workers. But it does assume that benefits which have already been earned will in fact be paid. The CBO assumed that federal retirement benefits have approximately the same risk as defined benefit pensions in the private sector and thus utilized a higher discount rate. This is not an unreasonable assumption, but we believe it overstates the true risk of accrued federal pension benefits. If our assumptions regarding the risk of accrued federal pension benefits prove to be more accurate, then the true benefits premium received by federal employees is even larger than estimated by the CBO.

much less data exist. However, we can discuss in qualitative terms some of the issues regarding the costs of contracting.

In analyzing the costs of contracting versus the costs of direct federal work, one cannot simply compare the prices contractors charge with the costs of salaries and benefits for federal workers. For one thing, contractors must include the cost of their overhead—say, their purchase of heavy equipment—into the prices they charge the government, but federal overhead is not fully reflected in the salaries and benefits paid to federal employees.

Second, contractors are not guaranteed permanent jobs. Once a federal employee passes through the first several years of service, his probability of dismissal is so low that he has what amounts to a “job for life.”⁷ In contrast, an individual federal contractor might be dismissed for poor performance at any time, and the composition of the broad contractor workforce can be shifted as the needs of the federal government change over time. This “option value” for federal managers is difficult to quantify, but we can safely conclude that a federal manager would be willing to pay more in exchange for the option to quickly alter the composition of his workforce as needs change.⁸

Third, federal regulations can prevent the government from selecting the lowest-bidding contractor in the first place. We are not experts in contract law, but documents from the Office of Management and Budget describe a federal mandate that potential contractors not receive an advantage in bidding for government work by offering health or retirement benefits that are less costly than those offered to full-time federal employees.⁹ It is not clear to us how this regulation is implemented but, as the CBO federal pay report shows, combined federal health and retirement benefits are much higher than those paid to similarly-skilled individuals working at large private sector firms.

We do not believe that any definitive analysis of federal contractor compensation has so far been conducted, especially in light of the three cautionary notes we described above. Lawmakers should consider additional data-gathering and analysis of federal contractors to facilitate higher quality comparisons.

⁷ See Biggs and Richwine, “Comparing Federal and Private Sector Compensation.”

⁸ See Foote, D.A. and T.B. Folta (2002). “Temporary workers as real options.” *Human Resource Management Review*, vol. 12, no. 4, pp. 579-597.

⁹ See “Competitive Sourcing Requirements in Division D of Public Law 110-16 Memorandum For Heads of Executive Departments And Agencies From Paul A. Denett, Administrator, Office of Management and Budget,” February 20, 2008.

Data and technical issues aside, federal contractors certainly *could* be overcompensated, just as federal employees are *right now*. After all, the federal government makes compensation decisions for both classes of workers. The more useful distinction from a policy point of view may not be whether certain tasks and duties should be performed by federal employees versus federal contractors, but whether those functions should be overseen by the federal government at all. In the private sector, competition helps to ensure that workers are paid no more and no less than fair market compensation. Those market forces are much weaker in the public sector, making excessive labor costs likely to persist even with our best efforts to avoid them.



AFGE Congressional Testimony

STATEMENT FOR THE RECORD

BY

JOHN GAGE
NATIONAL PRESIDENT
AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES, AFL-CIO

BEFORE

THE SENATE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS

SUBCOMMITTEE ON CONTRACTING OVERSIGHT

ON

CONTRACTORS: HOW MUCH ARE THEY COSTING THE GOVERNMENT?

MARCH 29, 2012

American Federation of Government Employees, AFL-CIO
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Chairwoman McCaskill and Members of the Subcommittee, on behalf of the American Federation of Government Employees, AFL-CIO, which represents more than 650,000 federal employees who are proud to serve the American people across the nation and around the world, I thank you, Chairwoman McCaskill, for the opportunity to submit testimony in writing for the March 29, 2012, hearing being held by the Subcommittee on Government Contracting entitled "Contractors: How Much Are They Costing the Government?"

Since the latter part of the Clinton Administration, AFGE has worked with Democratic and Republican lawmakers alike to remake the sourcing process into one that is more accountable to taxpayers and less unfair to federal employees. We are pleased by the landmark laws that have been enacted:

1. Requirements that any work last performed by federal employees be subjected to formal cost comparisons which determine that conversions to contractor performance can at least be guesstimated to benefit taxpayers before such conversions may take place;
2. Fundamental reforms to the public-private competition process which ensure that any "guesstimated" outsourcing savings can't be attributable to the provision by contractors of inferior health care and retirement benefits;
3. Prohibitions on the use of the OMB Circular A-76 privatization process until problems documented by the Government Accountability Office (GAO) and the Department of Defense (DoD) Inspector General (IG), among others, can be fixed;
4. Requirements that agencies develop inventories of their service contracts in order to identify which ones should be corrected, divested, or insourced, and to better identify and control the costs of service contracts; and
5. Requirements that agencies give "special consideration" towards insourcing functions that cost too much, are poorly performed, or include functions too important or sensitive to privatize.

Ultimately, except perhaps for some contractors, I think we can all agree that inherently governmental functions ought to be performed by federal employees; that functions closely associated with inherently governmental functions (e.g., overseeing contractors, developing regulations, preparing budgets) should be performed by federal employees "to the maximum extent practical"; that critical functions usually should be performed by federal employees; that performance decisions with respect to other functions should be based on law, cost, policy, and risk; and that agencies should have the same visibility and control over the costs of service contracts that they already have with respect to federal employee costs.

The good news is that there is an adequate statutory structure to ensure that this common-sense vision can become a reality. The bad news is that this Administration, like its predecessors, is unwilling to enforce the relevant sourcing and workforce management laws. As a result, too many sourcing

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decisions continue to be made on the basis of the wrong criteria, particularly arbitrary constraints on the size of the federal workforce.

I offer six recommendations for promoting the interests of taxpayers and all Americans who rely on the federal government for important services.

1. ENFORCE PROHIBITIONS AGAINST DIRECT CONVERSIONS

Despite the extensive use of the Office of Management and Budget (OMB) Circular A-76 privatization process (and the resulting proof of the superiority of in-house workforces—federal employees won 80% of the time during the Bush Administration, despite a process that independent observers agree is biased against them), much work last performed by federal employees is still being given to contractors without any proof that such conversions benefit taxpayers.

The Congress, on a bipartisan basis, has, repeatedly, prohibited agencies from perpetrating “direct conversions”—the term used to describe instances in which agencies give work last performed by federal employees to contractors without first conducting statutory cost comparisons. These prohibitions apply regardless of the number of positions or amount of work involved.

The Office of Federal Procurement Policy (OFPP) has embarked on a massive campaign of “myth-busting” in order to make the procurement process less problematic for contractors. On the other hand, OFPP refuses to even issue guidance—let alone mount a public relations effort—to ensure agencies finally comply with longstanding prohibitions against giving work last performed by federal employees to contractors without first complying with statutory cost comparison requirements. Most managers don’t know these prohibitions exist and those who do know believe that there are exceptions which in fact don’t exist. As a result, agencies regularly contract out work last performed by federal employees without any consideration of taxpayer interests. And because of caps, freezes, cuts, and other arbitrary constraints, which are invariably imposed on in-house workforces but not on contractors, much work last performed by federal employees is regularly contracted out based on individual federal employees’ retirement decisions, rather than whether such conversions make sense for taxpayers.

In December 2011, the Department of Defense (DoD), the largest department in the federal government, issued guidance to its managers to guard against direct conversions. This guidance was not issued to protect federal employees, but because of concern “that the Department not become overly reliant on contracted services.” As downsizing goes forward, DoD’s guidance warns that “we must be particularly vigilant to prevent the inappropriate conversion of work to contract.”

Given the budgetary situation, other agencies are also likely to experience significant downsizing. Nevertheless, OFPP refuses to issue guidance “to prevent the inappropriate conversion of work to contract” in non-DoD agencies. According to AFGE’s own survey of eight agencies, OFPP told none of them anything about direct conversions. In fact, an official at the Department of Veterans Affairs (DVA), which regularly violates the prohibitions against direct conversions, told AFGE: “We don’t know what the policy is on direct conversions.”

DoD should be commended for its sincere attempt to safeguard taxpayer interests by actually issuing guidance to enforce prohibitions against direct conversions. However, it should be noted that officials responsible for enforcing the law and the guidance can only use their powers of persuasion, and that direct conversions continue to occur, in large part, because of the arbitrary and arguably illegal imposition of a cap on the civilian workforce, which reduces in-house staffing to FY10 levels. When commanders and managers are required, on the one hand, to comply with prohibitions against direct conversions, and, on the other hand, a ruthlessly enforced Pentagon edict to arbitrarily slash the civilian workforce, even if substituting contractors would be more expensive, it's pretty obvious which path they will choose.

Here's an example of how DoD is ultimately unable to police itself. Some installations are directly converting work last performed by civilian personnel who are ultimately paid through non-appropriated funds (NAF). There are, of course, no exceptions in law or the department's guidance for NAF employees. There is, however, a longstanding prejudice against NAF employees—that they are often military spouses who are considered not to have career ambitions—which renders them second-class employees in the eyes of some managers. It makes no sense to try to carve out an exception to the law based on how employees are paid—let alone where they live or how they vote. The law is to protect taxpayers from arbitrary conversions to contractor performance, period.

The only support that these installations can claim for discriminating against NAF employees is a bizarre GAO bid protest decision that strained to incorporate a definition of "civilian employees" from the OMB Circular A-76, one which does not include NAF employees. However, as anyone familiar with the legislative history behind 10 USC 2461 would know, the whole point of the law was not to duplicate A-76, but rather to require that a particular cost comparison process always be used—in order to make up for the A-76 process' many loopholes which had allowed too much work to be contracted out without any cost comparisons. Far from codifying the A-76 circular, the cost comparison process established by 10 USC 2461 makes only one reference to the A-76 circular (which is limited to the type of most efficient organization that must be used).

In some instances, commanders and managers may feel compelled to convert work performed by civilian employees to performance by military personnel, a workforce sometimes referred to as "Borrowed Military Manpower". Because of their deservedly superior compensation packages, military personnel are usually considered to be twice as expensive as civilian employees. Nevertheless, the "Efficiency Initiative", with its cap on the civilian workforce, encourages managers to substitute military personnel for civilian personnel, regardless of cost or adverse impact on readiness.

There are no legal requirements to conduct cost comparisons before making civilian-to-military conversions. However, DTM 09-007, "Estimating and Comparing the Full Costs of Civilian and Military Manpower and Contract Support", provides a methodology for conducting such costs comparisons. The Army attempted to rationalize civilian-to-military conversions with the issuance of guidance in October 2011. However, there are now indications that the Air Force and the Marine Corps are undertaking wasteful civilian-to-military conversions. DoD issued helpful department-wide guidance earlier this month. Elimination of the cap on the civilian workforce would in turn eliminate much of the bureaucratic coercion to undertake such conversions. Ultimately, Congress should require DoD to use the DTM before converting work from civilian or contractor performance to military performance.

The issuance of guidance on civilian-to-contractor conversions and civilian-to-military conversions constitutes both good news and bad news. On the one hand, the department acknowledges it has a problem and is attempting to satisfactorily resolve it. On the other hand, the consensus necessary to issue such guidance would only be achieved if instances of direct conversions, whether to contractors or military personnel, were numerous or even rampant. And, ultimately, the perverse incentives that cause these direct conversions can only be eliminated if supervisors are allowed to manage federal employees by budgets and workloads, rather than by arbitrary caps, freezes, cuts, or other constraints.

2. MANAGE FEDERAL EMPLOYEES BY BUDGETS AND WORKLOADS, NOT ARBITRARY CONSTRAINTS

With the implementation of the "Efficiency Initiative", DoD has reverted to its traditional approach of managing its overall workforce at the expense of the civilian workforce. The imposition of an arbitrary FY10 cap on the civilian workforce is contrary to the law and completely inconsistent with the imperative to manage civilian personnel by budgets and workloads. If there is work to be done and money to pay for that work to be done, DoD managers should not be prevented from using civilian employees simply because they are civilian employees. Instead, performance decisions should be made on the basis of law, policy, risk, and cost. DoD claims that exceptions are allowed to the cap, mitigating against its intrinsically arbitrary nature. However, the process by which exceptions are sought and reviewed is as cumbersome as it is forbidding.

Two factors complicate the imposition of the cap. Workload reductions have not been commensurate with reductions in civilian personnel. Activities are attempting to muddle through with salami-slice tactics, whereby they struggle to do the same with less. In few instances, particularly with respect to the Army and the Air Force, have workload analyses been conducted prior to the imposition of reductions in civilian personnel. What functions are being divested and downsized because of these reductions? All too often, there are no answers to these questions. Doing more with less, i.e., not making the tough decisions about what the department will no longer perform, is a self-defeating management approach in the context of downsizing on the scale being contemplated for DoD. As non-DoD agencies begin to downsize, the DoD model is one to discard.

Worse, no comparable constraints are being imposed on DoD service contract spending. From FY01 through FY10, civilian personnel funding grew from \$41 billion to \$69 billion, while service contract spending grew from \$73 billion to \$181 billion. Even though civilian employees are cheaper and less numerous than their contractor counterparts, the "Efficiency Initiative" imposes far greater sacrifices on civilian employees. The inevitable result of the civilian personnel reductions, particularly in the absence of workload analysis, is that work that is now or could be performed more efficiently or more appropriately by civilian personnel is being outsourced or remaining outsourced. This can't help but increase costs to taxpayers and increase the amount of work performed by contractors that is actually inherently governmental, closely associated with inherently governmental functions, or critical.

Section 808 of the FY12 National Defense Authorization Act caps DoD's spending on service contracts for FY12 and FY13 (excluding Overseas Contingency Operation spending) at the level of the President's budget request in FY10. This cap, which originated in the Senate bill, was imposed because of the Senate Armed Services Committee's (SASC) concern that "(e)xpected savings from the reduction in staff augmentation services and the civilian workforce freeze could be easily lost if other categories of service contracts are permitted to grow without limitation so that spending can shift to these contracts". Moreover, as the SASC noted, "Over the last decade, DoD spending for contract services has more than doubled, from \$72 billion in fiscal year 2000 to more than \$150 billion, not including spending for OCO, while the size of the department's civilian employee workforce has remained essentially unchanged." The SASC also reported that a senior DoD official testified in September 2010: "(T)he low-hanging fruit really is (in contract services). There's a lot of money. There has been a very, very high rate of growth over the last decade, in services. They have grown faster than everything else...I think great savings can be had there, across the Services. It's essential that we look there...because that's half the money".

Unfortunately, DoD is not interested in complying with this law. In fact, DoD is already in violation of the law by failing to even issue the required guidance necessary to implement the law. Failure to comply with the means that DoD will continue to impose budget sacrifices disproportionately on the smaller and cheaper civilian workforce. Moreover, under Section 808, DoD can lift the contractor cap to the extent it lifts the self-imposed cap on the civilian workforce. Therefore, if DoD does not actually comply with Section 808, it will have no incentive to lift the civilian personnel cap, which is widely regarded as skewing sourcing decisions in favor of contractors (because the size of the civilian workforce is constrained while spending on contractors is not, absent compliance with Section 808).

It makes no sense to always cut the cheapest and most efficient of the department's three workforces. As Representatives Buck McKeon (R-CA) and Adam Smith (D-WA), the Chair and Ranking Member of the House Armed Services Committee, pointed out last year: "The Department now spends a greater portion of its budget purchasing services than it does purchasing weapons systems, hardware, and other products. In fact, the Department spends more on contracted services than it does on pay for military and civilian personnel combined."

We are seeing variations of the DoD "Efficiency Initiative" in other agencies. Whether they are called freezes, caps, or cuts, they invariably are being imposed in one-sided fashion—on the in-house workforce, not on the contractors. This can't help but skew sourcing decisions in favor of contractors and make it significantly less likely that such decisions will be made on the basis of acceptable criteria—law, cost, policy, and risk. Chairman Richard Durbin (D-IL) included a section in the FY12 Financial Services Appropriations Bill that would have taken the DoD requirement that the civilian workforce be managed by budgets and workloads and apply it to the non-DoD agencies. It is unfortunate that it is necessary to codify what should be common-sense. However, as downsizing proceeds, it is imperative that Congress take action to prevent the application of arbitrary constraints on the federal workforce that will prevent managers from assigning work to federal employees simply because they are federal employees.

3. COMPILE INVENTORIES OF CONTRACTS

Because the federal government's service contract workforce is larger and more expensive than its civil service workforce, any effort to achieve savings in how agencies provide services necessarily requires subjecting service contractors to severe scrutiny. In order to allow for such scrutiny, a law was enacted in 2009 that required non-DoD agencies to develop inventories of service contracts, which copied a 2007 law that required DoD to establish an inventory of service contracts.

Senate Armed Services Committee Chairman Carl Levin was the first to identify compliance with the inventory requirement and integration into the budget process as necessary if downsizing is to be done intelligently: "In the past, we've found that proposed cuts to contract services are nearly impossible to enforce because expenditures for service contracting are invisible in the department's budget."

As House Armed Services Committee Chairman McKeon and Ranking Member Smith recently noted, sagely, "A credible inventory that is fully integrated into the budget submission is necessary to identify and control contract costs, particularly in this time of fiscal constraints." Despite bipartisan and bicameral support for compliance with the DoD contractor inventory, OFPP is holding up the process at the request of contractors, refusing to grant the department the necessary exemption from the Paperwork Reduction Act, an exemption OFPP has already granted to the Army for its own contractor inventory even though the Army's methodology for its inventory is the basis for the methodology DoD uses for its own inventory.

Moreover, OFPP has been slow to implement the inventories of service contracts for non-DoD agencies and has failed to integrate those inventories into budget and management processes. In fact, OFPP has gone out of its way to oppose efforts to ensure that the contract inventories are comprehensive and reliable. The most recent example of this occurred in relation to the Senate's version of the FY12 Financial Services Appropriations Bill. OFPP objected to this language in Section 741: the service contractor inventories for non-DoD agencies should be based on "direct labor hours and associated cost data collected from contractors". This language--lifted directly from 10 USC 2330a, the contractor inventory requirement for DoD--was enacted pursuant to the FY11 NDAA. Why would OFPP accept this language for DoD's contractor inventory but not for the contractor inventories for the non-DoD agencies?

The contractor inventory law for non-DoD agencies already requires the collection of information related to direct labor hours. The new language would simply have clarified that contractors would supply this information in order to ensure its accuracy. The Army is already collecting this information from contractors, and its inventory is considered by Congress to be the model for the entire federal government.

Nevertheless, OFPP declared that "The proposed requirement to collect cost data would be unnecessarily burdensome on contractors without commensurate benefit." However, less than two weeks later, DoD, already under the law, came to the opposite conclusion when its Acquisition, Technology, and Logistics as well as Personnel and Readiness offices unambiguously endorsed, on behalf

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of the Pentagon, the Army methodology of collecting from contractors labor hours and associated cost data “to the maximum extent possible”, stipulating that “(a)fter five years of reporting” (i.e., collecting from contractors labor hours and cost data), “the Army has found that costs and administrative burden on the private sector have been minimal as well as the associated costs to Army organizations.”

Reliable and comprehensive contractor inventories are indispensable if agencies are ever to have the same visibility into, and control over, contractor costs as they have now over federal employee costs. The absence of reliable and comprehensive contractor inventories explains why agencies are now focusing downsizing efforts disproportionately on federal employees, even though federal employees are usually fewer and cheaper than contractors. At a time when the federal government is striving to reduce its costs, why would OFPP want to prevent non-DoD agencies from receiving the same cost information from contractors that DoD collects from its contractors? Why would OFPP reject as “burdensome on contractors” a methodology that DoD has embraced to the “maximum extent possible” because of its “minimal” impact on contractors?

4. USE INSOURCING TO REDUCE COSTS

All agencies are now required to develop insourcing policies for new work and outsourced work, in particular outsourced work that is inherently governmental and wrongly contracted out, work contracted out without competition and presumably more expensive than it should be, and work contracted out that is poorly performed. Nevertheless, insourcing in non-DoD agencies is proceeding slowly. In fact, OFPP has failed to issue guidance that would allow agencies to use insourcing to save money for the taxpayers by bringing in-house functions solely for cost reasons.

Given the results of the recent study by the Project on Government Oversight (POGO), which compared the costs of federal employees and contractors, taxpayers may well wonder why OFPP would want to shield from scrutiny the army of contractors who are responsible for so much documented waste, fraud, and abuse. According to POGO’s study—*Bad Business: Billions of Taxpayer Dollars Wasted on Hiring Contractors*—“on average, contractors charge the government almost twice as much as the annual compensation of comparable federal employees. Of the 35 types of jobs that POGO looked at in its new report—the first report to compare contractor billing rates to the salaries and benefits of federal workers—it was cheaper to hire federal workers in all but just 2 cases.”

The last OFPP administrator praised this study to POGO’s chief executive. So why would OFPP ignore the “special consideration” law and not ensure that agencies can systematically consider whether to substitute federal employees for contractors? Agency officials tell us that they would like to insource for cost reasons because they think significant savings are possible. However, they won’t do so until OFPP provides “political cover,” i.e., issues the necessary guidance. Some agencies may become so desperate to insource that they will devise their own costing methodologies. Most of those agency-specific methodologies will be accurate and reliable. OFPP bears responsibility for those that are not because of its failure—now going on four years—to issue the necessary guidance.

After sixteen years of indiscriminate privatization, DoD attempted to rebalance its workforce through targeted insourcing during parts of 2009 and 2010, both of functions which are inappropriate for contractor performance and functions which can be performed more efficiently in-house. DoD

reported that in FY10 insourcing generated significant savings, \$900 million, and brought in-house work performed by thousands of contractors that was actually too important or sensitive to privatize. Ultimately, 17,000 civilian personnel were added to handle insourced work. Insourcing continued in FY11; according to unofficial estimates, even with the Army not yet having reported, DoD added 9,100 positions through insourcing, with nearly 4,500 hiring actions executed against those and another 1,700 in process.

Contractors and their Congressional cronies took another shot last year at ending DoD insourcing in order to protect contractors at the expense of taxpayers and warfighters. However, on a bipartisan basis, Congress upheld the insourcing process in the FY12 NDAA. A House provision that would have allowed contractors to perform inherently governmental work was defeated. Another House provision that would have allowed insourcing determinations for closely associated with inherently governmental, acquisition, and critical functions to be made on the basis of cost, rather than the traditional legal and regulatory basis of risk, was also defeated. Still another House provision which would have narrowly defined critical functions was also defeated. A minimum cost differential (i.e., the 10%/\$10 million rule, which already applies when DoD tries to contract out work performed by civilian employees) was imposed on DoD before it can insource contractor work for cost reasons. Civilian employees must be shown to be marginally more efficient than contractors before contractor-to-civilian conversions can take place. Please note that this minimum cost differential does not apply when a large contractor insources work from a smaller contractor or when DoD wants to shift from one contractor to another contractor. Now, that the insourcing rules are settled—with DoD’s insourcing methodology being codified for each of the last two years—DoD should aggressively insource for cost reasons in order to generate substantial savings.

Contractors are now trying to use the appeal of small businesses to undermine insourcing. Earlier this month, the House Small Business Committee marked up three bills that included anti-insourcing provisions.

Two of the bills introduced would require that all agencies allow officials to advocate on behalf of small business contractors in insourcing decisions, while a third would give contractors legal standing to oppose agencies’ insourcing decisions.

Under H.R. 3980, agencies would be required to allow small business advocates to “participate in any session or planning process and review any documents with respect to a decision to convert an activity performed by a small business concern to an activity performed by a Federal employee”.

Under H.R. 3851, agencies’ small business advocates “shall review and advise such agency on any decision to convert an activity performed by a small business concern to an activity performed by a Federal employee”.

And under H.R. 3893, contractors would be given legal standing to challenge insourcing decisions before GAO and the Court of Federal Claims. It would also prohibit insourcing from occurring until agencies had “made publicly available, after providing notice and an opportunity for public comment, the procedures of the agency with respect to decisions to convert a function being performed by a small business concern by a Federal employee” and until those procedures are reviewed by officials who advocate for small business contractors.

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H.R. 3980 and H.R. 3851 would provide officials advocating for small business contractors unprecedented ability to influence insourcing decisions. Politicizing sourcing decisions, whether in favor of small businesses or unions, is wrong, period. Federal employees have no comparable advocates on their behalf when their jobs are being reviewed for outsourcing. Proponents claim that the legislation is based on a recent OMB policy letter, which requires that “The agency should involve its small business advocate if considering the insourcing of work currently being performed by small businesses.” Obviously, the legislation and the policy letter are fundamentally different with respect to the degree of involvement of the small business advocates. Moreover, this flawed argument does nothing to address our concern about the one-sidedness of these provisions.

H.R. 3893 is also one-sided. It gives legal standing to contractors in the insourcing context, but not to federal employees. Contractors have long had legal standing in the outsourcing context before GAO and the Court of Federal Claims. Not until recently were federal employees given limited legal standing before the GAO in the outsourcing context. Moreover, this legislation is unprecedented in that it gives contractors the ability to file bid protests even when agencies are attempting to insource work that is inherently governmental, closely associated with inherently governmental, or critical. Finally, agencies are not required to publish for comment their outsourcing plans, let alone run them past federal employee advocates.

It is not responsive for opponents of insourcing to ritualistically invoke OMB Circular A-76. The executive branch used A-76 indiscriminately in DoD during the Clinton Administration and in all agencies during the Bush Administration. A-76 aficionados—a collection of sad, misguided souls and unreconstructed federal employee haters—had their way for 16 years. And what do they have to show for the havoc and the disruption, besides enriching consultants (i.e., Beltway Bandits)? Nothing.

According to GAO, there is no proof all of this activity resulted in any savings.

“We have previously reported that other federal agencies—the Department of Defense (DoD) and the Department of Agriculture’s (USDA) Forest Service, in particular—did not develop comprehensive estimates for the costs associated with competitive sourcing. This report identifies similar issues at the Department of Labor (DoL). Without a better system to assess performance and comprehensively track all the costs associated with competitive sourcing, DoL cannot reliably assess whether competitive sourcing truly provides the best deal for the taxpayer...”

If A-76 had been a weapons program, it would have been killed a long time ago. Moreover, the A-76 process has been generally and specifically prohibited by Congress because of documented flaws in the process that have been identified by GAO and the DoD IG and acknowledged by OMB. Whether A-76 can be reformed and the prohibitions lifted are questions completely divorced from insourcing. According to GAO and the DoD IG, the A-76 privatization process

1. failed to keep track of costs and savings,

DoD IG: “DoD had not effectively implemented a system to track and assess the cost of the performance of functions under the competitive sourcing program...The overall costs and the estimated savings of the competitive sourcing program may be either overstated or understated. In addition, legislators and Government officials were not receiving

reliable information to determine the costs and benefits of the competitive sourcing program and whether it is achieving the desired objectives and outcomes...ⁱⁱⁱ

GAO: “[The Department of Labor’s (DoL)] savings reports...exclude many of the costs associated with competitive sourcing and are unreliable...(O)ur analysis shows that these costs can be substantial and that excluding them overstates savings achieved by competitive sourcing...DoL competition savings reports are unreliable and do not provide an accurate measure of competitive sourcing savings...Finally, the cost baseline used by DoL to estimate savings was inaccurate and misrepresented savings in some cases, such as when preexisting, budgeted personnel vacancies increased the savings attributed to completed competitions...ⁱⁱⁱ

2. resulted in the actual costs of conducting the privatization studies exceeding the guesstimated savings, and

GAO: “For fiscal years 2004 through 2006, we found that the Forest Service lacked sufficiently complete and reliable cost data to...accurately report competitive sourcing savings to Congress...(W)e found that the Forest Service did not consider certain substantial costs in its savings calculations, and thus Congress may not have an accurate measure of the savings produced by the Forest Service’s competitive sourcing competitions...Some of the costs the Forest Service did not include in the calculations substantially reduce or even exceed the savings reported to Congress...^{iv}

3. included fundamental biases against the in-house workforce.

DoD IG: “...In this OMB Circular A-76 public/private competition—even though (DoD) fully complied with OMB and DoD guidance on the use of the overhead factor—the use of the 12 percent (in-house) overhead factor affected the results of the cost comparison and (DoD) managers were not empowered to make a sound and justifiable business decision...In the competitive sourcing process, all significant in-house costs are researched, identified, and supported except for overhead. There is absolutely no data to support 12 percent as a realistic cost rate. As a result, multimillion-dollar decisions are based, in part, on a factor not supported by data...Unless DoD develops a supportable rate or an alternative method to calculate a fair and reasonable rate, the results of future competitions will be questionable...^v

Until the implementation of the reforms listed below, AFGE strongly believes that the temporary suspensions on new A-76 privatization studies should be continued:

1. The establishment of a reliable system to track costs and savings from the A-76 process that has been implemented, tested, and determined to be accurate and reliable, over the long-term as well as the short-term.
2. Consistent with the law, the establishment of contract inventories so that agencies can track specific contracts as well as contracts generally.

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3. Consistent with the law, the development and implementation of plans to actively insource new and outsourced work, particularly functions that are closely associated with inherently governmental functions, that were contracted out without competition, cost too much, and are being poorly performed.
4. Consistent with the law, the enforcement of government-wide prohibitions against direct conversions.
5. The development and implementation of a formal internal reengineering process that could be used instead of the costly and controversial A-76 process.
6. Revision of the rules governing the A-76 process to make it more consistent with agencies' missions, more accountable to taxpayers, and more fair to federal employees.
 - a. Increase the minimum cost differential to finally take into account the often significant costs of conducting A-76 studies, including preliminary planning costs, consultants costs, costs of federal employees diverted from their actual jobs to work on privatization studies, transition costs, post-competition review costs, and proportional costs for agencies' privatization bureaucracies (both in-house and out-house).
 - b. Double the minimum cost differential for studies that last longer than 24 months— from the beginning of preliminary planning until the award decision.
 - c. Eliminate the arbitrary 12% overhead charge on in-house bids.

5. CAP CONTRACTOR COMPENSATION

OMB has imposed a two-year freeze on the pay of federal employees who, among other things, care for our veterans and patrol our borders. With respect to contractors, however, OFPP can only call for capping at \$200,000 the taxpayer-subsidized compensation of each contractor's five most lavishly rewarded employees, while allowing thousands of contractors to charge taxpayers for compensation that far exceeds \$200,000 per employee, costing taxpayers tens of billions of dollars. In fact, OFPP is poised to significantly raise the current cap on taxpayer reimbursement of each contractor's five most lavishly compensated employees from almost \$700,000 annually to take into account an overdue hike from 2011 and an upcoming hike in 2012. That contrasts with the position taken by many Congressional Republicans who want to extend the freeze on federal employee pay for an additional three years without asking millionaire contractors to make any sacrifices.

Why do OMB and the Congress insist on imposing significant sacrifices on even the most modestly-paid federal employees, while allowing almost every single upper-income contractor to make no sacrifice whatsoever? The federal government employs hundreds of thousands of talented doctors, scientists,

and other award-winning professionals who are the most qualified in their fields. Why is it necessary for taxpayers to spend tens of billions of dollars on overpaid contractors instead of on reliable, experienced, and inexpensive federal employees?

Now, it is time for the richest contractors to make modest sacrifices. Currently, contractors can charge taxpayers up to \$693,000 annually for the compensation of a single employee. Since 1998, the compensation cap applicable to government contracts has more than doubled, from an egregious \$340,650 in 1998 to an unconscionable \$693,951 in 2010. From 1998 to 2010 the benchmark has grown 53 percent faster than the rate of inflation! Of course, contractors often make millions of dollars per year because their firms richly supplement the already generous compensation provided by taxpayers with fees and profits earned on federal contracts. AFGE is not proposing to limit contractor incomes; rather, we propose capping how much taxpayers must contribute towards contractor compensation. A former senior DCAA executive estimates that a cap of \$200,000 for all contractors would save \$50 billion over ten years.

Special praise should be given to Senators Barbara Boxer (D-CA) and Charles Grassley (R-IA) for successfully offering an amendment to the Senate version of the FY12 National Defense Authorization Act to cap taxpayer reimbursement for contractors at \$400,000 annually. (The cosponsorship of Chairwoman McCaskill and Senator Tester of this amendment is much appreciated by AFGE.) Although their dollar cap disappeared in the subsequent House-Senate conference, the two Senators were at least ultimately successful in subjecting all DoD contractors to the current \$693,000 cap. Previously, only the top five most lavishly compensated employees at each contractor were subject to the cap. Senators Boxer and Grassley recently introduced legislation (S. 2198) to cap compensation for all contractors at \$400,000. Representative Paul Tonko (D-NY) also deserves praise for introducing legislation (H.R. 2980) to cap compensation for all contractors at \$200,000.

6. ABOLISH OFPP

OFPP should be abolished and its responsibilities transferred to OMB's resource management offices (RMO's). It's not that what OFPP does isn't important. In fact, what OFPP does is of the utmost importance. That's why procurement and sourcing decisions shouldn't be made by an understaffed and increasingly isolated bureaucracy that has been all but taken over by the industry it is supposed to be regulating. Contractors are OFPP's one consistent constituency. Even the most independent-minded career staff would be beaten down by the relentless lobbying of a notoriously self-interested industry.

If procurement and sourcing decisions were made in the context of OMB's larger budget and management responsibilities, instead of in isolation, there is no question that the ability of contractors to influence those decisions would be greatly reduced, and that as a result those decisions would promote better management and take into account their impact on the budget. Of course, specialization is a virtue. However, in this instance, that specialization has been commandeered so that it is being consistently used to promote private interests at the expense of the public good. AFGE is not advocating that OMB stop making procurement and sourcing policy. However, it is clear that the public interest would be better served if those decisions were integrated into OMB's overall budget and management responsibilities.

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Why should the contractor-controlled OFPP be allowed to make decisions about the inventories of service contracts? The federal government spends hundreds of billions of dollars annually on service contracts, but we can't identify and control those costs, let alone systematically identify contracts that cost too much or include inappropriate functions. These inventories would allow agencies, for the first time, to control and rationalize huge parts of their budgets. At a time of downsizing, such newfound capabilities would be almost heaven-sent. We know why contractors oppose these inventories—with increased visibility inevitably comes increased accountability. But why should OFPP identify with contractors instead of taxpayers? OFPP opposes DoD's attempt to establish a department-wide inventory because of the "burden" imposed on contractors. Apparently it's a "burden" for contractors to provide taxpayers with cost data for the contracts they pay for, even though the provision of such information is required by law. Even contractors who provide services to the Army, whose inventory methodology is the basis for DoD's own inventory methodology, scoff at that nonsense. And what of the non-DoD contract inventories? They have become little more than painfully incomplete, check-the-box inventories that are divorced from their agencies' budget and management agendas. The Army is using its inventory to eliminate wasteful and duplicative contracts and identify those contracts that include inappropriate functions. How can that happen in the non-DoD agencies with OFPP calling the shots? Does anyone believe agencies would not have been much closer towards establishing reliable and comprehensive inventories that would have been integrated into their management processes if this policy had not been driven—i.e., derailed—by OFPP?

Why should OFPP be responsible for defining inherently governmental, "closely associated", and critical? Only contractors were pleased by OFPP's belated reaffirmation of the inadequate status quo that has left contractors supervising other contractors and contractors making policy, preparing budgets, and writing regulations. Is it any wonder that OFPP's definitions focused almost exclusively on acquisition and information technology functions, because of their parochial relation to the office's mission, while ignoring the myriad other functions that have been undermined by over-reliance on contractors? And look at what's happened after the definitions were promulgated? Virtually nothing. Has OFPP set deadlines for agencies to end their reliance on contractors for inherently governmental functions or to review contracts that include "closely associated" or critical functions to see if they should be corrected or insourced? Of course not. That would not be in the interests of OFPP's clients.

Why has no guidance been issued that would make it easy for agencies to substitute federal employees when they'd be cheaper than contractors? At a time when dollars are few, but service contracting consumes a huge part of discretionary spending, it is almost unimaginable that cost-based insourcing guidance has not been issued, especially when an independent study has shown that contractors usually cost almost twice as much as federal employees. Why does OFPP invest inordinate resources in "myth-busting" in order to create an even more relaxed and informal procurement environment for contractors, but never bother to uphold taxpayer interests by issuing guidance to enforce statutory prohibitions against direct conversions? Does anyone reasonably believe that, in both instances, taxpayers would not have fared better had such decisions been made by OMB's RMO's, which have to take into account broader interests than OFPP?

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Does anyone really think that OFPP's handling of contractor compensation is a model of good government and sound economy? It is one thing to carry out a bad law, but another to lobby against efforts to reform that law, as OFPP did last year in fighting back against the Boxer-Grassley amendment to cap contractor compensation at a more reasonable \$400,000 per annum. If policy on contractor compensation were not made in a contractor-controlled bureaucratic citadel like OFPP, is it not more likely that the executive branch would have proposed significant reform on its own a long time ago? Would the budget side of OMB really have left \$50 billion in unnecessarily lavish contractor compensation on the table the way OFPP has?

OFPP's credibility is further strained by claims of taxpayer savings from its procurement reforms. OFPP has touted an initiative to reduce service contract spending by 15% per year. However, OFPP's claims are based on a very small reduction in a sliver of service contracting dollars. The 15% "savings" is based on a claim of a \$6 billion reduction in "targeted" product and services codes (P5Cs) that amount to only \$40 billion in overall service contract spending, and the \$40 billion baseline represents only 12% of all service contract spending! So, the actual savings in service contract spending—if any is to be claimed at all—is less than 2%. In terms of overall federal contract spending, it is only about 1%. Changes in "contracting policy" have little to no impact on such a remarkably small change in spending. Much more relevant to these changes are factors such as appropriations availability, programmatic requirements, agency mission changes, and any number of factors that determine an agency's need for contracted services.

No discussion of OFPP's work on behalf of contractor interests would be complete without some mention of OFPP's monumental role in helping to diminish and undermine the work of the Cost Accounting Standards (CAS) Board. The CAS Board, which was originally chaired by the Comptroller General, was responsible for issuing accounting principles applicable to larger government contracts. During the past ten to fifteen years, unless prompted by specific Congressional action, the sole interest that OFPP has shown in the work of the CAS Board seems to be centered around limiting CAS applicability to the most narrow set of contracts and contractors possible, thus potentially costing taxpayers billions of dollars in improperly allocated costs. OFPP has openly flouted the CAS Board statute by appointing "accounting" industry members who were little more than shells for contractor interests. OFPP has sought to ignore the basic statutory appointment process by making appointments that do not even conform to the term requirements contained in the statute (4 years term appointments). The previous administrator justified ignoring the statutory requirements by claiming that he wanted to "stagger" the CAS Board member terms, which although perhaps a laudable goal, was done in manner contrary to the statutory requirements. Under the notorious leadership of a former administrator, who is currently serving a sentence in a federal penitentiary, OFPP allowed the CAS Board to function with "members" who had not been duly appointed at the time of their initial meetings. As an auditor, Chairwoman McCaskill, you may be surprised and disappointed by the mockery that OFPP has made of this once proud accounting standards setting entity.

Chairwoman McCaskill, thanks very much for inviting AFGE to provide our views about the important issues raised by this hearing. In choosing not to participate, OMB has missed a very significant opportunity to work with you to make sourcing decisions more accountable to taxpayers.

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APPENDIX: AFGE REVIEW OF GAO CRITIQUE OF DOD A-76 REPORT (GAO-11-923R)

In Section 325 of the FY10 National Defense Authorization Act (NDAA), the use of the OMB Circular A-76 privatization process was suspended in DoD until the department finally complied with an FY08 NDAA requirement to inventory its service contracts and submitted a report to Congress on how it would address longstanding problems in the A-76 privatization process that have been identified by the DoD IG, GAO, and others. In that same law, GAO was charged with assessing DoD's report.

According to GAO, DoD acknowledges it has not complied with the inventory requirement: *"DoD officials told us that the accuracy of the service contracts inventory is improving, but it is not ready to be certified."* (Page 11) As Senate Armed Services Committee Chairman Carl Levin (D-MI) noted: *"In the past, we've found that proposed cuts to contract services are nearly impossible to enforce because expenditures for service contracting are invisible in the department's budget. For this reason, (the FY08 NDAA) required that the the budget justification documents clearly and separately identify the amounts requested in each budget account for procurement of services. The department has not yet complied with that requirement."*

While acknowledging that DoD had submitted its A-76 report in June 2011, thus complying with the report requirement, GAO did express remaining concern about two very longstanding problems with the A-76 process, specifically the tracking of costs and savings as well as the calculation of in-house overhead costs. Unfortunately, GAO, on too many occasions, failed to critically examine DoD's excuses and rationales for not reforming the A-76 process.

Here are five of the more significant problems in the A-76 process that DoD was supposed to address in its report.

1. Failure to enforce prohibitions against direct conversions (i.e., giving work to contractors without first complying with the requirements of a formal cost comparison process):

DoD: *"(T)he Department has not had an opportunity to 'comply' with the changes directed by Sec 321"* because of the prohibitions imposed against the use of A-76. (Page 5)

GAO: *"Should the current moratorium on competitions be lifted, DoD's report states the department will not have any issues implementing and complying with the report."* (Page 7)

AFGE: Prohibitions against direct conversions in DoD were first imposed in the Defense Appropriations Bill, through annual general provisions, starting in FY04; the FY06 NDAA included a prohibition in Title 10. These laws prohibited DoD from giving work to contractors without first complying with the requirements of a formal cost comparison process for functions with more than 10 employees. In the FY10 NDAA and Defense Appropriations Act, the exceptions for functions involving 10 or fewer employees were eliminated.

It is very surprising that GAO would let pass DoD's fundamentally wrong assertion that it *"has not had an opportunity to comply"*. The danger of direct conversions exists whether A-76 studies are being undertaken or the process has been prohibited. Indeed, that is why the Army, on its own, issued guidance against direct conversions in May 2011, i.e., while the A-76 prohibition is still in effect, helpfully pointing out that, *"(I)t is imperative that that as the Army implements the results of its organizational assessments, we must be particularly vigilant in complying with statute and prevent any inappropriate conversion of work to contractor performance"*.^{vi} Unfortunately, this well-intentioned effort has not succeeded in eliminating direct conversions within the Army. Even DoD knew—unlike GAO, apparently—it had an *"opportunity to comply"*. Unfortunately, it wasn't until December 2011 that department-wide guidance was issued, i.e., again while the A-76 moratorium is still in effect. Worse, this guidance appears to have little effect. In order to comply with the arbitrary and arguably illegal FY10 cap on the civilian workforce, work performed by civilian employees is not just being illegally directly converted to contractor performance but also directly converted to military performance as well. That's not AFGE propaganda. The issuance of department wide guidance in the case of contractor direct conversions and military direct conversions is an implicit acknowledgement that these practices are widespread.

Conclusion: Should DoD comply with the law that prohibits giving work to contractors without first conducting formal cost comparisons? Even though such prohibitions have been in effect since 2004, both before and during the current A-76 moratorium, DoD claimed it hasn't had the opportunity to comply. GAO simply restates DoD's position. AFGE thinks responsible lawmakers will hold DoD to a higher standard.

2. Failure to tracking costs and savings:

DoD: We believe *"that the Department of Defense Commercial Activities Management Information System (DCAMIS) is a comprehensive and reliable system for the Department to track the cost and quality of the performance of functions in public-private competitions"*. (Page 11)

GAO: *"(C)oncerns remain...For example, the DoD report stated that upgrades to the current system used to track data on public-private competitions have been made, but because of the moratorium, DoD has not reviewed whether data reliability and accuracy actually has improved."* (Page 2)

AFGE: Concern about DoD's inability to track costs and savings is not a recent phenomenon: *"DoD had not effectively implemented a system to track and assess the cost of the performance of functions under the competitive sourcing program..."*^{vii} That DoD can do nothing more but serve up the same blithe assurances that they have finally fixed the problems—at the same time the rest of the department's accounting problems have achieved such notoriety—is, obviously, troubling.

However, GAO failed to remind readers of the concerns it had expressed as recently as 2008 that the A-76 process is systemically flawed because it fails to take into account significant costs of conducting privatization studies:

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“OMB does not require agencies to report these costs (the time in-house staff spent on competition activities, precompetition planning, certain transition costs, and postcompetition review activities) because they reflect what would be incurred as part of an agency’s typical management responsibilities.

However, our analysis shows that these costs can be substantial and that excluding them overstates savings achieved by competitive sourcing. For example, we found that including in-house staff time spent on competition activities would have doubled the costs reported for a competition...

*“We have previously reported that other federal agencies—the Department of Defense (DoD) and the Department of Agriculture’s (USDA) Forest Service, in particular—did not develop comprehensive estimates for the costs associated with competitive sourcing. This report identifies similar issues at the Department of Labor. **Without a better system to assess performance and comprehensively track all the costs associated with competitive sourcing, DoL cannot reliably assess whether competitive sourcing truly provides the best deal for the taxpayer.**”ⁱⁱⁱ (Emphasis added)*

Conclusion: Should DoD finally be required to track the costs and savings from conducting A-76 privatization studies? DoD, without proof, says all’s well. GAO expresses concern about the reliability of DoD’s assurances. However, GAO never discussed the findings it had reported earlier about systemic problems in the A-76 process that leave significant costs of conducting privatization studies unaccounted for. As OMB would acknowledge, these systemic problems have not been corrected, which may explain why OMB has not called for repeal of the government-wide A-76 prohibition.

3. Inability to ensure that actual costs of carrying out A-76 studies don’t exceed guesstimated savings:

DoD: *“OUSD(P&R) does not find a need for any significant changes at this time to the conversion differential...”* (Page 13)

GAO: *“DoD’s report states that the cost differential currently in effect is an appropriate methodology. The Commercial Activities Panel also viewed the differential as a reasonable way to take into account the costs of the disruption and risk of converting from the public to the private sector.”* (Page 9)

AFGE: DoD incurs significant costs in conducting A-76 studies. Some of those costs are non-quantifiable (e.g., “disruption and decreased productivity”, per A-76) and some are quantifiable (e.g., hiring outside consultants, diverting employees from their usual work to staff the studies). By its very definition, the A-76 cost differential includes only non-quantifiable costs: *“The conversion differential precludes conversions based on marginal estimated savings, and captures non-quantifiable costs related to a conversion, such as disruption and decreased productivity.”* In order to actually “preclude conversions based on marginal estimated savings”, i.e., ensure that guesstimated savings are not offset or exceeded by real costs, many believe, including AFGE, it is necessary that the minimum cost differential be increased in order to also take into account quantifiable costs.

GAO never even addresses this point, although it has earlier raised concerns, as discussed above, that the A-76 process fails to take into account significant quantitative costs, which can exceed guesstimated savings. GAO's invocation of the Commercial Activities Panel is as troubling as it is misleading. This Panel was deliberately stacked with contractors and Bush Administration officials, leaving pro-federal employee representatives outnumbered, 8-4. Nevertheless, the minimum cost differential as it is currently formulated to capture only non-quantitative costs was not included in the principles adopted unanimously by the panel. Moreover, the endorsement of the minimum cost differential by the pro-contractor majority acknowledged that it did not take into account quantitative costs: "...the Panel views that differential as a reasonable way, consistent with the principles, to take into account the disruption and risk entailed in converting between the public and private sectors."^{ix} (Emphasis added)

Conclusion: Should we prevent the actual quantitative costs of conducting privatization studies from exceeding the guesstimated savings? DoD says no. GAO, although it has acknowledged earlier that quantitative costs can exceed guesstimated savings, evidently doesn't care. AFGE thinks responsible lawmakers will feel otherwise.

4. Failing to prevent federal employees from being put at a competitive disadvantage through the imposition of excessive overhead charges:

DoD: "*Clear definitions for overhead, general and administrative costs, operations overhead, indirect cost, and indirect labor now exist for costing in DoD public-private competitions.*" (Page 13)

GAO: "*(U)ntil actual overhead costs are used to develop a more meaningful standard overhead rate, the magnitude of savings expected from public-private competitions will be imprecise and competition decisions could continue to be controversial. We recommended that OMB and DoD develop a methodology to determine appropriate overhead rates. The agencies did not agree with our recommendation.*" (Page 9)

AFGE: In 2003, the IG reported that an A-76 study involving more than 600 civilian employees had been wrongly decided because tens of millions of dollars in nonexistent overhead costs had been added to the in-house bid. DoD was required to add such costs because of an A-76 rule that automatically charges all in-house bids in all agencies with overhead costs that equal 12% of in-house personnel costs. Based on that scandal, the IG recommended that DoD either concoct a formula for overhead costs that is empirically based or specifically calculate in-house overhead for each A-76 study:

As a result, multimillion-dollar decisions are based, in part, on a factor not supported by data...Unless DoD develops a supportable rate or an alternative method to calculate a fair and reasonable rate, the results of future competitions will be questionable...^{ix}

DoD dismissed those recommendations then, and, now, eight years later, it is still dismissing them. Instead of judging DoD on its report, as required by the law, GAO allows DoD to, in effect, take the test over again by noting that DoD, after submitting its A-76 report in June, had begun in August a review of "procedures used to estimate and compare costs of service contracts". (Page 9) Why had DoD begun this review after submitting its A-76 report? Given that the overhead rate is an integral part of the OMB

Circular A-76, which is, obviously, overseen by OMB, how can DoD unilaterally change it? Surprisingly, GAO never bothers to ask such questions.

Conclusion: Should federal employees be charged for their actual overhead costs? GAO and the IG have reported that federal employees can be overcharged for their actual overhead costs under A-76. Officially, DoD says there is no need for reform. Off the record and after submitting its A-76 report, DoD tells GAO it will look into the matter—11 years after the IG made its recommendation. DoD has to win back our trust, so shouldn't the order be reversed—i.e., make reforms and comply with the law before being given permission to crank up the broken A-76 machinery? Of course, DoD cannot change the overhead rate because it is part of the OMB Circular A-76, not the DoD Circular A-76.

5. Failing to comply with the prohibition against automatically recompeting in-house workforces:

DoD: *"Current DoD policies are adequate to implement the" prohibition against automatic recompetitions..."(D)ue to the moratoriums, and decreased emphasis on public-private competitions under the current Administration, the draft revision of the Department's public-private competition policy further clarifying this policy has been suspended."* (Page 14)

GAO: *"DoD's report recommended that the department issue clarifying guidance regarding the statutory limitations on recompetitions and how to correctly apply them..."* (Page 10)

AFGE: Under the OMB Circular A-76 process, DoD is required to recompetete under A-76 all in-house activities within five years of their previous winning A-76 bids except in very limited circumstances. Needless to say, this automatic recompetition rule does not apply to contractors who win A-76 studies. Contractor cheerleaders invariably attempt to justify this obvious inequity by claiming that contractors would have to compete against other contractors, even if they are spared having to compete against civilian employees. However, as reported by GAO and the IG, contractors frequently win contracts on a sole-source basis or with limited competition. Congress prohibited automatic recompetition of in-house activities because of concern over the inequity as well as the wastefulness.^{xi}

DoD acknowledges that it has failed to implement the prohibitions against automatic recompetitions, but blames Congress for enacting prohibitions against undertaking new A-76 studies. This excuse is as perverse as it is disingenuous. The prohibition against automatic A-76 recompetitions in DoD, which was included in the FY08 NDAA, was enacted on January 28, 2008. The government-wide prohibition against undertaking new A-76 studies, which was included in the FY09 Omnibus Appropriations Act, was enacted on March 11, 2009. (The DoD-specific prohibition against undertaking new A-76 studies, which was included in the FY10 NDAA, was enacted on October 28, 2009.) DoD had more than one year to implement the automatic recompetition prohibition. Indeed, DoD's failure to implement that law was considered by lawmakers to be yet another reason to impose the government-wide and DoD-specific A-76 suspensions. It is unfortunate that GAO chose not to point this out.

GAO also failed to point out that the automatic recompetition rule is part of the OMB Circular A-76, which is something DoD can't change on its own, even if so inclined. It is surprising that neither DoD in its report nor GAO in its critique of that report ever acknowledged the obvious inequity of A-76 automatically recompeting federal employees but not contractors. As Chairman Levin has declared: *"This rule is fundamentally unfair"*.

Conclusion: Should DoD actually implement the prohibition against automatically recompeting DoD in-house workforces under A-76? DoD has had four years to issue guidance on its own. However, it apparently refuses to do so until *after* the A-76 suspension has been repealed. DoD has to win back our trust, so shouldn't the order be reversed—i.e., make reforms and comply with the law *before* being given permission to crank up the A-76 machinery? And should federal employees, but not contractors, be automatically recompeted under A-76? DoD and GAO can't be bothered to ask this question, let alone answer it satisfactorily. AFGE believes responsible lawmakers will think otherwise.

ⁱ Government Accountability Office, Department of Labor: Better Cost Assessments and Departmentwide Performance Tracking Are Needed to Manage Competitive Sourcing Program (GAO-09-14).

ⁱⁱ Department of Defense Inspector General, DoD Reporting System for the Competitive Sourcing Program (D-2006-028).

ⁱⁱⁱ Government Accountability Office, Department of Labor: Better Cost Assessments and Departmentwide Performance Tracking Are Needed to Manage Competitive Sourcing Program (GAO-09-14).

^{iv} Government Accountability Office, Forest Service: Better Planning, Guidance, and Data are Needed to Improve Management (GAO-08-195).

^v Department of Defense Inspector General, Public/Private Competition for the Defense Finance and Accounting Service Military Retired and Annuitant Pay Functions (D-2003-056).

^{vi} U.S. Army, *Update on Converting Certain Functions to Contractor Performance* (April 22, 2011).

^{vii} Department of Defense Inspector General, *DoD Reporting System for the Competitive Sourcing Program* (D-2006-028).

^{viii} Government Accountability Office, *Department of Labor: Better Cost Assessments and Departmentwide Performance Tracking Are Needed to Manage Competitive Sourcing Program* (GAO-09-14).

^{ix} Commercial Activities Panel, *Improving the Sourcing Decisions of the Government*, p. 39.

^x D-2003-056.

^{xi} Senator Carl Levin (D-MI) spoke eloquently in support of the prohibition when it was considered on the floor, on October 1, 2007: "I wish to focus on one provision of the amendment which addresses a fundamental element of fairness in competition between the private and public sectors. OMB circular A-76, which governs public-private competitions, establishes rules for what happens after one side or the other wins a competition. If the private sector wins a competition, the work stays in the private sector forever. If the public sector wins, however, the work must be subject to a new competition within 5 years. Attachment B to OMB circular A-76 specifically states that if the public sector competitor wins a competition, "an agency shall complete another...competition of the activity by the end of the last performance period" in the performance agreement. This rule is fundamentally unfair. It also undermines the morale of Federal civilian employees by contributing to the view of civil servants as second-class citizens. At a time when the Department of Defense should be recruiting thousands of new civilian employees to address a human capital crisis, the rule is clearly contrary to the Department's own interests. The Kennedy-Mikulski amendment would address this problem by stating that OMB may not require the Department of Defense to conduct a new public-private competition within any specified period of time after the public sector wins a competition. That is the right answer. DOD's human capital policies should be driven by the Department's human capital needs—not by arbitrary policies established by the Office of Management and Budget. So I hope our colleagues will support the Kennedy-Mikulski amendment."

Subcommittee on Contracting Oversight
Committee on Homeland Security & Government Affairs

"Contractors: How Much Are They Costing the Government?"
March 29, 2012

Written Testimony
Roger D. Waldron, President
The Coalition for Government Procurement

Madam Chairwoman, Ranking Member, and Members of the Subcommittee, thank you for inviting The Coalition for Government Procurement (the "Coalition") to provide written testimony. It is our privilege to assist you in the important task of assessing and improving the use of data to develop best practices around decisions to utilize contractors. Your efforts today continue a tradition in the subcommittee of seeking to improve the workings of government contracts. In this regard, the Coalition commends the leadership and members of the Committee on Homeland Security & Government Affairs for their contributions to government acquisition, specifically with regard to enhancing competition under the GSA Multiple-Award Schedule contracts.

The Coalition for Government Procurement is a non-profit association of approximately 300 firms selling commercial services and products to the Federal Government. Our members collectively account for approximately 70% of the sales generated through the GSA Multiple Award Schedules (MAS) program and about half of the commercial item solutions purchased annually by the Federal Government. Coalition members include small, medium, and large business concerns, and we are proud to have worked with Government officials over the past 30 years towards the mutual goal of common sense acquisition.

I. Accounting for and Analyzing the Costs of Contractors vs. Federal Employees

With regard to how the Government accounts for and analyzes the cost of contractors versus that of federal employees, the Coalition believes that improved cost analysis ultimately leads to better value for the Government, industry, and the American taxpayer.

Each agency has its own unique mission along with its own distinct requirements. It is not surprising, then, that the composition of each agency's workforce is inherently varied and unique. An agency will consider outsourcing when it does not believe it has the required capability in-house, but the question concerning government insourcing versus outsourcing is, indeed, nuanced and complex. When making sourcing decisions, an agency must understand its unique mission requirements and strategically determine which factors are important in meeting that mission. In other words, sourcing decisions are mission-driven.

The Acquisition Advisory Panel was authorized by Section 1423 of the Services Acquisition Reform Act of 2003 and enacted as part of the National Defense

Authorization Act of Fiscal Year 2004. Known as the "SARA Panel," it published its report in January 2007. On this subject, it notes,

Private sector companies spend significant amounts of time and resources developing business cases for services acquisition. They get the stakeholders involved and use highly qualified personnel to develop the business cases. Business case development helps to prevent false trade-offs. Cost reduction is just one component of the business cases. They have found that too much focus on cost reduction can lead to missed opportunities and, in some cases, reduce service quality in other areas of the organization. Stated differently, total cost of service acquisition does not equal total value captured through sourcing. (SARA Panel Report, 2007, p. 88)

Likewise, agencies should employ detailed and robust business case analysis when making sourcing decisions. Business case analysis that weighs value and not only cost, is vital to all agencies in determining how to meet their individual missions.

With the exception of inherently governmental functions, which understandably should be performed by federal employees, the Government should weigh a variety of factors when either outsourcing or insourcing. As stated, important factors for agency missions vary. In 2010, the Government Accountability Office (GAO) report on *Warfighter Support: A Cost Comparison of Using State Department Employees versus Contractors for Security Services in Iraq* stated that,

There are other factors that may play a role in the decision of whether to perform security services with federal employees or contractors. For example, it generally takes more time to hire and train enough federal employees than to acquire contractors. Additionally, the government could potentially be faced with having to take actions to reduce the number of government personnel hired if they are no longer needed. In contrast, if the need for the contract no longer existed, the Government could terminate the contract. (GAO-10-266R, *Warfighter Support*, p. 11)

For some agencies, flexibility and agility is paramount, and for others it is not. Each agency should carefully weigh these unique factors through business case analysis when making sourcing determinations.

In addition to utilizing business case analysis to understand the variety of factors at play when making sourcing decisions, the Government should make an effort to increase the effectiveness of its workforce, specifically its program managers. As noted in former Administrator for Federal Procurement Policy Dan Gordon's May 2010 testimony before the Subcommittee on Oversight and Government Management, it is critical that "Federal employees possess the appropriate training, experience, and expertise to understand the agency's requirements, formulate alternatives, [and] manage the work product." Management that has an intricate understanding of the needs of the agency and the capacity to make sound business decisions through effective analysis generally will benefit the federal procurement process. A well-trained and effective program manager that understands the necessary requirements will determine how a function should be sourced better than one that lacks these abilities.

Along these lines, as much as possible, acquisition professionals should be aligned and committed to programs during their performance life. The benefit of this alignment and commitment to programs may seem somewhat intangible, but it is vital to performance. A stable team develops a working dynamic that enhances program performance. Equally as important, the presence of professionals over the long-term assures the development of a program's institutional memory, allowing contract performance issues to be identified and addressed quickly on the basis of program precedent.

II. Controlling the Cost of Contracting

A. Improved Requirements Development

Essential to controlling the cost of contracting is the development of sound requirements that communicate clearly and effectively the needs of the agency. Improved requirements development enhances competition, which, in turn, will provide the best value to the Government. The SARA Panel stressed that,

Commercial organizations invest the time and resources necessary to understand and define their requirements. They use multidisciplinary teams to plan their procurements, conduct competitions for award, and monitor contract performance. They rely on well-defined requirements and competitive awards to reduce prices and to obtain innovative, high quality goods and services.

Procurements with clear requirements are far more likely to meet customer needs and be successful in execution. (SARA Panel, 2007, p. 87)

Similar to the practices in the commercial marketplace, the Government should endeavor to produce quality requirements for vendors in order to bolster competition and control costs.

There is a positive correlation between the quality of requirements development and the value of the service or good being procured. Clear, well-crafted requirements lead to robust vendor competition, high-quality proposals, low costs and high value to the Government. In order to achieve this level of effectiveness, the Coalition recommends implementing the SARA Panel's recommendation that agencies support requirements by establishing centers of expertise in requirements analysis and development. In addition, as the SARA Panel recommended, program managers and/or users should be required to sign off on complex requirements before an acquisition moves forward.

If the government wishes to control the cost of contracting, it needs to strengthen its requirements development by enhancing the applicable expertise available and focusing its efforts. The government has taken steps to improve requirements development. In particular, the Office of Federal Procurement Policy's "Myth-Busters" initiative to improve government-industry communications, particularly during the requirements development phase of an acquisition, has the potential for improving contracting and delivering greater value for government and the taxpayer.

B. Reducing Contract Duplication

The Coalition believes that the Federal Government has a significant opportunity to control costs associated with contracting by reducing unnecessary contract duplication. This opportunity is consistent with Congress' current objective to reduce program duplication across agencies in order to achieve greater efficiencies of operations. As highlighted in GAO's February 2012 report on *Opportunities to Reduce Duplication, Overlap and Fragmentation, Achieve Savings, and Reduce Revenue*, duplicative efforts and programs across Government lead to redundant inefficiencies. In the case of the federal acquisition system, these inefficiencies lead to increased Government and industry costs, costs that are ultimately borne by the taxpayer.

Contract duplication refers to the prevalence of contracts that offer the same or similar services and products across the Federal Government. Duplicative contracts increase bid and proposal costs and contract administrative costs for both Government and industry, costs that could be avoided through greater use of interagency contracts. As such, addressing the redundancies involved in establishing and managing multiple contracts for the same or similar services and products would provide Government and industry with significant reductions in costs.

In particular, duplication should be reduced through increased use of existing government-wide contract vehicles when there is an opportunity to realize cost savings. Government-wide multiple award contracts, such as the GSA Schedules program, provide a streamlined competitive ordering process that can save both the public and private sectors time and money associated with bid, proposal, and contract administration. The use of these pre-negotiated contracts allows the ordering activity to focus on requirements development rather than the administrative aspects associated with setting up an entirely new contract. Moreover, the Schedules enhance competitive contracting opportunities for small businesses. Indeed, with small business sales of over 30 percent, the Schedules program annually exceeds the government wide goal of 23 percent for small business contracting and represents the largest small business contracting program in government.

There are tools already available to the Government to reduce significantly contract duplication and the unnecessary costs associated with that duplication. A regulatory preference already exists for utilizing GSA Federal Supply Schedules in the Federal Acquisition Regulation (FAR 8.002). Additional guidance reminding contracting officers that the Federal Supply Schedules have priority over other commercial sources would help to reverse the current trend where agencies are developing their own contract vehicles for the same or similar services that are already offered under the GSA Schedules. Also, as part of the acquisition planning process, contracting officers should be required to document and explain why existing contract vehicles do not meet an agency's needs prior to establishing new contracts. This explanation should specifically make the case for why a new contract is the best procurement method to meet the Government's needs. We believe that both proposals are feasible within the current acquisition system and have the potential to result in huge cost savings for the Government.

III. Conclusion

The Coalition believes that thoughtful business case analysis that weighs each agency's unique mission requirements when sourcing decisions are made is crucial to better accounting for and analyzing the costs associated with the use of contractors versus federal employees. We also urge the Government to enhance its requirements development process to ensure increased competition and therefore lower costs. In short, we believe that these objectives can be achieved by:

1. Establishing a performance and financial business cases analysis framework.
2. Establishing program management certification requirements.
3. Setting clear Statements of Work with measurable outcomes.
4. Evaluating contract awards based on best value solutions that meet well-developed technical requirements.
5. Avoiding contract duplication by utilizing Federal Supply Schedules per FAR 8.002 and requiring contracting officers to document why existing contract vehicles do not meet an agency's needs prior to establishing new contracts.

Again, the Coalition thanks the Subcommittee for this opportunity to share our thoughts and to work to support the procurement community. We appreciate your continued commitment to enhancing the effectiveness of government contracting and look forward to continuing to partner with you to provide best value to the American taxpayer. Please feel free to contact us if you have any questions or concerns you wish to discuss.



**Statement of Colleen M. Kelley
National President
National Treasury Employees Union**

On

**“Contractors: How Much Are They Costing the
Government?”**

Submitted to

**Senate Committee on Homeland Security and Governmental
Affairs Subcommittee on Contracting Oversight**

March 29, 2012

1750 H Street, N.W. • Washington, D.C. 20006 • (202) 572-5500

Chairwoman McCaskill, Ranking Member Portman, and distinguished members of the Subcommittee, I would like to thank you for allowing me to provide comments on the costs of federal contracting. As President of the National Treasury Employees Union (NTEU), I have the honor of representing over 150,000 federal workers in 31 federal agencies and departments.

Madam Chairwoman, NTEU believes that in the current fiscal crisis, it is critical that the federal government look for ways to achieve cost savings wherever possible and to root out waste, fraud and abuse wherever they find it. One way in which NTEU believes that the federal government can best accomplish this is to reform the federal contracting process.

As you know, in recent years there has been an explosion in contract spending. This was primarily due to the previous administration's competitive sourcing agenda in which the jobs of federal employees were specifically targeted for public-private competition. As part of that effort, the rules governing these competitions were overhauled, quotas set for competed jobs, and grades given to agencies on their efforts in conducting competitions. The result of those efforts has been waste, fraud and widespread abuse in the contracting system and an over-reliance on federal contractors that has resulted in contractors performing functions that are clearly inherently governmental.

According to OMB, between 2000 and 2008, spending on Government contracts more than doubled, reaching over \$500 billion in 2008. Of greater concern was the amount of money spent on contracts awarded with no or inadequate competition during that period. According to OMB, total spending on contracts awarded without competition increased significantly from \$73 billion in FY 2000 to \$173 billion in FY 2008. Dollars obligated under contracts that were open to competition, but generated only one bid, also increased dramatically from \$14 billion in FY 2000 to \$ 67 billion in FY 2008. While there has been some fluctuation over the years, the percentage of contracts granted on a non-competitive basis has been in the range of 31 to 35 percent.

The explosion in contract spending has also resulted in a drastic increase in the size of the contract workforce, now estimated to be roughly five times the size of the civil service. With agencies so reliant on federal contractors, the in-house capacity of agencies to perform many critical functions has been eroded, jeopardizing their ability to accomplish their missions. It has also resulted in the outsourcing to contractors of functions that are inherently governmental or closely associated to inherently governmental functions.

One of the most egregious examples of the outsourcing of inherently governmental functions was the 2006 IRS private tax collection program. The program, under which private collection agencies were paid to collect taxes on a commission basis, was an unmitigated disaster. The program resulted in a net loss of almost \$5 million to the federal government and lead to taxpayer abuse. Further, at one juncture in the program, the IRS had to assign 65 of its own employees to oversee the work of just 75 private collection agency employees. Given the obvious failures of this undertaking, and in the face of strong opposition by NTEU and a broad range of consumer and public interest groups, Congress voted to cut off funding for the program. Then, in March 2009, after conducting a month-long, comprehensive review of the program, including the cost-effectiveness of the initiative, the IRS announced it was ending the program.

EFFORTS TO REFORM FEDERAL CONTRACTING

Madam Chairwoman, after taking office in 2009, President Obama quickly recognized that the federal contracting system was rife with waste, fraud and abuse and quickly took steps to reform the system. In 2009, the President directed agencies to save \$40 billion in contracting annually by the end of 2011 and apply fiscally responsible acquisition practices that better protect taxpayers from waste and cost overruns. The President's mandate has instilled a new sense of accountability in agencies, and the results are clear: after over a decade of dramatic contract growth that saw annual procurement budgets increase at an average rate of 12% per year between FYs 2000 and 2008, and by as much as 22 percent in a single year, the Administration has turned the tide and reduced contract spending.

OMB recently reported that federal agencies spent nearly \$80B less in FY 2010 than they would have spent had contract spending continued to grow at the same rate it had under the prior Administration. At that rate, contract spending would have reached a record \$615 billion. And in FY 2010, for the first time since 1997, overall contract spending declined from the previous year. In FY 2010, spending was \$535 billion versus \$550 billion in the prior year.

Agencies have achieved these savings through a combination of strategies including ending unnecessary or unaffordable contracts. They have also reduced their reliance on high-risk contracts, finding savings by competing contracts that, in the past, were awarded for higher prices on a sole-source or "no-bid" basis, as well as moving away from contracts where vendors are paid for the amount of time they spend working rather than for what they produce.

In addition, agencies have been directed to strengthen the acquisition workforce to help rebuild the capacity and capability that is needed to achieve and sustain better acquisition outcomes and improved government performance.

While NTEU believes good progress had been made in reforming the contracting process, we believe much more can be done. That is why we strongly support continuing the current moratorium on new A-76 competitions for federal work until the administration has fully implemented its plans to reform the contracting process. The President's budget proposes extending the moratorium through FY '13 and we would ask congress to support the President's request.

We also ask for your support for S.991, the "Correction of Longstanding Errors in Agencies Unsustainable Procurements (CLEAN UP) Act of 2011." This critical legislation, introduced by Sen. Barbara Mikulski (D-MD), would reduce waste, fraud, and abuse in government contracting by making substantive and long overdue reforms to the competitive sourcing process. These include ensuring that inherently governmental work or work closely related to inherently governmental work is actually performed by federal employees and by directing agencies to identify where such work is instead being performed by contractors and to bring that work back in-house over several years. The bill would also encourage agencies to give federal employees opportunities to perform new work and outsourced work that is being poorly performed and require agencies to establish contractor inventories to help determine which contracts include inherently governmental work, which contracts were awarded without competition, and which contracts are being poorly performed.

This legislation would also bring much needed reform to the discredited OMB Circular A-76 competitive sourcing process by ensuring that all costs of conducting competitions are considered and by imposing a temporary suspension on the use of A-76 studies until the OMB Director and the Inspectors General of the five largest agencies determine that all of the reforms required by this measure have been substantially implemented.

NTEU strongly believes the "CLEAN UP Act of 2011" will help reform and clean up the broken competitive sourcing process and ensure that federal sourcing is both fairer to federal employees and more accountable to taxpayers and we would ask for your support for this critical legislation.

CAPPING CONTRACTOR SALARIES

Madam Chairwoman, in addition to obtaining savings by reforming federal contracting and focusing on wasteful contract spending, NTEU believes further savings can be achieved by capping contractor salary reimbursement rates. Currently government contractors can charge taxpayers almost \$700,000 for the salaries of their top five employees, based on an executive compensation benchmark last amended in 1998. Employees of government contractors outside of the top five can and do earn taxpayer-funded amounts in excess of the current benchmark. Furthermore, according to OMB, unless Congress acts to limit executive compensation, they will be forced to raise the compensation level to nearly \$750,000 in the near future, in line with the congressional mandate to maintain parity with the private sector.

NTEU strongly believes that at a time when our economy is struggling, millions of Americans are unemployed, and our national debt and deficit continue to grow, taxpayers should not fund government reimbursements for private contractor salaries that are more than three times higher than the pay earned by Cabinet Secretaries.

Recently, Congress approved the National Defense Authorization Act of 2011 which extended the current salary reimbursement cap to all defense contractor employees, not just the top five employees. While the cap was not lowered and only would apply to defense contractors, NTEU believes it is a positive first step in reforming contractor pay. In the Second Session of the 112th Congress, NTEU will advocate instituting a cap on salary reimbursement for all contractor employees government wide, and lowering that cap to \$200,000. Recent studies have shown that lowering the cap to \$200,000 for all contractor employees would save \$50 billion over ten years.

We would note that Rep. Paul Tonko (D-NY) has introduced legislation in the House H.R. 2980, the "Stop Excessive Payments to Government Contractors Act of 2011," that would institute a \$200,000 cap on salary reimbursement for all contract employees government wide, while in the Senate, Sen. Boxer (D-CA) and Sen. Grassley (R-IA) recently introduced bipartisan legislation, S.2198, the "Commonsense Contractor Compensation Act of 2012" which would cap salary reimbursements at \$400,000, equal to what the President earns. S.2198 was referred to the Committee on Homeland Security and Government Affairs and NTEU strongly urges the committee to consider this critical legislation.

CONCLUSION

Madam Chairwoman, thank you, again, for the opportunity to submit our views on federal contracting. NTEU believes that by continuing to require federal agencies to cut wasteful contract spending, reduce overreliance on contractors, and improve oversight and accountability, the federal government can better ensure that agencies are able to accomplish their mission and provide taxpayers with the best value.



Testimony of POGO's Scott Amcy, General Counsel
before the Senate Committee on Homeland Security
and Governmental Affairs, Subcommittee on
Contracting Oversight

I want to thank Chairman McCaskill, Ranking Member Portman, and the Subcommittee for asking the Project On Government Oversight (POGO)¹ to submit written testimony about the important, but often ignored, issue of service contracting costs. Although there are many initiatives in place to cut federal agency spending and reduce the costs associated with the federal workforce, the cost of contractor services has escaped scrutiny. Such avoidance is extremely disturbing because the government annually spends more taxpayer dollars on contractor services than it spends on goods, over \$320 billion and \$210 billion in FY 2011, respectively.² To put that level of spending in perspective, total contract spending was \$205 billion in FY 2000, of which services accounted for \$128 billion of the total.³ This hearing, titled "Contractors: How Much Are They Costing the Government?" will cast a light on one of the most, if not the most, important topics for the government today.

The Subcommittee will have trouble reaching a definitive answer about whether the hundreds of billions of dollars spent on services are being spent wisely. The reason is simple: except in very limited circumstances, the federal government does not have accurate data about service contracts and the contractors performing those services. Moreover, the government does not have a government-wide cost modeling system that compares the life-cycle cost of in-house and contractor personnel. As a result, the government often turns to service contractors under the misguided assumption that market economies enable contractors to be more cost efficient than the government.

As a matter of introduction, I will strongly encourage this Subcommittee to avoid that trap. A POGO study empirically confirmed that, in essence, there are three labor markets (the private sector, the public sector, and the contractor sector) and that salaries, compensation, overhead, and profit differ among the three. POGO's findings have been confirmed by isolated cases, which we highlight in our report, *Bad Business: Billions of Taxpayer Dollars Wasted on Hiring Contractors*.⁴ POGO's report convincingly dispels the myth that private sector market economies

¹ Founded in 1981, POGO is a nonpartisan independent watchdog that champions good government reforms. POGO's investigations into corruption, misconduct, and conflicts of interest achieve a more effective, accountable, open, and ethical federal government. For more information about POGO, please visit www.pogo.org.

² USAspending.gov.

³ USAspending.gov.

⁴ See Appendix A for a copy of the report, excluding its appendices. POGO Report, *Bad Business: Billions of Taxpayer Dollars Wasted on Hiring Contractors*, September 13, 2011. <http://www.pogo.org/pogo-files/reports/contract-oversight/bad-business/co-gp-20110913.html> (hereinafter POGO *Bad Business* report)

necessarily allow contractors to perform government services at a cost savings to the government. The reality is that there are no generalizations that withstand scrutiny as to which market sector provides the optimal cost efficiency for any service area, no less all service areas. As a result, the federal government must, on a case-by-case basis, analyze whether it is more appropriate and cost efficient to employ government or contractor employees.

The purpose of this hearing is to examine whether and how cost information is used by government agencies to make decisions about whether work should be performed by federal employees or contractors. Throughout this testimony, I will expand on the lack of personnel and cost data and what needs to be done to improve the system. POGO truly believes that if simple fixes are made, the government will save billions of dollars without expanding or reducing the size of the total federal workforce, which includes government and contractor employees.

Today, witnesses will likely testify about two comparative cost models that are currently used to determine whether it is less costly to have private contractors perform government services, OMB Circular A-76 and the Defense Department's Directive-Type Memorandum (DTM) 09-007, "Estimating and Comparing the Full Costs of Civilian and Military Manpower and Contract Support."⁵ Those models are utilized, however, in only a small percentage of cases where the government contracts for services. In a vast majority of those instances, the models demonstrated that contractors were unable to accord any savings; indeed, were the government to transfer government services to contractors, the government would incur excessive costs. But even these models have been the subject of criticism for their failure to provide the government with an effective cost modeling system that accurately reflects all the relevant cost factors.⁶ Because it does not approach the state-of-the-art systems employed by sophisticated business enterprises, the government limits its ability to make competent human capital planning decisions.

I hope that this written testimony provides the Subcommittee with useful information about the government's current inability to evaluate service contracting costs. More importantly, I hope this testimony will make clear what is missing in the current system and how to begin rectifying systematic flaws that cost taxpayers billions of dollars each year. So much is unknown about the true size and cost of both the government and contractor workforce. Congress must pass legislation that will create an effective government-wide cost modeling system and overhaul

⁵ Federal law requires that the "Secretary of Defense shall use the least costly form of personnel consistent with military requirements and other needs of the Department," which includes considering converting work from military, civilian, or private contract. 10 U.S.C. 129a. <http://uscode.house.gov/uscode-cgi/fastweb.exe?getdoc+uscview+09t12+75+1++%28%29%20%20AND%20%28%2810%29%20ADJ%20USC%29%43ACITE%20AND%20%28USC%20w%2F10%20%28129a%29%29%3ACITE>

⁶ Congressional Research Service, *Defense Outsourcing: The OMB Circular A-76 Policy* (RL30392), June 30, 2005, pp. 4-6. <http://www.fas.org/spp/crs/natsec/RL30392.pdf> (Downloaded April 20, 2011); In addition, a Center for Strategic and International Studies (CSIS) report highlights the inherent problems with government life-cycle cost comparison models and appropriate overhead rates, and proposed a cost-estimating methodology. Although the report discusses a comprehensive cost estimation methodology that should be used to create a baseline for making more accurate cost comparisons, it is silent on all the costs the government incurs, above and beyond fixed billing rates, associated with the award, administration, and oversight of service contracts. Center for Strategic and International Studies, *DoD Workforce Cost Realism Assessment*, May 2011, pp. 11-19. http://csis.org/files/publication/110517_Berteau_DoDWorkforceCost_Web.pdf (Downloaded May 18, 2011) (hereinafter DoD Workforce Cost Realism Assessment)

service contract inventories.⁷ Such legislation will enable decision makers to identify costly service contracts and provide agencies with the tools necessary to avoid transferring government services to contractors at unjustifiable costs.

Service Contracting Myths

POGO has watched federal contract award dollars dramatically increase from just over \$200 billion in FY 2000 to over \$530 billion in FY 2011.⁸ At the same time, service contract dollars have also been escalating at a rapid pace. There is no doubt that the increase in contract spending is the direct result of 9/11, Hurricanes Katrina, Rita, and Wilma, and the wars in Iraq and Afghanistan. However, the problem is more long-standing, and is the direct result of multiple administrations moving functions from the public to the private sector under the guise of cost savings.

Both political parties have taken issue with the proper size of the federal civilian workforce and the proper balance between government employees and contractor employees.⁹ Initiatives to make the government run like the private sector and shrink the size of the federal government became very popular in the 1980s and 1990s. Even today, there are calls in Congress to reduce the size of government and freeze federal employee salaries.¹⁰

The first myth of service contracting involves the notion that when the federal government outsources work to contractors, contractor employees are not part of “big government,” although many are retired federal employees, are paid with taxpayer dollars, work inside government offices, and/or perform government missions. Because they are generally not seen as part of the total government workforce, they are spared the wrath of budget hawks calling for personnel reductions and cuts in benefits. The number of contractor employees in the federal workforce is in excess of 7 million, nearly four times the size of the federal employee workforce (which is over 2 million).¹¹ The actual number of service contractors is, at best, an estimate,¹² although

⁷ GAO found differing methodologies among the services and data was not complete. Government Accountability Office, *Defense Acquisitions: Observations on the Department of Defense Service Contract Inventories for Fiscal Year 2008* (GAO-4 10-350R), January 29, 2010, pp. 1-5. <http://www.gao.gov/assets/100/96539.pdf> (Downloaded March 27, 2012)

⁸ According to data compiled by POGO from the Federal Procurement Data System – Next Generation and USAspending.gov for fiscal years 2000 and 2011. <http://www.usaspending.gov/>

⁹ Ed O’Keefe, “Eye Opener: Homeland Security has more contractors than feds,” *The Washington Post*, February 24, 2010. http://voices.washingtonpost.com/federal-eye/2010/02/eye_opener_homeland_security_h.html (Downloaded September 27, 2010)

¹⁰ For example, the House Budget Committee is seeking to “[b]oost private-sector employment by slowing the growth of the public sector, achieving a 10 percent reduction over the next three years in the federal workforce through attrition, coupled with a pay freeze until 2015 and reforms to government workers’ fringe benefits. House Budget Committee, *The Path to Prosperity: A Blueprint for American Renewal*, March 20, 2012, p. 32. <http://budget.house.gov/UploadedFiles/Pathtoprosperity2013.pdf> (Downloaded March 26, 2012)

¹¹ U.S. Office of Personnel Management, Federal Employment Statistics, “Historical Federal Workforce Tables: Executive Branch Civilian Employment Since 1940.” <http://www.opm.gov/feddata/HistoricalTables/ExecutiveBranchSince1940.asp> (Downloaded March 27, 2012)

¹² When the contractor workforce is combined with civilians, military personnel, U.S. Postal Service employees, and grantees, the size of the blended federal workforce was estimated at 14.6 million people in 2005. Paul C. Light, *The New True Size of Government*, New York University, August 2006, p. 8. http://wagner.nyu.edu/performance/files/True_Size.pdf (Downloaded March 27, 2012); Paul C. Light, “The real

there are efforts underway to improve those estimates.¹³ Recent legislation designed to create inventories of service contracts and identify the precise number of contractor employees has failed to be implemented in a manner that would achieve its intent.¹⁴ As a result, no one has a better understanding of the size of the contractor workforce today than we did before the legislation was adopted. Congress should amend the laws creating service contract inventories to mandate a full and comprehensive account of precisely how large a contractor workforce each federal agency maintains. Further, it must include all tiers of subcontractors, broken out by the types of services they provide, the billing rates the government must pay, and the costs it must incur to maintain that workforce.

The second myth is that the private sector is in all ways more cost efficient, more innovative, and more flexible than the government. This supposition might be true in certain circumstances, but policymakers have been misled about promised across-the-board savings resulting from hiring service contractors. In fact, long-term service contracts (which began as short-term quick fixes) remove government flexibility and result in cost inefficiencies rather than savings over the lifetime of the contract.¹⁵ Consequently, recent GAO reports sought to discuss areas where agencies could achieve better cost savings, but not a single report attempted to identify the government's over-bloated reliance upon service contracts as an area for cost savings.¹⁶ The excessive costs associated with service contracts such as those documented in POGO's *Bad Business* report do not appear on the radar screen of Congress' primary auditing and investigative organization. This institutional failure reflects the power of the aforementioned myth. Congress must bust this myth and bring focus and attention to maybe the most critical source of government waste and administrative inefficiencies.

crisis in government," *The Washington Post*, January 12, 2010, p. A17. <http://www.washingtonpost.com/wp-dyn/content/article/2010/01/11/AR2010011103255.html> (Downloaded March 29, 2011); Hearing Statement of Paul C. Light, New York University/The Brookings Institution, before the U.S. Senate Subcommittee on Oversight of Government Management, the Federal Workforce and the District of Columbia, "An Update on the Bush Administration's Competitive Sourcing Initiative," July 24, 2003.

<http://wagner.nyu.edu/faculty/publications/files/lightCompetitiveSourcing.pdf> (Downloaded September 27, 2010); Government Accountability Office, *Defense Acquisitions: Observations on the Department of Defense Service Contract Inventories for Fiscal Year 2008* (GAO-10-350R), January 29, 2010, pp. 2-4.

<http://www.gao.gov/new.items/d10350r.pdf> (Downloaded March 26, 2012)

¹³ Government Accountability Office, *OMB Service Contracts Inventory Guidance and Implementation* (GAO-11-538R), May 27, 2011, p. 4. <http://www.gao.gov/new.items/d11538r.pdf> (Downloaded March 26, 2012)

¹⁴ National Defense Authorization Act for Fiscal Year 2008 (Pub. Law 110-181), § 807(a), January 28, 2008; Consolidated Appropriations Act for FY 2010 (Pub. Law 111-117), § 743, December 16, 2009.

¹⁵ For instance, the Army logistics support LOGCAP IV contract award to three different contractors has one base year and nine option years. U.S. Army Sustainment Command Public Affairs, "ASC selects LOGCAP IV contractors," June 28, 2007. <http://www.army.mil/article/3836/asc-selects-logcap-iv-contractors/> (Downloaded May 31, 2011)

¹⁶ Government Accountability Office, *2012 Annual Report: Opportunities to Reduce Duplication, Overlap and Fragmentation, Achieve Savings, and Enhance Revenue* (GAO-12-342SP), February 2012.

<http://www.gao.gov/assets/590/588818.pdf> (Downloaded March 26, 2012); Statement of Cathleen A. Berrick, Managing Director Homeland Security and Justice Issues Government Accountability Office, "Department of Homeland Security: Actions Needed to Reduce Overlap and Potential Unnecessary Duplication, Achieve Cost Savings, and Strengthen Mission Functions" (GAO-12-464T), March 8, 2012. <http://www.gao.gov/assets/590/589125.pdf> (Downloaded March 27, 2012)

An attempt by a private sector think tank to study the issue of comparative costs was flawed, as the report compared public and private sector salary or compensation and projected their findings onto the costs of transferring services to the contractor sector without a shred of evidence that such projections are valid. Indeed, such projections are both theoretically and factually flawed. Moreover, POGO is aware of a GAO study that is underway that is reviewing public and private sector pay comparability. However, it is our understanding that GAO will not address whether or how such comparisons inform the cost effectiveness of contracting for government services.¹⁷

Additionally, last year, the House Subcommittee on Federal Workforce, U.S. Postal Service, and Labor Policy held a hearing titled “Are Federal Workers Underpaid?”¹⁸ The hearing discussed the findings of a study funded by the Heritage Foundation comparing public and private sector pay.¹⁹ The Heritage study suffered from a number of methodological problems that call into question the validity of its findings and recommendations, including its recommendation that the government hire more contractors.²⁰ Despite Heritage’s claim that federal employees are compensated at higher rates than private sector employees, Heritage did not empirically determine whether or not those savings would, in fact, be realized were the government to transfer its services to the contractor sector.

A recent report by the Congressional Budget Office (CBO), “Comparing the Compensation of Federal and Private-Sector Employees,”²¹ also compared public and private sector pay. CBO found that, overall, “federal workers tend to be older, more educated, and more concentrated in professional occupations than private-sector workers,” and, on average, are paid 16 percent more than similar employees in the private sector. However, that trend occurs mostly in the lower education levels. Public servants with advanced degrees were paid 18 percent less in total compensation than the private sector.²² POGO found a very similar disparity in our *Bad Business* report. However, our report also found that contractors cost, on average, 83 percent more than federal employees and over 100 percent more than their peers in the private sector for 35 comparable occupations.

¹⁷ POGO staffers have met on two occasions with GAO personnel who are conducting a congressionally requested study of public and private sector pay. “Comparability” of federal employee compensation with private sector compensation is legislatively mandated. Office of Personnel Management, “Federal Employees Pay Comparability Act of 1990”. <http://www.opm.gov/fcddata/html/paystructure/2004/fepcal990.asp> (Downloaded March 26, 2012)

¹⁸ Hearing of House Oversight and Government Reform Subcommittee on Federal Workforce, U.S. Postal Service, and Labor Policy, “Are Federal Workers Underpaid?”, March 9, 2011. <http://oversight.house.gov/hearing/are-federal-workers-underpaid/>

¹⁹ James Sherk, *A Report of the Heritage Center for Data Analysis: Inflated Federal Pay: How Americans Are Overtaxed to Overpay the Civil Service* (Report # 10-05), July 7, 2010, p. 1.

http://thf_media.s3.amazonaws.com/2010/pdf/CDA10-05.pdf (Downloaded September 27, 2010) (hereinafter Heritage Study). The Heritage Foundation “is a research and educational institution—a think tank—whose mission is to formulate and promote conservative public policies based on the principles of free enterprise, limited government, individual freedom, traditional American values, and a strong national defense.” <http://www.heritage.org/About>

²⁰ Heritage Study, p. 16.

²¹ Congressional Budget Office, *Comparing the Compensation of Federal and Private-Sector Employees*, January 2012. <http://www.cbo.gov/sites/default/files/cbofiles/attachments/01-30-FedPay.pdf> (Downloaded March 26, 2012) (hereinafter CBO Pay Study)

²² CBO Pay Study, p. vii-ix.

We should also consider the data that has been analyzed by the Office of Personnel Management (OPM). OPM data compares various occupations, including those set and adjusted in the General Schedule (GS) rates of pay, documenting that compensation for many white collar jobs is lower in the federal government than in the private sector. One example provided by OPM clearly shows that federal pay for a government engineer is lower than private sector pay.²³

Studies comparing public and private sector pay are only useful for limited purposes, but they will continue to drive policy decisions until Congress mandates that cost comparisons include the aforementioned third market: contractor costs. This includes salary, full fringe benefits, all overhead to house federal and contractor employees, accurate data on contractor personnel, and fully loaded costs. Without taking the full universe of costs into account, the government risks wasting billions of dollars and jeopardizing the quality of government services.²⁴

POGO's Study Proves a More Complete Picture is Needed

For the first time, POGO's study introduced into discussions concerning public-private compensation the issue of costs associated with transferring government jobs to contractors. POGO compared total annual compensation for federal and private sector employees with federal contractor billing rates in order to determine whether the current costs of federal service contracting serve the public interest. POGO found that the government pays service contractors at rates exceeding the cost of employing federal employees to perform comparable functions and far exceeding (more than double) the cost of employing private sector workers.

POGO's study analyzed the total compensation paid to federal and private sector employees, and annual billing rates for contractor employees across 35 occupational classifications covering over 550 service activities.²⁵ (See Table 1) Our findings were shocking—POGO determined the government pays billions more to hire contractors than it would spend to hire federal employees to perform the same service. Specifically, POGO's study shows that the federal government approves service contract billing rates—deemed fair and reasonable—that pay contractors **1.83 times** more than the government pays federal employees in total compensation, and more than **2 times** the total compensation paid in the private sector for comparable services.

We also found:

- Federal government employees were less expensive than contractors in **33 of the 35** occupational classifications POGO reviewed.
- In one instance, contractor billing rates were **nearly 5 times** more than the full compensation paid to federal employees performing comparable services.

²³ Office of Personnel Management, "Use of Bureau of Labor Statistics Data for Setting General Schedule Pay." <http://www.opm.gov/oca/pay/html/UsingBLSData.asp> (Downloaded March 27, 2012)

²⁴ Howard Risher, "Analysis: Politics of federal pay obscures the facts," *Government Executive*, May 25, 2011. http://www.govexec.com/story_page.cfm?articleid=47870&oref=todaysnews (Downloaded May 26, 2011)

²⁵ The complete methodology is included in POGO's *Bad Business* report. <http://www.pogo.org/pogo-files/reports/contract-oversight/bad-business/co-gp-20110913-1.html>

- Private sector compensation was lower than contractor billing rates in **all 35** occupational classifications we reviewed.
- Most importantly, the federal government has failed to determine how much money it saves or wastes by outsourcing or insourcing/retaining services, and has no methodology for doing so.

POGO's investigation highlights two basic facts about outsourcing government work to contractors. First, comparing federal to private sector compensation reveals nothing about what it actually costs the government to outsource services. Second, the federal government is not doing a good job of obtaining genuine market prices²⁶ and is therefore not realizing the savings often promised in connection with outsourcing services. The argument for outsourcing services states that free market competition will result in efficiencies and save taxpayer dollars, but our study showed that using contractors to perform services may actually waste taxpayers dollars.

POGO's report has not escaped criticism.²⁷ We acknowledge that we were very limited in conducting our survey based on the lack of contracting cost data, comparable occupational data, and government overhead rates for work performed by government and contractor employees. However, since the release of our report, our findings have been validated by several federal agencies. Additionally, POGO has submitted numerous Freedom Of information Act requests for additional data about service contract rates and labor hours, the contractor workforce, and the implementation of Circular A-76 or other cost comparison procedures. (Appendix B)

Because the POGO study is based upon data reflecting only a subset of government contracts, we do not contend that our findings can, or should, be projected across the entire federal government. That is why we strongly advocate that Congress direct GAO to conduct a similar analysis of government-wide contracting that would provide a valid basis for estimating precisely how many billions of dollars the government is wasting each year by relying so heavily upon service contractors.

Before directing GAO conduct such a study, however, it would be imperative for Congress to legislate critical changes in government data systems. Failures in government procurement practices and employment data systems limit the government's and the public's ability to assess costs. Failures include the lack of standards for producing cost estimates; the lack of data related to negotiated service contract billing rates; the lack of data about the actual number of contractor

²⁶ Steve Kelman, "How agencies can cut contracting costs," *Federal Computer Week*, August 9, 2011. <http://fcw.com/articles/2011/08/08/comment-kelman-save-money-for-government.aspx> (Downloaded August 11, 2011); Steve Kelman, "GSA schedules: Are agencies paying too much?," *Federal Computer Week*, July 29, 2010. <http://fcw.com/Blogs/Lectern/2010/07/Steve-Kelman-GSA-schedules-pricing-July-29.aspx> (Downloaded June 23, 2011); Steve Kelman, "Are agencies paying too much through the GSA schedule? Readers respond," *Federal Computer Week*, August 3, 2010. <http://fcw.com/Blogs/Lectern/2010/08/Steve-Kelman-GSA-schedule-pricing-reaction.aspx> (Downloaded June 23, 2011); One recent story indicated that cost is emerging as major factor in federal contracting. Sarah Chacko, "Feds driving harder bargain at procurement table," *Federal Times*, July 25, 2011, p. 1. <http://www.federaltimes.com/article/20110724/ACQUISITION03/107240302/1009/ACQUISITION> (Downloaded July 26, 2011)

²⁷ Scott Amey, "Outsourcing Savings - Myth BUSTED!," *POGO Blog*, September 16, 2011. <http://pogoblog.typepad.com/pogo/2011/09/outsourcing-savingsmyth-busted.html>

employees holding a specific occupational position under any given contract; and the lack of a universal job classification system.

The expanding “shadow government” wastes billions of dollars annually. The focus on comparing federal and private sector salaries is a distraction from determining what the government actually pays for services. Instead, the focus should be on the full costs of paying service contractors, which accounts for approximately one-quarter of all discretionary spending.²⁸

Agencies’ Service Contracts are Costly²⁹

Instead of a comprehensive cost comparison that analyzes the life-cycle costs of hiring or retaining federal employees as compared to contractors, government comparisons have been limited to isolated cases, which POGO discussed in its *Bad Business* report. Since that report was released, a few additional cost comparison audits have been made public.

For example, in 2011, the Department of Defense (DoD) reported that in fiscal year 2010 it had established (insourced) nearly 17,000 new government civilian positions to perform services that had been performed by contractors.³⁰ Of the reasons cited by the Pentagon for insourcing those services, cost savings was cited **50 percent** of the time.³¹ However, DoD did not report the number of contractor employees whose functions were insourced because, as was later noted by the GAO, the Department does not have access to this data.³² “[DoD] contracts for services to be performed, so the number of employees used to perform these services is not a decision of the department but is at the discretion of the contractor,” the GAO reported.³³ The GAO warns that more comprehensive and reliable contracting data is needed to ensure that DoD officials are able to manage and oversee insourcing and meet Department workforce goals.³⁴

Despite growing evidence of the excessive costs associated with service contracts, DoD has proposed cuts to its civilian workforce. According to media reports, the Army and Air Force are

²⁸ In 2010, service contracts accounted for \$320 billion of the nearly \$1.26 trillion discretionary spending total. According to data compiled by POGO from the Federal Procurement Data System – Next Generation (FPDS-NG), the federal government awarded \$320 billion in service contracts in fiscal year 2010. https://www.fpds.gov/fpdsng_cms/; Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2012*, p. 200. <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/budget.pdf> (Downloaded August 18, 2011)

²⁹ Additional examples of cost comparisons are found in POGO’s *Bad Business* report, some of which show that in-house workers are more cost efficient while others show that service contractors are cheaper. POGO *Bad Business* report. <http://www.pogo.org/pogo-files/reports/contract-oversight/bad-business/co-gp-20110913.html#Government%20Cost%20Studies>

³⁰ Department of Defense, Office of the Under Secretary of Defense for Personnel and Readiness, “Report to the Congressional Defense Committees on the Department of Defense’s FY 2010 In-sourcing Actions,” September 2011. <http://www.pogo.org/resources/contract-oversight/co-gp-20110913.html> (Downloaded March 26, 2012)

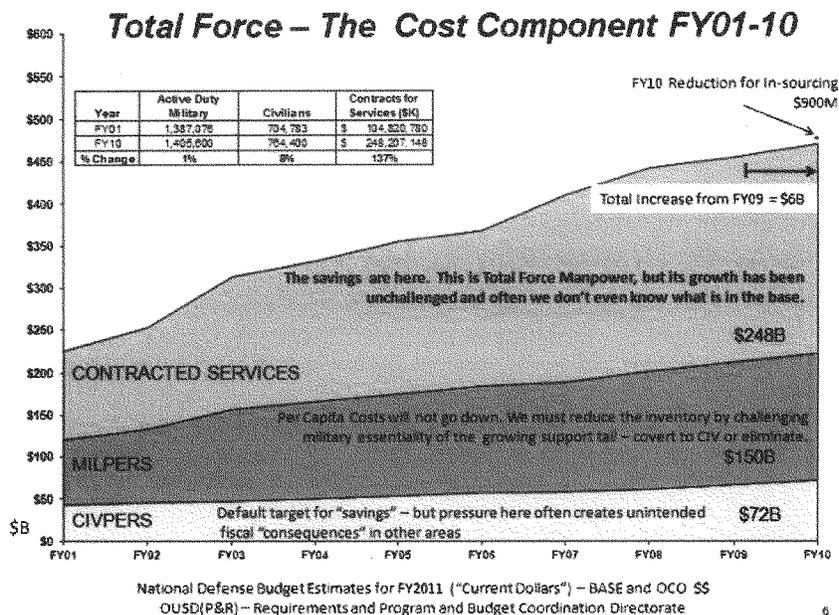
³¹ *Id.* at 5.

³² Government Accountability Office, *DOD Needs to Better Oversee In-sourcing Data and Align In-sourcing Efforts with Strategic Workforce Plans*, (GAO-12-319), February 2012. <http://www.gao.gov/assets/590/588425.pdf> (Downloaded March 26, 2012)

³³ *Id.*, at 14.

³⁴ *Id.*, at 1.

cutting thousands of civilian jobs.³⁵ Internal DoD documents, however, reveal that the civilian workforce is less costly when compared to military and contractor personnel. As the following chart indicates, civilian personnel cost DoD \$72 billion in FY 2010 as compared to \$150 billion for military personnel and nearly \$250 billion for contractors.³⁶



³⁵ Amber Corrin, "Army to hit civilian workforce with nearly 9,000 cuts—Impending budget cuts drive workforce reduction," *Defense Systems*, December 12, 2011. <http://defensesystems.com/articles/2011/12/09/army-cutting-8700-jobs.aspx> (Downloaded March 27, 2012); Markeshia Ricks, "Air Force to shed 13,500 civilian jobs," *Federal Times*, November 5, 2011. <http://www.federaltimes.com/article/20111105/DEPARTMENTS01/111050301/> (Downloaded March 27, 2012)

³⁶ Department of Defense, American Society of Military Comptrollers, "Service Support Contractors One of the FY 2012 Budget Efficiencies, October, 2011, p. 6. <http://www.google.com/url?sa=t&rcrt=j&q=&esrc=s&source=web&cd=1&ved=0CCYQFjAA&url=http%3A%2F%2Fwww.asmconline.org%2Fwp-content%2Fuploads%2F2011%2F10%2FASMCBreakfastServiceSupportContractors.pptx&ei=aLxTF6mSB8Ws0AGTnO3kAQ&usq=AFQjCNEh0nL-p93KKWbfnJPC2GT9bs79HQ> (Downloaded March 27, 2012)

In another example, the Securities and Exchange Commission (SEC) has awarded millions of dollars to federal contractor Booz Allen Hamilton for management support services.³⁷ According to *Reuters*, some lawmakers and SEC insiders are questioning the fiscal wisdom of the SEC's decision. Booz Allen consultants are costing the SEC anywhere from \$100 an hour to over \$300 an hour and are being paid an average of \$140 per hour as compared to \$93 per hour for SEC staff.³⁸ That's a differential of over 50 percent, which over a year is a cost premium of nearly \$100,000 per employee.³⁹

Congressional Involvement is Needed

Not many people can grasp the big picture—fully understanding how the total workforce has dramatically increased with the increased hiring of contractors; how service contracts operate; and how limitations have reduced flexibility in government hiring, all of which have resulted in increased government spending. Accordingly, there have been many missed opportunities to realize savings that would result from cost analyses matching specific federal occupations to comparable contractor occupations. Government reports or policies are published each year promoting competition,⁴⁰ cost realism,⁴¹ and partnering with cost-conscious contractors.⁴² Unfortunately, those reports or policies fail to include a comprehensive cost comparison as proposed by POGO prior the awarding renewal, or extension of federal service contracts.

Oversight agencies like the GAO occasionally examine the cost aspects of service contracts, but largely squander the opportunity to conduct meaningful comparative cost analyses of service contracts. For instance, the GAO now publishes an annual report providing examples where federal programs may be able to achieve greater efficiencies or become more effective in providing services by eliminating duplication, overlap, and fragmentation.⁴³ The most recent report identified 51 such examples, but only three directly address service contract costs.⁴⁴ Furthermore, the report only recommended ways to streamline, reevaluate or renegotiate these

³⁷ Sarah N. Lynch, "Critics question cost as consultants nip and tuck SEC," *Reuters*, March 1, 2012. <http://www.reuters.com/article/2012/03/01/sec-consultants-idUSL2E8E12Y120120301> (Downloaded March 27, 2012); Booz Allen Hamilton, Inc. received \$1.6 billion in FY 2010. [USAspending.gov](http://www.usaspending.gov). http://www.usaspending.gov/explore?&tab=By+Prime+Awardee&overridecook=yes&&carryfilters=on&fromfiscal=yes&contracts=Y&fiscal_year=2010&val=&contractorid=14806

³⁸ Sarah N. Lynch, "Critics question cost as consultants nip and tuck SEC," *Reuters*, March 1, 2012. <http://www.reuters.com/article/2012/03/01/sec-consultants-idUSL2E8E12Y120120301> (Downloaded March 27, 2012)

³⁹ To calculate the cost premium, POGO multiplied the hourly rates by 2080.

⁴⁰ Government Accountability Office, *Opportunities to Reduce Potential Duplication in Government Programs, Save Tax Dollars, and Enhance Revenue* (GAO-11-318SP), March 2011, p. 211. <http://www.gao.gov/new.items/d11318sp.pdf> (Downloaded March 27, 2012)

⁴¹ Defense Contract Audit Agency, "Master Document – Audit Program," Version No. 1.6, updated January 2012. http://www.dcaa.mil/sap/27010_AP_NA.pdf (Downloaded March 27, 2012)

⁴² Sarah Chacko, "DoD looking for 'cost-conscious' contractors, Assad says," *Federal Times*, March 23, 2012. <http://www.federaltimes.com/article/20120323/ACQUISITION03/203230301/1001> (Downloaded March 27, 2012)

⁴³ Government Accountability Office, "Improving Efficiency & Effectiveness: GAO's body of work on duplication, overlap, and fragmentation across the federal government." <http://www.gao.gov/duplication> (Downloaded March 27, 2012)

⁴⁴ Government Accountability Office, *2012 Annual Report: Opportunities to Reduce Duplication, Overlap and Fragmentation, Achieve Savings, and Enhance Revenue* (GAO-12-342SP), February 2012. <http://www.gao.gov/assets/590/588818.pdf> (Downloaded March 26, 2012)

contracts in order to save money. It did not conduct a comprehensive cost analysis in order to answer the most basic of procurement questions: whether contractors cost less than government employees.

Senators Joseph Lieberman (I-CT) and Susan Collins (R-ME) have examined service contracts, but that has not resulted in government-wide policy change. On February 23, 2010, Senators Lieberman and Collins sent a letter to Department of Homeland Security (DHS) Secretary Janet Napolitano expressing concerns about the number of DHS contractors, the costs, and whether contractors were performing inherently governmental functions.⁴⁵ Specially, the letter stated:

We also note that DHS's FY 2011 budget request reflects several instances of **cost savings** resulting from the **conversion of contractor positions to federal employees**. While the fundamental question in deciding whether a federal employee should perform a task, or whether the task may appropriately be assigned to a contractor, should not simply be which option is cheapest but rather whether or not the government's interests are best served by having the work performed by federal employees, **nonetheless it is notable that the shift to a more appropriate employee-to-contractor ratio may well also save the Department and the taxpayers money.** (Emphasis added)

On October 14, 2011, the Senators sent a letter to the Joint Select Committee on Deficit Reduction, proposing many cost savings reforms.⁴⁶ The letter included the following proposal:

As with decisions about the number of federal employees, we believe that the best way to achieve desired cost savings in contracting is through the statutory limits on spending that were put in place under the Budget Control Act. Such an approach to reducing spending will ensure, for example, that **any reductions in the number of federal employees will not merely be offset by increases in the number of contractor employees, who may, depending on the services procured, be more expensive than federal employees.** However, control of contractor costs, as well as federal employee costs, must be a key component of deficit reduction. We therefore recommend that the Joint Committee consider requiring that agencies **reduce their reliance on management support services contracts by 15 percent in Fiscal Year 20 12 (as OMB has proposed), for a savings of \$6 billion.** (Emphasis added)

Regrettably, Congress has not meaningfully helped federal agencies save money with regard to service contracts. Congress has all too frequently legislated without having the empirical data needed to make informed decisions about whether it would be more cost effective to increase the

⁴⁵ Letter from Senators Lieberman and Collins to Secretary of the Department of Homeland Security Janet Napolitano, February 23, 2010. <http://www.hsgac.senate.gov/media/minority-media/senators-lieberman-collins-astounded-dhs-contract-workers-exceed-number-of-civilian-employees>

⁴⁶ Letter from Senators Lieberman and Collins to Secretary of the Joint Select Committee on Deficit Reduction, October 14, 2011, p. 4. <http://www.hsgac.senate.gov/download/lieberman-collins-letter-to-super-committee>

number of federal employees in order to implement programs.⁴⁷ Unfortunately, in many cases, agencies were left no recourse but to hire contractors as permanent- or semi-permanent staff, largely because of congressionally imposed federal personnel ceilings,⁴⁸ consequently increasing spending on wasteful service contracts.

Recommendations

POGO's *Bad Business* report included numerous recommendations that would permit the government to compare full life-cycle costs of comparable occupations, ensure promised cost savings are realized, remove federal full-time equivalents ceilings, improve the quality of service contractor data, and increase the practice of using short-term federal employees.⁴⁹

There are two recommendations in particular which deserve heightened attention by this Subcommittee—comparative cost modeling and improved service contract inventories.

Current government cost modeling systems are insufficient. They are not comprehensive because they do not take into consideration all relevant cost data. There is an urgent need for specificity and comparability of all government and contractor costs. For example, such criteria as types of services/occupations, standardized government administrative and overhead costs, including those for awarding, administering, and overseeing service contractors (especially those contractors working in government facilities), administrative costs, revenues (tax consequences), and intangibles (flexibility, quality of performance, education, and service experience) need to be considered. There is also a need for government-wide standards for comparative cost analyses and an independent comparative cost review. Finally, the government needs a comparative tax revenue paradigm that reflects contractor tax obligations/deductions. Some of these criteria are included in Circular A-76 and the Defense Department's cost modeling system, but those systems must be revisited to ensure that all life-cycle costs are included.

The current structure of service contract inventories is insufficient in providing the government and public with comprehensive data about the use of service contractors.⁵⁰ POGO recommends

⁴⁷ Federal Workforce Restructuring Act of 1994 (P.L. 103-226); Government Accountability Office, Statement of Timothy P. Bowling, Associate Director, Federal Management and Workforce, *Federal Downsizing: The Status of Agencies' Workforce Reduction Efforts* (GAO/T-GGD-96-124), May 23, 1996. <http://www.gao.gov/archive/1996/gg96124t.pdf> (Downloaded March 27, 2012)

⁴⁸ Congressional Research Service, *Inherently Governmental Functions and Department of Defense Operations: Background, Issues, and Options for Congress* (R40641), June 22, 2009, p. 34. http://prhome.defense.gov/RSI/REQUIREMENTS/docs/CRS_DoDIGCA.pdf (Downloaded September 27, 2010) (hereinafter *Inherently Governmental Functions and Department of Defense Operations: Background, Issues, and Options for Congress* (R40641))

⁴⁹ POGO *Bad Business* report, p. 35. <http://www.pogo.org/pogo-files/reports/contract-oversight/bad-business/co-gp-20110913.html#Recommendations>

⁵⁰ In December 2011, POGO published a blog critiquing current service contract inventories entitled "Federal Service Contract Inventories: A Failure to Address Which Contracts Are Cost Justified." It details all the flaws that exist in how these inventories are currently identifying the data upon which Congress intended agencies to rationalize their human resources and cost cutting decisions. <http://pogoblog.typepad.com/pogo/2010/12/federal-service-contract-inventories-a-failure-to-address-which-contracts-are-cost-justified.html>; Earlier in June 2011, POGO submitted a public comment concerning a proposed amendment to the Federal Acquisition Regulation concerning service contracts reporting requirements, stressing the need to utilize valid data sources and service cataloging systems and to incorporate meaningful cost information; unfortunately, the government determined they

that the government uses a coding/identification system that is comparable to OPM's personnel system, and take into consideration the duration of the contract; the number of all prime and subcontractor personnel (by service/occupation and total); the hours worked; the hourly/annual billing rates for such personnel; the costs that must be incurred to maintain that workforce; and the justification for contracting those services (e.g., cost efficiency, the lack of legislative authority for hiring government personnel, the lack of government expertise, short-term needs, flexibility hours, etc.).

If the government collects enhanced data about the number and cost of service contractors, it will be in a position to ensure that there is a proper balance of the total government workforce and that all potential savings are realized.

Thank you for inviting me to submit written testimony for this very important hearing. I look forward to working with the Subcommittee to further explore how service contracting can be improved and how costs can be appropriately factored into any government human capital planning.

lacked legislative authority to make such improvements. <http://www.pogo.org/pogo-files/letters/contract-oversight/co-t-20110620.html>,

Table 1: Cost Analyses

POGO's study evaluated whether the current practice of outsourcing federal services to contractors is actually cost beneficial. To do this, POGO compared the average of the General Services Administration's listed annual contractor billing rates (which we referred to throughout the *Bad Business* report as "average annual contractor billing rates") with the full costs of federal employee annual compensation for comparable services. POGO also compared federal employee full annual compensation with private sector employee full annual compensation, as well as average annual contractor billing rates with private sector employee full annual compensation, in order to evaluate the validity of the current private sector versus federal employee debate. These three comparisons are set forth below in Table 1.⁵¹

OPM Series Description	Federal to Private*	Contractor to Federal†	Contractor to Private‡	Full Federal Annual Compensation	Full Private Sector Annual Compensation	Contractor Annual Billing Rates††
Accounting	1.50	2.40	3.60	\$124,851	\$83,132	\$299,374
Auditing	1.47	2.31	3.40	\$122,373	\$83,132	\$283,005
Budget Analysis	.89	2.75	2.43	\$110,229	\$124,501	\$302,661
Building Management	.62	2.38	1.48	\$111,564	\$179,740	\$265,242
Cartography	1.47**	1.46	2.14**	\$116,481	\$79,219	\$169,520
Cemetery Administration Services	1.12	2.83	3.17	\$106,124	\$94,485	\$299,832
Claims Assistance and Examining	.76	4.83	3.66	\$57,292	\$75,637	\$276,598
Computer Engineering	1.04	1.97	2.04	\$136,456	\$131,415	\$268,653
Contracting	.98	2.29	2.24	\$113,319	\$115,596	\$259,106

⁵¹ Table 1, along with its accompanying "sources" and "notes" descriptions, were pulled directly from POGO's study. Project On Government Oversight, *Bad Business: Billions of Taxpayer Dollars Wasted on Hiring Contractors*, September 13, 2012. <http://www.pogo.org/pogo-files/reports/contract-oversight/bad-business/co-gp-20110913.html#Government%20Cost%20Studies>

Correctional Officer	2.17	1.15	2.49	\$72,977	\$33,598	\$83,803
Environmental Protection Specialist	1.20	1.40	1.68	\$127,247	\$105,964	\$177,570
Equal Opportunity Compliance	1.40	2.05	2.87	\$125,368	\$89,394	\$256,381
Facility Operations Services	.90	1.66	1.50	\$108,060	\$119,449	\$179,254
Financial Analysis	1.24	1.30	1.61	\$132,262	\$106,679	\$171,288
Financial Management	1.13	2.05	2.32	\$164,218	\$145,486	\$337,002
Fire Protection and Prevention	1.04**	1.25	1.29**	\$65,452	\$63,105	\$81,702
Food Inspection	1.04**	1.29	1.34**	\$58,090	\$55,883	\$74,963
General Attorney	.79	3.17	2.51	\$175,081	\$220,924	\$554,923
General Inspection, Investigation, Enforcement, and Compliance	1.17	1.62	1.90	\$104,712	\$89,394	\$169,666
Groundskeeper	2.00	.80	1.60	\$64,896	\$32,396	\$51,709
Human Resources Management	1.11	2.05	2.27	\$111,711	\$100,465	\$228,488
Information Technology Management	1.09	1.59	1.73	\$124,663	\$114,818	\$198,411
Language Specialist	1.80**	1.92	3.46**	\$110,014	\$61,010	\$211,203

Logistics Management [Deployment]	.94	1.76	1.66	\$116,047	\$123,349	\$204,443
Logistics Management [Planning]	1.19	1.46	1.74	\$116,047	\$97,269	\$168,938
Management and Program Analysis	1.15	2.15	2.48	\$124,602	\$108,132	\$268,258
Mechanical Engineering	1.15	1.50	1.72	\$126,177	\$109,961	\$189,197
Medical Records Technician	1.26	.99	1.24	\$58,641	\$46,705	\$57,782
Nurse	1.16	1.65	1.92	\$105,714	\$91,042	\$174,803
Police	1.24	1.34	1.66	\$71,256	\$57,533	\$95,659
Program Management	.97	1.56	1.50	\$173,551	\$179,740	\$269,901
Quality Assurance	.94	1.09	1.03	\$98,939	\$104,891	\$107,786
Security Guard	1.53	1.36	2.08	\$50,257	\$32,953	\$68,515
Statistics	1.15	1.66	1.91	\$125,192	\$108,586	\$207,563
Technical Writing and Editing	1.25	1.08	1.35	\$103,801	\$82,873	\$112,091
Average Cost Premiums	1.20	1.83	2.09			

Sources:

The full methodology, data descriptions, and complete data tables for how the figures in this table were obtained are provided in the *Bad Business* report at Appendices A, B, C, and D. Appendix B contains a table of the 35 occupational classifications (including OPM, BLS, and GSA identification codes) with the base salaries and full compensation paid to federal employees and private sector employees (according to two BLS surveys), as well as the GSA billing rates for specified contracts. Appendix C contains the job titles and descriptions provided by OPM, BLS, and GSA for the 35 matching GS occupational series, SOC codes, and GSA SINs. Appendix D contains a table of the GSA contracts and the 35 occupational classifications covering over 550 service activities selected for calculating the average hourly and annual contractor billing rates for the various SINs used for comparing costs, along with the listed hourly billing rates. Annual

dollar figures are rounded to the nearest dollar. For the contractor rates, while POGO used an average annual billing rate, agencies do not necessarily purchase services over a full year's period of time.

Notes:

The comparisons in this table are expressed as ratios in accordance with the following calculations:

* The federal to private comparisons are calculated by dividing the average annual full compensation paid to federal employees by the average annual full compensation paid to private sector employees performing similar services.

† The contractor to federal comparisons are calculated by dividing the average annual contractor billing rate for performing these services by the average annual full compensation paid to federal employees performing similar services

‡ The contractor to private sector comparisons are calculated by dividing the average annual contractor billing rate by the average annual full compensation paid to private sector employees performing similar services.

†† Average annual contractor billing rates are typically based on a 2,087-hour conversion method, but for the sake of comparison to total government compensation, POGO used a 2,080-hour conversion. As a result, POGO multiplied the average hourly contractor billing rate by 2,080 to calculate the average annual contractor billing rate.

** No National Compensation Survey data were available for comparison; therefore Occupational Employment Statistics data were used.

Appendix A

Bad Business: Billions of Taxpayer Dollars Wasted on Hiring Contractors

September 13, 2011

Project On Government Oversight

Bad Business: Billions of Taxpayer Dollars Wasted on Hiring Contractors

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EXECUTIVE SUMMARY

Based on the current public debate regarding the salary comparisons of federal and private sector employees, the Project On Government Oversight (POGO)¹ decided to take on the task of doing what others have not—comparing total annual compensation for federal and private sector employees with federal *contractor* billing rates in order to determine whether the current costs of federal service contracting serves the public interest.

The current debate over pay differentials largely relies on the theory that the government pays private sector compensation rates when it outsources services. This report proves otherwise: in fact, it shows that the government actually pays service contractors at rates far exceeding the cost of employing federal employees to perform comparable functions.

POGO's study analyzed the total compensation paid to federal and private sector employees, and annual billing rates for contractor employees across 35 occupational classifications covering over 550 service activities. Our findings were shocking—POGO estimates the government pays billions more annually in taxpayer dollars to hire contractors than it would to hire federal employees to perform comparable services. Specifically, POGO's study shows that the federal government approves service contract billing rates—deemed fair and reasonable—that pay contractors **1.83 times more** than the government pays federal employees in total compensation, and more than **2 times** the total compensation paid in the private sector for comparable services.

Additional key findings include:

- Federal government employees were less expensive than contractors in **33 of the 35** occupational classifications POGO reviewed.
- In one instance, contractor billing rates were **nearly 5 times** more than the full compensation paid to federal employees performing comparable services.
- Private sector compensation was lower than contractor billing rates in **all 35** occupational classifications we reviewed.
- The federal government has failed to determine how much money it saves or wastes by outsourcing, insourcing, or retaining services, and has no system for doing so.

POGO's investigation highlights two basic facts about outsourcing government work to contractors. First, comparing federal to private sector compensation reveals nothing about what it *actually* costs the government to outsource services. The only analysis that will shed light on the true costs of government is that of contractor billing rates and the full cost of employing federal employees to perform comparable work. The Commission on Wartime Contracting in Iraq and Afghanistan recently completed a fundamental study of costs, and found that, in certain contingency operations, although savings resulted from hiring local or third-country nationals, military and civilian employees can cost less than hiring American contractors.

¹ For more information on POGO's contract investigations, please visit POGO's website, <http://www.pogo.org/investigations/contract-oversight/>. POGO also maintains the Federal Contractor Misconduct Database containing instances of criminal, civil, and administrative misconduct involving the largest federal contractors. <http://www.contractormisconduct.org/>

Second, the federal government is not doing a good job of obtaining genuine market prices, and therefore the savings often promised in connection with outsourcing services are not being realized. The argument for outsourcing services is that, by outsourcing services on which the government holds a monopoly, free market competition will result in efficiencies and save taxpayer dollars. But our study showed that using contractors to perform services may actually increase rather than decrease costs to the taxpayers.

POGO found several failures in government procurement, employment, and data systems that limit the government's and the public's abilities to assess and correct excessive costs resulting from insourcing or outsourcing federal services. Failures included the lack of standards for calculating cost estimates and justifying insourcing or outsourcing decisions; the lack of data related to negotiated service contract billing rates; not publishing government information about the number of actual contractor employees holding a specific occupational position under any given contract; and that there is no universal job classification system.

For decades there have been increasing political pressures to reduce the size of the federal government. In response the government has awarded service contracts, resulting in an expanding "shadow government" that costs hundreds of billions of dollars annually. The focus on comparing federal and private sector salaries needs to shift because they have nothing to do with what the government actually pays for services. Instead, the focus properly belongs on analyzing the full costs of paying contractors to perform federal services. Given the nation's ongoing economic problems, this analysis has become even more relevant—approximately one-quarter of all discretionary spending now goes to service contractors.

POGO's recommendations include:

1. Congress should require all federal agencies, when awarding service contracts, to use service coding systems that are consistent with OPM's job classification system. Congress should also require the collection, reporting, and oversight of life-cycle costs associated with government services performed by federal employees or contractors.
2. Congress should pass legislation requiring greater transparency and improved pricing on GSA Schedule service contracts.
3. Congress should strengthen the FAIR Act to enhance service contract reporting.
4. Congress should remove full-time equivalents ceilings, and decrease the maximum benchmark compensation amount applicable to contractor employees.
5. Agencies should use their existing authorities to hire federal employees for short-term projects.

INTRODUCTION

There is no doubt that contractors play a substantial role in supporting government operations, missions, programs, and projects domestically and abroad. For many years the federal government has increasingly relied on contractors to perform government functions. This shift to outsourcing² followed the call to reduce the size of the federal employee workforce, even as the U.S. population and demand for government services grew.³ Now, in some federal offices contractor employees outnumber federal employees.⁴ Unfortunately, the government has turned to contractors without an eye toward cost savings.⁵

Since 1999, the size of the federal employee workforce has remained relatively constant at about 2 million,⁶ while the contractor workforce has increased radically—from an estimated 4.4 million to 7.6 million in 2005.⁷ In other words, the federal contractor workforce dwarfs the federal employee workforce nearly four-fold.

² “Outsourcing refers to the transfer of an existing federal business or administrative function to the commercial sector, with the government remaining responsible for the affected services. Privatization refers to the transfer of a federal business or administrative function, including the responsibility for the affected services, to the commercial sector.” General Accounting Office, *Outsourcing and Privatization: Private-Sector Assistance for Federal Agency Studies* (B-282180), March 26, 1999. <http://archive.gao.gov/paprpd/2/161965.pdf> (Downloaded June 15, 2011)

³ Acquisition Advisory Panel, *Report of the Acquisition Advisory Panel to the Office of Federal Procurement Policy and the United States Congress*, January 2007, pp. 2-3. https://www.acquisition.gov/comp/aap/24102_GSA.pdf (Downloaded September 27, 2010) (hereinafter Acquisition Advisory Panel Report)

⁴ A specific example is the Department of Defense: “at 15 of the 21 [contracting] offices we reviewed, contractor employees outnumbered DOD employees and comprised as much as 88 percent of the workforce.” Government Accountability Office, *Defense Contracting: Additional Personal Conflict of Interest Safeguards Needed for Certain DOD Contractor Employees* (GAO-08-169), March 2008, p. 3. <http://www.gao.gov/new.items/d08169.pdf> (Downloaded April 28, 2011) (hereinafter GAO-08-169); “DOD relies extensively upon contractors to support overseas contingency operations. As of March 2011, DOD had more contractor personnel in Afghanistan and Iraq (155,000) than uniformed personnel (145,000). Contractors made up 52% of DOD’s workforce in Afghanistan and Iraq.” Congressional Research Service, *Department of Defense Contractors in Afghanistan and Iraq: Background and Analysis* (R40764), May 13, 2011, Summary. <http://www.fas.org/spp/crs/natsec/R40764.pdf> (Downloaded June 9, 2011) (hereinafter *Department of Defense Contractors in Afghanistan and Iraq: Background and Analysis* (R40764)) Another example is Department of Homeland Security (DHS): “Because of the Department of Homeland Security’s aggressive Secure Border Initiative program schedule coupled with shortages of government program managers and acquisition specialists... Customs and Border Protection relied on contractors to fill the skills gap and get the program underway... [CBP] continues to rely heavily on contract personnel, who comprise more than 50% of the Secure Border Initiative workforce.” Department of Homeland Security, Office of Inspector General, *Better Oversight Needed of Support Services Contractors in Secure Border Initiative Programs* (OIG-09-80), June 2009, p. 1. http://www.dhs.gov/xoig/assets/mgmtrpts/OIG_09-80_Jun09.pdf (Downloaded April 28, 2011)

⁵ In addition to cost savings, outsourcing services was premised on the idea that contractors provide a level of flexibility that federal employees do not. Flexibilities include the ability to meet short-term needs, to fire poorly performing contractors, and terminate or not renew a contract.

⁶ Office of Personnel Management, “Historical Federal Workforce Tables - Executive Branch Civilian Employment Since 1940,” September 30, 2010. <http://www.opm.gov/feddata/HistoricalTables/ExecutiveBranchSince1940.asp> (Downloaded March 29, 2011); Office of Personnel Management, “Fed Scope Employment Trend.” [http://www.fedscope.opm.gov/cognos/cgi-bin/ppdscgi.exe?DC=Q&E=/FSe%20-%20Longitudinal/Employment%20Trend%20\(Year-to-Year\)&LA=en&LO=en-us&BACK=%2F%20cognos%2Fcgi-bin%2Fppdscgi.exe%3Ftoc%3D%252FFSe%2520-%2520Longitudinal%26LA%3Den%26LO%3Den-us](http://www.fedscope.opm.gov/cognos/cgi-bin/ppdscgi.exe?DC=Q&E=/FSe%20-%20Longitudinal/Employment%20Trend%20(Year-to-Year)&LA=en&LO=en-us&BACK=%2F%20cognos%2Fcgi-bin%2Fppdscgi.exe%3Ftoc%3D%252FFSe%2520-%2520Longitudinal%26LA%3Den%26LO%3Den-us) (Downloaded March 29, 2011); Paul C. Light, *The New True Size of Government*, New York University, August 2006, p. 11. http://wagner.nyu.edu/performance/files/True_Size.pdf (Downloaded March 16, 2011) (hereinafter *The New True Size of Government*); “In 1953, there was one Federal worker for every 78 residents. In 2009, it was one for every 147.” Hearing Statement of the Honorable John Berry, Director of the U.S. Office of Personnel Management, before the U.S. House Subcommittee on Federal Workforce, U.S. Postal Service, and Labor Policy, Committee on Oversight and Government Reform, “Are Federal Workers Underpaid?” March 9, 2011, p. 2.

There is currently no way to quantify the *actual* number of contractor employees who perform government functions at a particular department or agency at any given time.⁸ Because the federal government does not keep timely and accurate statistics of the actual size of its contractor workforce, Congress mandated that civilian agencies and the Department of Defense (DoD) keep such records.⁹ However, as there is no consistency in the methodologies employed by the various agencies, data from these inventories are unreliable and do not provide a complete picture of jobs, functions, or activities being provided by service contractors. In addition, even with the changes, the inventories still fail to provide timely and accurate data on contractor employees or cost information that would be helpful when comparing federal with contractor employees.¹⁰ Improvements are forthcoming—a proposed regulation will require annual disclosures of inventories for service contracts that will include a description of the services, how those services will achieve agency objectives, the total dollar amount obligated and invoiced for services under the contract, and additional contract-related information.¹¹

This is important because the federal government currently spends over \$320 billion on service contracts each year.¹² Often, those expenditures rest on the claim that the private sector can provide services at substantial cost savings to the government and taxpayers¹³ because of the free market's ability to conduct business more cost-effectively than the government.¹⁴

http://oversight.house.gov/images/stories/Testimony/Berry_Testimony.pdf (Downloaded March 17, 2011) (hereinafter Berry 2011 Testimony)

⁷ When the contractor workforce is combined with civilians, military personnel, U.S. Postal Service employees, and grantees, the size of the blended federal workforce was estimated at 14.6 million people in 2005. *The New True Size of Government*, p. 11; Paul C. Light, "The Real Crisis in Government," *The Washington Post*, January 12, 2010, p. A17. <http://www.washingtonpost.com/wp-dyn/content/article/2010/01/11/AR2010011103255.html> (Downloaded March 29, 2011); Hearing Statement of Paul C. Light, New York University/The Brookings Institution, before the U.S. Senate Subcommittee on Oversight of Government Management, the Federal Workforce and the District of Columbia, "An Update on the Bush Administration's Competitive Sourcing Initiative," July 24, 2003.

<http://wagner.nyu.edu/faculty/publications/files/lightCompetitiveSourcing.pdf> (Downloaded September 27, 2010)

⁸ Acquisition Advisory Panel Report, p. 416.

⁹ National Defense Authorization Act for Fiscal Year 2008 (Pub. Law 110-181), § 807(a), January 28, 2008. (hereinafter NDAA FY 2008); Consolidated Appropriations Act for FY 2010 (Pub. Law 111-117), Sec. 743, December 16, 2009.

¹⁰ Letter from John P. Hutton, Government Accountability Office, to Congressional Committees, "Defense Acquisitions: Observations on the Department of Defense Service Contract Inventories for Fiscal Year 2008," January 29, 2010, Enclosure I, p. 42. <http://www.gao.gov/new.items/d10350r.pdf> (Downloaded September 27, 2010); The DHS has begun to keep statistics on the size of its shadow government workforce of contractor employees. It had estimated that the size of its contractor employee workforce was 200,000, as compared with 188,000 DHS employees, but recently changed the estimate to 110,000 contractor employees. Ed O'Keefe, "Eye Opener: Homeland Security Has More Contractors Than Feds," *The Washington Post*, February 24, 2010. http://voices.washingtonpost.com/federal-eye/2010/02/eye_opener_homeland_security_h.html (Downloaded September 27, 2010); Sean Reilly, "Whoops: Estimate on number of DHS contract employees off by 100,000 or so," *Federal Times*, April 11, 2011.

<http://blogs.federaltimes.com/federal-times-blog/2011/04/11/whoops-estimated-number-of-dhs-contract-employees-off-by-at-least-100000/> (Downloaded April 12, 2011)

¹¹ *Federal Register*, Vol. 76, No. 76, April 20, 2011, p. 22070.

¹² According to data compiled by POGO from the Federal Procurement Data System – Next Generation (FPDS-NG), the federal government awarded \$336 billion and \$320 billion in service contracts in fiscal years 2009 and 2010, respectively.

https://www.fpsng.gov/fpsng_cms/; "Civilian agencies obligated over \$135 billion in fiscal year 2010 for services—80 percent of total civilian spending on contracts." Government Accountability Office, *Acquisition Planning: Opportunities to Build Strong Foundations for Better Services Contracts* (GAO-11-672), August 2011, p. 1. <http://www.gao.gov/new.items/d11672.pdf> (Downloaded August 11, 2011)

¹³ Statement by Jacques S. Gansler, Ph.D., Before the Commission on Wartime Contracting in Iraq and Afghanistan, "Implementing Improvements to Defense Wartime Contracting," April 25, 2011, pp. 12-13.

http://www.wartimecontracting.gov/docs/hearing2011-04-25_testimony-Gansler.pdf (Downloaded April 28, 2011) Dr. Gansler is the Chairman of the Commission on Army Acquisition and Program Management in Expeditionary Operations, Chairman of the Defense Science Board Task Force on Improvements to Services Contracting, and a professor at the

POGO's study tested the accuracy of the cost-savings claim. A few other studies have compared specific jobs and the associated costs, but POGO has gone one step further by looking at a larger sampling of comparable jobs and their costs when they are performed by government, private sector, and contractor employees.¹⁵

POGO's investigation into the costs of outsourcing seems particularly timely in light of recent efforts to reduce government spending and considering that government spending on services now eclipses its spending on goods.¹⁶ If POGO's recommendations are implemented, government officials, both legislative and executive, will be better informed in deciding when insourcing or outsourcing services is cost-justified. They also will be better informed when debating what legislative or regulatory reforms to institute to eliminate billions of dollars in waste each year.¹⁷

BACKGROUND

Reducing the size of the federal employee workforce and increasing budgetary savings have been pet projects of policymakers for decades.¹⁸ Yet it wasn't until the 1950s during the Eisenhower administration that there emerged a formalized policy favoring the outsourcing of federal services if it could be shown that those services were commercially available at a cost savings to the taxpayer.¹⁹

In 1966, the Office of Management and Budget (OMB) incorporated this policy in its Circular

University of Maryland. He served as Under Secretary of Defense (Acquisition, Technology, and Logistics) from 1997 to 2001.

¹⁴ Reliance on service contractors is sometimes justified by the claim that they provide enhanced performance and innovation. This report does not address the validity of that claim.

¹⁵ See Table 1. There have been a few limited government studies, which we examine later in this report, that have compared contractor costs to federal employee compensation.

¹⁶ According to data compiled by POGO from the Federal Procurement Data System – Next Generation and USAspending.gov, service contract award dollars accounted for 62 percent and 60 percent of all contract spending in fiscal years 2009 and 2010 respectively; Acquisition Advisory Panel Report, pp. 2-3. "Almost 80 percent of contract obligations made by civilian agencies in fiscal year 2010 were for service contracts." Government Accountability Office, *OMB Service Contracts Inventory Guidance and Implementation* (GAO-11-538R), May 27, 2011, p. 1. <http://www.gao.gov/new.items/d11538r.pdf> (Downloaded May 27, 2011) (hereinafter GAO-11-538R)

¹⁷ For example, "The [FY 2010] Budget proposes reducing spending on contractor services in the Department of Defense (DOD) in 2010 to achieve net savings of \$0.9 billion by bringing some contracted services in house." Office of Management and Budget, *Terminations, Reductions, and Savings: Budget of the U.S. Government Fiscal Year 2010*, p. 78. <http://www.gpoaccess.gov/usbudget/fy10/pdf/trs.pdf> (Downloaded April 12, 2011)

¹⁸ According to the organization In the Public Interest, states are facing budget constraints similar to those of the federal government, and are outsourcing work and privatizing public assets, including education systems, toll roads, road and bridge construction and maintenance, prisons, parking meters, libraries, and trash collection/recycling. Those efforts have at times seen higher costs and a decline in mission performance. In the Public Interest, "What's at stake." <http://inthepublicinterest.org/whats-at-stake> (Downloaded June 17, 2011); Craig Gustafson, "Ambulance deal shorted city, whistle-blower says: Former head of San Diego operation says \$12 million could be at stake," *San Diego Union-Tribune*, April 25, 2011. <http://www.signonsandiego.com/news/2011/apr/25/ambulance-service-contract-questioned/> (Downloaded April 26, 2011)

¹⁹ Bulletin from Rowland R. Hughes, Executive Office of the President, Bureau of the Budget, to the Heads of Executive Departments and Establishments, "Commercial-industrial activities of the Government providing products or services for governmental use," Bulletin 55-4, January 15, 1955, pp. 1, 3. http://www.governmentcompetition.org/uploads/Bureau_of_the_Budget_Bulletin_55-4_January_15_1955.pdf (Downloaded May 5, 2011); GAO-11-538R, p. 1.

A-76, an administrative vehicle for handling personnel needs by competing agency work between government offices and contractors.²⁰ OMB has supplemented the A-76 Circular with a handbook that includes procedures for determining which government jobs should remain in-house, and which could be transferred to contractors by either cost comparison²¹ generally depending on which bid was more cost-efficient²² or by direct conversion.²³ As part of the public-private competition process, the government identifies the work, prepares an in-house cost estimate (which can include a mix of federal and contractor employees), and compares the agency's bid to the best offer from contractors.²⁴

Both political parties have taken issue with the proper size of the federal civilian workforce and the proper balance between government employees and contractor employees.²⁵ In the 1980s, the Reagan administration was a strong advocate for a smaller government. In its attempt to shrink the size of government, the administration frequently clashed with Congress over whether the government or private industry should perform certain functions.²⁶ When President Reagan was sworn into office in 1981, he declared, "In this present crisis, government is not the solution to our problem; government is the problem,"²⁷ and his administration began pushing agencies to outsource commercial functions.²⁸

When President Clinton took office in 1993, he also took up the mantle of "small government," promising to reduce the federal workforce by 300,000 employees.²⁹ The Clinton administration instituted the "reinventing government" initiative and oversaw the implementation of the Federal Activities Inventory Reform (FAIR) Act³⁰ with the goal of increasing the outsourcing of commercial functions. The FAIR Act was originally introduced as the Freedom from Government Competition Act, which would have prohibited agencies from engaging in any activity producing goods or services that could be provided by the private sector.³¹

²⁰ OMB issues instructions and information to federal agencies about various policy issues. Office of Management and Budget, "OMB Circular A-76." http://www.whitehouse.gov/omb/circulars_default (Downloaded June 17, 2011) (Hereinafter OMB Circular A-76); Government Accountability Office, *Commercial Activities Panel: Improving the Sourcing Decisions of the Federal Government* (GAO-02-847T), September 27, 2002, p. 2. <http://www.gao.gov/new.items/d02847t.pdf> (Downloaded September 27, 2010) (hereinafter GAO-02-847T)

²¹ The A-76 competition process (also known as public-private competition) allows government employees to bid for the work against contractors. POGO avoids the use of the term "public-private" competitions through most of this report so that there is no confusion between the contractor and private sector data that is presented.

²² GAO-02-847T, p. 2.

²³ Under a process called "direct conversion," the federal government can outsource government jobs without competition and cost comparisons. GAO-02-847T, pp. 2-3.

²⁴ GAO-02-847T, p. 3.

²⁵ Ed O'Keefe, "Eye Opener: Homeland Security Has More Contractors Than Feds," *The Washington Post*, February 24, 2010. http://voices.washingtonpost.com/federal-eye/2010/02/eye_opener_homeland_security_h.html (Downloaded September 27, 2010)

²⁶ Congressional Research Service, *Inherently Governmental Functions and Department of Defense Operations: Background, Issues, and Options for Congress* (R40641), June 22, 2009, p. 5. http://prhome.defense.gov/RSI/REQUIREMENTS/docs/CRS_DoDIGCA.pdf (Downloaded September 27, 2010) (hereinafter *Inherently Governmental Functions and Department of Defense Operations: Background, Issues, and Options for Congress* (R40641))

²⁷ Ronald Reagan, First Inaugural Address, January 20, 1981.

http://www.reaganfoundation.org/pdf/Inaugural_Address_012081.pdf (Downloaded June 17, 2011)

²⁸ Acquisition Advisory Panel Report, p. 399, n. 18.

²⁹ Testimony of Dan Guttman, Fellow at the Johns Hopkins' Washington Center for the Study of American Government, before the Senate Committee on Governmental Affairs, "Who's Doing Work for Government? Monitoring, Accountability and Competition in the Federal and Service Contract Workforce," March 6, 2002.

<http://hsgac.senate.gov/030602guttman.htm> (Downloaded September 27, 2010)

³⁰ Federal Activities Inventory Reform Act of 1998 (Pub. Law 105-270), § 2(d) and (e), October 19, 1998.

³¹ *Inherently Governmental Functions and Department of Defense Operations: Background, Issues, and Options for Congress* (R40641), pp. 5, 8 n. 37.

The George W. Bush administration continued the Clinton administration's pro-outsourcing agenda. In his President's Management Agenda, President Bush announced early in his first term his intention of making the federal government more "market-based."³² The Bush administration also "proposed amending OMB Circular A-76 so that all functions were presumed to be commercial unless agencies justified why they were inherently governmental."³³ The Bush administration employed contractors in the military and reconstruction operations in Iraq³⁴ and Afghanistan,³⁵ and in the cleanup efforts after Hurricanes Katrina and Rita in the Gulf region.³⁶ In May 2003, the Bush administration revised OMB Circular A-76 to emphasize competition of services with "streamlined cost comparisons."³⁷

In 2002, the Commercial Activities Panel³⁸ concluded that A-76 competitions had achieved significant savings and efficiencies for the government.³⁹ The panel "strongly supported a continued emphasis on competition as a means to improve economy, efficiency, and effectiveness of the government."⁴⁰

Six years later in May 2008, OMB reported that from FY 2003 through FY 2007 the federal government conducted 1,375 A-76 competitions, which, at the time of the report, resulted in accrued actual savings of \$1.88 billion.⁴¹ OMB projected that, over the long run, there would be \$7.2 billion in total savings.⁴² In the majority of cases, the savings did not result from outsourcing to contractors, but

³² Executive Office of the President, Office of Management and Budget, *The President's Management Agenda: Fiscal Year 2002*, p. 4. <http://www.dtic.mil/cgi-bin/GetTRDoc?AD=ADA394421&Location=U2&doc=GetTRDoc.pdf> (Downloaded September 27, 2010)

³³ *Inherently Governmental Functions and Department of Defense Operations: Background, Issues, and Options for Congress* (R40641), p. 6.

³⁴ "DOD obligated approximately \$15.4 billion on contracts in the Iraq theater of operations in FY2010, representing 20% of total spending in those regions. From FY2005 to FY2010, DOD obligated approximately \$12.8 billion on contracts primarily in the Iraq theater of operations, representing 19% of total obligations for operations in Iraq." *Department of Defense Contractors in Afghanistan and Iraq: Background and Analysis* (R40764), p. 19.

³⁵ "DOD relies extensively upon contractors to support overseas contingency operations. As of March 2011, DOD had more contractor personnel in Afghanistan and Iraq (155,000) than uniformed personnel (145,000). Contractors made up 52% of DOD's workforce in Afghanistan and Iraq. Since December 2009, the number of DOD contractors in Afghanistan has exceeded the number in Iraq....According to FPDS, DOD obligated approximately \$11.8 billion on contracts in the Afghanistan theater of operations in FY2010, representing 15% of total obligations...in the area. From FY2005-FY2010, DOD obligated approximately \$33.9 billion on contracts primarily in the Afghanistan theater, representing 16% of total DOD obligations for operations in that area." *Department of Defense Contractors in Afghanistan and Iraq: Background and Analysis* (R40764), pp. Summary, 13.

³⁶ Hearing Statement of David E. Cooper, Government Accountability Office, Director, Acquisition and Sourcing Management, Before the Senate Committee on Small Business and Entrepreneurship, "Hurricanes Katrina and Rita: Preliminary Observations on Contracting for Response and Recovery Efforts," GAO-06-246T, November 8, 2005, pp. 2-3. <http://www.gao.gov/new.items/d06246t.pdf> (Downloaded April 27, 2011)

³⁷ The revised circular in 2003 stated: "The longstanding policy of the federal government has been to rely on the private sector for needed commercial services. To ensure that the American people receive maximum value for their tax dollars, commercial activities should be subject to the forces of competition." OMB Circular A-76, Revised May 2003. http://www.whitehouse.gov/omb/circulars_a076_a76_incl_tech_correction (Downloaded September 27, 2010).

³⁸ Commercial Activities Panel was chaired by David M. Walker, Comptroller General of the United States, to study the policies and procedures governing the transfer of commercial activities from federal employees to contractors.

³⁹ GAO-02-847T, p. 8.

⁴⁰ GAO-02-847T, p. 9.

⁴¹ Executive Office of the President, Office of Management and Budget, *Report on Competitive Sourcing Results: Fiscal Year 2007*, May 2008, pp. 4, 13-14.

http://www.whitehouse.gov/sites/default/files/omb/assets/procurement/comp_sourc_fy2007.pdf (Downloaded April 5, 2011) (hereinafter *Report on Competitive Sourcing Results*)

⁴² *Report on Competitive Sourcing Results*, pp. 2, 4, 11-12. The project savings require independent validation to determine if the benefits and cost savings promised during the A-76 competition process were or will be realized. *Report on Competitive Sourcing Results*, pp. 14-15; Memorandum from Clay Johnson III, Deputy Director for Management, Executive Office of the President, Office of Management and Budget, to the President's Management Council, "Validating

rather from keeping the work in-house. In fact, **83 percent of the competitions were won by federal employees (as a percentage of total FTEs competed)**.⁴³ Consequently, the vast majority of projected savings might not be a function of private sector efficiencies, but may instead have been due to the government's structural reengineering of the federal employee workforce.⁴⁴ In many instances, government agencies cut their workforces through measures "including buyouts, early retirements, [and] reassignment to priority programs within the agency or at another agency."⁴⁵

Despite the cost savings associated with the A-76 process, it has been criticized by both government officials and contractor trade groups for a number of reasons. For instance, both sides claim the process favors the other side.⁴⁶ Additionally, some agencies have been criticized for their inability to effectively administer the competitions and document the actual savings achieved.⁴⁷ Other criticisms include the fact that, generally speaking, the A-76 process only provides a small look into overall outsourcing activities and that it is a political vehicle to place government services in the hands of contractors.⁴⁸

The Obama administration's policy on the issue of outsourcing has fluctuated. President Obama issued a March 4, 2009, memo on government contracting that expressed concerns about federal contract spending, including the level of competition, the use of risky contracts, and the need to protect functions that should be performed by federal employees.⁴⁹ The President directed OMB to develop and issue government-wide guidance to assist agencies in reviewing "existing contracts in order to identify contracts that are wasteful, inefficient, or not otherwise likely to meet the agency's needs, and

the Results of Public-Private Competition," April 13, 2007.

<http://www.fai.gov/pdfs/MemonValidatingResultsCompetitions.pdf> (Downloaded May 24, 2011)

⁴³ *Report on Competitive Sourcing Results*, p. 2. "As part of this process, the government identifies the work to be performed (described in the performance work statement), prepares an in-house cost estimate on the basis of its most efficient organization, and compares it with the winning offer from the private sector." A footnote related to this text stated, "The most efficient organization is the government's in-house plan to perform a commercial activity. It may include a mix of federal employees and contract support." GAO-02-8471, p. 3.

⁴⁴ *Report on Competitive Sourcing Results*, p. 10.

⁴⁵ *Report on Competitive Sourcing Results*, p. 10.

⁴⁶ Congressional Research Service, *Defense Outsourcing: The OMB Circular A-76 Policy* (RL30392), June 30, 2005, pp. 4-6. <http://www.fas.org/spp/crs/natsec/RL30392.pdf> (Downloaded April 20, 2011); In addition, a Center for Strategic and International Studies (CSIS) report highlights the inherent problems with government lifecycle cost comparison models and appropriate overhead rates, and proposed a cost-estimating methodology. Although the report discusses a comprehensive cost estimation methodology that should be used to create a baseline for making more accurate cost comparisons, it is silent on all the costs the government incurs, above and beyond fixed billing rates, associated with the award, administration, and oversight of service contracts. Center for Strategic and International Studies, *DoD Workforce Cost Realism Assessment*, May 2011, pp. 11-19. http://csis.org/files/publication/110517_Berteau_DoDWorkforceCost_Web.pdf (Downloaded May 18, 2011) (hereinafter DoD Workforce Cost Realism Assessment)

⁴⁷ For instance, GAO found that in one competition, DOL reported projected savings to Congress that overestimated its actual savings due to the fact that its costs were underreported by 100 percent. Government Accountability Office, *Department of Labor: Better Cost Assessments and Departmentwide Performance Tracking Are Needed to Effectively Manage Competitive Sourcing Program* (GAO-09-14), November 21, 2008, pp. 4-5. <http://www.gao.gov/new.items/d0914.pdf> (Downloaded September 27, 2010).

⁴⁸ American Federation of Government Employees, "Public Comments on the Presidential Memorandum on Government Contracting," July 15, 2009. <http://www.afge.org/index.cfm?page=Privatization&Fuse=Content&ContentID=1953> (Downloaded July 12, 2011)

⁴⁹ Memorandum from President Barack Obama, to the Heads of Executive Departments and Agencies, "Government Contracting," March 4, 2009. http://www.whitehouse.gov/the_press_office/Memorandum-for-the-Heads-of-Executive-Departments-and-Agencies-Subject-Government/ (Downloaded May 11, 2011) (hereinafter Obama Contracting Memo)

to formulate appropriate corrective action in a timely manner.”⁵⁰ As a result, agencies received guidance to improve the insourcing process and better manage the multi-sector workforce.⁵¹

The insourcing effort was short-lived and, despite the concerns about government contracting President Obama expressed in his March 2009 memo, the administration appears to have backed away from that policy.⁵² Specifically, President Obama signed into law a two-year freeze on federal employee salaries,⁵³ which could have the effect of harming the government’s ability to hire and retain federal employees and thus increase the need for contractors.⁵⁴ In addition, the government has temporarily banned new A-76 competitions at DoD,⁵⁵ and has made little effort to identify and eliminate any excessive costs of outsourcing the over \$320 billion in services contracts awarded each year while this ban is in effect.⁵⁶ In fact, only one federal agency has taken any meaningful steps to rein in contractors during this period of time. The Department of Energy (which is uniquely positioned because of its significant contractor workforce) has taken the unprecedented move of freezing

⁵⁰ Obama Contracting Memo.

⁵¹ Memorandum from Director Peter R. Orszag, Executive Office of the President, Office of Management and Budget, “Managing the Multi-Sector Workforce,” OMB Memo M-09-26, July 29, 2009, pp. 1-2. http://www.whitehouse.gov/sites/default/files/omb/assets/memoranda_fy2009/m-09-26.pdf (Downloaded September 27, 2010); Stephen Losey, “Huge Federal Staffing Planned in 2010,” *Federal Times*, May 12, 2009. <http://www.federaltimes.com/article/20090512/PERSONNEL02/905120301/1050/PERSONNEL04> (Downloaded September 27, 2010); Ashton Carter, “A Message from the Under Secretary of Defense For Acquisition, Technology and Logistics.” <https://acc.dau.mil/ad/en-US/365272/file/50295/2%20-%20ActionMemo%20TAB%20A%20Carter%20Memo%20v17%20Publish%20D.pdf> (Downloaded April 11, 2011); Alice Lipowicz, “DHS draws flak for review of services contracts,” *Federal Computer Week*, June 5, 2009. <http://fcw.com/Articles/2009/06/08/NEWS-DHS-contracts.aspx> (Downloaded April 11, 2011)

⁵² Memorandum from Secretary of the Army John M. McHugh to Principal Officials of Headquarters—Department of the Army, and others, “Reservation of In-Sourcing Approval Authority,” February 1, 2011. <http://www.pscouncil.org/AM/Template.cfm?Section=Home1&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=6796> (Downloaded May 18, 2011); Marjorie Censer, “The Pentagon retreats on insourcing as spending slows,” *The Washington Post*, April 3, 2011. http://www.washingtonpost.com/business/capitalbusiness/the-pentagon-retreats-on-insourcing-as-spending-slows/2011/03/28/AFsJxWC_story.html (Downloaded on April 11, 2011)

⁵³ Continuing Appropriations and Surface Transportation Extensions Act, 2011 (Pub. Law 111-322), § 1 (b) and (c), December 22, 2010; Memorandum for President Barack Obama, to the Heads of Executive Departments and Agencies, “Freezing Federal Employee Pay Schedules and Rates That Are Set By Administrative Discretion,” December 22, 2010. <http://www.whitehouse.gov/the-press-office/2010/12/22/memorandum-adjustments-certain-rates-pay> (Downloaded April 3, 2011). The Republicans’ FY 2012 budget resolution seeks to extend the pay freeze through 2015. Emily Long and Kellie Lunney, “GOP budget resolution calls for pay freeze through 2015,” *Government Executive*, April 5, 2011. http://www.govexec.com/story_page.cfm?articleid=47515&dcn=todaysnews (Downloaded on April 11, 2011)

⁵⁴ There are differing viewpoints on the result of freezing federal employees salaries. Howard Risher, “The true cost of a 5-year pay freeze,” *Federal Times*, May 1, 2011. <http://www.federaltimes.com/article/20110501/ADOP06/105010306/> (Downloaded May 3, 2011); “News Digest: May 9—Pay freeze unlikely to hurt retention, official says,” *Federal Times*, May 9, 2011, p. 4. <http://www.federaltimes.com/article/20110508/DEPARTMENTS05/105080301/> (Downloaded June 1, 2011)

⁵⁵ Department of Defense Appropriations Act, 2010 (Pub. Law 111-118), § 8117 (hereinafter Department of Defense Appropriations Act, 2010); National Defense Authorization Act for Fiscal Year 2010 (Pub. Law 111-84), § 325; Omnibus Appropriations Act, 2009 (Pub. Law 111-8), § 737. DoD is seeking to have its A-76 authority restored. Sarah Chacko, “DoD report seeks return to A-76 job competitions,” *Federal Times*, July 19, 2011.

<http://www.federaltimes.com/article/20110719/DEPARTMENTS01/107190307/1023/DEPARTMENTS01> (Downloaded July 22, 2011). DoD is prohibited from undertaking direct conversions “unless the conversion is based on the result of a public-private competition...” 10 U.S.C. § 2461; Department of Defense and Full-Year Continuing Appropriations Act, 2011 (Pub. Law 112-10), § 8015.

⁵⁶ “Since fiscal year 2006, civilian agencies have obligated over \$100 billion annually to obtain a range of services from contractors.” GAO-11-538R, p. 1.

contractor employees' salaries.⁵⁷ Although this is a good move, other agencies may be less effective in controlling excessive contract prices.⁵⁸ Generally, most contracts include annual escalation clauses or increased rates for each option year of the contract—and, in some instances, those contracts include options for nine years or more.⁵⁹

The 112th Congress is even taking steps to promote the government's hiring of contractors, no matter the cost. The House version of the FY 2012 Defense Authorization bill includes a "sense of Congress" provision that states that insourcing should only occur when it involves inherently governmental functions.⁶⁰

No matter the reasons for shifts in policies, the fact remains that the overall size of the blended federal workforce and the dollars spent on service contracts have dramatically increased. As budgets decrease, federal employee total compensation will receive increased scrutiny despite policymakers not having all the facts.⁶¹

SUMMARY OF METHODOLOGY⁶²

POGO reviewed 35 occupational classifications for this study. We employed two critical selection criteria: (1) whether the occupational classifications involved a "special interest function,"⁶³ and (2) whether the occupational classification had been converted to a "commercial" function for the purposes of a FAIR Act inventory or subject to outsourcing pursuant to Circular A-76.⁶⁴ POGO analyzed classification systems from the Office of Personnel Management's (OPM) General Schedule (GS) and Job Grading Standards for Trades, Craft, and Labor Positions (WG) series (which we refer to throughout the report as GS series),⁶⁵ Bureau of Labor Statistics' (BLS) Standard Occupational

⁵⁷ Alyah Khan, "DOE holds unique power to freeze contractor pay," *Washington Technology*, December 22, 2010. <http://washingtontechnology.com/articles/2010/12/22/unique-arrangement-allows-doe-to-freeze-contractor-pay.aspx> (Downloaded April 3, 2011)

⁵⁸ Congress has made a control contract costs with DoD. The Senate's National Defense Authorization Act for Fiscal Year 2012 (S. 981) includes Section 807 applying allowable senior executive benchmark compensation limits to all contractor employees, and Section 301 freezes DoD's operation and maintenance funding at 2010 levels. Emily Long, "Pain of Defense service contractor cuts might not be felt evenly," *Government Executive*, June 20, 2011. http://www.govexec.com/story_page.cfm?articleid=48047&sid=60 (Downloaded June 23, 2011)

⁵⁹ For instance, the Army logistics support LOGCAP IV contract award to three different contractors has one base year and nine option years. U.S. Army Sustainment Command Public Affairs, "ASC selects LOGCAP IV contractors," June 28, 2007. <http://www.army.mil/article/3836/asc-selects-logcap-iv-contractors/> (Downloaded May 31, 2011) (hereinafter ASC selects LOGCAP IV contractors)

⁶⁰ Sarah Chacko, "House bill urges DoD to halt insourcing," *Federal Times*, May 27, 2011. <http://www.federaltimes.com/article/20110527/ACQUISITION03/105270302/1001> (Downloaded May 31, 2011)

⁶¹ Howard Risher, "Analysis: Politics of federal pay obscures the facts," *Government Executive*, May 25, 2011. http://www.govexec.com/story_page.cfm?articleid=47870&oref=todaysnews (Downloaded May 26, 2011)

⁶² The complete methodology can be found in Appendix A.

⁶³ "Special interest functions are functions that require increased management attention due to heightened risk of workforce imbalance." Memorandum from Daniel I. Gordon, Administrator, Office of Federal Procurement Policy, to Chief Acquisition Officers, "Service Contract Inventories," November 5, 2010, Attachment, pp. 3-4. <http://www.whitehouse.gov/sites/default/files/omb/procurement/memo/service-contract-inventories-guidance-11052010.pdf> (Downloaded July 13, 2011)

⁶⁴ The occupational classifications selected by POGO would pass the "Yellow Book Test," indicating that they are services easily found in a phone book. Those types of services have been targeted by Members of Congress for outsourcing. Matthew Weigelt, "Lawmakers want competitive sourcing on the table," *Federal Computer Week*, July 19, 2011.

<http://fcw.com/articles/2011/07/19/competitive-sourcing-appropriations-committee-letter.aspx> (Downloaded July 22, 2011)

⁶⁵ The GSA Schedule program provides agencies with a "simplified process for obtaining commercial supplies and services at prices associated with volume buying." Federal Acquisition Regulation Subpart 8.402. Service contracts often are

Classification (SOC) system, and General Services Administration's (GSA) service activities as classified in its Special Item Number (SIN) system to establish comparable occupational services. (Appendix C) POGO then identified appropriate data tables published by each agency that allowed POGO to determine and compare the average rate of full annual compensation paid to federal and private sector employees with the average annual billing rates for contractor employees performing comparable services at government sites. (Appendices B and D) Because the contractor billing rates published by GSA include not only salaries but also other costs including benefits contractors provide their employees,⁶⁶ POGO added OPM's 36.25 percent benefit rate to federal employee salaries⁶⁷ and BLS's 33.5 percent loading to private sector employee salaries to reflect the full fringe benefit package paid to full-time employees in service-providing organizations that employ 500 or more workers.⁶⁸ All supporting data for this study are found in Table 1 and Appendices B through D.⁶⁹

POGO is aware that its methodology does not incorporate some governmental cost factors: i.e., non-directly associated overhead (e.g., executive management and administration, information technology, and legal support), material and supplies (e.g., insurance and maintenance), or facilities (e.g., depreciation, rent, insurance, maintenance and repair, utilities, capital improvements).⁷⁰ However, given the fact that POGO relied exclusively on GSA's listed contractor billing rates for performance at government sites, many of those cost factors would essentially be canceled out.⁷¹ In fact, when contractors perform work at contractor sites, POGO found that contractor billing rates were, on average, 15 percent higher than rates for work performed at government sites. In addition, POGO did not include in its comparative analysis additional costs that the government incurs as a result of

awarded through high-risk labor-hour contracts, a type of time and material contract, that is considered a last resort. FAR Subpart 16.601(d); Sarah Chacko, "White House orders agencies to cut spending on services contracts," *Federal Times*, July 11, 2011, p. 3. <http://www.federaltimes.com/article/20110707/ACQUISITION03/107070308/> (Downloaded July 12, 2011) Labor-hour contracts are generally more susceptible to waste, fraud, and abuse than fixed price or cost-type contracts, and therefore the rates provided in GSA Schedule contracts tend to be higher than the equivalent amounts that would otherwise be paid by the government under fixed price and cost-type contracts.

⁶⁶ GSA contracts supply hourly billing rates. Those rates are not just the salaries contractor employees are paid, but include benefits, overhead, administrative costs, and profit. There is no way to determine the portion of those rates that are designated as salary.

⁶⁷ Memorandum from Jim Nussle, Director, Office of Management and Budget, to the Heads of Executive Departments and Agencies, "Update to Civilian Position Full Fringe Benefit Cost Factor, Federal Pay Raise Assumptions, and Inflation Factors used in OMB Circular No. A-76, 'Performance of Commercial Activities,'" M-08-13, March 11, 2008, p. 2. <http://www.whitehouse.gov/sites/default/files/omb/memoranda/fy2008/m08-13.pdf> (Downloaded September 27, 2010) (hereinafter Update to Civilian Position Full Fringe Benefit Cost Factor)

⁶⁸ Because the vast majority of contract service providers are large corporate entities, POGO thought it appropriate to calculate benefits based on this workforce classification. Bureau of Labor Statistics, "Table 14. Private industry workers, by establishment employment size: employer costs per hours worked for employee compensation and costs as a percentage of total compensation, 2004-2010, 500 workers or more," March 9, 2011, pp. 187-189. <ftp://ftp.bls.gov/pub/special.requests/ocwc/ect/ececrqm.pdf> (Downloaded March 28, 2011)

⁶⁹ In preparing this study, POGO utilized certain data modeling of Avue Technologies Corporation, a provider of automated management platform solutions. However, POGO remains solely responsible for the ultimate analysis and conclusions presented.

⁷⁰ OMB Circular A-76 outlines numerous costs, including a 12 percent overhead rate, that must be added to full compensation labor costs in order to accurately compare the total cost to the government when making public-private cost comparisons. OMB Circular A-76, Revised May 2003, B-17. http://www.whitehouse.gov/omb/circulars_a076_a76_incl_tech_correction (Downloaded September 27, 2010); DoD Workforce Cost Realism Assessment, pp. 16-19.

⁷¹ For instance, within the Defense Finance and Accounting Service the DoD Inspector General stated that it "found no relationship or any instances where general and administrative costs would be reduced by the conversion of work from in-house to contract performance." Department of Defense, Office of the Inspector General, *Infrastructure and Environment: Public/Private Competition for the Defense Finance and Accounting Service Military Retired and Annuitant Pay Functions* (D-2003-056), March 21, 2003, pp. 19, 22. <http://www.dodig.mil/audit/reports/fy03/03-056.pdf> (Downloaded May 19, 2011)

outsourcing services to contractors. Those costs would only add to the costs associated with outsourcing documented in this report.

POGO made every effort to ensure that its study is as accurate as possible. However, there are a number of factors that potentially limit the accuracy of POGO's findings. For instance, over the course of our investigation, we discovered some disturbing limitations to the federal databases available to us. The most critical limitations are that: 1) the government's coding, classification, and data collection systems are inconsistent and do not allow for reliable cost analyses⁷²; 2) government websites do not provide access to agency documents that detail cost estimates and the justifications for outsourcing decisions; 3) the government does not publish information on the number of actual contractor employees holding a specific occupational position under any given contract; 4) the government only lists the ceiling prices that it can be billed by contractors for the specific occupational positions—the government is at liberty to negotiate prices that are lower than those listed, but it does not publish those negotiated rates (however, based on POGO's review of GSA contracts, and anecdotal evidence, the government tends to pay the listed billing rates rather than negotiating lower rates⁷³); and 5) government websites do not disclose what the expected cost savings for service contracts are, nor the actual savings (or lack of savings) that result from those contracts. These shortcomings prevent government officials, as well as the public, from accurately assessing outsourcing costs. There are other factors that may limit the accuracy of POGO's findings, and we detail those in the full methodology in Appendix A.

POGO'S COST ANALYSIS

POGO's study evaluates whether the current practice of outsourcing federal services to contractors is actually cost beneficial.⁷⁴ To do this, POGO compared the average of GSA's listed annual contractor billing rates (which we refer to throughout the report as "average annual contractor billing rates")⁷⁵ with the full costs of federal employee annual compensation for comparable services. POGO also compared federal employee full annual compensation with private sector employee full annual compensation, as well as average annual contractor billing rates with private sector employee full annual compensation, in order to evaluate the validity of the current private-sector versus federal-employee debate. These three comparisons are set forth below in Table 1.

⁷² For example, two OPM documents provide inconsistent data for matching its GS Series of job classifications with the BLS's SOC job classification codes; specifically, in more than a third of the occupations POGO compared, OPM's GS job classification codes conflicted with the data utilized in the annual U.S. Pay Agent reports (located in Appendix VII of the 2002 report) to establish comparable compensation for federal civilian employees and private sector employees.

⁷³ Steve Kelman, "How agencies can cut contracting costs," *Federal Computer Week*, August 9, 2011.

<http://fcw.com/articles/2011/08/08/comment-kelman-save-money-for-government.aspx> (Downloaded August 11, 2011);

Steve Kelman, "GSA schedules: Are agencies paying too much?," *Federal Computer Week*, July 29, 2010.

<http://fcw.com/Blogs/Lectern/2010/07/Steve-Kelman-GSA-schedules-pricing-July-29.aspx> (Downloaded June 23, 2011);

Steve Kelman, "Are agencies paying too much through the GSA schedule? Readers respond," *Federal Computer Week*, August 3, 2010. <http://fcw.com/Blogs/Lectern/2010/08/Steve-Kelman-GSA-schedule-pricing-reaction.aspx> (Downloaded June 23, 2011); One recent story indicated that cost is emerging as major factor in federal contracting. Sarah Chacko, "Feds driving harder bargain at procurement table," *Federal Times*, July 25, 2011, p. 1.

<http://www.federaltimes.com/article/20110724/ACQUISITION03/107240302/1009/ACQUISITION> (Downloaded July 26, 2011)

⁷⁴ This study was a quantitative rather than qualitative study, and did not look at outcomes of contractor or federal employee performance. In general, cost comparisons should be a factor—but not the only factor—when assigning service tasks to either federal or contractor employees.

⁷⁵ In some instances, the listed billing rates can be negotiated down to a lower rate. POGO has no access to how many rates are negotiated or for how much.

Table 1: Cost Analyses

OPM Series Description	Federal to Private*	Contractor to Federal†	Contractor to Private‡	Full Federal Annual Compensation	Full Private Sector Annual Compensation	Contractor Annual Billing Rates††
Accounting	1.50	2.40	3.60	\$124,851	\$83,132	\$299,374
Auditing	1.47	2.31	3.40	\$122,373	\$83,132	\$283,005
Budget Analysis	.89	2.75	2.43	\$110,229	\$124,501	\$302,661
Building Management	.62	2.38	1.48	\$111,564	\$179,740	\$265,242
Cartography	1.47**	1.46	2.14**	\$116,481	\$79,219	\$169,520
Cemetery Administration Services	1.12	2.83	3.17	\$106,124	\$94,485	\$299,832
Claims Assistance and Examining	.76	4.83	3.66	\$57,292	\$75,637	\$276,598
Computer Engineering	1.04	1.97	2.04	\$136,456	\$131,415	\$268,653
Contracting	.98	2.29	2.24	\$113,319	\$115,596	\$259,106
Correctional Officer	2.17	1.15	2.49	\$72,977	\$33,598	\$83,803
Environmental Protection Specialist	1.20	1.40	1.68	\$127,247	\$105,964	\$177,570
Equal Opportunity Compliance	1.40	2.05	2.87	\$125,368	\$89,394	\$256,381
Facility Operations Services	.90	1.66	1.50	\$108,060	\$119,449	\$179,254
Financial Analysis	1.24	1.30	1.61	\$132,262	\$106,679	\$171,288
Financial Management	1.13	2.05	2.32	\$164,218	\$145,486	\$337,002
Fire Protection and Prevention	1.04**	1.25	1.29**	\$65,452	\$63,105	\$81,702
Food Inspection	1.04**	1.29	1.34**	\$58,090	\$55,883	\$74,963
General Attorney	.79	3.17	2.51	\$175,081	\$220,924	\$554,923
General Inspection, Investigation, Enforcement, and Compliance	1.17	1.62	1.90	\$104,712	\$89,394	\$169,666
Groundskeeper	2.00	.80	1.60	\$64,896	\$32,396	\$51,709
Human Resources Management	1.11	2.05	2.27	\$111,711	\$100,465	\$228,488
Information Technology Management	1.09	1.59	1.73	\$124,663	\$114,818	\$198,411
Language Specialist	1.80**	1.92	3.46**	\$110,014	\$61,010	\$211,203
Logistics Management [Deployment]	.94	1.76	1.66	\$116,047	\$123,349	\$204,443

Logistics Management [Planning]	1.19	1.46	1.74	\$116,047	\$97,269	\$168,938
Management and Program Analysis	1.15	2.15	2.48	\$124,602	\$108,132	\$268,258
Mechanical Engineering	1.15	1.50	1.72	\$126,177	\$109,961	\$189,197
Medical Records Technician	1.26	.99	1.24	\$58,641	\$46,705	\$57,782
Nurse	1.16	1.65	1.92	\$105,714	\$91,042	\$174,803
Police	1.24	1.34	1.66	\$71,256	\$57,533	\$95,659
Program Management	.97	1.56	1.50	\$173,551	\$179,740	\$269,901
Quality Assurance	.94	1.09	1.03	\$98,939	\$104,891	\$107,786
Security Guard	1.53	1.36	2.08	\$50,257	\$32,953	\$68,515
Statistics	1.15	1.66	1.91	\$125,192	\$108,586	\$207,563
Technical Writing and Editing	1.25	1.08	1.35	\$103,801	\$82,873	\$112,091
Average Cost Premiums	1.20	1.33	2.09			

Sources:

The full methodology, data descriptions, and complete data tables for how the figures in this table were obtained are provided in Appendices A, B, C, and D. Appendix B contains a table of the 35 occupational classifications (including OPM, BLS, and GSA identification codes) with the base salaries and full compensation paid to federal employees and private sector employees (according to two BLS surveys), as well as the GSA billing rates for specified contracts. Appendix C contains the job titles and descriptions provided by OPM, BLS, and GSA for the 35 matching GS occupational series, SOC codes, and GSA SINs. Appendix D contains a table of the GSA contracts and the 35 occupational classifications covering over 550 service activities selected for calculating the average hourly and annual contractor billing rates for the various SINs used for comparing costs, along with the listed hourly billing rates. Annual dollar figures are rounded to the nearest dollar. For the contractor rates, while POGO used an average annual billing rate, agencies do not necessarily purchase services over a full year's period of time.

Notes:

The comparisons in this table are expressed as ratios in accordance with the following calculations:

- * The federal to private comparisons are calculated by dividing the average annual full compensation paid to federal employees by the average annual full compensation paid to private sector employees performing similar services.
- † The contractor to federal comparisons are calculated by dividing the average annual contractor billing rate for performing these services by the average annual full compensation paid to federal employees performing similar services.
- ‡ The contractor to private sector comparisons are calculated by dividing the average annual contractor billing rate by the average annual full compensation paid to private sector employees performing similar services.

†† Average annual contractor billing rates are typically based on a 2,087-hour conversion method, but for the sake of comparison to total government compensation, POGO used a 2,080-hour conversion. As a result, POGO multiplied the average hourly contractor billing rate by 2,080 to calculate the average annual contractor billing rate.

** No National Compensation Survey data were available for comparison; therefore Occupational Employment Statistics data were used.

The result of POGO's analysis was shocking. In 94 percent (33 of the 35) of the occupational series POGO analyzed, the average annual contractor billing rate was much more than the average annual full compensation for federal employees: on average, contractors may be billing the government approximately **1.83 times** what the government pays federal employees to perform similar work.⁷⁶ When the average annual contractor billing rates were compared with the average annual full compensation paid to private sector employees in the open market, POGO found that in all occupational classifications studied, **the contractor billing rates were, on average, more than twice the costs incurred by private sector employers for the same services.**

The most egregious example of an outsourced occupational classification that resulted in excessive costs rather than cost savings is claims assistance and examining—administrative support positions that involve examining, reviewing, developing, adjusting, reconsidering, or recommending authorization of claims by or against the federal government. To provide these services, on average, federal employees are fully compensated at \$57,292 per year, private sector employees are fully compensated at \$75,637 per year, and the average annual contractor billing rate is \$276,598 per year. POGO found the government may therefore be paying contractors, on average, nearly **5 times** what it pays government employees to perform the same services.⁷⁷ Put another way, the government may be paying the contractor providing support services for claims assistance and examining more than it does federal judges or administrative law judges, who earn less than \$200,000 per year.⁷⁸ Contractors may be billing the government, on average, approximately **3.66 times** what private sector employees are compensated for performing similar services.

General attorney services often involve the resolution, management, or disposition of assets held by the federal government. To provide these services, a federal government attorney is paid on average \$175,081 per year,⁷⁹ a private sector attorney is paid on average \$220,924 per year, and a contractor attorney may be billing the government on average \$554,923 per year. In other words, contractors may be billing the federal government up to **3.17 times more**, on average, what the government pays a federal attorney, and up to **2.51 times** what private sector employees are compensated. It is hard to discern how the government can justify these excessive costs. In fact, contractor legal assistants or law clerks who lack the advanced education and skills of an attorney cost more than federal attorneys.⁸⁰

When POGO analyzed accounting, auditing, and budget analysis occupational positions (some of which fall on the line between inherently governmental and closely associated with inherently

⁷⁶ While the policy of downsizing the federal government by outsourcing services failed to generate the cost savings advocates of outsourcing have promised, POGO acknowledges that not all federal service contracts impose unreasonable costs; indeed, some as yet indeterminable percentage of these contracts may result in cost savings to the government.

⁷⁷ Throughout this report, whenever we refer to "pay" or "is paid," we are referring to the fully loaded compensations (base salary plus benefits), which are listed in detail in Appendix B.

⁷⁸ U.S. Courts, "Federal Judicial Pay Increase Fact Sheet."

<http://www.uscourts.gov/JudgesAndJudgeships/JudicialCompensation/JudicialPayIncreaseFact.aspx> (Downloaded April 12, 2011)

⁷⁹ A recent media report detailed that numerous government lawyers earned more than \$180,000 per year, which is similar to the average government attorney salary found in this study. Kevin McCoy, "Doctors, lawyers, dentists tops in fed jobs that pay \$180K-plus," *USA Today*, May 3, 2011. http://www.usatoday.com/money/economy/2011-05-02-highest-paid-federal-workers_n.htm (Downloaded May 3, 2011)

⁸⁰ The legal assistant or law clerk rate was \$89 per hour in 2009, which is an annual rate of \$185,120. General Services Administration, eLibrary, "Sullivan Cove Consultants, LLC, Contract Number GS-23F-0181S SIN 520-6 Professional Legal Services," May 17, 2006 – May 16, 2011, p. 3. <http://www.gsaelibrary.gsa.gov/ElibMain/contractorInfo.do?contractNumber=GS-23F-0181S&contractorName=SULLIVAN+COVE+CONSULTANTS+LLC&executeQuery=YES> (Downloaded April 13, 2011)

governmental functions),⁸¹ we found that federal employees are paid on average \$119,000 per year, private sector employees are paid less than \$100,000 a year, and contractors may be billing the government nearly \$300,000 per employee per year, on average. This means that, on average, it can cost the government approximately 2.5 times more to use contractor employees for these services than federal employees, and that contractors may be billing the government 3 times on average what private sector employees are compensated.

Information technology work is widely outsourced throughout the federal government because of the assumption that IT companies provide vastly superior skills and cost savings.⁸² But the cost savings are not being realized. POGO found that the federal government may be paying contractors to provide computer engineers, on average, \$268,653 per year, nearly twice what it costs to use federal employees at \$136,456 per year. For information technology management services, on average, the government may be paying annual rates of \$198,411 for contractor employees, which is 1.59 times what the government pays federal employees at \$124,663,⁸³ and 1.73 times what private sector companies compensate their employees at \$114,818 to perform comparable services.

With regard to human resources management, POGO found that the government may be paying contractors, on average, annual rates of \$228,488, more than twice what the government compensates federal employees (\$111,711). Contractors' average annual billing rates are 2.27 times what private sector companies compensate their employees (\$100,465).

Contracting functions, which are closely associated with inherently governmental functions,⁸⁴ are critical to maintaining a balanced and effective federal acquisition workforce that helps agencies meet their missions. Federal agencies are becoming increasingly dependent on contractors to provide those services.⁸⁵ POGO found that the federal government may be paying contractors, on average, \$259,106 per year, 2.29 times what it pays federal employees at an average of \$113,319, to perform comparable

⁸¹ FAR Subpart 7.503(c) and (d). https://www.acquisition.gov/far/current/html/Subpart%207_5.html#wp1078196 (hereinafter FAR Subpart 7.5); POGO will be releasing a report that focuses on the questionable use of contractors to perform inherently governmental functions, which are functions that *must* be performed by government employees.

⁸² IT contracts have been the subject of allegations of overbilling, improper payments, and kickbacks which have surfaced in federal and state IT contracts. Project On Government Oversight, "Federal Contractor Misconduct Database." <http://www.contractormisconduct.org/index.cfm/1,73,222,html?CaseID=1233>, <http://www.contractormisconduct.org/index.cfm/1,73,222,html?CaseID=1085>, <http://www.contractormisconduct.org/index.cfm/1,73,222,html?CaseID=738>; and Chad Vander Veen, "Is IT Outsourcing Still In?" *Governing Magazine*, June 2010. <http://www.governing.com/topics/technology/Is-IT-Outsourcing-Still-In.html> (Downloaded September 27, 2010)

⁸³ Recent commentary by Howard Risher, "a managing consultant for the studies that led to pay reform in the Federal Employees Pay Comparability Act of 1990," offered some thoughts on comparing salaries, stating that "Federal technology specialists would benefit most from a market-sensitive salary system....The comparisons are striking. The lowest pay among selected federal technology jobs is 20 percent below market, while the highest is 27 percent above the market level. The comparisons are all over the place, which is not surprising because federal salaries have never been aligned with market levels." Howard Risher, "The barriers to market pay for the federal IT workforce," *Federal Computer Week*, May 3, 2011. <http://fcw.com/articles/2011/05/09/comment-howard-risher-it-job-classifications.aspx> (Downloaded May 4, 2011)

⁸⁴ FAR Subpart 7.503(d).

⁸⁵ For example, "at 15 of the 21 [contracting] offices we reviewed, contractor employees outnumbered DOD employees and comprised as much as 88 percent of the workforce." GAO-08-169, p. 3; Government Accountability Office, *Defense Contracting: Army Case Study Delineates Concerns With Use of Contractors as Contract Specialists* (GAO-08-360), March 2008, p. 3. <http://www.gao.gov/new.items/d08360.pdf> (Downloaded April 28, 2011); Government Accountability Office, *Department of Homeland Security: Improved Assessment and Oversight Needed to Manage Risk of Contracting for Selected Services* (GAO-07-990), September 2007, pp. 1, 8. <http://www.gao.gov/new.items/d07990.pdf> (Downloaded April 28, 2011)

services. We found that contractors may be billing the federal government **2.24 times** on average what private sector employers are compensating their workers to perform similar services, at **\$115,596** per year on average.

Safety and security services are another area in which the federal government has a substantial commitment to awarding service contracts. For instance, the Department of Justice relies on contractors to provide correctional officers.⁸⁶ Similarly, the Department of Homeland Security's Federal Protective Service (FPS), which is responsible for providing security for government buildings, outsources over 90 percent of its security guard services.⁸⁷ POGO found that the federal government may be billed by contractors on average **1.15 times** and **1.36 times**, respectively, more than what it pays federal correctional officers (**\$72,977**) and security guards (**\$50,257**).⁸⁸ Similarly, the federal government may be billed on average **1.25 times** and **1.34 times**, respectively, more than what it compensates federal employees for fire protection (**\$65,452**) and police services (**\$71,256**).⁸⁹ Contractors may be billing the federal government on average **1.29 to 2.49 times** the full compensation costs associated with private sector employees performing similar services on the open market.

Many of the job classifications POGO analyzed are typically characterized as "commercial" in nature—services that can be found in the phone book. The federal government also outsources functions and activities that are critical to our nation's security. For example, the Office of the Director of National Intelligence has reported that the government has outsourced 28 percent of its intelligence workforce⁹⁰ and is paying contractors 1.66 times what it costs to have this work performed by federal employees (\$207,000 annually for a contractor employee versus \$125,000 for a federal employee).⁹¹ POGO's analysis supports this. POGO analyzed the costs associated with outsourcing language specialists, who are frequently used to perform intelligence functions, and found that contractors may be billing the government, on average, **\$211,203** per year, **more than 1.9 times** the \$110,014 per year the government compensates a federal employee. And contractors may be billing the federal government **nearly 3.5 times**, on average, the **\$61,010** per year private sector language specialists are compensated on the open market.

While nearly all of the occupations POGO analyzed revealed excessive outsourcing costs, POGO did find two where utilizing contractors was more cost-effective. POGO found that the government incurs excessive costs by keeping groundskeeper services in-house. Specifically, federal groundskeeper

⁸⁶ Government Accountability Office, *Cost of Prisons: Bureau of Prisons Needs Better Data to Assess Alternatives for Acquiring Low and Minimum Security Facilities* (GAO-08-6), October 2007, p. 1. <http://www.gao.gov/new.items/d086.pdf> (Downloaded April 28, 2011)

⁸⁷ Department of Homeland Security, "About the Federal Protective Service." http://www.dhs.gov/xabout/structure/gc_1253889058003.shtm (Downloaded April 11, 2011). "In recent years, [GAO's] work has identified significant weaknesses in FPS's oversight and management of its security workforce, including the failures to ensure that its contract security guards maintain required training and certifications and to annually evaluate security guard performance. Such oversight gaps have raised questions about FPS's reliance on a contract workforce. Footnote omitted. Government Accountability Office, *Federal Facility Security: Staffing Approaches Used by Selected Agencies* (GAO-11-601), June 2011, p. 1. <http://www.gao.gov/new.items/d11601.pdf> (Downloaded August 16, 2011) (hereinafter GAO-11-601)

⁸⁸ The GAO found that base pay for in-house security is \$36,822. GAO-11-601, p. 14.

⁸⁹ The GAO found that base pay for in-house police positions is \$48,737. GAO-11-601, p. 14.

⁹⁰ Office of the Director of National Intelligence, "Key Facts About Contractors," p. 2. http://www.dni.gov/content/Truth_About_Contractors.pdf (Downloaded April 11, 2011)

⁹¹ Conference Call with Dr. Ronald Sanders, Associate Director of National Intelligence for Human Capital, "Results of the Fiscal Year 2007 U.S. Intelligence Community Inventory of Core Contractor Personnel," August 27, 2008, p. 8. http://www.asisonline.org/secman/20080827_interview.pdf (Downloaded April 28, 2011)

employees are compensated,⁹² on average, \$13,187 per year more than what contractors may be billing the government. POGO estimates that a 20 percent savings results when the government outsources groundskeeper services, which closely matches government estimates.⁹³ Average annual contractor billing rates are 1.6 times what private sector groundskeepers are compensated. In addition, POGO found that the government pays federal employees operating as medical record technicians .01 times more than the average annual contractor billing rates (\$58,641 and \$57,782, respectively).

By shifting the focus from comparing federal with private sector employee compensation to comparing contractor billing rates with federal employee full compensation, POGO was able to examine the comparable costs of hiring federal and contractor employees. POGO's findings confirm the basic premise that government employees are generally compensated at a higher rate than private sector employees.⁹⁴ However, in the 35 occupational classifications and 550 specific jobs POGO analyzed, reliance on contractor employees costs significantly more than having federal employees provide similar services. As a result, taxpayers are left paying the additional costs associated with corporate management, overhead, and profits that the government has no need to incur.

Contractors make profits by providing services,⁹⁵ and that is a sound business practice. The federal government also provides services, but does so without making any profit. The critical question is not whether contractors are entitled to earn profits but whether the government is paying higher costs to contractors for comparable services that could be provided by federal employees.

Because POGO's cost analyses were limited to contracts for services entered into under GSA's Schedule program, we did not address the issue of contractors' executive compensation.⁹⁶ Federal law currently permits a contractor to bill the federal government a portion of executive compensation. For example during FY 2010, contractors were allowed to bill the government up to \$693,951⁹⁷ of a

⁹² The full federal annual compensation for Groundskeeper is listed in FedScope pursuant to OPM's Job Grading Standards for Trades, Craft, and Labor Positions (WG) series under the occupation of "Gardening." Office of Federal Personnel Management, "Federal Wage System Job Grading Standard for Gardening." WG Series 5003. <http://www.opm.gov/fedclass/fws5003.pdf> (Downloaded August 11, 2011)

⁹³ "Apparently, DOD saves 20 percent by privatizing food service, grass cutting, civilian personnel administration, and similar functions." Captain John R. Withers, "Contracting for Depot-Level Maintenance," *Army Logistician*, Vol. 32, Issue 1, January-February 2000. <http://www.almc.army.mil/alog/issues/JanFeb00/MS453.htm> (Downloaded April 20, 2011)

⁹⁴ There may be a number of reasons federal employees generally receive higher rates of compensation than do employees in the private sector, including that federal employees are, on average, older, in management and professional positions, more experienced, more tenured, and more educated than the private sector workforce. Congressional Research Service, *Selected Characteristics of Private and Public Sector Workers* (R41897), July 1, 2011, pp. 7-15. <http://www.govexec.com/pdfs/071911kl1.pdf> (Downloaded July 22, 2011); Office of Management and Budget, Blog Posted by Peter Orszag, "Salary Statistics," March 10, 2010. <http://www.whitehouse.gov/omb/blog/10/03/10/salary-statistics/> (Downloaded September 27, 2010) (hereinafter Peter Orszag Blog)

⁹⁵ According to an industry survey, 40 percent of survey participants reported profit rates before interest and taxes of 1-5% as a percentage of revenue; 35 percent reported profit rates of 6-10%; 9 percent reported profit rates of 11-15%; and 6 percent reported profit rates above 15%. The remaining 10 percent reported profit rates of zero or experienced a loss. Grant Thornton LLP, *16th Annual Government Contractor Industry Survey Highlights Book: Industry survey highlights 2010*, January 17, 2011, pp. 6-7. http://www.granthornton.com/staticfiles/GTCom/Government%20contractors/Government%20contractor%20files/16th_HighlightsBook.pdf (Downloaded April 6, 2011)

⁹⁶ POGO addressed the issue of excessive compensation for contractor executives in an April 22, 2010, letter to OMB Director Peter Orszag. <http://www.pogo.org/pogo-files/letters/contract-oversight/co-cas-20100422.html>

⁹⁷ Federal Register Office of Management and Budget, "Office of Federal Procurement Policy Cost Accounting Standards Board Executive Compensation, Benchmark Maximum Allowable Amount." http://www.whitehouse.gov/omb/procurement_index_exec_comp/ (Downloaded May 25, 2011) (hereinafter Office of Federal Procurement Policy Cost Accounting Standards Board Executive Compensation) This is the amount of executive

contractor's executive compensation.⁹⁸ While that rate may reflect only a partial level of an executive's corporate compensation, it constitutes approximately **three times** the level of actual salary the federal government pays its top executives. For example, in 2010, the President was paid \$400,000 per annum, the Speaker of the House was paid \$223,500 per annum, the Senate Majority Party Leader and the Senate Minority Party Leader, as well as the House Majority and Minority Leaders, were each paid \$193,400 per annum, and Cabinet Members were paid \$199,700 per annum.⁹⁹ The fact that high-level executives in the private sector often receive seven-figure salaries and benefit packages should not have any bearing on how much those executives should bill federal taxpayers, which should not exceed the salary paid to senior federal employees performing comparable work.

GOVERNMENT COST STUDIES

Despite numerous reports highlighting the government's lack of in-house capabilities¹⁰⁰ and studies mandated by law comparing federal and private sector compensation,¹⁰¹ reviews of federal and contractor employee compensation and costs are not as abundant as the public might think.

Contingency Operations

The most recent comparison was conducted by the Commission on Wartime Contracting in Iraq and Afghanistan (CWC). (Appendix E) In its final report released on August 31, 2011, the CWC stated:

For lower- and mid-level-worker skills, contractors employing local or third-country nationals are less costly than military or federal civilian employees. However, when contractors employ U.S. citizens in higher-skill positions (as may be the case with communications support and professional services), their costs are roughly equivalent to military and federal civilians in comparable grade levels. The military is substantially more expensive when the contingency extends beyond rotation cycles and dwell costs are recognized. Commission on Wartime Contracting in Iraq and Afghanistan, *Final Report to Congress*, August 2011, p. 226.

The CWC's cost study is timely based on the dramatic increase in the use of contractors supporting the troops in the battlefield and conducting reconstruction operations. There is no denying that the use of local and third-country nationals saves the government money. However, despite a methodology closely mirroring POGO's, the CWC's study misses the mark on a few vital points. First, the CWC

salary that may be priced into, or reimbursed under, government contracts. The contractor typically pays executives much higher salaries and other compensation in the form of benefits.

⁹⁸ 75 Federal Register, 19661, *Determination of Benchmark Compensation Amount for Certain Executives*, April 15, 2010. <http://edocket.access.gpo.gov/2010/pdf/2010-8641.pdf> (Downloaded August 11, 2011)

⁹⁹ The payments listed are salaries and do not include additional compensation in the form of benefits. TheCapitol.Net, Inc., "Pay and Perquisites of Members of Congress, Including A History of House and Senate Salaries." <http://www.thecapitol.net/FAQ/payandperqs.htm> (Downloaded July 22, 2011); Office of Personnel Management, "Salary Table No. 2010-EX: Rates of Basic Pay for the Executive Schedule." <http://www.opm.gov/oca/10tables/pdf/ex.pdf> (Downloaded June 17, 2011)

¹⁰⁰ Department of Defense Contractors in Afghanistan and Iraq: Background and Analysis (R40764), p. 1; Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics, *Report of the Defense Science Board Task Force on Improvements to Services Contracting*, March 2011, p. 23. <http://www.acq.osd.mil/dsb/reports/2011-05-Services.pdf> (Downloaded June 17, 2011); Government Accountability Office, *Contingency Contracting: Improvements Needed in Management of Contractors Supporting Contract and Grant Administration in Iraq and Afghanistan* (GAO-10-357), April 2010, p. 11. <http://www.gao.gov/new.items/d10357.pdf> (Downloaded June 17, 2011); Government Accountability Office, *Department of Homeland Security: Risk Assessment and Enhanced Oversight Needed to Manage Reliance on Contractors* (GAO-08-142T), October 17, 2007, p. 4. <http://www.gao.gov/new.items/d08142t.pdf> (Downloaded June 17, 2011)

¹⁰¹ 5 U.S.C. § 5301 *et seq.*; Federal Employees' Pay Comparability Act of 1990 (Pub. Law 101-509), § 101.

described the costs of prolonged operations as being “roughly equivalent,” but in fact, its own table showed that hiring “higher-skill” American contractor employees costs up to 30 percent more than DoD civilian employees. Second, the CWC did not include the cost to the government for the *U.S. citizens* in middle-skill positions, including plumbers and electricians, which were hired by Kellogg Brown and Root and Services Employees International, Inc.—the primary employers of workers on the Army’s LOGCAP III contract. The inclusion of only local and third-county nationals for the middle tier ignores the fact that the government was paying a premium that might exceed the cost of using military or DoD civilian workers for those jobs.

In 2008, GAO reported that over the past 20 years DoD had increasingly relied on contractors for maintenance and logistics support of weapons systems.¹⁰² This move was driven in large part by a change in DoD “guidance and plans” in the mid-1990s that placed greater emphasis on outsourcing logistics functions.¹⁰³ DoD’s new policy “*assumed large cost savings* would result from increased privatization.”¹⁰⁴ (Emphasis added) DoD was projecting cost savings of \$20 billion to \$30 billion per year, despite subjecting only 9 percent of these contracts to a competitive bidding process.¹⁰⁵ Although increased reliance on contractors for these activities was based on the *assumption* that there would be significant cost savings, GAO was “*uncertain to what extent cost savings have occurred or will occur.*”¹⁰⁶ (Emphasis added)

DoD is one of the leading agencies that rely on contractor support,¹⁰⁷ but other agencies are also facing similar problems.¹⁰⁸ To assess the cost consequences of outsourcing, it is essential to compare the total compensation paid federal employees in a specific occupation with the rates *contractors actually bill* the federal government for comparable occupations. Only then is it possible to determine if savings are being realized, and if the current level of service contracting is in the public interest. What follows is a survey of government reports that review the costs of federal and contractor employees.

Domestic Security Work

In June 2011, the GAO released its review of the government’s use of in-house and contract security employees. GAO found both benefits and challenges when it came to cost, personnel flexibility, staff selections, and staff development and retention for in-house and contractor staffing decisions. As with many cost issues, the GAO found wide ranging opinions:

Smithsonian officials reported it uses contract security guards at lower-risk areas of its facilities which has enabled it to staff five posts with contract security guards for the same cost as three posts staffed with federal security guards. In addition, the use of an in-house security workforce increases the number of FTEs an agency must recruit, train, schedule, and manage, and adds to the in-house administrative responsibilities and associated costs that could otherwise be handled by a contractor. However, Army

¹⁰² Government Accountability Office, *Defense Management: DoD Needs to Reexamine Its Extensive Reliance on Contractors and Continue to Improve Management and Oversight* (GAO-08-572T), March 11, 2008, pp. Summary, 1, 21. <http://www.gao.gov/new.items/d08572T.pdf> (Downloaded September 27, 2010) (hereinafter GAO-08-572T)

¹⁰³ GAO-08-572T, pp. 22-23.

¹⁰⁴ GAO-08-572T, pp. 22-23.

¹⁰⁵ GAO-08-572T, pp. 27-28.

¹⁰⁶ GAO-08-572T, p. 4.

¹⁰⁷ Congressional Budget Office, *Contractors’ Support of U.S. Operations in Iraq* (Pub. No. 3053), August 2008, p. 13. <http://www.cbo.gov/ftpdocs/96xx/doc9688/08-12-IraqContractors.pdf> (Downloaded September 27, 2010) (hereinafter CBO Iraq Report)

¹⁰⁸ Dana Priest and William M. Arkin, “Top Secret America,” *The Washington Post*, 2010. <http://projects.washingtonpost.com/top-secret-america/> (Downloaded June 17, 2011)

officials reported that an Army analysis for fiscal year 2009 showed that while contract security guards would have offered savings over in-house security guards in the first 2 years of an insourcing decision, in-house security guards would be more cost effective over time as start-up costs for training, equipment, and uniforms are reduced. They noted it had sufficient administrative capacity to absorb the increased workload without additional administrative staff.¹⁰⁹

Federal and contractor representatives raised additional issues with GAO about federal employee health and retirement benefits, as well as overtime, flexibility and budgetary concerns, and the low pay in the private sector that can “present challenges in assembling a qualified security workforce, which could present security risks.”¹¹⁰ GAO did not look at specific contracts to compare actual cost of hiring security contractors to the cost of hiring federal employees, but the report certainly highlights pros and cons of each workforce and the need to look at case-by-case costs when considering insourcing and outsourcing decisions.

Security Work Abroad

On point with POGO’s investigative approach are reports issued by the Congressional Budget Office (CBO)¹¹¹ and the Government Accountability Office (GAO)¹¹² analyzing the cost of outsourcing services related to work in Iraq.

The CBO examined contract expenditures in Iraq between 2003 and 2007. They estimated that the government awarded \$85 billion in contracts during that period, of which between \$6 billion and \$10 billion went to private security contractors (PSCs).¹¹³ The only occupation CBO reported was for PSCs, and it found that “the costs of a private security contract are comparable with those of a U.S. military unit performing similar functions.”¹¹⁴

The CBO analyzed available information on a \$332 million security contract between Blackwater and the Department of State for the one-year period beginning in June 2004.¹¹⁵ The contract award total for that one-year period was \$98.5 million. CBO estimated the government’s cost for military security to be \$88.2 million (POGO assumes for the same one-year period, although CBO did not specify). The analysis attributed 37 percent of those estimated military costs, or \$32.8 million,¹¹⁶ to placing a certain number of military personnel stateside to rotate into action should hostilities extend beyond a set period of time. Given that the period of time for which the comparison was made was limited to one year, POGO finds no logical basis for including the cost of maintaining a rotational military force. The appropriate cost estimate for using military personnel for that one-year period would therefore have been the \$55.4 million CBO estimated for deployed units.¹¹⁷

¹⁰⁹ GAO-11-601, p. 16.

¹¹⁰ GAO-11-601, pp. 16-23.

¹¹¹ CBO Iraq Report

¹¹² Government Accountability Office, *Warfighter Support: A Cost Comparison of Using State Department Employees Versus Contractors for Security Purposes in Iraq* (GAO-10-266R), March 4, 2010.

<http://www.gao.gov/new.items/d10266r.pdf> (Downloaded September 27, 2010) (hereinafter GAO-10-266R)

¹¹³ CBO Iraq Report, p. 2.

¹¹⁴ CBO Iraq Report, p. 2.

¹¹⁵ CBO Iraq Report, p. 16. According to POGO’s review, the Blackwater PSC contract (S-AQMPD-04-D-0061) was active from June 2004 to January 2010, and totaled over \$332 million.

¹¹⁶ CBO Iraq Report, p. 17. CBO ran costs for two cases which provided a deployed unit and a rotational force of 1.2 and 2.0 soldiers at home for each soldier deployed. POGO’s analysis focused on the 1.2 rotational force because that was the estimated ratio from 2004 to 2007. The cost of the 2.0 unit case was \$110.1 million.

¹¹⁷ CBO Iraq Report, p. 17.

Comparing the government's \$55.4 million cost for deployed units with the \$98.5 million for the Blackwater contract shows the government had to pay **1.78 times more** for outsourcing these security guard functions, rather than the parity finding asserted in the CBO report.¹¹⁸ Even when the \$32.8 million cost for stateside rotational military personnel is included, CBO cost estimates support POGO's findings of lost savings when outsourcing services: military plus rotational costs were \$88.2 million, and Blackwater's costs were \$98.5 million.¹¹⁹

For another study, the GAO was charged with conducting a cost analysis of security services provided by contractors and government employees for both the Defense and State Departments during contingency operations in Iraq, and in 2010 released its findings.¹²⁰ GAO's analysis was limited to State Department contracts because DoD was unable to provide data.¹²¹ The analysis was further limited by the fact that State could not provide data on the administrative costs associated with procuring and managing security contracts.¹²² GAO studied one contract for Baghdad embassy security and four distinct task orders under the Worldwide Personal Protective Services II contract. The obligations under the Baghdad Embassy contract and the Worldwide task orders totaled \$643.6 million annually.¹²³ The cost analysis focused on the major quantifiable cost components such as salary, benefits, overseas costs, training, recruitment, background screenings, and support.¹²⁴

GAO's cost analysis showed that contractors performed for less cost on the Baghdad Embassy contract as well as on three of the four task orders, saving an estimated \$872 million for taxpayers.¹²⁵ The fourth task order showed that the use of federal rather than contractor employees would have saved the government nearly \$141 million.¹²⁶ The results of this study highlight the importance of conducting cost analyses on a contract-by-contract basis prior to award in order to create a realistic baseline for either awarding a service contract or performing the work in-house to achieve cost savings.

In addition to these studies, warnings concerning the blanket claim of outsourcing savings have come from a senior government official. Based on his role and experience on the ground as commander of NATO's International Security Assistance Force and of U.S. forces in Afghanistan, General Stanley McChrystal stated that "the use of contractors was done with good intentions... we thought we could save money.... I think it doesn't save money. I actually think it would be better to reduce the number of contractors involved, increase the number of military if necessary, and where we have contractors, in

¹¹⁸ The CBO analysis did not evaluate the price the military must pay for breakdowns in communications between contractors and military command personnel, or the costs associated with contract administration and compliance.

¹¹⁹ CBO Iraq Report, p. 17. The CBO study reviewed the use of military personnel only. The hiring of federal employees to perform private security functions should also have been included, which might provide cost savings.

¹²⁰ GAO-10-266R, p. 2. GAO selected data for the year 2005 to conduct this cost analysis.

¹²¹ GAO-10-266R, p. 2.

¹²² GAO-10-266R, p. 3.

¹²³ GAO-10-266R, p. 6.

¹²⁴ GAO-10-266R, p. 7. When estimating the cost to deploy a State Department employee to Iraq, GAO determined that only 26 percent of the cost could be attributed to salary and benefits, the remainder being attributed to costs associated with overseas deployment. GAO made no attempt to segregate out comparable cost factors for contractor employees, as the vast majority of contractor employees are foreign nationals (65%). GAO-10-266R, p. 10.

¹²⁵ GAO-10-266R, p. 6. The Baghdad Embassy contract saved the government \$785.1 million, one Worldwide task order saved \$43.7 million, a second Worldwide task order saved \$40.3 million, and a third Worldwide task order saved \$3.3 million.

¹²⁶ GAO-10-266R, p. 6.

many cases, I believe we could stop using foreign contractors and use a greater number of Afghan contractors.”¹²⁷

Contractors Overseeing Contracts

According to a March 2008 GAO study of contractor contract specialists, the Army Contracting Agency’s Contracting Center of Excellence (CCE) paid contractors more than federal employees would have been compensated. The Army paid

more on average for contractor-provided contract specialists than for its government contract specialists who are doing equivalent work. [GAO] found that on average and taking into account benefits and overhead rates, the cost of a GS-12 CCE contract specialist is \$59.21 per hour, as compared to the contractors’ average loaded hourly labor rate of \$74.99, or about 17 percent more. The average cost of CCE’s GS-13 specialists is \$72.15 per hour, while it is paying the contractor specialists \$84.38 per hour, or about 27 percent more. [GAO] also reviewed available résumés of six contract employees supporting CCE for at least 6 months and found that they had from 5 to 32 years, or an average of 18 years, of contracting-related experience. In comparison, the five CCE government contract specialists hired in fiscal year 2007 had from 6 to 17 years, or an average of about 12 years, of contracting-related experience. All six contract employees had previously worked for, and were trained by, the federal government before being hired by the contractor.¹²⁸

The cost differential arguably might have been explained by the fact that the contractor employees were more experienced, but the GAO study was silent on whether additional experience was required or necessary to effectively perform the contracted services.

Air Force Logistics

An example of how DoD’s historical propensity for outsourcing services has resulted in excessive costs rather than cost savings was recently revealed. In 2009, the Air Force began implementing a DoD policy in support of insourcing services, including services that contractors were not performing at a cost savings to the federal government.¹²⁹ In one such case, Santa Barbara Applied Research, Inc. (SBAR) sued the government, challenging an Air Force decision to insource work that SBAR had performed under a 2007 logistics support contract.¹³⁰ The court decided the case in the government’s favor and highlighted the complexity of government-to-contractor cost analyses.

¹²⁷ Pierre Tran, “NATO Commander: Too Many Contractors in Afghanistan,” *Federal Times*, April 20, 2010. <http://www.federaltimes.com/article/20100420/DEPARTMENTS01/4200307/1009/ACQUISITION> (Downloaded September 27, 2010)

¹²⁸ Government Accountability Office, *Defense Contracting: Army Case Study Delineates Concerns with Use of Contractors as Contract Specialists* (GAO-08-360), March 26, 2008, p. 5. <http://www.gao.gov/new.items/d08360.pdf> (Downloaded September 27, 2010)

¹²⁹ *Santa Barbara Applied Research, Inc. v. United States*, Court of Fed. Claims, No. 11-86C, May 4, 2011, p. 5. <http://www.uscfc.uscourts.gov/sites/default/files/FIRESTONE.SANTA050411.pdf> (Downloaded May 6, 2011) (hereinafter *SBAR*); Memorandum from William Lynn, Deputy Secretary of Defense, to the Secretaries of the Military Departments, “In-sourcing Contracting Services – Implementation Guidance,” May 28, 2009. <http://www.asamra.army.mil/scra/documents/DepSecDef%20Memo%2028MAY09%20In-sourcing%20Implementation%20Guidance.pdf> (Downloaded May 10, 2011) (hereinafter *In-sourcing Contracting Services – Implementation Guidance*)

¹³⁰ *SBAR*, pp. 1-2.

The Air Force contract required SBAR to perform management, operations, and maintenance services at nine locations within the Air Force Space Command.¹³¹ Subsequently, new laws and regulations required DoD to better estimate and compare full costs of keeping work in-house or outsourcing it.¹³² Following that requirement, the Air Force identified contracts that were viable for insourcing by using the COMPARE cost-calculating tool.¹³³ In 2010, after analyzing costs and determining that hiring civilian federal employees would be less expensive than hiring contractors, the Air Force notified SBAR that it was insourcing a portion of the contract.¹³⁴ The Air Force originally calculated cost savings of more than \$31 million, but after SBAR's challenge, the Air Force conducted a new cost analysis based on the most recent data and found savings of approximately \$8.8 million when the work was performed in-house.¹³⁵

Army Operations Research

The guidance DoD issued to better determine whether civilian federal employees or contractor employees can perform functions at a lower cost¹³⁶ included an example in which DoD examined the relative costs to the Department of the Army of hiring an operations research analyst or contracting for an analyst to perform at a comparable level.¹³⁷ DoD found that the full cost to the government of hiring a civilian federal employee was \$168,349, and that the cost of outsourcing the position to a contractor was \$218,592.¹³⁸ This example demonstrates that outsourcing resulted in excessive costs of \$50,243, or 30 percent.

Army Corps of Engineers

In addition to the publicly accessible cost reviews cited above, POGO obtained an Army Corps of Engineers (USACE) review¹³⁹ that found contractor employees "consist of 15 percent of the [USACE Engineering and Support Center Huntsville (CEHNC)] workforce" and "there could be an annual potential savings of \$874,289 by competitively hiring government civil service employees (GS) versus contractor personnel."¹⁴⁰ The report cited the following concerns:

¹³¹ SBAR challenged the insourcing decision at four of the nine locations. *SBAR*, pp. 2-3, 9.

¹³² NDAA FY 2008, § 324; Ike Skelton National Defense Authorization Act for Fiscal Year 2011 (Pub. Law 111-383), § 323(b), January 7, 2011; In-sourcing Contracting Services—Implementation Guidance; Memorandum from Christine H. Fox, Director of Cost Assessment and Program Evaluation, to the Secretaries of the Military Departments, "Directive-Type Memorandum (DTM) 09-007, 'Estimating and Comparing the Full Costs of Civilian and Military Manpower and Contract Support,'" January 29, 2010, revised October 21, 2010. <http://www.dtic.mil/whs/directives/cores/pdf/DTM-09-007.pdf> (Downloaded May 10, 2011) (hereinafter DTM-09-007)

¹³³ COMPARE is a software program used to compare "the relative costs of operating commercial activities by in-house, other Government agency, or commercial entities for purposes of OMB Circular A-76." *SBAR*, pp. 5-6. DoD subsequently updated the COMPARE database with costing procedures outlined in DTM-09-007, which is set to expire on September 1, 2011.

¹³⁴ *SBAR*, p. 8.

¹³⁵ *SBAR*, pp. 8, 11.

¹³⁶ DTM-09-007, p. 5.

¹³⁷ DTM-09-007, p. 23. Using a methodology similar to POGO's, DoD's example is based on base pay and benefits for military and civilian personnel, and the contractor hourly rates were from the GSA Federal Services Schedule, which were converted to an annual rate by multiplying the hourly rate by 2,087.

¹³⁸ DTM-09-007, pp. 23-25. The full cost to the government includes DoD costs as well as other agency costs. DoD calculated that its cost to hire a civilian federal employee was \$157,239. The government's example provides costs for contractors working at a government (\$218,592) and contractor (\$268,555) site. POGO referred to the government site contractor rate because it corresponded to the rates utilized in our study. The example also found that military personnel ("Military O-5, 20 Years of Service") would cost DoD \$210,968 and the government \$264,548 (this includes costs that agencies such as Veterans Affairs and the Department of Education incur related to military personnel).

¹³⁹ U.S. Army Corps of Engineers, Engineering and Support Center, Huntsville, "Consulting Review of Contractor (In-House) Support Services Contracts," CEHNC-IR-2006-009, July 21, 2005. (hereinafter USACE Huntsville)

¹⁴⁰ USACE Huntsville, p. 1.

- 15 percent of CEHNC workforce is composed of support contractors. 54 percent of the support contractors are located in-house and the other 46 percent are located at the contractor site or the assigned worksite.
- 58 percent of the in-house contractors charge direct while 38 percent charge indirect (overhead).
- CEHNC provides 100 percent of in-house contractor personnel with the tools and equipment needed to perform their tasks.
- Approximately 75 percent of in-house contractor' [sic] scope of work does not provide a clear and concise explanation of the services contracted.
- Several instances were noted where the contractor performed work that could highly be considered personal services.
- Distinguishing between civil servants and contractor personnel needs improvement.
- Approximately 95 percent of the contractor personnel work station or cubicle [sic] were not clearly distinguishable from Government personnel.
- Contractor personnel have filled the same positions at CEHNC for more than 3 years and some as much as 8 years.
- In-house contractor personnel are located side-by-side with government civil service employees.
- Approximately 80 percent of the 42 contracts reviewed were extended beyond the original performance period.
- 13 (12%) of contractor support was identified as retired or previously employed by CEHNC.
- 14 (13%) of contractors [sic] personnel held positions such as Project Control Specialist, Consultant, Project Manager, Senior Investment, etc. These contractor employees' salaries are comparable to GS 14 and 15 salaries. The cost to hire GS government employees in this contracted position would result in an annual savings of \$537,573 (61% of the total estimated cost savings).¹⁴¹

Many of those concerns echo POGO's findings, including the long-term period of work for service contracts and the lack of cost savings. Additional concerns were raised in the USACE report relating to conflicts of interest and poor contract planning and administration that also place taxpayer funds at risk. If the government were to investigate whether these conditions permeate the USACE and other agencies, it would be in a position to determine if billions are being wasted.

Protesting West Point Outsourcing

The aforementioned studies actually test the belief that outsourcing results in cost savings, but more frequently the government acted on this belief without ever testing it, as documented by a variety of bid protests. For example, in 2006, the Army began preliminary planning for an A-76 competition at West Point for public works jobs.¹⁴² In 2008, the Army issued a request for proposal (RFP)¹⁴³ that contemplated either the issuance of a performance agreement with a "most efficient organization" (MEO) of federal employees or the award of a cost-plus fixed-fee contract to a contractor.¹⁴⁴ The RFP indicated a number of critical factors that would be considered, and that the "lowest-cost technically-

¹⁴¹ USACE Huntsville, pp. 1-2.

¹⁴² Government Accountability Office, "Decision in the matter of Frank A. Bloomer – Agency Tender Official, B-401482.2; B-401482.3," October 19, 2009, p. 2. <http://www.gao.gov/decisions/bidpro/4014822.pdf> (Downloaded September 27, 2010) (hereinafter Bloomer Bid Protest)

¹⁴³ Bloomer Bid Protest, p. 2. Federal Business Opportunities, "West Point A-76 Department of Public Works – Custodial Support Services Solicitation Number: W91 IS0-08-R-0009," March 26, 2009.

https://www.fbo.gov/?s=opportunity&mode=form&tab=core&id=82c7cdc05420770eb2a3c0c85d022def&_cview=0 (Downloaded April 5, 2011)

¹⁴⁴ Bloomer Bid Protest, p. 2.

acceptable proposal” would prevail.¹⁴⁵ It was expected that a significant portion of the work under this contract would be done by issuing about 20,000 standard operating orders and 340 individual job orders per year, involving 16 different trades.¹⁴⁶

The RFP required the submission of a cost proposal and indicated that the Army would conduct a “cost realism” analysis.¹⁴⁷ The cost proposals were required to provide detailed fringe benefit cost information,¹⁴⁸ direct labor costs, overhead costs, administrative costs, subcontracts, and profit.¹⁴⁹ The Army cost evaluator deemed both the agency and winning contractor prices to be “realistic, reasonable, and complete.”¹⁵⁰

The contractor claimed it would perform the work 10 percent more efficiently than the government. The contractor based this claim on similar projects and services it had performed in the past. The contractor’s cost estimate was approximately \$58 million. The federal employees’ cost estimate was approximately \$68 million. The award went to the contractor, and federal employees filed a bid protest with the GAO.¹⁵¹

In the end, GAO sustained the federal employees’ protest on the basis that the Army’s cost realism analysis, on which the cost review relied, was “materially flawed.”¹⁵² The GAO found that the record provided no reasonable basis for the Army to accept the contractor’s performance estimates, because the contractor did not provide “factual support for its increased efficiency assumption.”¹⁵³

The Army’s decision to outsource work highlights the government’s willingness to operate on the belief that outsourcing results in cost savings without any evidence to substantiate that belief. To ensure GAO’s advisory decision was not circumvented, Congress mandated that no activities performed at West Point be outsourced to private contractors pursuant to an A-76 study.¹⁵⁴

IRS Contractors Tax Public

Outsourcing work at the Internal Revenue Service (IRS) has been a hotly debated issue for years. In 1996, the IRS conducted a pilot private debt collection program to reduce the gross tax gap,¹⁵⁵ but canceled the program after one year.¹⁵⁶ The cancellation occurred because both the IRS and the OMB considered tax collection to be inherently governmental work.¹⁵⁷ Additionally, the program was not

¹⁴⁵ Bloomer Bid Protest, p. 2.

¹⁴⁶ Bloomer Bid Protest, p. 3.

¹⁴⁷ Bloomer Bid Protest, pp. 1, 4.

¹⁴⁸ Health-benefit and retirement-benefit costs were to be consistent with the costs in the agency tender. Bloomer Bid Protest, p. 4.

¹⁴⁹ Bloomer Bid Protest, p. 4.

¹⁵⁰ Bloomer Bid Protest, p. 7.

¹⁵¹ Bloomer Bid Protest, p. 9.

¹⁵² Bloomer Bid Protest, pp. 1, 10.

¹⁵³ Bloomer Bid Protest, pp. 13-14.

¹⁵⁴ Department of Defense Appropriations Act, 2010.

¹⁵⁵ “The gross tax gap is the amount of tax that is imposed by law for a given tax year but not paid voluntarily or timely.”

Internal Revenue Service, *National Taxpayer Advocate: 2004 Annual Report to Congress*, Vol. I, December 31, 2004, p. 226. <http://www.irs.ustreas.gov/pub/irs-utl/ntafy2004annualreport.pdf> (Downloaded May 4, 2011) (hereinafter *National Taxpayer Advocate 2004*)

¹⁵⁶ Government Accountability Office, *Tax Debt Collection: IRS Is Addressing Critical Success Factors for Contracting Out but Will Need to Study the Best Use of Resources* (GAO-04-492), May 2004, p. 6.

<http://www.gao.gov/new.items/d04492.pdf> (Downloaded April 28, 2011) (hereinafter GAO-04-492)

¹⁵⁷ General Accounting Office, *Internal Revenue Service: Issues Affecting IRS’ Private Debt Collection Pilot* (GAO/GGD-97-129R), July 18, 1997, p. 2. <http://archive.gao.gov/papprpdf/1159007.pdf> (Downloaded June 17, 2011); United States

producing the desired results—the amount of revenue collected by the private collectors was offset by the costs of the program.¹⁵⁸ The IRS continued to experience an expanded annual gross tax gap, which by 2001 reached over \$300 billion in unpaid taxes.¹⁵⁹

Collection staffing shortages in the early 2000s again compelled the IRS to seek help from contractors in recovering billions of dollars in delinquent federal taxes.¹⁶⁰ The IRS envisioned hiring contractors called private collection agencies (PCAs) to work on “simple” collection cases.¹⁶¹ By 2004, in response to the degradation of IRS’ debt collection efforts, Congress passed the American Jobs Creation Act of 2004, authorizing the IRS to proceed with its Private Debt Collection (PDC) initiative, a pilot program for outsourcing elements of its responsibility for collecting delinquent taxes.¹⁶² PCAs would be given slightly more discretion in resolving cases¹⁶³ and would be paid up to 25 percent¹⁶⁴ of the amount of taxes they recovered.¹⁶⁵ The new program was instituted in 2006.¹⁶⁶

In 2008, the benefits of this cost savings initiative were called into question. The IRS’s National Taxpayer Advocate reported that in FY 2007, the IRS collected \$2.7 trillion in taxes, while the PDC initiative brought in only \$37 million in FY 2008 (before subtracting the operating costs of the program, commissions paid to the contractor of up to 25 percent, and indirect payments).¹⁶⁷ The National Taxpayer Advocate report concluded that the PDC program was “probably causing a net reduction in federal revenue, which obviously defeats the purpose of the program. IRS data now show that the IRS’s Collection function outperforms the PCAs in almost every way.”¹⁶⁸

In March 2009, the IRS published the results of its cost effectiveness study of the PDC.¹⁶⁹ In one sample, the study compared the cost effectiveness of contractors and the IRS’s Automated Collection

Constitution, Art. I, sec. 8, cl. 1 (“The Congress shall have Power to Lay and Collect taxes....”)
http://www.archives.gov/exhibits/charters/constitution_transcript.html (Downloaded June 17, 2011); In its landmark 1819 decision in *McCulloch v. Maryland*, the U.S. Supreme Court ruled that the power to tax “is an incident of sovereignty, and is coextensive with that to which it is an incident.” 17 U.S. 316 (1819), p. 429.
http://www.law.cornell.edu/supct/html/historics/USSC_CR_0017_0316_ZO.html (Downloaded June 17, 2011); OMB Circular A-76, as it existed in 1999, specifically listed the collection of taxes as an inherently governmental function. Executive Office of the President, Office of Management and Budget, *Circular No. A-76: Revised Supplemental Handbook: Performance of Commercial Activities*, March 1996, updated through transmittal memorandum 20, June 1999, p. 60.
http://www.whitehouse.gov/sites/default/files/omb/assets/agencyinformation_circulars_procurement_pdf/a076supp.pdf (Downloaded June 17, 2011)
¹⁵⁸ Government Accountability Office, *Tax Debt Collection: IRS Is Addressing Critical Success Factors for Contracting Out but Will Need to Study the Best Use of Resources* (GAO-04-492), May 2004, p. 6.
<http://www.gao.gov/new.items/d04492.pdf> (Downloaded April 28, 2011) (hereinafter GAO-04-492)
¹⁵⁹ National Taxpayer Advocate 2004, p. 228.
¹⁶⁰ GAO-04-492, pp. 5-6.
¹⁶¹ GAO-04-492, p. 6.
¹⁶² The American Jobs Creation Act of 2004 (Pub. Law 108-357), § 881, October 22, 2004.
¹⁶³ GAO-04-492, p. 6.
¹⁶⁴ Internal Revenue Service, *National Taxpayer Advocate: 2008 Annual Report to Congress*, Vol. I, December 31, 2008, p. 328. http://www.irs.gov/pub/irs-utl/08_tas_arc_intro_toc_msp.pdf (Downloaded June 1, 2011) (hereinafter National Taxpayer Advocate 2008)
¹⁶⁵ GAO-04-492, p. 7.
¹⁶⁶ Internal Revenue Service, “IRS Outlines Taxpayer Protections in Private Debt Collection Program,” August 23, 2006. <http://www.irs.gov/newsroom/article/0,,id=161300,00.html> (Downloaded May 4, 2011)
¹⁶⁷ National Taxpayer Advocate 2008, p. 328.
¹⁶⁸ National Taxpayer Advocate 2008, p. 328.
¹⁶⁹ Internal Revenue Service, *Private Debt Collection: Cost Effectiveness Study*, March 2009. <http://grassley.senate.gov/news/upload/PDC-Cost-Effectiveness-Study-March-2009-2.pdf> (Downloaded April 28, 2011) (hereinafter Private Debt Collection: Cost Effectiveness Study)

System for collecting delinquent taxes. The study found that the cost per delinquent dollar collected was more than three times greater for contractors than for IRS employees. Additionally, IRS employees collected nearly three times more in delinquent taxes and resolved more than twice the number of cases as PCAs.¹⁷⁰ That same month, the IRS announced it was not renewing the collections contracts, thereby ending the PDC program.¹⁷¹

TSA's Screening Partnership Program

The Transportation Security Administration's (TSA) airport screening program also provides cost reviews of federal and contractor employees. TSA created the Screening Partnership Program (SPP) to allow commercial airports an opportunity to use contractor screeners instead of federal employees.¹⁷² In 2009, GAO reported on a TSA contractor study that "concluded that passenger screening at [airports staffed by contractors] has historically cost from 9 to 17 percent more than at [airports staffed by federal employees], and [contractor] screeners performed at a level that was equal to or greater than that of federal [employees]."¹⁷³ GAO highlighted limitations in TSA's methodology and made recommendations to correct future reviews.¹⁷⁴ Two years later, GAO revisited TSA's cost and performance reviews and reported that TSA claimed that airports with contractor screeners "would cost 3 percent more to operate in 2011 than airports using federal screeners."¹⁷⁵

Another comparative cost analysis, however, arrived at a different conclusion. The House Committee on Transportation and Infrastructure issued an analysis in June 2011 finding that: 1) taxpayers would save \$1 billion over five years if the nation's top 35 airports operated as efficiently as the San Francisco International airport under the SPP program, and 2) SPP screeners are 65 percent more efficient than their TSA federal counterparts.¹⁷⁶

All of these government study examples illustrate the difficulty in comparing costs, and the contradictory results that can result from disparate methodologies. Until the government creates a system to accurately estimate the cost of performing commercial services, the public will never know the actual savings that could have been realized.

¹⁷⁰ Private Debt Collection: Cost Effectiveness Study, p. 9.

¹⁷¹ Internal Revenue Service, "IRS Conducts Extensive Review, Decides Not to Renew Private Debt Collection Contracts -- IRS Employees More Flexible, More Cost Effective," March 5, 2009. <http://www.irs.gov/newsroom/article/0,,id=205021,00.html> (Downloaded April 28, 2011)

¹⁷² Aviation and Transportation Security Act (Pub. L. No. 107-71), § 108, November 19, 2001.

¹⁷³ Government Accountability Office, *Aviation Security: TSA's Cost and Performance Study of Private-Sector Airport Screening* (GAO-09-27R), January 9, 2009, p. 5. <http://www.gao.gov/new.items/d0927r.pdf> (Downloaded June 15, 2011) (hereinafter GAO-09-27R)

¹⁷⁴ GAO-09-27R, pp. 24-30.

¹⁷⁵ Government Accountability Office, *Aviation Security: TSA's Revised Cost Comparison Provides a More Reasonable Basis for Comparing the Costs of Private-Sector and TSA Screeners* (GAO-11-375R), March 4, 2011, p. 4. <http://www.gao.gov/new.items/d11375r.pdf> (Downloaded June 15, 2011)

¹⁷⁶ House Committee on Transportation and Infrastructure Oversight and Investigations, *Staff Report: TSA Ignores More Cost Effective Screening Model*, June 3, 2011, p. 2. http://republicans.transportation.house.gov/Media/file/112th/Aviation/2011-06-03-TSA_SPP_Report.pdf (Downloaded June 15, 2011); The Committee report appears to be in response to a January decision by TSA Administrator John Pistole that announced that TSA would not expand SPP beyond its current 16 airports "as I do not see any clear or substantial advantages to do so at this time." John S. Pistole, Administrator, Transportation Security Administration, "TSA Statement on Contractor Screening Program," January 28, 2011. http://www.tsa.gov/press/happenings/2011/012811_contractor_screening_program.shtm (Downloaded June 21, 2011); The House Committee on Homeland Security, "King, Rogers, McCaul Introduce Bill to Aid Airports Seeking to Replace TSA Screening with Private Screening Companies," April 15, 2011. <http://homeland.house.gov/press-release/king-rogers-mccaul-introduce-bill-aid-airports-seeking-replace-tsa-screening-private> (Downloaded June 15, 2011)

Cautionary Notes Relating to Other Cost Analyses

As mentioned previously, POGO's investigation is unique in that we compared federal and private sector employees' full compensation with average annual contractor billing rates for a sampling of occupational classifications. As reflected in Table 1, with a few exceptions, POGO confirms the results of studies that compared the public with the private sector, finding that federal employees generally make approximately 20 percent more in salary and full compensation than do their counterparts in the private sector. While POGO's investigation adds some credibility to the government and private sector comparison studies, POGO has some concerns about those other studies.

For example, *USA Today* analyzed a sample of 40 occupations using BLS data for 2008 and found that the typical federal employee is paid 20 percent more than a private sector employee in the same occupation.¹⁷⁷ The study found that "federal employees earn higher average salaries than private-sector workers in more than eight out of 10 occupations." *USA Today* used median salaries and did not adjust for any other cost factors, including health care and pension benefits. That study was refuted by National Treasury Employees Union President Colleen Kelley, who stated it "compares apples and oranges" because certain government work "has more complexity and requires more skill than...work in the private sector."¹⁷⁸

A similar opinion has been stated by former OMB director Peter Orszag:

...the truth is that a comparison of federal and private-sector pay, even by occupation, is misleading because the employees hired by the federal government often have higher levels of education than their counterparts in the private sector—even within the same occupations. When you factor in the education and experience of the federal workforce, there is no statistically significant difference in average pay levels.¹⁷⁹

OPM Director John Berry, when he testified before the Senate in March 2010, similarly stated that comparisons showing that federal employees make more than private sector employees are conveying "misinformation" because they are not comparing workers with comparable skills and work experience.¹⁸⁰ Three months later, Berry announced that OPM enlisted outside experts to work with government statisticians to help settle the debate over pay differences.¹⁸¹ Although OPM has historically employed the methodology found in the annual Pay Agent's Report to make these

¹⁷⁷ Dennis Cauchon, "Federal pay ahead of private industry," *USA Today*, March 8, 2010. http://www.usatoday.com/news/nation/2010-03-04-federal-pay_N.htm (Downloaded September 27, 2010) (hereinafter "Federal pay ahead of private industry")

¹⁷⁸ "Federal pay ahead of private industry"

¹⁷⁹ Peter Orszag Blog.

¹⁸⁰ Testimony of the Honorable John Berry, Director of the U.S. Office of Personnel Management, Before the U.S. Senate Subcommittee on Financial Services and General Government, Committee on Appropriations, March 24, 2010.

<http://appropriations.senate.gov/webcasts.cfm?method=webcasts.view&id=11f73d73-2d37-4d41-8f28-4193860f1e80/> (Downloaded April 3, 2011); Stephen Losey, "New OPM Taskforce to Study Pay Gap," *Federal Times*, March 24, 2010. <http://www.federaltimes.com/article/20100324/BENEFITS01/3240304/1001> (Downloaded September 27, 2010)

¹⁸¹ Stephen Losey, "OPM Enlists Outside Experts to Determine Federal-Private Pay Gap," *Federal Times*, June 17, 2010. <http://www.federaltimes.com/article/20100617/BENEFITS01/6170302/1001/AGENCY04> (Downloaded September 27, 2010)

comparisons,¹⁸² it is not known what data and methodology the outside experts are using for their comparisons.¹⁸³

Another study comparing federal employee wages to private sector employee wages for comparable services was published by the Heritage Foundation. The Heritage Foundation found that “[t]he federal pay system gives the average federal employee hourly cash earnings 22 percent above the average private worker’s, controlling for observable skills and characteristics.... Overall, controlling for other factors, federal employees earn approximately 30 percent to 40 percent more in total compensation (wages and benefits) than comparable private-sector workers.”¹⁸⁴ In light of that finding, Heritage recommended hiring more contractors.¹⁸⁵

However, the Heritage study presents a number of methodological problems that call into question the validity of its findings and recommendations. The most critical problem, as it relates to whether outsourcing promotes cost savings, is Heritage’s recommendation that the government hire more contractors. Heritage bases this recommendation on its comparative analysis of private-public compensation, despite the fact that the study did not compare federal costs for comparable services performed by contractors. So, despite Heritage’s claims that federal employees are costing taxpayers, it is impossible for Heritage to empirically determine whether or not those savings would, in fact, be realized based on its study.

Another problem with the Heritage study is that it used another BLS survey, the Current Population Survey (CPS), to document wage comparisons. There are several concerns with the CPS. First, the CPS is a household employment survey with a sample size significantly smaller in scale than the National Compensation Survey (NCS). The CPS sample constitutes approximately 60,000 households,¹⁸⁶ whereas the NCS sampling frame is made up of more than 5,400,000 business respondents.¹⁸⁷ The NCS’s larger sampling frame provides for more valid and reliable results.

¹⁸² The annual Pay Agent’s Report compares rates of federal and private sector pay, identifies areas in which a pay disparity exists and specifies the size of the disparity, and makes recommendations for locality rates. Office of Personnel Management, “President’s Pay Agent.” <http://www.opm.gov/oca/payagent/> (Downloaded June 17, 2011)

¹⁸³ It is not known, for instance, whether the experts will take into consideration a June 2010 white paper issued by an American Bar Association task force that highlights a criticism of the methodology used in the cost studies addressed in the Office of Federal Procurement Policy’s (OFPP) Proposed Policy Letter dated March 31, 2010: namely, “arbitrarily assigning overhead values... across the board... as well as imposing ‘plug’ numbers for personnel costs [i.e., fringe benefits] as opposed to actual loaded labor costs.” Task Force of the American Bar Association, Public Contract Law Section, Privatization, Outsourcing and Financing Transactions and Battlespace Committees, *Work Reserved for Performance by Federal Government Employees: OFPP Draft Policy Letter dated March 31, 2010 – Issues and Challenges*, June 16, 2010, p. 9. http://meetings.abanet.org/webupload/commupload/PC800100/otherlinks_files/wp061610.pdf (Downloaded September 27, 2010)

¹⁸⁴ James Sherk, *A Report of the Heritage Center for Data Analysis: Inflated Federal Pay: How Americans Are Overtaxed to Overpay the Civil Service* (Report # 10-05), July 7, 2010, p. 1. http://thf_media.s3.amazonaws.com/2010/pdf/CDA10-05.pdf (Downloaded September 27, 2010) (hereinafter Heritage Study). The Heritage Foundation “is a research and educational institution—a think tank—whose mission is to formulate and promote conservative public policies based on the principles of free enterprise, limited government, individual freedom, traditional American values, and a strong national defense.” <http://www.heritage.org/About>

¹⁸⁵ Heritage Study, p. 16.

¹⁸⁶ Bureau of Labor Statistics, “Labor Force Statistics from the Current Population Survey: Overview – Source of data.” http://www.bls.gov/cps/cps_over.htm#source (Downloaded June 17, 2011)

¹⁸⁷ Bureau of Labor Statistics, “National Compensation Survey, December 2006 – January 2008,” Appendix Table 2. <http://www.bls.gov/ncs/sp/nctb0767.pdf> (Downloaded September 27, 2010)

Second, CPS average hourly wage data for private sector employees markedly differs from the comparable NCS data due to CPS's insufficient sample sizes for specific occupations.¹⁸⁸ POGO analyzed a subset of eight occupations reported in the Heritage study and determined that the reliance on CPS data resulted in significant distortions. According to POGO's analysis, the distortions between the CPS and NCS data ranged from negative 19 percent in the case of security guards to 84 percent in the case of financial managers.¹⁸⁹

Third, CPS average hourly wage data for federal employees differs markedly from the government's official statistics. The CPS data for federal employees results in distortions similar to that found in the private sector employees data because it relies on a less representative sample size when compared with the government's data, which is based on a total population analysis. When CPS data is compared with OPM's FedScope data,¹⁹⁰ POGO found that for the subset of eight occupations,¹⁹¹ discrepancies ranged from negative 29 percent in the case of security guards to 67 percent in the case of financial managers.¹⁹²

Fourth, when NCS wage data for private sector employees are compared with OPM wage data for federal employees (the proper data comparison for estimating the private-federal wage differential) the differentials for the eight occupations we compared are significantly different from the 30 to 71 percent differentials found by The Heritage Foundation.¹⁹³ Indeed, for the eight private-to-federal comparisons we examined, POGO found The Heritage Foundation's claimed wage differentials were distorted anywhere from 21 to 146 percent.¹⁹⁴

¹⁸⁸ The CPS data used for comparable occupations in the Heritage study is found in Table 6 of Heritage's report and is based on data from 2006 through 2009. Heritage Study, pp. 5, 7-8. The NCS data for comparison purposes is for December 2007 to January 2009. Bureau of Labor Statistics, "Table 4: Full-time private industry workers: Mean and median hourly, weekly, and annual earnings and mean weekly and annual hours," pp. 4-1 through 4-37. <http://www.bls.gov/ncs/ocs/sp/ncbl1311.pdf> (Downloaded September 27, 2010)

¹⁸⁹ Specifically, the analysis shows the following discrepancies: Electrical and electronics engineers: \$28.50 (CPS) v. \$40.51 (NCS), a 42% discrepancy; Statisticians: \$25.47 (CPS) v. \$37.92 (NCS), a 49% discrepancy; Financial managers: \$24.59 (CPS) v. \$45.22 (NCS), a 84% discrepancy; Budget analysts: \$24.20 (CPS) v. \$31.41 (NCS), a 30% discrepancy; Accountants and auditors: \$22.60 (CPS) v. \$29.55 (NCS), a 31% discrepancy; Human resources: \$22.05 (CPS) v. \$28.75 (NCS), a 30% discrepancy; Purchasing agents: \$21.69 (CPS) v. \$28.71 (NCS), a 32% discrepancy; Security guards: \$14.02 (CPS) v. \$11.37 (NCS), a -19% discrepancy.

¹⁹⁰ FedScope is an OPM dataset of federal salary information for all federal employees.

¹⁹¹ FedScope only provides data on annual salaries and does not include overtime pay or awards. POGO used the average annual salaries for all federal employees in a specified occupation and divide by 2080, the number of official hours for which federal employees are paid. Appendix A includes directions on where to find the data upon which POGO's comparisons are based.

¹⁹² Specifically, the analysis shows the following discrepancies: Electrical engineers: \$37.04 (CPS) v. \$47.82 (FedScope), a 29% discrepancy; Statisticians: \$33.55 (CPS) v. \$42.76 (FedScope), a 27% discrepancy; Financial managers: \$32.84 (CPS) v. \$54.83 (FedScope), a 67% discrepancy; Budget analysts: \$32.36 (CPS) v. \$36.95 (FedScope), a 14% discrepancy; Accountants and auditors: \$30.26 (CPS) v. \$42.15 (FedScope), a 39% discrepancy; Human resources: \$30.50 (CPS) v. \$37.57 (FedScope), a 23% discrepancy; Purchasing agents: \$31.88 (CPS) v. \$38.44 (FedScope), a 21% discrepancy; Security guards: \$24.03 (CPS) v. \$17.04 (FedScope), a -29% discrepancy.

¹⁹³ Heritage Study, p. 8 ("total differences" in Table 6).

¹⁹⁴ The True Differential column compares NCS hourly rates with OPM hourly rates. Heritage compared CPS hourly rates. The Heritage Distortion column compares the True Differential with Heritage's CPS Differential. The specific distortions are set forth below:

	NCS	OPM	True	CPS	Heritage
	Private	Federal	Differential	Differential	Distortion
Electrical engineers	\$40.51	\$47.82	18%	30%	67%
Statisticians	\$37.92	\$42.76	13%	32%	146%
Financial managers	\$45.22	\$54.83	21%	34%	62%
Budget analysts	\$31.41	\$36.95	18%	34%	89%
Accountants and auditors	\$29.55	\$42.15	43%	34%	-21%

Finally, The Heritage Foundation claims that federal employees get an average annual benefits package worth \$32,115, while private sector employees get an average annual benefits package worth only \$9,882. In fact, OMB calculates that federal employees receive an estimated annual benefits package that is 36.25 percent of their annual salaries.¹⁹⁵ In comparison, based on NCS data, the BLS calculates that private sector employees who work for large companies receive an estimated annual benefits packages worth 33.5 percent of their annual salaries.¹⁹⁶ The differential in benefits compensation is therefore only approximately 8 percent, not the 325 percent claimed by The Heritage Foundation.

And in yet another study, in a congressional effort to determine whether reducing federal employee compensation is appropriate and an effective way to save taxpayer money, the Congressional Research Service (CRS) was directed to conduct a study comparing the salaries of the 50 state governors with federal employees working in their states.¹⁹⁷ The CRS study documented that 77,057 federal employees earned more in total annual pay than their respective state governors.¹⁹⁸ Although the results of this study are alarming, policymakers should not rush to judgment that federal employees are overpaid. Similar to salary comparisons involving federal and private sector employees, CRS ignores what is most telling—the total cost to the federal government, no matter if the work is performed by federal or contractor employees.

When policymakers use these or similar studies to justify outsourcing, they will miss the mark. Because the major source of excessive costs results from government's reliance on contractors, any such study, without a review of the rates contractors will bill the government, will most likely provide little, if any, useful information about how to achieve cost savings.

SAVINGS RISKED BY LONG-TERM CONTRACTS AND FEDERAL EMPLOYMENT RESTRICTIONS

POGO is also concerned with the number of long-term service contracts, which removes government flexibility and can result in cost increases rather than savings. The federal government regularly enters into contracts that extend over long periods of time—sometimes 10 years or more.¹⁹⁹

One reason for such long-term contracts is Congress's failure to remove the ceiling on federal employee full-time equivalents (FTE)²⁰⁰ under the guise of reducing the size of government. But with this freeze, agencies are forced to bring in contractors for support in order to meet their missions and provide flexibility to meet changing government financial situations and demands. POGO agrees that

Human resources	\$28.75	\$37.57	31%	38%	23%
Purchasing agents	\$28.71	\$38.44	34%	47%	38%
Security guards	\$11.37	\$17.04	50%	71%	42%

¹⁹⁵ Update to Civilian Position Full Fringe Benefit Cost Factor, pp. 1, 2.

¹⁹⁶ Bureau of Labor Statistics, "Employer Costs for Employee Compensation: Historical Listing: March 2004 – March 2011," Table 14, 500 workers or more. <ftp://ftp.bls.gov/pub/special.requests/ocwc/ect/ecccqrtn.txt> (Downloaded June 21, 2011)

¹⁹⁷ Memorandum from Wendy Ginsberg, Analyst in American National Government, Congressional Research Service, to Senator Tom Coburn, "Federal Employee Salaries and Gubernatorial Salaries," May 6, 2011. http://coburn.senate.gov/public/index.cfm?a=Files.Serve&File_id=8718cd7d-b243-49bf-8805-e7eb0fdc7709 (Downloaded June 10, 2011) (hereinafter Federal Employee Salaries and Gubernatorial Salaries)

¹⁹⁸ Federal Employee Salaries and Gubernatorial Salaries, p. 3.

¹⁹⁹ "ASC selects LOGCAP IV contractors."

²⁰⁰ *Inherently Governmental Functions and Department of Defense Operations: Background, Issues, and Options for Congress* (R40641), pp. 33-34.

contractors can provide flexibility, especially in the case of short-term projects. However, if federal hiring restrictions are in place, the government's overall flexibility is undermined while the size of government still increases in the form of a shadow government contractor workforce.

For instance, the Coast Guard's Deepwater program became one of the most egregious examples of excessive costs associated with outsourcing government work. The program was designed to upgrade the Coast Guard's fleet, including efforts to build or modernize five classes of ships and aircraft. In 2002, the Coast Guard contracted with Integrated Coast Guard Systems (ICGS), a joint venture formed by Lockheed Martin and Northrop Grumman, to manage the entire operation. After years of cost overruns, design flaws, and ships and technology that failed to meet contract requirements, the Coast Guard assumed the position as program manager in 2010.²⁰¹ As seen in this example, transferring skills and experience from the federal government to contractors is not always in the government's and taxpayers' interest.

According a 2009 *Federal Times* article, 16 intelligence agencies urged Congress to remove caps on staffing at intelligence agencies.²⁰² Agencies were left no recourse but to hire contractors as semi-permanent staff, largely because of imposed staff ceilings,²⁰³ increasing spending on service contracts. Unfortunately, Congress has all too frequently legislated without empirical data to make informed decisions about whether it would be more cost effective to authorize sufficient numbers of federal FTEs in order to implement government programs, or to authorize agencies to contract out the work.

As noted before, recent efforts by policymakers to freeze federal employee compensation without mandating a freeze on service contract awards or on service contractor billing rates (which often increase annually) will impose additional risks of greater taxpayer costs by limiting the government's ability to hire and retain federal employees. Hiring ceilings and salary freezes might actually widen the existing gap between federal and contractor employee costs, thereby increasing the cost to the government and taxpayers.

In addition to freezing federal employee compensation, Congress is now exploring whether to *reduce* federal employee compensation in an effort to further reduce costs to the federal government and taxpayers. In 2011, the House Committee on Oversight and Government Reform conducted hearings to determine if federal employee compensation was comparable to private sector compensation and whether reductions of the federal workforce are necessary.²⁰⁴ Testimony focused on recent studies

²⁰¹ Congressional Research Service, *Coast Guard Deepwater Program: Background, Oversight Issues, and Options for Congress*, June 22, 2007, p. 1. <http://www.au.af.mil/au/awc/awcgate/crs/r133753.pdf> (Downloaded April 6, 2011) (hereinafter *Coast Guard Deepwater Program*); Government Accountability Office, *Coast Guard: Update on Deepwater Program Management, Cost, and Acquisition Workforce* (GAO-09-620T), April 22, 2009, p. 2. <http://www.gao.gov/new.items/d09620t.pdf> (Downloaded September 27, 2010); Testimony of Jane Holl Lute, Deputy Secretary Department of Homeland Security, before the Subcommittee on Homeland Security Committee on Appropriations, "Homeland Security Major Systems Acquisition," *CQ Transcriptions*, March 2, 2010, p. 11; Chris Strohm, "Coast Guard takes control from Deepwater's integrators," *CongressDaily*, March 3, 2010. http://www.govexec.com/story_page.cfm?articleid=44706&sid=61 (Downloaded May 11, 2011)

²⁰² Stephen Losey and Elise Castelli, "Thousands of intel jobs being insourced," *Federal Times*, July 27, 2009. <http://www.federaltimes.com/article/20090728/ACQUISITION02/907280301/-1/RSS> (Downloaded June 14, 2011)

²⁰³ CRS IGF and DoD report, p. 34

²⁰⁴ House Committee on Oversight and Government Reform, Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy, "Are Federal Workers Underpaid?" March 9, 2011. http://oversight.house.gov/index.php?option=com_content&view=article&id=1175%3A3-9-11-qare-federal-workers-underpaid&catid=15&Itemid=2 (Downloaded June 17, 2011); House Committee on Oversight and Government Reform, Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy, "Rightsizing the Federal Workforce," May 26,

claiming federal employees were compensated at higher rates than private sector employees, and should be in line with private sector compensation for comparable work. Unfortunately, with the lone exception of one ranking Congressman, the Committee did not focus on latent costs that could exceed the expected savings that would result from reducing the size of and compensation paid to the federal employee workforce. As testimony by the federal employee union representatives made clear,²⁰⁵ reducing federal employee compensation would impact the government's ability to retain highly skilled and experienced workers, which in turn would necessitate outsourcing those jobs to contractors. Simply stated, the consequence of reducing federal employee compensation in the service occupations documented in POGO's study would be an increase in government spending on those services.

Need for a Special Pool of Part-Time and Full-Time Federal Employees

The federal government is the country's largest employer—when the contractor workforce is combined with civilians, military personnel, U.S. Postal Service employees, and grantees, the size of the blended federal workforce was estimated at 14.6 million people in 2005.²⁰⁶ To avoid the dilemma of having to hire contractors for short-term projects, federal agencies must utilize existing authorization to hire short-term at-will federal employees.²⁰⁷ The government should generate pools of federal employees who would be able to move from program to program, agency to agency, on a temporary basis to meet the multitude of short-term needs of the federal government. In addition, there is a constant need for workers who have prior government experience and institutional knowledge to provide services over a short period of time, but existing regulations impose impediments and disincentives to exploiting these resources, resulting in myriad service contracts that pay high-level retirees at far higher rates than if they were allowed to be rehired back into the government.²⁰⁸

CONCLUSION

Contrary to popular belief, many government services are not performed by federal employees, but by contractors. The government spends hundreds of billions of dollars annually on services—in fact,

2011. http://oversight.house.gov/index.php?option=com_content&view=article&id=1300%3A5-26-11-qrightsizing-the-federal-workforce&catid=15&Itemid=26 (Downloaded June 17, 2011)

²⁰⁵ Testimony of Colleen M. Kelley, National President, National Treasury Employees Union, before the Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy, House Committee on Oversight and Government Reform, "Are Federal Workers Underpaid?" March 9, 2011, pp. 6-8.

http://oversight.house.gov/images/stories/Testimony/Kelley_Testimony.pdf (Downloaded June 10, 2011); Statement of William R. Dougan, National President, National Federation of Federal Employees, and Chairman, Federal Workers Alliance, before the House Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy, "Rightsizing the Federal Workforce," May 26, 2011, pp. 6-8. http://oversight.house.gov/images/stories/Testimony/5-26-11_Dougan_FedWorkforce_Testimony.pdf (Downloaded June 10, 2011)

²⁰⁶ *The New True Size of Government*, p. 11; "With about 2.0 million civilian employees, the Federal Government, excluding the Postal Service, is the Nation's largest employer." Department of Labor, Bureau of Labor Statistics, "Career Guide to Industries, 2010-11 Edition." <http://www.bls.gov/oco/cg/cgs041.htm> (Downloaded April 26, 2011)

²⁰⁷ Authority for temporary and term appointments resides at 5 CFR Part 316 for competitive service and at 5 CFR part 213 for excepted service appointments.

²⁰⁸ Reemployment by the federal government can cause an employee's salary to be offset by the amount of his or her annuity or, depending on the type of retirement, their annuity will stop. Agency heads have the discretion to rehire federal retirees on a limited, part-time basis without offset of annuity. Generally, annuitants may not work more than 520 hours for the first six months and no more than 1040 hours during any 12-month period, and are limited to 3,120 hours total. The total number of annuitants that can be rehired this way may not exceed 2.5 percent of the total number of FTEs of the agency. National Defense Authorization Act for Fiscal Year 2010 (Pub. Law 111-84), § 1122, October 28, 2009; National Defense Authorization Act for Fiscal Year 2004 (Pub. Law 108-136), § 1101, November 24, 2003; There are a few limited circumstances when retired federal employees can be reemployed by the government without discontinuing their annuity. General Services Administration Modernization Act, Pub. Law 109-313, § 4; 5 C.F.R. §§ 553.201 and 553.202.

approximately one-quarter of all discretionary spending now goes to service contractors²⁰⁹—and POGO’s analysis found these contracts may be costing taxpayers, on average, **1.83 times more** than if federal employees had done the work. In order to reduce those excessive costs, a government-wide system to conduct federal employee versus service contract cost analyses needs to be created. Instead of directly hiring service contractors without considering hiring federal employees—perhaps from a newly created pool of part-time or temporary federal employees—conducting cost reviews at the start of the process would allow the government to save billions of dollars annually.

Federal agencies should move aggressively to limit or curtail service contracting, unless contractors can show that they both save taxpayer dollars *and* enhance performance as compared to when the work is performed by federal employees. In no event should agencies contract for work that is inherently governmental work, or closely associated with inherently governmental work, and agencies should curtail or eliminate the outsourcing of services that have been poorly performed by contractors—whether due to quality of the work or cost issues, including cost overruns.

Based on POGO’s findings, we believe awarding government service contracts is nearly always more expensive than having such work performed by federal employees, even after accounting for the total cost to the government of federal employee fringe benefits and associated overhead costs.

Under the current federal personnel and service contracting systems, waste to the tune billions of dollars a year will continue for the foreseeable future. The government’s failure to ameliorate its reliance on service contractors, its failure to base outsourcing actions on cost analyses, and its failure to review existing contracts for potential cost savings have serious budget consequences.

RECOMMENDATIONS

1. Congress should pass legislation requiring:
 - a) All federal agencies awarding service contracts to use service coding systems that are consistent with OPM’s job classification system. Use of systems consistent with OPM’s will help ensure that cost analyses matching specific federal positions to comparable contractor and private sector positions is valid. These systems should be required for all Federal Activities Inventory Reform (FAIR) Act inventories to allow a comprehensive understanding of the services being performed by federal employees and contractors;
 - b) The Office of Management and Budget (OMB) to promulgate guidance establishing a uniform set of standards and guidelines for comparing the full lifecycle costs (including contract modifications, amendments, and options) of outsourcing federal services with the costs of having those services performed by federal employees;
 - c) Inspectors General of agencies awarding \$5 billion or more annually in total contracts to file an annual report detailing amounts awarded in service contracts, and including competition information, a cost analysis of savings resulting from hiring contractors rather than federal employees, and whether insourcing those services would result in cost savings;

²⁰⁹ In 2010, service contracts accounted for \$320 billion of the nearly \$1.26 trillion discretionary spending total. According to data compiled by POGO from the Federal Procurement Data System – Next Generation (FPDS-NG), the federal government awarded \$320 billion in service contracts in fiscal year 2010. https://www.fpds.gov/fpdsng_cms/; Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2012*, p. 200. <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/budget.pdf> (Downloaded August 18, 2011)

- d) Federal agencies to conduct pre-award contract cost analyses to determine whether the use of contractors is less costly and provides enhanced performance over the use of federal employees. These analyses should be conducted by an entity independent of the office responsible for the contracting decision;
 - e) Federal service contracts be subjected to periodic post-award reviews by the agency's Office of Inspector General (OIG) to certify that the costs of contractor performance is less than if the work were performed by federal employees. If the OIG determines that this is not the case, the contract should be terminated (if practical), and the work should be performed by federal employees;
 - f) The removal of federal full-time equivalents (FTE) ceilings, and requiring agencies to manage personnel costs (whether incurred by civil servants, the military, or contractors) by budget function or category, rather than by artificially relying on contractors or the military in order to meet civil service personnel ceilings;
 - g) GSA's Inspector General to annually audit all the agency's Schedule contracts for services to determine whether the billing rates reflect fair and reasonable market prices, and to require the agency to renegotiate any rates the IG certifies fail that standard; and
 - h) GSA to continuously update its Schedule Sales Query data system to identify for each Schedule service contract the following information: the occupational classification and Special Item Number for each job position offered, the number of contractor employees hired under each occupational classification, the real-time billing rates for each occupational classification under each contract, and the total government expenditures.
2. Congress should amend the FAIR Act's service contracts reporting requirements to include:
- a) The occupational classification(s) of the person(s) performing the service;
 - b) The actual number of all contractor and all subcontractor employees performing the service by occupational classification; and
 - c) The actual billing rate(s) for each occupational classification of persons performing the service.
3. Congress should pass legislation requiring OMB to submit to Congress and make publicly available an annual report on federal service contracts providing the following information and analysis:
- a) How much money the federal government spent outsourcing services, broken down by agency and legislative program;
 - b) How many contractor and subcontractor employees provided services to the federal government, broken down by agency, legislative program, and occupational category;
 - c) How much money the federal government actually saved by outsourcing services, broken down by agency, legislative program, and occupational category;
 - d) Which inherently governmental or closely associated to inherently governmental functions the agencies insourced (this is especially important as insourcing is about ensuring appropriate federal control of government policies, programs, and missions);
 - e) How much money the federal government actually saved by insourcing services, broken down by agency, legislative program, and occupational category; and
 - f) Recommendations for legislative reforms for saving more money and for achieving an effective balance in the federal workforce between federal and contractor employees.
4. Congress should amend the Office of Federal Procurement Policy Act (41 U.S.C. § 1127) to ensure that the maximum benchmark compensation amount applicable to contractor employees shall not

exceed the compensation paid to Level I positions pursuant to 5 U.S.C. § 5312 and the Office of Personnel Management's rates of basic pay for the Executive Schedule.

5. Agencies should:

- a) Periodically consider hiring federal employees for short-term projects—existing personnel authorities are very flexible and more than adequate for this purpose; and
- b) Place much more emphasis on cost analyses in their decisions to utilize contractors. Cost analyses will provide significantly greater insight into how much contractors should charge for the work to be performed and will serve as a benchmark for project costing, whether performed by contractors or federal employees.

ACRONYMS AND GLOSSARY

A-76	Office of Management and Budget's Circular A-76
BLS	Bureau of Labor Statistics
CBO	Congressional Budget Office
CCE	Army Contracting Agency's Contracting Center of Excellence
CEHNC	Corps of Engineers Huntsville Center
CPS	Current Population Survey
CRS	Congressional Research Service
CSIS	Center for Strategic and International Studies
CWC	Commission on Wartime Contracting in Iraq and Afghanistan
DHS	Department of Homeland Security
DOE	Department of Energy
DoD	Department of Defense
DOL	Department of Labor
FAIR	Federal Activities Inventory Reform
FAR	Federal Acquisition Regulation
FTE	Full-Time Equivalent
FY	Fiscal Year
GAO	Government Accountability Office
GS	General Schedule
GSA	General Services Administration
IG	Inspector General
IGF	Inherently governmental function
IRS	Internal Revenue Service
IT	Information technology
LOGCAP	Logistics Civil Augmentation Program
MEO	Most efficient organization
NCS	National Compensation Survey
NATO	North Atlantic Treaty Organization
OES	Occupational Employment Statistics
OFPP	Office of Federal Procurement Policy
OMB	Office of Management and Budget
OPM	Office of Personnel Management
PCA	Private Collection Agency
PDC	Private Debt Collection Initiative
PSC	Private Security Contractor
RFP	Request for proposal
SBAR	Santa Barbara Applied Research, Inc.
SIN	Special Item Number
SOC	Standard Occupational Classification system
USACE	U.S. Army Corps of Engineers

Acquisition workforce

Federal contracting officers (COs), contracting officer representatives/contracting officer technical representatives (COTRs), contract specialists (GS-1102 series), purchasing agents (GS-1105 series), procurement assistants (GS-1106 series), auditors, engineers, logistics specialists, and program managers or specialists with responsibilities for planning, defining the requirements of, purchasing, monitoring, and/or evaluating federal contracts and/or contractors.

Bid protest

An actual or prospective bidder's challenge to a contract that has been, or is about to be, awarded alleging a violation of law or regulation that governs the contracting process. Generally, bid protests can be filed with the GAO and the U.S. Court of Federal Claims.

Circular A-76

The OMB policy for the competition of commercial activities between federal employees and contractors.

Closely associated with inherently governmental functions

An activity so integrally related to an inherently governmental function that it may be in the public interest for the activity to be performed by a federal employee. FAR Subpart 7.503(d).

Commercial function

A recurring federal service that could be performed by a contractor employee because it is not so intimately related to the public interest as to mandate performance by a federal employee. One of the designations used in FAIR Act inventories.

Commission on Wartime Contracting

An independent, bipartisan legislative commission established to study wartime contracting in Iraq and Afghanistan. The CWC's final report was issued in August 2011.

COMPARE

The A-76 costing software that allows a comparison of federal employee and contractor bids.

Contractor

An entity that provides goods to or performs services for a federal agency in accordance with a contract.

Cost estimating

Use of various analytical techniques to estimate the prospective cost or price of goods or services.

Cost overrun

Funds expended by an agency for goods or services in excess of the cost or price stated in the originally executed contract, task order, or delivery order.

Cost-plus contract

A contract under which the government reimburses the contractor for allowable costs incurred in providing goods or services. These contracts generally include a fee paid to the contractor in addition to reimbursement of costs. FAR Subpart 16.3.

Current Population Survey

A monthly survey of households conducted by the Bureau of Census for the Bureau of Labor Statistics. It provides data on the labor force, employment, unemployment, persons not in the labor force, hours of work, earnings, and other demographic and labor force characteristics.

Direct conversion

When the federal government outsources government jobs without competition and cost comparisons. DoD is currently prohibited from making such conversions.

Estimated or projected cost savings

The amount of money the government expects to save when comparing government employee full compensation with contractor billing rates for the performance of services.

FedScope

An OPM dataset of federal salary information for all federal employees.

Federal Acquisition Regulation

The government-wide regulation governing federal contracts. The FAR is codified at 48 CFR Chapter 1, which sets forth the policies and procedures used in awarding and administering federal government contracts.

Federal agency

A department of the executive branch of the U.S. government, a sub-unit of a federal department, or an independent entity created by Congress.

Federal workforce

As used in this report, the totality of federal civilian and contractor employees who perform federal government functions. It does not include military personnel, Postal Service employees, or government grantees who also provide services for the government.

Full compensation

Compensation paid to government or private sector employees that includes salary plus a full fringe benefit package, based upon OPM and BLS data respectively.

Full-Time Equivalent

The standard for measuring the time a full time employee is required to be employed during one calendar year. As defined by the federal government, one FTE equals 40 hours per week at 52 weeks per year, or 2080 hours.

Inherently governmental function

A function that is so intimately related to the public interest as to mandate performance by federal employees. It includes activities that require either the exercise of discretion in applying government authority, or the making of value judgments in making decisions for the government. FAR Subparts 2.101 and 7.503(c). See also OMB Circular A-76, Attachment A, which defines inherently governmental functions as, "activities require the exercise of substantial discretion in applying government authority and/or in making decisions for the government."

Insourcing

Transferring performance of government service functions from the contractor workforce to the federal employee workforce.

Logistics Civil Augmentation Program

LOGCAP is an Army Materiel Command program providing support from civilian contractors for military troops operating in wartime and in other contingency situations. Contractors provide laundry, food, maintenance, engineering, construction, medical, and management services. LOGCAP III was competitively awarded in 2001 to Kellogg Brown and Root (KBR). LOGCAP IV was awarded in 2007 to KBR, DynCorp International LLC, and Fluor Intercontinental Inc.

National Compensation Survey

A comprehensive survey of businesses, conducted and analyzed by the Department of Labor's Bureau of Labor Statistics, that generates data on private sector occupational wages, employment cost trends, and employee benefits.

Occupational Employment Statistics

A program of the Department of Labor's Bureau of Labor Statistics that produces employment and wage estimates for job occupations. These estimates include the number of people employed in certain occupations by federal, state, and local government agencies and in the private sector, as well as estimates of the wages and benefits paid to them.

Outsourcing

Transferring performance of government service functions from the federal employee workforce to the contractor workforce (also known as "competitive sourcing" or "conversion"), or hiring contractors to perform work not already performed by federal employees (also known as "direct conversion").

Overhead costs

All costs of doing business except for direct labor, direct materials, and other direct expenses. As used in this report, given that work is performed on government sites, some examples of pertinent expenses might include accounting fees, advertising, insurance, legal fees, and taxes. OMB Circular A-76 outlines numerous costs, including a 12 percent overhead rate, that must be added to federal employees' full compensation labor costs in order to accurately compare the total cost to the government when making public/private cost comparisons.

Public-private competition

The process where federal employees and contractors submit competing bids to perform government service functions. This competition is also known as an A-76 competition or the competitive sourcing initiative.

Privatization

The total transfer of a federal business or administrative function, including the responsibility for the affected services, to the private sector.

Shadow government

The workforce of contractor employees who perform federal government services.

Special interest functions

Functions that require increased management attention due to heightened risk of workforce imbalance.

Special Item Number

The General Services Administration's categorization method that groups together similar goods and services to aid in the acquisition process.

Standard Occupational Classification system

A federal job coding and classification system created by the Department of Labor's Bureau of Labor Statistics to classify workers into occupational categories for the purpose of collecting, calculating, or disseminating data. All workers are classified into one of 840 detailed occupations according to their occupational definition.

Task order

An order for services placed against an established contract or with government sources. FAR Subpart 16.5.

Appendix B

POGO FOIA Request



January 19, 2012

Robert Dickerson
 Chief, Freedom of Information Act Office
 Attn: AAHS-RDF
 7701 Telegraph Road, Suite 144
 Alexandria, VA 22315-3905

Re: Freedom of Information Act Request

Dear Sir or Madam:

I am making this request under the Freedom of Information Act ("FOIA"), 5 U.S.C. § 552. Please provide me the following records that reflect operative policies, guidance, orders, and memoranda dating from January 1, 2005 to present:

1. All records requiring and/or explaining how and when cost comparisons are to be conducted to determine whether work would or has cost more if/when performed by service contractors or cost more if/when performed by federal employees.
2. All records that order and/or report the results of any public/contractor cost comparisons.
3. All records that require OMB's 12 percent estimate of government overhead costs to be used in all A-76 competitions.
4. All records that discuss how to calculate, analyze, report, and/or use the data to be included in the agency's annual service contract inventory.
5. A copy of the most recent A-76 COMPARE analysis for a competition that was won by an agency MEO and one won by a private contractor.
6. All records showing the total procurement costs for each year (direct and indirect) that the agency budgeted, expended, and/or obligated as a result of service contracts.
7. All records for each year that:
 - a. determine, or explain how to determine, the agency's overhead costs associated with service contracts and/or
 - b. show the annual total costs (direct and indirect) that the agency incurred to award, administer, monitor, oversee, and close-out its service contracts.
8. All records showing during each year:
 - a. the total number of full-time civilian workers that the agency employed and/or
 - b. the total number of part-time civilian workers that the agency employed.

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9. All records that address whether and/or how to calculate the total number of full-time equivalent workers employed by contractors and all tiers of subcontractors that perform work on service contracts for the agency.

10. All records for each year showing the total number of full-time equivalent workers employed by contractors and all tiers of subcontractors that perform the work on service contracts and how these contractor employees are stratified by occupation and/or public service code.

11. All records showing for each service contract and task order executed by the agency during the past fiscal year the following information

- a. what the agency was billed, and/or
- b. what were the total number of hours worked on government premises, and/or
- c. what were the total number of hours worked on contractor premises, and/or
- d. what costs were incurred by the contractor, segregated by salaries, employee benefits, overhead (direct and indirect), general administrative expenses, and/or
- e. what costs were incurred by the agency, segregated by salaries, employee benefits, overhead (direct and indirect), general administrative expenses.

12. All records relating to the agency's implementation of and compliance with OMB's Policy Letter 93-1 (Reissued) on May 16, 1994, as authorized pursuant to section 6(a) of the Office of Federal Procurement Policy Act, as amended, codified at 41 U.S.C. § 405.

13. All records relating to whether and/or how:

- a. service contracts were accomplishing what was intended, and/or
- b. service contracts were cost effective, and/or
- c. inherently governmental functions were being performed by service contractors, and/or
- d. service contracts were and/or should be subject to full and open competition, and/or
- e. sufficient trained and experienced officials are available within the agency to manage and oversee the procurement and administration of service contracts, and/or
- f. effective management practices are used to prevent waste, fraud, and abuse in services contracting, and/or
- g. certain service contracts require greater oversight and the nature of that oversight, and/or
- h. agency officials ensure that their acquisition strategy for procuring services will result in the acquisition of services from a quality vendor that constitute the best value considering costs and other relevant factors, and yield the greatest benefit to the agency.

14. All records relating to "best practices" the agency has considered, adopted, and/or implemented for the procurement and administration of service contracts.

I request a waiver of all costs associated with fulfilling this submission pursuant to 5 U.S.C. § 552(a)(4)(A)(iii). Disclosure of the requested information will further the “public interest because it is likely to contribute significantly to public understanding of the operations or activities of the government and is not primarily in the commercial interest” of the requester, the Project On Government Oversight (POGO). Specifically, POGO will use the information requested to inform the public about whether and how the federal government is saving taxpayers money by contracting for services. See fee waiver supplement.

Founded in 1981, POGO is a nonpartisan independent watchdog that champions good government reforms. POGO’s investigations into corruption, misconduct, and conflicts of interest achieve a more effective, accountable, open, and ethical federal government. POGO disseminates information about its activities to thousands of concerned citizens, policymakers, and the media via email, direct mail, and its web site <http://www.pogo.org>, which receives approximately 140,000 page views monthly. The information provided by the agency will be used for the following activities: publication by email and on our website; publication in reports and newsletters issued by POGO; publication in the newsletters of affiliated nonprofit organizations; efforts to educate Congress, the Executive Branch, and other policymakers in Washington, D.C.; or investigational projects conducted in conjunction with the news media. POGO’s use of all of those actions ensures that the public is well informed about the actions and operations of the federal government.

If this request is denied in full or in part, please cite the exemptions pursuant to 5 U.S.C. § 552(b) that justify the denial. If an exemption applies, however, please consider exercising the agency’s discretionary release powers to disclose the information. Additionally, please release all reasonably segregable portions of that information that do not meet an exemption.

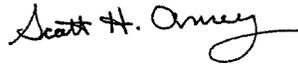
I look forward to your response within 20 days of the receipt of this request, unless, in the case of “unusual circumstances,” the time limitation is “extended by written notice.” I am aware that I have a right to appeal this request if it is wholly or partially denied or if the agency fails to respond within 20 days. I am aware that, if successful, a federal district court may assess “reasonable attorney fees and other litigation costs” per 5 U.S.C. § 552(a)(4)(E).

Please contact me or Scott Amey if this request requires further clarification. We can be reached at 202-347-1122, or via e-mail at pchassy@pogo.org or scott@pogo.org. Thank you for your prompt attention to this matter.

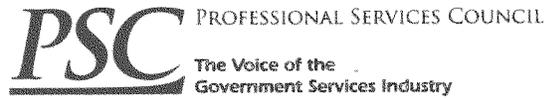
Sincerely,



Paul Chassy, Ph.D., J.D.
Investigator



Scott H. Amey
General Counsel



STATEMENT FOR THE RECORD OF THE
PROFESSIONAL SERVICES COUNCIL

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

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

MARCH 29, 2012



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

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

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

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

- I. While cost is a critical factor in most sourcing decisions, in others it is not relevant. The first question that must be asked is not which sector or provider is more cost effective but what is the nature of the work itself? For example, as the Obama administration has made clear, when work is deemed to be "inherently governmental" in nature, it should always be performed by government employees, regardless of cost. The same is generally true for a small subset of work that is sometimes referred to as "closely associated with inherently governmental" or "critical" functions. By the same token, when work is commercial in nature (i.e., engineering, software development, management consulting, etc.); involves skills the government is not generally able to internally hire, retain, or provide essential training capabilities for; or is work for which there may only be a limited need, then cost comparisons may be of less significance in the decision process. In these latter cases, understanding the associated cost comparison is important but the realities of the human capital market or the government's temporal mission means that cost alone should not be the basis for a sourcing decision.
- II. The key to getting the "right" answer for the American taxpayer in cases where cost is a factor lies in ensuring that the government is using the best and most complete taxonomy for conducting its cost comparisons. To date, the evidence overwhelmingly suggests that this objective is not being achieved. For work that is contracted, the costs to the government are clear and are detailed in proposals received and in the resulting contract(s). Regrettably, the same is far from true for government cost estimates. Although absolute "apples-to-apples" comparisons of the cost of government versus private-sector performance are elusive, significant improvements to the current process are achievable and much needed.
- III. Government in-house cost estimates fail to account for the full cost impacts incurred by other than the requiring agency or true "lifecycle" costs associated with the hiring of federal personnel

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

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

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

Focus on the Taxonomy

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

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

For example:

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

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

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

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

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

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

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

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

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

--One good example of this misleading trend is evident in the suggestion that private security contractors in Iraq were substantially more expensive than equivalent military capacity. Such "analyses" compare the reported daily "rate" for some private security personnel with the Army's pay rate. However, as the Congressional Budget Office¹ and Congressional Research Service² both concluded, such comparisons ignore the fact that the contractor rate includes a wide range of non-pay overhead, benefits, training, equipment and other costs that were not included in the base pay rate of the uniformed military. Under those circumstances, both CBO and CRS concluded that there is very little, if any, difference in the total immediate costs of using private security contractors versus Army personnel. Both also noted, however, that in peacetime the bulk of the Army personnel would remain in the Army (accruing all costs

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

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

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

--Similarly, the Government Accountability Office³ and U.S. Department of State assessed the relative costs of using private security forces versus using State Department Diplomatic Security Service personnel. Their conclusion was that the use of private security was an order of magnitude less expensive than using DSS personnel. In short, while there is general agreement today that cost alone should not determine the circumstances under which the government should use private security, these studies are especially instructive in that they are among the few that sought to assess total lifecycle costs of government performance.

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

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

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

A More Accurate and Balanced Taxonomy

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

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

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

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

Key Analytical Weaknesses of the DTM

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

According to CSIS, the DTM specifically:

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

Cost Analyses Under OMB Circular A-76

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

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

Misaligned Inputs

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

Addressing the Gaps; Improving the Taxonomy

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

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

The CSIS recommended taxonomy can be summarized as follows:

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

A Simple, But Focused, Legislative Response

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

Therefore, PSC recommends that Congress:

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

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

CONCLUSION

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

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

**Post-Hearing Questions for the Record
Submitted to**

**Jay Aronowitz, Deputy Assistant Secretary, Force Management, Manpower and Resources
U.S. Department of Army
From Senator McCaskill**

“Contractors: How Much Are They Costing the Government?”

Tuesday, March 29, 2012, 10:00 A.M.

**United States Senate, Subcommittee on Contracting Oversight,
Committee on Homeland Security and Governmental Affairs**

Question: To what extent is the Army sharing any lessons learned on the development of its contractor inventory with the Office of Management and Budget, civilian agencies or other military departments and defense components?

Answer: The Army has shared lessons learned on the development of its contractor inventory extensively with other military departments. Numerous meetings have taken place between the Army and its relevant counterparts in other military departments in order to share the Army’s experiences with them. The Army also had the opportunity to meet with representatives from the Office of Management and Budget in January 2010 to discuss lessons learned with them, though it has not otherwise had the opportunity to meet with agencies and components outside the Department of Defense.

Question: To what degree is the contractor inventory data informing or improving the process by which Army personnel are making acquisition decisions?

Answer: To date, contractor inventory data has been primarily used by the Manpower community in its Total Force Management reviews. Beginning in Fiscal Year 2012, however, the Army Acquisition Executive is obtaining Army-wide semi-annual service requirements forecasts and quarterly cost reports for service acquisitions valued at \$10M or more to provide program management and funding visibility for services acquisitions. Additionally, the Panel for Documentation of Contractors has, since 2009, performed a contractor inventory review to identify inherently governmental, closely associated with inherently governmental, critical, and authorized and unauthorized personal services functions.

Question: When the analysis shows that using a federal employee is the best route, is the Army actually able to do this? If not, why? Please provide examples.

Answer: When the analysis shows that using a federal employee is the best route, the Army is able to do this, subject to certain constraints. The Resource Management Decision 703A2 issued by the Secretary of Defense directed the Components to freeze their civilian full-time equivalents (FTE) for Fiscal Year (FY) 2011 through FY 2013 (and later extended through FY 2018) to the levels budgeted in FY 2010. This “civilian cap” has reduced the flexibility of the Army to utilize the types of manpower it sees as most beneficial to the performance of its missions.

Additionally, since the implementation of the Secretary of the Army's in-sourcing policy dated 1 February 2011, individual Commands within the Army have functioned with de facto civilian hiring ceilings in order to keep the Army compliant with the civilian FTE freeze. Since that time, the Secretary of the Army has given permission for the hiring against 640 positions and the creation of 79 new authorizations due to in-sourcing.

Question: Have the current caps on federal employees hiring hampered agencies from actually making cost-analysis based decisions when contracting?

Answer: The current caps on federal employees hiring have hampered agencies from actually making cost-analysis based decisions when contracting. The civilian full time equivalent cap instituted by the Secretary of Defense in Resource Management Decision 703A2 has had the side effect of removing some of the flexibility that the Army and its attendant Commands previously had to manage its workforce to the appropriate manpower mix. In practical terms, if the Army cannot hire civilians, then it must turn to other sources of labor—like contracting—when it needs to execute missions, provided the work is not inherently governmental.

Question: How many exemptions from the civilian caps have been requested? How many have been granted? Please provide a short explanation of the functions at issue and the Department's reasons for granting or denying the exemptions.

Answer: The only Army request to OSD for relief from the civilian cap was made by the Secretary of the Army on 5 April 2012. This exemption was a request regarding 857 positions at the Defense Language Institute Foreign Language Center (DLIFLC). The DLIFLC trains military personnel and civilian employees from across the Department of Defense, and supports the Department's intelligence missions.

The Army is the Executive Agent for the DLIFLC and made this request in order to continue offering instruction and support for students in 23 different languages and two dialects, including strategically vital languages like Arabic and Farsi. OSD has not yet responded to this request for an exemption, so a discussion of the Department's reasons for granting or denying the exemption is not possible at this time.

Question: What further analysis will need be done to fully understand the information collected by the Army regarding overhead costs? When will that work be completed?

Answer: The deadline for the collection of Fiscal Year 2011 data in the Contractor Manpower Reporting Application (CMRA) was May 1, 2012. As such, we are now concluding the closeout for the data collection itself and can proceed to analysis.

Analysis of the collected data has not yet been conducted, as the collection was not, as mentioned, complete. Now that the collection has been finished, analysis on a number of different factors can be initiated on a collaborative basis between the Assistant Secretary of the Army for Acquisition, Logistics, and Technology, and the Assistant Secretary of the Army for Financial Management and Comptroller, and the Assistant Secretary of the Army for Manpower and Reserve Affairs. Analysis will include, among other things, the examination of the effect levels of subcontracting have on overall and overhead costs, as well as the effect that the type of contract vehicle and type of contract service has on overall and overhead costs.

Given the recent completion of the data collection and the need to now begin analysis, it is expected that data examination and synthesis by the aforementioned offices will require around six months to complete.

Question: Please estimate the savings to the Army in the event that the contractor compensation cap is lowered to \$400,000 per year.

Answer: If a \$400K/Full Time Equivalent (FTE) Rate Cap was applied to the Fiscal Year (FY) 2011 Army Inventory of Contract Services, labor costs reported in the Contractor Manpower Reporting Application (CMRA) for FY 2011 would be reduced by \$6B (approximately 15% of the \$41B in invoices reported in FY 2011 for contract services).

This estimate was reached utilizing the following methodology:

1. Using the data reported in CMRA for the FY 2011 Inventory of Contract Services, Labor Costs and Labor Rates were computed for the individual services listed within each Contract Task Order, where:
 - a. Labor Cost = Total Amount Invoiced minus Direct Non-Labor Cost; and
 - b. Labor Rate = Labor Cost divided by Number of Contractor FTEs.
2. For labor rates greater than \$400K/FTE, the associated labor costs were recomputed using the \$400K maximum. Reductions in labor costs using this method totaled \$6B.
3. Total costs reported for contract services in CMRA for FY 2011 amounted to \$41B. The application of the \$6B reduction from the utilization of the \$400,000/FTE cap represents a drop to \$35B, a reduction of approximately 15%.

Question: You stated that contractor costs are not accounted for in the budget process prospectively. What are the challenges with projecting contractor costs forward?

Answer: There are two main challenges associated with projecting contractor costs forward. The first challenge is that many of the services and skills provided by contractors are not necessarily full-time, enduring requirements, but rather provide Army with various services and skills to complete a variety of functional requirements. Although some of the requirements for which Army contracts for services are enduring, using task-based contracts provides Army the flexibility to execute funding on a variety of functional requirements throughout the year of execution whereas programming an enduring requirement for a civilian billet for a specific requirement limits the Army's flexibility to adjust to emerging requirements.

The second main challenge arises from the fact that the budget is built from Object Classes. Contract services, however, are managed and grouped into "portfolios," as directed by USD(ATL) in response to statutory mandate. These budget objects and portfolios are not interchangeable: there is no clear cross-walk between them. Acquisition support managers are supposed to be controlling contract services spending based on these portfolios, but because these portfolios are not interchangeable with the object classes used in the budget and financial accounting systems, this cannot be done effectively. Object Class data itself is also not without

its own flaws; the "Other services" object class includes a disparate variety of functions, like data digitization, chaplain services, intelligence services, and auditing. This kind of problem in budget object classifications only serves to further exacerbate the problem of lack of interchangeability with portfolios, and makes it even more difficult to project contracts costs forward.

Question: In testimony you stated that from FY08 to FY10 the Army was able to reduce expenditures on non-OCO service contracts from \$51B to \$36B. You stated that this reduction stemmed from an insourcing program combined with the contractor inventory review process. In FY11 that amount increased to \$40B.

Answer: The facts presented above are correct and consistent with our written testimony. From Fiscal Years 2008 to 2010, there was indeed a decrease in expenditures on non-Overseas Contingency Operations (OCO) funding for contract services, as a result of the Department of Defense's institution of an active in-sourcing program, as well its service contract pre-award approval process and contractor inventory review process.

Question: Why was there an increase in FY11 service contract expenditures?

Answer: There was an increase in service contract expenditures in Fiscal Year (FY) 2011 due to the confluence of various factors. The voluntary in-sourcing program, as well as the use of pre-award analysis via the Panel for Documentation of Contractors, both contributed to the decline in service contract expenditures. In FY 2010, in-sourcing was no longer voluntary and was mandated by budgetary targets. Some viewed these targets as upward limits on in-sourcing, even for inherently governmental functions. In FY 2011, the institution of the civilian full time equivalent cap removed a great deal of the Army's flexibility in determining its manpower mix, but this flexibility was not accompanied by an attendant reduction in mission.

Question: Have you continued to subject contracts for services to the same pre-award analysis?

Answer: Yes, the Army has continued to subject contracts for services to the same pre-award analysis. However, the effect of mandated in-sourcing targets through the budget process starting in Fiscal Year 2010, combined with the subsequent full time equivalent cap, can often override the results of such pre-award analysis, as funding drives behavior.

Question: What impact did this have on Army spending for federal civilians or was there any correlation at all?

Answer: Total pay for Army civilians in Fiscal Years (FY) 2009-2011 is as follows:

FY 2009: \$20,257,579,000

FY 2010: \$21,820,440,000

FY 2011: \$24,154,232,000

The Army's in-sourcing brought 921 civilians onboard in FY 2009, 6039 civilians in FY 2010, and 1126 civilians in FY 2011. The increase in total pay for Army civilians in FY 2009-2011

seen above cannot be solely explained by this in-sourcing. The addition of 921 civilians through in-sourcing in FY 2009 increased Army spending on civilian pay by about \$96.5M; the addition of 6039 in FY 2010 increased spending by about \$636.5M; and the addition of 1126 in FY 2011 increased spending by about \$125.2M. These three years combined amount to about \$858M, but even the combined amount is not enough to account for the spending increase outlined above.

Question: Can the Army distinguish between non-OCO and OCO related service contracting costs?

Answer: Yes, as described in the testimony, the Army can distinguish between non-Overseas Contingency Operations (OCO) and OCO related service contracting costs. The accounting system itself can identify a substantial amount of OCO-funded contractor services, though the accounting is neither perfect nor complete.

Question: Are there functions that could be classified as inherently governmental being performed by contractors at this time in the Army? Please explain why and what is being done to change that.

Answer: Yes, there are functions that could be classified as inherently governmental being performed by contractors at this time in the Army. There are a number of possible reasons for this. When a function being performed by a contractor is identified as being inherently governmental, that function's performance must be divested, shifted to existing workforce if it cannot be divested, or in-sourced, if neither of the previous options is possible. In-sourcing of functions can, at times, be a lengthy process, not the least because of the need to identify offsets as a result of the civilian full time equivalent cap.

Additionally, the realities of actual contract performance are such that inherently governmental functions may be performed by contractors, even if statements of work deliberately exclude such functions. The Army's review of contracted work, both by individual contract and by task order, is an ongoing process, performed at both the pre-award and post-award stages. In practical terms, this review and analysis is iterative, and the longer it goes on, the greater the likelihood that more inherently governmental functions will be identified and appropriately dealt with.

Finally, the Secretary of the Army recently issued guidance on 10 February, 2012, that will withdraw funds by May 2012 from organizations that continue to contract inherently governmental functions or unauthorized personal services contracts and have not submitted packages within 90 days to in-source those functions.

Question: The Government Accountability Office (GAO) released a report (GAO-12-357) on April 6, 2012 that found that the Army inventory review identified 1,935 instances in which contractors were performing inherently governmental functions. According to GAO, in 8 of the 12 Army and Air Force cases GAO reviewed, contractors continued to perform inherently governmental functions because of DOD's decision to cap the number of civilian federal employees at 2010 levels. Is the Army continuing to review functions that are closely associated to inherently governmental or critical?

Answer: Yes, the Army is continuing to review functions that are closely associated with inherently governmental or critical. In a memo dated December 29, 2011, the Acting Under Secretaries of Defense for Acquisition, Technology, and Logistics, and Personnel and Readiness directed the Department components to complete an Inventory of Contracts for Services for Fiscal Year 2011, a part of which is the "identification of contracts under which functions closely associated with inherently governmental functions are being performed." The Army is currently engaged in this review process, and at the moment approximately 11,000 contracts (or, about 10%) still need to be reviewed for closely associated with inherently governmental and critical functions.

**Post-Hearing Questions for the Record
Submitted to Jay Aronowitz, Deputy Assistant Secretary,
Force Management, Manpower and Resources, U.S. Army
From Senator Daniel K. Akaka**

**“Contractors: How much are they costing the government?”
March 29, 2012**

1. I am concerned by the 2011 cap on full time Department of Defense civilians mentioned in your testimony because I believe it prevents the insourcing of inherently governmental work and does not allow the Department to correctly balance its workforce.
 - a. How has the civilian workforce cap impacted the Army?
 - b. Do you believe the civilian workforce cap should be lifted?

Answer: The civilian workforce cap has impacted the Army in a number of different ways. As a result of the civilian cap, individual Army Commands have a cap on their own manpower, in order to ensure the Army’s ongoing compliance with policy. This cap limits the flexibility that the Army has, both as a whole and in individual components, when managing its manpower mix. If a civilian cannot be hired, then the only remaining options are to contract the function, or use borrowed military manpower. The use of military personnel is usually not an option, which leaves only contracting as a viable means of executing a mission.

When faced with hiring decisions, people are therefore being placed in the unenviable position of having to decide whether to comply with the civilian cap, or to comply with the other statutes and policies governing the workforce (like the prohibition on the performance of inherently governmental functions by contractors).

Although the goal of the civilian cap—the reduction in overall Department of Defense expenditures—is clearly a good one, the workforce cap has had the unintended consequence of limiting the flexibility of the Army in managing its workforce. Cost-effective workforce management decisions ought to be based on allowing for the hiring of civilians to perform missions, rather than contractors, if the civilians will be cheaper. The lifting of the civilian workforce cap would restore this flexibility, and in that sense it would seem to be a positive potential step forward.

2. You testified that this is the first year the Army’s contractor inventory has been fully populated with data, and that its primary purpose has been to identify outsourcing of inherently governmental work. Does the Army have a strategy for using the data as part of its budget and acquisition process?

Answer: Contractor inventory data has not yet been used by the Army as part of its budget and acquisition process, but there is a strategy to utilize the data going forward. Beginning in Fiscal Year 2012, the Army Acquisition Executive is obtaining Army-wide semi-annual services requirements forecasts and quarterly cost reports for services acquisitions valued at \$10M and

above. This data will help to provide program management and funding visibility for services acquisitions. This initiative implements part of the Army's 2011 Services Optimization Implementation Plan, with an aim to increase effectiveness, efficiency, and promote costs savings as the Army acquires essential services to support our Soldiers and their families. The Deputy Assistant Secretary of the Army, Civilian Personnel and Quality of Life has also assembled a working group with the Army Budget Office, Army Program Analysis & Evaluation, and the Assistant Secretary of the Army for Manpower and Reserve Affairs to integrate the Contractor Manpower Reporting Application into the budget process.

3. The Army relies on self-reported data from contractors to populate its Contractor Manpower Reporting Application. What sort of oversight is done to make sure labor hours and costs are accurately reported?

Answer: There are a number of different kinds of oversight to make sure that labor hours and costs are accurately reported into the Army Contractor Manpower Reporting Application (CMRA), though there is no real alternative to self-reporting for fixed-price contracts, as only contractors have access to this information. CMRA alerts users when they are entering labor costs and hours that project an hourly rate that is extremely high or extremely low. An additional CMRA edit check alerts users when entering labor costs that exceed the total amount invoiced for the contract task order. These tools assist in preventing inaccuracy during the initial phase of data entry.

Additionally, Resource Managers of the major Army Commands review the results of data reported by contractors to ensure the correct alignment between reported contract services and requiring activities, and to ensure that the level of contract services reported by contractors is commensurate with the resources allocated by the Command for contracts that involve services. In these ways, Resource Managers play an important role in ensuring that labor hours and costs are accurately reported.

Finally, during compilation of the annual inventory, extreme outliers in labor hours and costs are identified, researched and resolved. In addition, invoices for contract services reported by contractors in CMRA are compared with obligations for contract services recorded in Army finance and accounting systems to ensure contractor manpower reporting is complete. These last oversights provide the final checks to ensure that issues are resolved, and that data reporting is both complete and accurate.

4. In his Plan for Economic Growth and Deficit Reduction, the President proposed a cap on contractor pay equal to the top of the Federal Executive Schedule –approximately \$200,000 per year. Under the current formula, taxpayers may have to pay up to \$700,000 for contractor employees. What are your thoughts on the President's proposal and should it be implemented?

Answer: The President's proposal to cap contractor pay at a level equal to the top of the Federal Executive Schedule is worth considering as part of an holistic look at how spending on contract services can be reduced across the Department of Defense. This reduction is even larger than the reduction to \$400,000 proposed by Senators Boxer and Grassley and referenced by Senator

McCaskill at the hearing on March 29, 2012. Any significant reduction in the cap on contractor pay needs to take into account the possible second- and third-order effects of such a decision.

For example, contractors are utilized in instances when the Army requires the services of highly-qualified specialists whose abilities may not be present in the current, available Army manpower pool. This kind of need is especially present in fields like Information Technology. These contractors, because of the relative scarcity of their skills, command a high price. This is not to say, of course, that the government should simply throw money at a problem, but rather to say that if a contractor pay cap were to be implemented, the effects such a cap might have on contractor willingness to work for the government at reduced prices would need to be considered.

**Post-Hearing Questions for the Record
Submitted to
Debra Tomchek, Executive Director, Balanced Workforce Program Management,
U.S. Department of Homeland Security
From Senator McCaskill
“Contractors: How Much Are They Costing the Government?”**

**Tuesday, March 29, 2012, 10:00 A.M.
United States Senate, Subcommittee on Contracting Oversight,
Committee on Homeland Security and Governmental Affairs**

Question: You described in your testimony that the Balanced Workforce Strategy (BWS) Tool was to assure control of DHS's mission. It is obvious that this tool has been a success in determining and evaluating critical areas of the DHS' mission that had been in the control of contractors.

Are you able to collect data using the BWS Tool? If so, how is DHS using this data?

Response: The Balanced Workforce Strategy (BWS) Tool collects a variety of data for each analysis, including identifying information for the function (or contract); the Component's responses to questions concerning the function; the suggested ratio of federal employees to contractors; and the Component's reaction to the recommendation. The Component is supplied with all of the data and summaries for each analysis to assist it in making final recommendations for how to best source a function.

The current version of the BWS Tool was built quickly by DHS to ensure that all Components could analyze functions in an automated, systematic, and documented way. At the present time, data associated with specific analyses must be aggregated manually in order for trends across analyses to be examined. As part of a continual BWS process improvement effort, manual reviews of the aggregate data occur. An upgrade to the BWS Tool platform is slated for FY 2013 that will include more robust data archive and reporting capabilities.

Question: Are you reviewing any prior contracts under this tool or only new contracts?

Response: When the BWS launched in 2010, DHS asked Components to analyze contracts already in place. In September 2011, DHS launched a pilot requiring BWS reviews for pending contract requirements from a limited number of special interest product service codes (PSCs).

Question: To what extent is DHS sharing its work on the BWS with the Office of Management and Budget or other federal agencies?

Response: Since the launch of BWS in 2010, DHS has shared its work extensively with the Office of Management and Budget (OMB) and other federal agencies. In 2010, DHS met with the OMB Office of Federal Procurement Policy (OFPP) Administrator to discuss the BWS process and demonstrate the BWS Tool. In 2011, the Associate Administrator of OFPP attended the 2011 biannual Balanced Workforce Strategy event, delivering a keynote address to

Component representatives responsible for implementing the BWS process. DHS continues to provide OMB staff with regular updates on our progress.

In FY 2011, DHS conducted over 15 briefings with officials from federal agencies, including the Office of Personnel Management, the Government Accountability Office, the Congressional Research Service, the Department of Energy, the Department of Defense, and Senate and House of Representatives committee staff.

In FY 2012, DHS has already briefed the Department of the Interior and the Department of Defense. Additional briefings are pending with representatives from the Departments of the Treasury, Navy, Army, Justice, and Veterans Affairs.

Question: In your testimony you described a data call regarding the cost savings from an insourcing effort, converting contractor positions to federal civilians, implemented by DHS.

Approximately how many contractor positions were converted in fiscal year 2010 and 2011, and what were the resulting savings?

Response: Past estimates from Components indicate approximately \$28 million in cost savings as a result of the 2009-2010 insourcing efforts.

Currently, the Office of the Chief Human Capital Officer is working closely with the Office of the Chief Financial Officer to source and validate updated insourcing-related cost savings from Components. DHS will provide the Committee with new data for the record as soon as this effort is complete.

Question: Are there planned steps to use these analyses to inform workforce decisions?

Response: DHS Components use the three-step Balanced Workforce Strategy (BWS) process to determine the proper balance of federal employees and contractor personnel for programs and functions. After Components "Identify the Work" and "Analyze the Work" (which may include Cost Comparison Analysis), they move on to the final step of the process, "Implement the Sourcing Decision." If the BWS analysis reveals that the workforce for a function requires rebalancing, numerous Component stakeholders from across lines of business must collaborate to implement the change.

The BWS process is designed to analyze workforce balance on a function by function basis; no plans exist to use aggregate cost savings information to influence decisions concerning the workforce for specific functions.

Question: How are potential cost savings considered relative to other concerns when deciding whether to contract for services?

Response: The primary aims of the BWS process are ensuring adherence to the law and minimizing potential risk to the DHS mission. When analyzing a function using the BWS process, the Component first considers the issue of mission control, and if it is determined that

either federal employees or contractors would be suitable to perform a function, the Component must then consider cost to DHS, as prescribed by section 736 of the *FY 2009 Omnibus Appropriations Act*, P.L. 111-8. In such cases, the DHS Balanced Workforce Strategy guidance mandates that Components perform Cost Comparison Analysis to determine the most efficient sourcing decision.

Question: What methodology, including assumptions, does DHS use to determine such savings?

Response: When performing a Cost Comparison Analysis for a function, the Component first calculates the cost of federal workers using the DHS Modular Cost Model. This model incorporates a variety of factors to describe the fully-loaded cost for a federal employee.

On the contract side, the cost of the current contract is used, including the cost of contract oversight. If a new requirement is being reviewed, an Independent Government Cost Estimate serves as the basis for comparison.

Question: What data does DHS use to compare the costs of contractors to federal employees?

Response: When performing a Cost Comparison Analysis for a function, the Component first calculates the cost of federal workers using the DHS Modular Cost Model. This model incorporates a variety of factors to describe the fully-loaded cost for a federal employee. There are several key data elements used for the federal side, including items such as grade level and geographic location.

On the contract side, the cost of the current contract is used, including the cost of contract oversight. For fixed price contracts, the total cost is used. For other contract types, invoices are reviewed. If a new requirement is being reviewed, an Independent Government Cost Estimate serves as the basis for comparison.

Question: Does DHS have any plans to move forward to start collecting contractor data, similar to the Army's contractor inventory, and to start looking at costs?

Response: By the end of FY 2012, DHS will have the ability to more accurately collect cost data for service contracts consistent with the requirements of FAR Case 2010-010 Service Contract Reporting Requirements. The FAR change requires contractors to report the total dollar amount invoiced for services and the number of Contractor direct labor hours expended on the services performed during the previous Government fiscal year. This information will be used to analyze the cost of contractor support for services at the same time DHS prepares its annual service contract inventory. At this time, DHS does not intend to apply the Army methodology, but to adhere to guidance promulgated for use by domestic agencies.

Question: Is a DHS agency permitted to rely on federal civilians over contractors for purely cost reasons?

Response: If a DHS Component's responses to the Balanced Workforce Strategy (BWS) Tool questionnaire indicate that a function can be performed by either the public or private sector without risk to mission control, the Component must then consider cost to DHS. The DHS

Balanced Workforce Strategy guidance mandates that Components perform Cost Comparison Analysis to determine the most efficient sourcing decision.

Question: Do you know of any DHS agencies comparing costs before awarding contracts for services?

Response: As part of the ongoing pilot requiring BWS reviews for pending contract requirements from a limited number of special interest product service codes (PSCs), Components must consider cost if the either federal employees or contractors would be suitable to perform a function.

In general, the DHS acquisition planning process requires that program officials and acquisition specialists regularly consider issues of cost, which can include performing thorough market research and creating Independent Government Cost Estimates.

Question: During the hearing you stated that you would coordinate with your colleagues in the interdisciplinary group at DHS to determine how much savings could be had from lowering the contractor reimbursement cap from the FY10 level of \$693,951 to \$400,000, or the same level as what the government pays the President of the United States.

How much money would this lower cap save at DHS?

Response: DHS is unable to provide a reasonable estimate of the savings that DHS would realize should the FY 2010 executive compensation be lowered from the current cap of \$693,951 to \$400,000, because we have insufficient information. A senior executive at a company may support multiple contracts that provide supplies and services to multiple customers. In accordance with FAR 52.204-10, prime contractors and first tier subcontractors must report the total compensation of their "five most highly compensated employees in management positions at each home office and each segment of the contractor." However, the information reported does not include how much of the reported salary should be allocated to commercial customers, allocated to other federal customers or allocated to DHS contracts. Additionally, the cap on executive compensation limits the price of only some contracts types (generally, cost type and a small portion of fixed-price type contracts). Short of performing extensive audits of each company with which DHS contracts, there is no way at this time to determine what portion of the savings gained from reducing executive compensation would be allocated to contracts where there would be a price reduction or to determine how much of the executive compensation should be allocated to DHS contracts.

**Post-Hearing Questions for the Record
Submitted to Debra Tomchek, Executive Director,
Balanced Workforce Program Management Office,
U.S. Department of Homeland Security
From Senator Daniel K. Akaka**

**“Contractors: How much are they costing the government?”
March 29, 2012**

1. There is a Government-wide shortage of acquisition professionals with the proper training to clearly define contract requirements and oversee them. Additionally, the Balanced Workforce Strategy requires collaboration between acquisition and human resources professionals. How has the Department of Homeland Security (DHS) made sure that its acquisition and human resources workforces have the training and tools needed to properly implement the Balanced Workforce Strategy?

Answer: Since the development of the Balanced Workforce Strategy (BWS) in mid-2010, DHS has utilized a variety of approaches to ensure that employees receive the education and support required to successfully implement the BWS. The comprehensive BWS education strategy has included instructional events/summits, training classes, guidance documents, and regular dialogue with Component employees via meetings and desk officer support.

Instructional Events

DHS launched the BWS at a July 2010 educational event, which included statements from senior leadership and instruction on the BWS process for Component representatives from human capital, procurement, finance, legal, and program offices. The Department held two such “biannual” events in 2011, and each served as an opportunity to share guidance with Component employees and to field questions concerning the BWS. In 2011, the BWS Departmental Working Group (DWG) also hosted a costing forum, specifically designed to address Component challenges related to cost comparison analyses; subject matter experts from the Office of the Chief Financial Officer (OCFO) and the Office of the Chief Procurement Officer (OCPO) both spoke and fielded Component questions.

Training Classes

The Office of the Chief Human Capital Officer (OCHCO) has developed formal, in-person training classes on all three steps of the BWS process for reviewing existing service contracts: Identify the Work, Analyze the Work, and Implement the Sourcing Decision. Recently, additional content was added to the classes to address Component questions about the pilot requiring BWS analyses of new and re-competed functions. Between September 2010 and May 2012, DHS has held over 25 in-person training sessions, with over 225 Component representatives trained from human capital, procurement, finance, legal, and program offices. In addition, e-learning options have been piloted and are being implemented.

In collaboration with OCHO, OCPO updated its policies and procedures to implement the Office of Federal Procurement Policy (OFPP) Policy Letter 11-01, “Performance of Inherently

Governmental and Critical Functions” and emphasize the importance of maintaining a balanced workforce. To ensure members of the acquisition workforce fully understand the BWS and related OCPO policies and procedures, OCPO has trained over 500 members of the acquisition workforce between December 2011 and May 2012. Training is on-going.

Guidance Documents

To support all Component employees as they learn and implement the BWS, DHS created a comprehensive BWS guidance document, which is periodically updated to improve clarity and describe any process improvements; Version 2.0 was released in November 2011. The BWS guidance describes how to assess and make decisions regarding the balance and effective use of the federal and contractor resources, and the guidance includes appendices with forms, tools, and instructional information aimed to support the management of the BWS process at the Component level. Supplementary “User’s Guide” documents with step-by-step instructions were also published for each of the three steps in the BWS process.

Meetings and Desk Officer Interactions

Each DHS Operational and support Component has a BWS desk officer responsible for assisting its employees with BWS implementation. Desk officer support includes briefing Component staff on policies and procedures, supporting Component use of the BWS Tool, and fielding Component questions for resolution by DHS Headquarters.

DHS also holds bi-monthly meetings of the Balanced Workforce Executive Steering Group (ESG), comprised of senior leaders from the Management Directorate and representatives from Components, to discuss challenges and allow Components to provide input on the BWS.

2. You testified that the Balanced Workforce Strategy has been used to assess all contracts in place as of 2010, but is used to review only a handful of new contracts.
 - a. Why is there such limited use of the Balanced Workforce Strategy for new contracts?
 - b. Does DHS have plans to expand its pilot program?

Answer: In 2010, DHS launched the BWS with a pilot featuring a sample of 65 existing service contracts from DHS Components. This pilot approach allowed the Department to test procedures, surface lessons learned, and improve the existing contract review process prior to full-scale implementation.

The BWS process requiring review of new and re-competed functions will eventually be expanded to apply to all new service contracts. The decision was made to start requiring the BWS review of new and re-competed functions via a limited-scope pilot, during which Components could test procedures and identify process improvement opportunities. At the end of June 2012, the BWS Departmental Working Group will begin to conduct a thorough assessment of the pilot to determine lessons learned and consider broadening the scope to include additional functions.

While the BWS pilot underway currently applies to a limited number of functions, updates to Office of the Chief Procurement Officer policies and procedures require a separate Component review of all service contracts to ensure full compliance with the Federal Acquisition Regulations and the Office of Federal Procurement Policy Letter 11-01, "Performance of Inherently Governmental and Critical Functions." This parallel review process, which will be combined with the BWS process in the future, ensures that all new contracts are being appropriately assessed by the Department prior to procurement.

3. In his Plan for Economic Growth and Deficit Reduction, the President proposed a cap on contractor pay equal to the top of the Federal Executive Schedule –approximately \$200,000 per year. Under the current formula, taxpayers may have to pay up to \$700,000 for contractor employees. What are your thoughts on the President's proposal and should it be implemented?

Answer: The Administration's efforts to decrease the amount the government reimburses contractors for their compensation costs is an important step in strengthening fiscal accountability and improving our ability to contain procurement costs.



UNITED STATES OFFICE OF PERSONNEL MANAGEMENT
Washington, DC 20415

**Post-Hearing Questions for the Record
Submitted to Chuck Grimes,
Chief Operating Officer, U.S. Office of Personnel Management
From Senator Daniel K. Akaka**

**“Contractors: How much are they costing the government?”
March 29, 2012**

- 1. You testified that Strategic Alignment is an essential part of effective workforce planning. How can agencies make sure that insourcing evaluates human capital needs to fulfill an agency’s mission and is not driven by quotas?**

The strategic alignment process initiates the crosswalk between an agency’s mission to its strategic plan to help determine the human capital (quantity of staff, staffing requirements and/or competencies) required to ensure mission accomplishment. In conjunction, through a strategic workforce planning process, agencies assess the composition of their current workforce by an analysis of their current personnel in the context of agency mission and specific strategic goals to calculate staffing and/or competency gaps.

In short, the strategic alignment and strategic workforce planning processes determine agencies’ human capital needs enabling agencies to build their workforce to ensure mission fulfillment.

- 2. The Congressional Budget Office (CBO) recently issued a report comparing Federal and private sector compensation. However, it compared individual employee characteristics rather than occupations. Additionally, some of the data may have mistakenly come from contractors, possibly making Federal compensation appear higher. What impact does CBO’s methodology have on the reliability of the study’s results?**

The CBO study compared compensation (both pay and benefits) per hour worked of Federal employees with the compensation of private sector employees with similar characteristics in large establishments. The employee characteristics CBO considered included broad occupational group, estimated years in the labor market, education level, age, gender, race, whether the employee was in a metropolitan area, etc. The CBO study did not compare similar jobs at the same levels of work within each locality pay area as required by both the General Schedule locality pay system and the Federal Wage System. CBO used 24 very broad occupational groupings, and the distribution of Federal versus private sector employees across specific occupations within those groupings may be very different. However, CBO’s findings did not change substantively when they used narrower occupational groups. CBO did not consider



UNITED STATES OFFICE OF PERSONNEL MANAGEMENT
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the employee's tenure with the specific employer. CBO also included private sector workers in the Leisure and Hospitality industry which tends to provide fewer benefits to its employees. The Federal Government has few employees in many of the jobs found in the Leisure and Hospitality industry and including these employers likely understates the value of benefits provided to private sector employees in jobs similar to Federal jobs.

More generally, it is worth reiterating, as noted in OPM's written testimony, that a simple comparison of labor costs alone is not likely to answer the question of which sector would be more cost-effective and efficient in performing a given task in a specific circumstance. For example, a cost comparison to consider in-house performance as an alternative to continued contract performance might be beneficial if requirements tend to be managed best through an employer-employee relationship, the agency has experience performing the work in-house, the ability to recruit for the skill is high, and the government has historically had challenges with contractor performance. By contrast, the benefit of a cost comparison may be lower if the agency is looking to meet a surge, short term, capacity that would be costly to address through a long-term hiring, the agency currently lacks an in-house capability to perform the work, and the agency has had considerable success in getting good performance at a reasonable cost from its contractors. All of these factors may have a role in determining when a cost comparison is likely to be most effective in achieving best value for the taxpayer.

3. **In his Plan for Economic Growth and Deficit Reduction, the President proposed a cap on contractor pay equal to the top of the Federal Executive Schedule –approximately \$200,000 per year. Under the current formula, taxpayers may have to pay up to \$700,000 for contractor employees. What are your thoughts on the President's proposal and should it be implemented?**

The Administration's efforts to limit the amount reimbursed for contractor compensation will improve fiscal management and better contain procurement costs.

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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D. C. 20503

May 25, 2012

The Honorable Claire McCaskill
Chairman
Subcommittee on Contracting Oversight
Committee on Homeland Security
and Governmental Affairs
United States Senate
Washington, DC 20510

Dear Madam Chairman:

This letter is in response to questions posed to the Office of Management and Budget (OMB) following a March 29, 2012, hearing to examine the cost of using contractors. You asked when OMB plans to release additional guidance to agencies on insourcing and cost analysis and what topics the guidance will address. You also asked when OMB plans to issue a decision regarding a request by the Department of Defense for an exemption from the Paperwork Reduction Act (PRA) in connection with the planned collection of information from contractors to support the development of its annual service contractor inventory.

As part of President Obama's commitment to changing the way Washington does business, the Administration has made major strides to reform contracting under this Administration. We are buying less and buying smarter. Agencies put an end to the unsustainable growth in contracting experienced between 2000 and 2008 and, for the first time in nearly two decades, overall contract spending has declined or stayed flat two years in a row. By pooling our purchasing power and renegotiating contracts to secure deeper discounts, we are delivering better prices for taxpayers and reducing the wasteful proliferation of duplicative contracts for common needs.

Part of our contracting reform efforts have focused on striking the right balance between Federal employees and contractors that best protects the public's interest and serves the American people in a cost-effective manner. To date, most of these efforts have focused on clarifying what functions are inherently governmental or otherwise must be performed by Federal employees. These clarifications have been achieved through policy, including the issuance of a comprehensive policy letter by OMB's Office of Federal Procurement Policy, management guidance, and pilots.

We are now focusing on the development of guidance and tools, including cost comparisons, to help agencies consider where rebalancing of work can save money. The guidance will build on important cost principles OMB laid out in its 2009 memorandum on managing the multi-sector workforce – namely, that if either sector can perform the work and cost is the driver, agencies should ensure their comparisons (1) address the full cost of

government and private sector performance and (2) compare like costs. See OMB Memorandum M-09-26 available at http://www.whitehouse.gov/sites/default/files/omb/assets/memoranda_fy2009/m-09-26.pdf.

The guidance will be further shaped by experiences gained by the Departments of Defense (DoD) and Homeland Security and include management practices for identifying where analyses are likely to be most effective. We expect to issue guidance by mid-July.

Closely related to these efforts is our work with DoD and civilian agencies to strengthen the use of service contract inventories. Service contract inventories, which help agencies better understand how contracted services are being used to support mission and operations, are an important tool for achieving greater budgetary accountability and more fiscally responsible contracting, both of which ensure investments in contract services are affordable and cost-effective.

On May 22, 2012, OMB concluded review of DoD's most recently proposed implementation of its service contract inventory requirements -- which includes obtaining information from contractors on direct labor costs -- and concluded that this guidance constitutes a "collection of information" under the PRA, 44 U.S.C. § 3502(3). Although DoD initially requested an "emergency" clearance of its information collection request, see 44 U.S.C. § 3507(j), DoD worked with OMB to process its request using the normal clearance process, similar to how OMB handled several related information collection requests in past years by the Department of the Army, on which much of the DoD-wide guidance is based. OMB has provided an approval number for the collection (OMB no. 0704-0491), which will allow DoD to begin implementing its collection process.

Thank you again for the opportunity to address these issues. We look forward to working with you and your staff as we move forward on these important matters.

Sincerely,



Jeffrey D. Zients
Acting Director

