# H.R. 3802, THE ELECTRONIC REPORTING STREAMLINING ACT OF 1996 AND H.R. 3189, TO DELAY THE PRIVATIZATION OF THE OFFICE OF FEDERAL INVESTIGATIONS OF THE OFFICE OF PERSONNEL MANAGEMENT

## HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION, AND TECHNOLOGY

OF THE

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT

HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

SECOND SESSION

ON

**H.R. 3802**

TO AMEND SECTION 552 OF TITLE 5, UNITED STATES CODE, POPULARLY KNOWN AS THE FREEDOM OF INFORMATION ACT, TO PROVIDE FOR PUBLIC ACCESS TO INFORMATION IN AN ELECTRONIC FORMAT, AND FOR OTHER PURPOSES

AND ON

**H.R. 3189**

TO DELAY THE PRIVATIZATION OF THE OFFICE OF FEDERAL INVESTIGATIONS OF THE OFFICE OF PERSONNEL MANAGEMENT IN ORDER TO ALLOW SUFFICIENT TIME FOR A THOROUGH REVIEW TO BE CONDUCTED AS TO THE FEASIBILITY AND DESIRABILITY OF ANY SUCH PRIVATIZATION, AND FOR OTHER PURPOSES

MAY 22, 1996

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# H.R. 3802, THE ELECTRONIC REPORTING STREAMLINING ACT OF 1996 AND H.R. 3189, TO DELAY THE PRIVATIZATION OF THE OFFICE OF FEDERAL INVESTIGATIONS OF THE OFFICE OF PERSONNEL MANAGEMENT

**WEDNESDAY, MAY 22, 1996**

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION, AND TECHNOLOGY,
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,
*Washington, DC.*

The subcommittee met, pursuant to notice, at 2 p.m., in room 2154, Rayburn House Office Building, Hon. Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Horn, Flanagan, Davis, and Maloney.

Ex officio present: Representative Clinger.

Staff present: J. Russell George, staff director and counsel; Mark Brasher, professional staff member; Andrew G. Richardson, clerk; and David McMillen and Mark Stephenson, minority professional staff members.

Mr. HORN. The Subcommittee on Government Management, Information, and Technology will come to order. Today, we examine two separate measures. One bill has yet to be introduced, the Electronic Reporting Streamlining Act. And the second bill, H.R. 3189, which would delay the planned privatization of the Office of Federal Investigations within the Office of Personnel Management, OPM.

The Federal Government is a monopoly, which will never go out of business. As a result, it is often some years behind the private sector in adopting new techniques to simply work and improve quality and service. That's why we need to rely on some level of expertise, and, if need be, a nudge from the private sector as we modernize our operations to take advantage of new technologies.

The Electronic Reporting and Streamlining Act aims to increase the involvement of the private sector in identifying regulatory processes capable of being conducted electronically, reduce the burden of reporting on the regulated community, ensure the electronic data reported to agencies are in a useful format, ensure public access to data submitted to Federal agencies in an electronic format, and, finally, to stimulate Federal agencies to improve their regulatory program through the use of technology.

H.R. 3189 will examine a decision by the Office of Personnel Management to privatize its employee background investigations

duty, a function currently performed by Federal employees to a new U.S. Investigations Service. The subcommittee is interested in Federal agencies obtaining these background checks at the lowest total cost with the best levels of service and confidentiality available. We must restructure Government and do so in an efficient manner.

However, today we will be examining OPM's proposed privatization in that vein and will be interested in the comments that our various witnesses will have on that legislation. To examine these issues, we've assembled a very knowledgeable cross-section of experts from the Federal Government and private industry.

[The texts of H.R. 3802 and H.R. 3189 follow:]

I

104TH CONGRESS
2D SESSION

# H. R. 3802

To amend section 552 of title 5, United States Code, popularly known as the Freedom of Information Act, to provide for public access to information in an electronic format, and for other purposes.

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IN THE HOUSE OF REPRESENTATIVES

JULY 12, 1996

Mr. TATE (for himself, Mr. HORN, Mrs. MALONEY, and Mr. PETERSON of Minnesota) introduced the following bill; which was referred to the Committee on Government Reform and Oversight

---

# A BILL

To amend section 552 of title 5, United States Code, popularly known as the Freedom of Information Act, to provide for public access to information in an electronic format, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE.**

This Act may be cited as the "Electronic Freedom of Information Amendments of 1996".

**SEC. 2. FINDINGS AND PURPOSES.**

(a) FINDINGS.—The Congress finds that—

(1) the purpose of section 552 of title 5, United States Code, popularly known as the Freedom of Information Act, is to require agencies of the Federal Government to make certain agency information available for public inspection and copying and to establish and enable enforcement of the right of any person to obtain access to the records of such agencies, subject to statutory exemptions, for any public or private purpose;

(2) since the enactment of the Freedom of Information Act in 1966, and the amendments enacted in 1974 and 1986, the Freedom of Information Act has been a valuable means through which any person can learn how the Federal Government operates;

(3) the Freedom of Information Act has led to the disclosure of waste, fraud, abuse, and wrongdoing in the Federal Government;

(4) the Freedom of Information Act has led to the identification of unsafe consumer products, harmful drugs, and serious health hazards;

(5) Government agencies increasingly use computers to conduct agency business and to store publicly valuable agency records and information; and

(6) Government agencies should use new technology to enhance public access to agency records and information.

(b) PURPOSES.—The purposes of this Act are to—

(1) foster democracy by ensuring public access to agency records and information;

(2) improve public access to agency records and information;

(3) ensure agency compliance with statutory time limits; and

(4) maximize the usefulness of agency records and information collected, maintained, used, retained, and disseminated by the Federal Government.

**SEC. 3. APPLICATION OF REQUIREMENTS TO ELECTRONIC FORMAT INFORMATION.**

Section 552(f) of title 5, United States Code, is amended—

(1) by redesignating such section as section (f)(1);

(2) by striking the period at the end and inserting "; and"; and

(3) by adding at the end the following:

"(2) For purposes of this section, 'information', 'record', and any other term used in this section in ref-

erence to information includes such information maintained in an electronic format.".

**SEC. 4. HONORING FORM OR FORMAT REQUESTS.**

Section 552(a)(3) of title 5, United States Code, is amended—

(1) by inserting "(A)" after "(3)";

(2) by striking out "(A)" the second place it appears and inserting "(i)";

(3) by striking out "(B)" and inserting "(ii)"; and

(4) by adding at the end the following new subparagraphs:

"(B) In making any record available to a person under this paragraph, an agency shall provide the record in any form or format requested by the person if the record is readily reproducible by the agency in that form or format. Each agency shall make reasonable efforts to maintain its records in forms or formats that are reproducible for purposes of this section.

"(C) In responding under this paragraph to a request for records, an agency shall make reasonable efforts to search for the records in electronic form or format.

"(D) For purposes of this paragraph, the term 'search' means to review, manually or by automated

means, agency records for the purpose of locating those records which are responsive to a request.".

**SEC. 5. STANDARD FOR JUDICIAL REVIEW.**

Section 552(a)(4)(B) of title 5, United States Code, is amended by adding at the end the following new sentence: "A court shall accord substantial weight to an affidavit of an agency concerning the agency's determination as to technical feasibility under paragraph (2)(C) and subsection (b) and reproducibility under paragraph (3)(B).".

**SEC. 6. ENSURING TIMELY RESPONSE TO REQUESTS.**

(a) MULTITRACK PROCESSING.—Section 552(a)(6) of title 5, United States Code, is amended by adding at the end the following new subparagraph:

"(D)(i) Each agency may promulgate regulations, pursuant to notice and receipt of public comment, providing for multitrack processing of requests for records or information.

"(ii) Regulations under this subparagraph may provide a person making a request that does not qualify for the fastest multitrack processing an opportunity to limit the scope of the request in order to qualify for faster processing.

"(iii) This subparagraph shall not be considered to affect the requirement under subparagraph (C) to exercise due diligence.".

(b) UNUSUAL CIRCUMSTANCES.—Section 552(a)(6)(B) of title 5, United States Code, is amended to read as follows:

"(B)(i) In unusual circumstances as specified in this subparagraph, the time limits prescribed in either clause (i) or clause (ii) of subparagraph (A) may be extended by written notice to the person making such request setting forth the unusual circumstances for such extension and the date on which a determination is expected to be dispatched. No such notice shall specify a date that would result in an extension for more than ten working days, unless the person making the request has (I) agreed upon a longer timeframe for processing the request, or (II) refused to reasonably modify the request. In the event that the person making the request refuses to agree upon a reasonable timeframe for processing the request or to reasonably modify the request, the agency may offer such refusal as evidence of exceptional circumstances under subparagraph (C).

"(ii) As used in this subparagraph, 'unusual circumstances' means, but only to the extent reasonably necessary to the proper processing of the particular requests—

"(I) the need to search for and collect the requested records from field facilities or other estab-

lishments that are separate from the office processing the request;

"(II) the need to search for, collect, and appropriately examine a voluminous amount of separate and distinct records which are demanded in a single request; or

"(III) the need for consultation, which shall be conducted with all practicable speed, with another agency having a substantial interest in the determination of the request or among two or more components of the agency having substantial subject-matter interest therein.".

(c) EXCEPTIONAL CIRCUMSTANCES.—Section 552(a)(6)(C) of title 5, United States Code, is amended by inserting "(i)" after "(C)", and by adding at the end the following new clauses:

"(ii) For purposes of this subparagraph, the term 'exceptional circumstances' does not include a delay that results from a predictable agency workload of requests under this section.

"(iii) If a person refuses to reasonably modify the scope of a request under this section after being requested to do so by the agency to whom the person made the request, such refusal may be considered evidence of exceptional circumstances.

"(iv) In determining whether exceptional circumstances exist, a court may consider the efforts by an agency to reduce the number of pending requests under this section.".

**SEC. 7. TIME PERIOD FOR AGENCY CONSIDERATION OF REQUESTS.**

(a) EXPEDITED PROCESSING.—Section 552(a)(6) of title 5, United States Code (as amended by section 6(a) of this Act), is further amended by adding at the end the following new subparagraph:

"(E)(i) Each agency shall promulgate regulations, pursuant to notice and receipt of public comment, providing for expedited processing of requests for records—

"(I) in cases in which the person requesting the records demonstrates a compelling need; and

"(II) in other cases determined by the agency.

"(ii) Notwithstanding subparagraph (A)(i), regulations under this subparagraph must ensure—

"(I) that a determination of whether to provide expedited processing shall be made, and notice of the determination shall be provided to the person making the request, within 10 days after the date of the request; and

"(II) expeditious consideration of administrative appeals of such determinations of whether to provide expedited processing.

"(iii) Agency action to deny or affirm denial of a request for expedited processing pursuant to this subparagraph, and failure by an agency to respond timely to such a request—

"(I) may only be for cause; and

"(II) shall be subject to judicial review under paragraph (4), except that the judicial review shall be based on the record before the agency at the time of the determination.

"(iv) For purposes of this subparagraph, the term 'compelling need' means—

"(I) that a failure to obtain requested records on an expedited basis under this paragraph could reasonably be expected to pose an imminent threat to the life or physical safety of an individual; or

"(II) with respect to a request made by a person engaged in disseminating information, compelling urgency to the public.".

(b) EXTENSION OF GENERAL PERIOD FOR DETERMINING WHETHER TO COMPLY WITH A REQUEST.—Section 552(a)(6)(A)(i) of title 5, United States Code, is amended by striking "ten days" and inserting "20 days".

(c) ESTIMATION OF MATTER DENIED.—Section 552(a)(6) of title 5 United States Code (as amended by section 6 of this Act and subsection (a) of this section), is further amended by adding at the end the following new subparagraph:

"(F) In denying a request for records, in whole or in part, an agency shall make a reasonable effort to estimate the volume of any requested matter the provision of which is denied, and provide any such estimate to the person making the request.".

**SEC. 8. COMPUTER REDACTION.**

Section 552(b) of title 5, United States Code, is amended in the matter following paragraph (9) by striking the period and inserting the following: "The deletions shall be indicated on the released portion of the record. If technically feasible, each deletion shall be indicated at the place in the record where such deletion was made.".

**SEC. 9. AGENCY REPORTS.**

(a) CONTENTS OF ANNUAL REPORTS.—Section 552(e) of title 5, United States Code, is amended—

(1) in paragraph (6), by striking "and" after the semicolon;

(2) by redesignating paragraph (7) as paragraph (10); and

(3) by inserting after paragraph (6) the following new paragraphs:

"(7) a complete list of all statutes relied on by the agency to authorize the agency to withhold information, and a description of the scope of information withholdable;

"(8) the time estimated to be necessary for the agency to complete requests for information of different categories of size and complexity in the future;

"(9) reference materials and guides made available by the agency under subsection (g); and".

(b) ELECTRONIC AVAILABILITY.—Section 552 of title 5, United States Code, is amended by redesignating subsection (f) as subsection (h), and by inserting after subsection (e) the following new subsection:

"(f)(1) The head of each agency shall make information contained in the reports of the agency under subsection (e) available to the public—

"(A) by means of computer telecommunications; or

"(B) if computer telecommunications means have not been established by an agency, by other electronic means.

"(2) The Administrator of the Office of Information and Regulatory Affairs in the Office of Management and Budget shall establish a single electronic access point for all agency reports under subsection (e). The Administrator may delegate this responsibility to the head of any other appropriate agency.

"(3) This subsection shall apply to agency reports under subsection (e) submitted after the conclusion of the first fiscal year beginning after the date of the enactment of the Electronic Freedom of Information Amendments of 1996.".

**SEC. 10. REFERENCE MATERIALS AND GUIDES.**

Section 552 of title 5, United States Code, as amended by section 9(b) of this Act, is further amended by inserting after subsection (f) the following new subsection:

"(g) The head of each agency shall make available to the public, reference material or a guide for requesting records or information from the agency, including—

"(1) an index of all major information systems of the agency; and

"(2) a description of major information and record locator systems maintained by the agency.".

**SEC. 11. EFFECTIVE DATE.**

(a) IN GENERAL.—Except as provided in subsection (b), this Act shall take effect 90 days after the date of the enactment of this Act.

(b) PROVISIONS EFFECTIVE ON ENACTMENT.—Sections 6 and 7 shall take effect one year after the date of the enactment of this Act.

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I

104TH CONGRESS
2D SESSION

# H. R. 3189

To delay the privatization of the Office of Federal Investigations of the Office of Personnel Management in order to allow sufficient time for a thorough review to be conducted as to the feasibility and desirability of any such privatization, and for other purposes.

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IN THE HOUSE OF REPRESENTATIVES

MARCH 28, 1996

Mr. DAVIS (for himself, Mr. ENGLISH of Pennsylvania, and Mr. MORAN) introduced the following bill; which was referred to the Committee on Government Reform and Oversight

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# A BILL

To delay the privatization of the Office of Federal Investigations of the Office of Personnel Management in order to allow sufficient time for a thorough review to be conducted as to the feasibility and desirability of any such privatization, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. CONTINUATION OF THE OFFICE OF FEDERAL INVESTIGATIONS.**

(a) IN GENERAL.—During the 2–year period beginning on the date of the enactment of this Act—

(1) the Office of Federal Investigations shall continue to perform all functions performed by such Office on the day before the date of the enactment of this Act; and

(2) the number of full-time equivalent positions within the Office of Federal Investigations may not be reduced in connection with any efforts to terminate such Office or to privatize any of its functions.

(b) REPORTS.—Not later than 1 year after the date of the enactment of this Act, the General Accounting Office and the Office of Personnel Management shall each submit to the Congress a report on the feasibility and desirability of terminating the Office of Federal Investigations and privatizing its functions. Each such report shall include—

(1) with respect to the proposed termination and privatization, an analysis of any concerns relating to—

(A) national security;

(B) quality assurance;

(C) maintenance of individual privacy; and

(D) access to sensitive information by private investigators;

(2) a cost-benefit analysis of the proposed termination and privatization;

(3) findings as to the feasibility and desirability of the proposed termination and privatization; and

(4) if appropriate, recommendations as to how any such termination or privatization should be effected.

(c) OFFICE OF FEDERAL INVESTIGATIONS.—For purposes of this Act, the term "Office of Federal Investigations" means the Office of Federal Investigations of the Office of Personnel Management.

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Mr. HORN. Now, we have with us at the beginning here on panel I, the Honorable Sally Katzen, the Administrator, Office of Information and Regulatory Affairs of the Office of Management and Budget, part of the Executive Office of the President.

We have Mr. Richard Ferguson, board member and executive director, Environment and Safety Data Exchange.

We have Mr. David Roe, the senior attorney, Environmental Defense Fund.

Also, we have Mr. Jeffrey Snow, the Electronic Data Interchange project, International Association of Industrial Accident Boards and Commissions.

One of the traditions of the Committee on Government Reform and Oversight is that we do swear all witnesses.

[Witnesses sworn.]

Mr. HORN. The clerk will note that all four witnesses affirmed. We will just begin in the order that I stated. Our first witness will be Sally Katzen. May I say, just so you're all alerted, we have three votes going on on the floor. And I will have to leave with 5 minutes to go when the second vote comes up. So we're going to have some interruptions here and there this afternoon, I think.

Ms. Katzen.

**STATEMENTS OF SALLY KATZEN, ADMINISTRATOR, OFFICE OF INFORMATION AND REGULATORY AFFAIRS, OFFICE OF MANAGEMENT AND BUDGET; RICHARD A. FERGUSON, BOARD MEMBER AND EXECUTIVE DIRECTOR, ENVIRONMENT AND SAFETY DATA EXCHANGE; DAVID ROE, SENIOR ATTORNEY, ENVIRONMENTAL DEFENSE FUND; AND JEFFREY SNOW, ELECTRONIC DATA INTERCHANGE PROJECT, INTERNATIONAL ASSOCIATION OF INDUSTRIAL ACCIDENT BOARDS AND COMMISSIONS**

Ms. KATZEN. Thank you, Mr. Chairman. Before I begin, I would like to make a point of personal privilege. The last time I testified before you, it was on the subject of statistical agencies. In the course of that testimony, I said that I expected that we would be able to have one-stop shopping of economic statistics shortly. I would like to tell you that yesterday we unveiled the economic statistics briefing room and the social statistics briefing room on the White House home page. And it was written up this morning in the Wall Street Journal and, I think, the New York Times.

So we have held true to that commitment, and I, for one, was delighted to see it happen.

Mr. HORN. Congratulations. I know that you've tried to do a lot of streamlining. That's appreciated.

Ms. KATZEN. I'm delighted to be here today to talk about the Federal Government's use of information technology to reduce the burden on respondents and to facilitate access to Government data. We understand and generally agree with the goals for the draft Electronic Reporting Streamlining Act of 1996.

We, too, want to reduce the burden of reporting on the regulated community. We also wish to capture the benefits of greater involvement of the private sector in identifying reporting associated with regulatory monitoring and enforcement that is capable of being conducted electronically.

And we all support ensuring that the public has proper access to such data.

Now, the draft legislation seeks to achieve these goals by focusing on technical standards, the standards used by agencies in computers and related technology for collecting data electronically from private parties. It is true that technical standards play an important role in developing an open and interoperable information infrastructure. And it is also true that the private sector has much to contribute to the setting of these standards.

The draft legislation, however, would transform the present consensus standard-setting process into a highly formalized, multistep rulemaking process run by OMB. The existing experts at NIST, the National Institute of Standards and Technology in the Department of Commerce, would no longer be in charge of the process. Rather, OMB would be placed in the unprecedented role of an operational regulatory agency.

Moreover, the draft legislation would establish a petition process with short deadlines and narrow constraints on OMB flexibility, requiring OMB to make technical evaluations and findings concerning the details of agency electronic information collection and dissemination activities as applied to specific regulatory enforcement programs. But it is the regulatory agencies and their enforcement staffs, not OMB, that have the detailed knowledge and the technical expertise to determine operationally how best to obtain compliance-related data, how to use that data and how to evaluate when and how to make company-specific data available to the public.

In my written statement, which I assume will be incorporated as part of this record, I have provided some of the recent developments regarding electronic transmission of information to the Federal Government and the use of consensus standards, including OMB Circular A–130; the Paperwork Reduction Act, and President Clinton signing a statement in which he signaled his strong commitment to electronic reporting, directing the agencies to henceforth make their reporting requirements available electronically, or else explain why to OMB, through the issuance of the FIPS 161 so that agencies would cease using proprietary standards and instead use the material in the public domain, the ANSI X12 or UN/EDIFACT standards as appropriate.

The revision to FIPS 161 to ensure that agency implementation of these standards are fully compatible with industry practice and the two recently enacted statutes, the Information Technology Management Reform Act and the National Technology Transfer and Advancement Act, both of 1996, which address the critical issue of standards. With this recitation in the written testimony, the point that I was trying to make is that we seem to be in real time in this policy area.

Several of the statutes that have already been passed have not yet taken effect. It is, therefore, difficult to know precisely what additional help is needed and what is not, and to prescribe a clear path for what may be missing in the statutory schemes that have thus far been enacted.

Mr. Chairman, I must also point out that while the pace of change has not been as quick as many have hoped, I do not believe

the problem is a lack of desire to move to electronic submissions, nor a lack of technical standards to implement the change, nor any deficiency in the standard setting process.

Rather, the problem is one of agency resources and priorities. And the draft legislation does not and cannot realistically address those issues. The infusion of technical support from the private sector on which this draft legislation is based is clearly desirable and certainly would help given the restraints that we are faced with on resources. But a mandate that requires certain agency actions to take place in tight timeframes will not by itself make it happen. Moreover, shifting responsibility from the agencies to OMB will only complicate and possibly delay attempts to achieve a transition to the use of electronic data because it is the agencies that have the expertise and program knowledge.

We welcome your interest in encouraging agencies to move forward. And we would be prepared to discuss with you a host of ways in which we could work together to increase agency use of information technology in a constructive fashion. I see my time is about to expire and before the light turns red, I will thank you and look forward to your questions.

[The prepared statement of Ms. Katzen follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

ADMINISTRATOR
OFFICE OF
INFORMATION AND
REGULATORY AFFAIRS

STATEMENT OF SALLY KATZEN
ADMINISTRATOR
OFFICE OF INFORMATION AND REGULATORY AFFAIRS
OFFICE OF MANAGEMENT AND BUDGET
BEFORE THE
SUBCOMMITTEE ON MANAGEMENT, INFORMATION, AND TECHNOLOGY
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
HOUSE OF REPRESENTATIVES

May 22, 1996

Good afternoon, Mr. Chairman and Members of this Subcommittee. I am Sally Katzen, Administrator of the Office of Information and Regulatory Affairs (OIRA) within the Office of Management and Budget (OMB). It is a pleasure to be here to discuss the Federal government's use of information technology to reduce burden on respondents and facilitate access to government data, particularly in the context of regulatory reporting and compliance monitoring.

In your letter of invitation, you listed a number of goals for the draft "Electronic Reporting Streamlining Act of 1996." As a general matter, we agree on the benefits from greater involvement of the private sector in identifying reporting associated with regulatory monitoring and compliance that is capable of being conducted electronically. We all want to reduce the burden of reporting on the regulated community. And we all support ensuring that electronic data reported to agencies are in a useful format and that the public has proper access to such data.

The draft legislation seeks to address these goals by focussing on technical standards -- the standards used by agencies in computers and related technology for collecting data electronically from private parties. It is true that technical standards play an important role in developing an open and interoperable information infrastructure. It is also true that the private sector has much to contribute to the setting of these standards.

The draft legislation would, however, transform the present consensus standard setting process, administered by NIST in the Department of Commerce, into a highly formalized multi-step rulemaking process run by OMB. OMB would be placed in the unprecedented role of an operational regulatory agency.

Moreover, the draft legislation would establish a detailed petition process, with short deadlines, requiring OMB to make technical evaluations and findings concerning the details of agency electronic information collection and dissemination activities as applied to specific regulatory enforcement programs. It is the regulatory agencies and their enforcement staff, not OMB, that have the detailed knowledge and technical expertise to determine operationally how best to obtain compliance-related data. It is also the agencies that must use the data to enforce specific statutory and regulatory standards administratively and in court, and must evaluate what and how company-specific data is to be disseminated generally to the public.

To provide a context for these concerns, I would like to step back a little and describe where we are regarding electronic transmission of information to the Federal government, and regarding the Federal government's commitment to the use of voluntary consensus standards.

**Background**

Over the last decade, data networks -- including the Internet -- coupled with the use of commercially accepted standards such as "Electronic Data Interchange" (EDI), and the level of technology available to the public, have become mature and accessible enough to make electronic filing and similar applications a reality.

These technologies, however, are neither magical nor free. Their use requires careful planning and development, often at significant expense. They need to be tailored carefully to provide the benefits of burden reduction to the public and to facilitate proper public access to data without at the same time imposing unreasonable costs and technological burdens on those they are intended to assist or on the agencies themselves.

The articulation of legislative and administrative policy regarding the use of technology generally, and for addressing reduction of burden and ease of public access through electronic reporting specifically, has been an evolving process. The Paperwork Reduction Act of 1980 ('80 PRA) contained very little on agency use of information technology.[1] The 1986 amendments

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[1] For example, "automatic data processing and telecommunications technologies are [to be] acquired and used by the Federal Government in a manner which improves service delivery and program management ... and, where ever practicable and appropriate, reduces the information processing burden for the Federal Government and for persons who provide information to the Federal Government". 44 U.S.C. 3501(5), as enacted in P.L. 96-511

to the '80 PRA, as well as the first version of OMB Circular A-130,[2] discussed agency acquisition and management of information technology, but did not focus on using information technology to reduce paperwork burden or to facilitate ease of public access.

This lack of emphasis was remedied with the 1993 revisions to OMB Circular A-130, which articulated a basic assumption that modern information technology can help the government and the public in the government's collection of information. While some information collections may not be good candidates for electronic techniques, many are.

The policy at Section 8a(3) of the Circular[3] encourages agencies to use automated techniques for collection of information, and sets forth conditions conducive to the use of those techniques:

> "(3) **Electronic Information Collection.** Agencies shall use electronic collection techniques where such techniques reduce burden on the public, increase efficiency of government programs, reduce costs to the government and the public, and/or provide better service to the public. Conditions favorable to electronic collection include:
>
> "(a) The information collection seeks a large volume of data and/or reaches a large proportion of the public;
>
> "(b) The information collection recurs frequently;
>
> "(c) The structure, format, and/or definition of the information sought by the information collection does not change significantly over several years;
>
> "(d) The agency routinely converts the information collected to electronic format;
>
> "(e) A substantial number of the affected public are known to have ready access to the necessary information technology and to maintain the information in electronic form;
>
> "(f) Conversion to electronic reporting, if mandatory, will not impose substantial costs or other adverse effects on the public, especially State and local

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(December 11, 1980).

[2] 50 Fed. Reg. 52730, December 24, 1985.

[3] 61 Fed. Reg. 6428, 6432 (February 20, 1996).

governments and small business entities."

It is significant, we believe, that this Circular emphasizes considering whether the respondent population has access to the necessary information technology, and directs agencies not to convert to electronic reporting if it would impose substantial costs on the public, especially small businesses. In the past, small businesses have expressed concerns about overly aggressive agency initiatives to automate reporting requirements. For example, the Social Security Administration (SSA) has been criticized for pushing small businesses too hard and too fast to file their wage and withholding reports electronically. In response, SSA has been phasing in its electronic reporting requirements beginning with large businesses. It is now exploring a user-friendly modem dial-up technology to reach the remaining small businesses which have not yet been able to cost-effectively convert to electronic filing.

**Paperwork Reduction Act**

The policy objectives and concerns quoted above were codified in the Paperwork Reduction Act of 1995 ('95 PRA).[4] A stated purpose of the '95 PRA is to "ensure that information technology is acquired, used, and managed to improve performance of agency missions, including the reduction of information collection burdens on the public."[5] Agencies, in seeking public comment on proposed collections of information, are required to solicit public comment to "minimize the burden of the collection of information on those who are to respond, <u>including through the use of automated collection techniques or other forms of information technology</u>."[6] Agencies, in submitting proposed collections of information for OMB review and approval, are also required to certify that the collection of information "uses information technology to reduce burden and improve data quality, agency efficiency and responsiveness to the public."[7]

In signing the '95 PRA, President Clinton specifically signalled his commitment to a prompt transition to electronic

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[4] P.L. 104-13, May 22, 1995.

[5] 44 U.S.C. 3501(10). See also 44 U.S.C. 3504(h)(5), which calls upon agencies to "promote the use of information technology by the Federal Government to improve the productivity, efficiency, and effectiveness of Federal programs, including through dissemination of public information and the reduction of information collection burdens on the public."

[6] 44 U.S.C. 3506(c)(2)(A)(iv) (emphasis added).

[7] 44 U.S.C. 3506(c)(3)(J).

reporting, stating:

> From this point forward, I want all of our agencies to provide for the electronic submission of every new government form or demonstrate to OMB why it cannot be done that way. The old way will still be available, but I think once people see how fast and efficient electronic filing can be, we'll see less paperwork and more of these [holding up a computer diskette]. So, we're trying to do our part to act in good faith the way these Members of Congress intended the executive branch to act.[8]

Last summer, OMB issued regulations implementing the '95 PRA.[9] As part of those regulations, OMB explicitly included provisions directed at this Congressional and Presidential interest in having agencies expand the opportunities for the public to submit information electronically.

**Information Technology Management Reform Act**

The recently enacted Information Technology Management Reform Act of 1996 (ITMRA), Division E of P.L. 104-106, is directly relevant to the electronic filing issue. ITMRA instructs agencies to reengineer their business processes before investing money to automate them:

> [Agencies shall] analyze the missions of the executive agency and, based on the analysis, revise the executive agency's mission-related processes and administrative processes, as appropriate, before making significant investments in information technology to be used in support of those missions.[10]

The point here is that information technology should not be used simply to "automate the mess," but should be applied only after a concerted effort to consolidate and streamline agency processes has been completed. Part of the reason that agency electronic commerce initiatives have not always been as successful as might be hoped, is that agencies have too often been attempting to merely put electronic "front ends" on a paper-based process. Even when these "front ends" utilize voluntary consensus standards, the benefit is not realized unless the information systems using the standards have been reengineered and streamlined to improve the overall program needs of the

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[8] Presidential Documents, May 29, 1995, Vol. 31, No. 21, p. 886.

[9] 5 C.F.R. 1320, 60 Fed. Reg. 44978 (August 29, 1995).

[10] P.L. 104-106, Sec. 5113(b)(2)(C) (emphasis added).

agency. In other words, it does no one any good for an agency to receive data in standard formats only to either print it out on paper, or to otherwise process the data in an inefficient or otherwise not very useful manner. And that is where some agencies still are.

**Voluntary Standards**

Of equal importance to the Federal government's commitment to use information technology to reduce burden, is its commitment to the use of voluntary consensus standards as appropriate in these initiatives. OMB Circular A-130 very specifically directs agencies to "use voluntary standards and Federal Information Processing Standards where appropriate or required" in furtherance of their information technology activities.[11]

Federal Information Processing Standards, or "FIPS," are promulgated by the Secretary of Commerce through the National Institute of Standards and Technology to direct Federal agencies as to the specific technical standards to use in particular applications. Section 5131 of the Information Technology Management Reform Act of 1996 recodified the FIPS authority which was previously in the so-called "Brooks Act," and gave further emphasis to the need for Federal agencies to use voluntary consensus standards.

The Commerce Department has taken a proactive approach to standards work in the context of regulatory and other reporting to the government. Government-wide policy regarding use of approved EDI standards was first enunciated in FIPS 161, "Electronic Data Interchange."[12] FIPS 161 provided that Federal agencies would cease using proprietary EDI standards, and would use public domain ANSI X12 or UN/EDIFACT as appropriate. It gave relatively equal weight to both families of standards, but urged the use of EDIFACT standards for international interchanges. Adoption of this Federal standard admittedly took longer than we would have liked. However, given its broad scope -- all governmental electronic data interchange -- we took the time to seek two rounds of public comment so as to ensure that we were completely in step with industry and the voluntary consensus-based standards it had developed.

Last month, the Secretary of Commerce revised FIPS 161 to further strengthen the Administration's policy commitment to

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[11] 61 Fed. Reg. at 6432.

[12] 56 Fed. Reg. 13123 (March 21, 1993).

standards based EDI.[13] In addition to stressing the use of EDI in the emerging area of health care applications, including Medicare and Medicaid billings and filings, the revised FIPS creates mechanisms to improve the governments' implementation of the EDI standards themselves.

Specifically, it creates an EDI Standards Management Coordinating Committee to ensure that agencies correctly implement the EDI standards, and to minimize the chance of inconsistent agency implementation placing unnecessary burdens on industry. Chaired by the National Institute of Standards and Technology, the Coordinating Committee will check that all agency EDI implementations conform to the published X12 and UN/EDIFACT standards, and post those implementations on the Internet for public information and, where appropriate, comment. In addition, the Coordinating Committee will establish functional work groups, e.g., procurement, mortgage finance, and health care, to ensure that government EDI applications in those functional areas are fully compatible with industry practices. The Committee will also work closely with and utilize the advice of the existing, private sector X12 Committee of the American National Standards Institute.

Finally, it is useful to note Congress' recent reaffirmation of the U.S.'s voluntary standards process. The recently enacted Technology Transfer Act places yet further emphasis on the use of consensus technical standards by Federal agencies. Section 12 of P.L. 104-113 requires that all Federal agencies must: (1) use voluntary consensus standards in their information and other activities; (2) consult with and participate in the standards setting process with industry; and (3) report to OMB and Congress any instance when use of a consensus standard is inconsistent with applicable law or otherwise impractical.

* * *

As is apparent from this brief recitation, there has been a significant amount of activity in this policy area over the past few years. Indeed, several new laws, recently enacted, have not yet even taken effect. It is therefore difficult to know precisely what is needed and what is not, and to prescribe a clear path for what may be needed.

Mr. Chairman, I must also point out that while the pace of change has not been as quick as many have hoped, I do not believe the problem is a lack of desire to move toward electronic submissions, nor a lack of technical standards to implement the

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[13] FIPS 161-2. Federal Register publication expected May 22, 1996.

change, nor any deficiency in the standards setting process. Rather, the problem is one of agency resources and priorities, and the draft legislation does not and cannot realistically address these issues.

The infusion of technical support from the private sector on which this draft legislation is based is clearly desirable and certainly would help given the reality of resource constraints. But a mandate that requires certain agency actions to take place in tight time frames will not by itself make it happen. Agencies are struggling to adapt their missions to reduced resources, and agencies and the private sector alike are struggling to keep pace with advances in technology.

Moreover, shifting responsibility from the agencies to OMB will only worsen the situation because it is the agencies that have the expertise and program knowledge to understand and evaluate the applicability of general technical standards to specific regulatory monitoring and enforcement needs. Inserting OMB into the details of this process, with or without time deadlines, will only complicate and possibly delay attempts to achieve a prompt transition to the use of electronic data to monitor and carry out regulatory enforcement.

We welcome your interest in encouraging agencies to move forward. We would like to discuss with you ways in which we can work together to increase agency use of information technology in a sensible, workmanlike way.

Thank you for the opportunity to appear today before you. I am happy to answer any questions you may have.

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Mr. HORN. Well, we thank you. Let me start by asking some questions. I understand that you have to be in a few other places, and I can appreciate that. We're going to hear separately from Mr. Ferguson and Mr. Roe, but I wonder, having heard the point made about the operational role that we're sort of placing on OMB, I wonder if either of you gentlemen would care to comment on your feelings on anything Ms. Katzen said, so she can also get a gist of what you're saying and comment before she leaves.

Go ahead, Mr. Ferguson.

Mr. FERGUSON. I'd like to comment. In the technical standard setting area, there is a certain amount of technical work to be done. And the statute as drafted invites the non-Federal entities to do that technical work.

The only task that's left to OMB here and OMB, assisted by a partly volunteer data management advisory committee, is to review the technical work of others on a small number of criteria. It's neither very technical nor very detailed.

What's more, some of those criteria, some of those structures, the data items in particular, are the same data items that OMB should already be reviewing as part of its information collection clearances under the Paperwork Reduction Act of 1980.

So I think what we're trying to do is take an existing process at OMB—there may well be some learning curve time required. But simply adapting the kind of paperwork clearance process that looks for duplication, redundancies and so forth, and add the electronic dimension to it. I just don't see it as being this enormous technical production effort. We're trying to get the agencies and OMB out of the business of creating technical standards themselves and into the business of critiquing and adopting work products that are done essentially by non-Federal entities.

Mr. HORN. Mr. Roe.

Mr. ROE. Thank you, Mr. Chairman. The Environmental Defense Fund is agnostic about where in government the function contemplated in this draft bill should lie. And Ms. Katzen obviously speaks from great experience about OIRA and OMB.

The key thing is what I think she focused on, which is mobilizing the support of the private sector and, frankly, the resources, the hard, gritty, day-to-day labor from the private sector, which we have seen done successfully in California under A.B. 3537. If that can be accomplished at the Federal level, that is the real leap forward. And how that can be done is a matter that we, too, would be very willing to engage in discussion.

There is a possible, not misunderstanding, but misalignment of terms here in that standards is a word that can be used in a number of different ways. To the extent it refers to the X12 standards, which Mr. Ferguson has been involved in generating, those are generic. They're very useful, but generic. They're like having a dictionary.

The process that's focused on, I believe, in this bill is more like actually writing the short stories that are needed for each individual reporting requirement at each individual agency level. That's the chore that's so labor intensive.

And I think Ms. Katzen is absolutely right that it's a resource issue, why that chore hasn't been done more rapidly. This is a way

to stimulate all of the players and ideally to have an infusion of private activity from the best kind of self-interest into making that a higher priority without necessarily requiring a large infusion of new Federal resources.

So I guess the essence of my response is, if we can accomplish here what was accomplished with the modest program in California, we're way ahead.

Mr. HORN. I take it your citing of the California program, they did tap into the basic grassroots knowledge of the entities that were filing. And as I remember, let them develop some of the codes and all of the rest. And the agency obviously related to that, ultimately had the final say as to whether the system made sense.

And I believe in one of the hearings we held, a member of the National EPA was there, said they thoroughly approved of that approach and would like to adopt it at the Federal level, as I recall the testimony.

Mr. Snow, do you have a comment on this?

Mr. SNOW. No. Just that the basis of my testimony will be to support the development by private groups working with Government at a lower level.

Mr. ROE. Mr. Chairman, I would simply reinforce the point you made: that it's that oversight and supervision within Government that is an essential piece of the process. And the advisory committee mechanism is one useful way to do that.

Mr. HORN. Well, should we leave it essentially to the operational agency to worry about that and not focus on it in OMB? What's your thinking on that?

Mr. ROE. There is a—I wouldn't call it exactly a delegation provision, but in the Paperwork Reduction Act, it's actually 3505(a)(2) and 3505(b). There is what seems to me to be the outline of a waiver and delegation process, which could well be built upon in structuring this mechanism, so that what's described as the operational function, the formal rulemaking, the notice and comment function, could be located in the individual agencies even within the structure of the law that we already see, particularly if this is done in stages and begins with something like the pilot program mechanism that the California law also set up.

I'm not necessarily suggesting a xerox of that, but I'm suggesting that an incremental approach—so that OMB can see how delegation works, see if it likes it, sees if it's consistent with OMB's and OIRA's larger role under the Paperwork Reduction Act—might be a very prudent way to proceed.

Ms. KATZEN. Mr. Chairman, if I could pick up on a couple of points?

Mr. HORN. Ms. Katzen, would you like to reply?

Ms. KATZEN. Yes; if I may.

Mr. HORN. May I say, after she finishes her answer, we will automatically go in recess for 15 to 20 minutes. We have two votes to cast over there. Go ahead.

Ms. KATZEN. Thank you. With respect to the referenced pilot, I think that is an important point, because the California situation was a pilot program in two counties, which, when it was completed, it was determined that we had sufficient information to make it work in California.

And the California experiment did work, and supporters of it have much to be proud of. But the California legislation and this draft legislation bear little, if any, resemblance to one another. The California one was focused on CAL EPA. This covers all Federal agencies.

And I hope it's clear that the way it's written now, we're talking not just about environmental reporting, we are talking about IRS tax filings, FDA new drug and medical device submissions, FCC mobile radio licenses, custom import declarations, FHA mortgage applications, Coast Guard commercial vessel licenses, FAA pilot license applications, DOL construction labor wage reports, Medicare/Medicaid reimbursements, farmers' and small business loan applications, and student loan applications. And I list these all because these are all in the process, either from concept or almost completely finished of being done electronically.

To put that kind of scope within OMB makes no sense. These belong at the individual agencies as the CAL EPA project was with the CAL EPA.

Second—and I have to respond to Mr. Ferguson, I don't think we can have it both ways. Either there is or is not a role for the reviewer. It cannot be that the technical review is really very small. And we have very little discretion.

Our main job here is to use a rubberstamp. If that's the case, we shouldn't be doing that at all anyway, because we're making findings which, upon the presentment of one section or one sector of an industry who says, we like this standard, if it's viable, suddenly we put our stamp on it and it will be applicable to everybody in that industry. We have to make a public interest finding, so we have to have some input.

And once we have some input, we should have some technical expertise to base that decision on. So I don't think we can have it both ways, that we really don't need to have expertise and then on the other hand, we do.

Finally, it seems to me that the oversight and supervision issue is there. It is taking the delegation provision of the PRA a long, long way from where it originally was born. The notion of the delegation in the Paperwork Reduction Act is where an agency has demonstrated consistently the capability of being able to do its own review with information collection requests, where it has demonstrated a structural arrangement within the agency to have an office independent from the program office, to apply statistical policy in a sensible way, and to have this kind of dispassionate objective oversight that OMB would provide, where it has that demonstrated record, we can then delegate.

To say we should delegate before we even know what the agencies can do in this area, indeed in the face of criticisms they haven't done enough, is to stand the delegation on its head.

But having said that, I'll go back to your recommendation for a pilot and say, let's focus on a particular agency, one of the lists I've given you or any other that you might like, look to the originating agency. We've got enough Governmentwide edicts in effect and say, how can we proceed, because there is no question that there is benefit to be derived from having the industry do the technical work.

There is no disagreement that there is benefit to be derived from having these standards in place as a necessary infrastructure for electronic reporting, which is something that we have been espousing consistently since I've been here for the last 3 years.

[Recess.]

Mr. HORN. At 2:51, the subcommittee will resume its hearing. Let's proceed, Mr. Ferguson, now with your testimony.

Mr. FERGUSON. Thank you, Mr. Chairman. Thank you for the invitation to testify once again. Again, I live and work in Palo Alto as an electronics engineer and attorney specializing in information systems for compliance. I want to make the point that I serve as a volunteer executive director of the Nation's environmental information technology association, the ESDX.

In October 1994, I was elected vice chairman of one of the ANSI X12 data standards subcommittee. And I serve on that committee as a volunteer.

And since December 1994, again as a volunteer, I've served as the elected chairman of the California environmental data standards development group on the industry side.

All three of these organizations share one important characteristic. And that is, they are volunteer industrywide groups who understand that it's justifiable and cost beneficial to participate in standards setting. Common electronic formats let information technology do many more jobs than it can do in single, fragmented incompatible formats.

So we support the subcommittee's proposed legislative structure. It does offer a more up-to-date, a more workable, and a more consistent Federal Governmentwide approach to standards setting. The notion that you want to align data formats across agencies is at the heart of what we're proposing here.

Ms. Katzen, before the recess, gave us a long list of the different agency programs who would be pulled into this process. And I want to underscore this point. In the absence of an effective, enforceable alignment mechanism or process for data standards at the Federal level, the person who is stuck with the cost and the task of aligning disparate data items is the person in the regulated company, non-Federal entity. It might be a State government.

And that's the person who every day, who every day pays the costs and suffers the frustrations of nonperformance and nonalignment across the Federal agencies.

Mr. HORN. Let me interject at this point. The ranking minority has arrived, Mrs. Maloney. And Mr. Clinger has arrived. The time is roughly 2:53. Go ahead.

Mr. FERGUSON. Thank you, Mr. Chairman. The person in the regulated company faces this cost today, faced this cost 2 and 5 years ago. And in the absence of a good, Federal alignment mechanism, is going to face this cost in the future. That leads me to Ms. Katzen's comments about the resource requirements implied in this new legislative or new data standard approach.

Her argument is made as if we're not incurring costs today from unaligned data items. Lots of people are incurring costs of dealing with unaligned data formats across agencies. I suspect even in the individual agency she cited, there are people, data managers in

those agencies who are facing frustrating incompatibilities among their own agency programs.

If we could tax that amount of incompatibility cost management that we're paying today and reallocate that resource to OMB or someone else who sits astride the multiple agencies and is in a position to put a little technical enforcement into this data dictionary and data standards alignment, we will have done a good thing. This is a tough nut to crack. I confess to that.

But I don't think when you look at the total resources expended today that deal with the proliferation of standards and the proliferation of agency behavior, that that's going to get a whole lot bigger if we follow the general structure in the proposed legislation.

Let me get back to my statement here. The things that are particularly good in that structure of legislation, just to hit the high points, are these.

It's important for one piece of Federal Governmentwide legislation, not an OMB guideline, not an agency consensus committee statement—I mean, a piece of legislation carved in the statute book. It's important for that to say that it's OK to use electronic data transmission as an alternative option form of reporting to government. It's just so important to have that carved into the statute as it was for the early electronic reporting in tax.

The bill also just says no to proliferation of these incompatible data formats. It provides a mechanism. Yes, it requires some work, mostly on the non-Federal side, but it requires a new kind of work to be done inside the Federal Government to ensure that there is not proliferation going into the future. And it sets up OMB and the NIST and this Federal Data Management Advisory Committee as a sounding board, advisors in identifying and eliminating those cases of proliferation that might arise in the future.

The third thing—and maybe this is the most important of all, is that the legislation requires that agencies produce a detailed itemized data dictionary. I'm going to wear my techie hat here. You can't do data alignment, you can't do data standards, you can't begin the process unless somebody sits down and creates the data dictionary. That's not a hard thing to do, but it's an essential task.

I included as an exhibit to my testimony four pages of data item lists from different environmental programs in California, just to give the committee an idea of what we're talking about here. This is no computer magic. This is just a list of specific data items.

And I'd like to call your attention, if you see that exhibit—it starts on page 7 of the stapled testimony—that about 30 percent of the data items on these four California data item lists are grayed out, they're shaded. And the beauty of that is that those represent data items that we found to be duplicative across these agency programs. The shaded items are now deleted, so that companies affected by two, three, or four of these programs don't have to send those data items four times.

The only reason we could get to this point is because somebody imposed the discipline of creating a data dictionary. Under the California environmental statute, that's the duty of the California EPA. And we thought, having seen it work in California, that that's a good task to assign to the agencies and to invite OMB simply to review the items for duplication so that OMB can assist in

the graying out, if you will, of the duplicative items coming into the future.

The fourth component of the statute that we think solves problems in the existing electronic standard setting structure is that it gives the ball back to the data submitters. The people who really do pay the larger fraction of the cost to report are also the people in the best position to understand the cost burdens and understand the opportunities for efficiency across programs.

Many companies are affected by multiple Federal agencies. Not all combinations affect all companies, that's true. And I'm sure there is a small business or wrinkle that needs to be accommodated.

But the fact is there is a body of technical knowledge there that ought to be given first opportunity to state what the standards ought to be and where the best opportunities for alignment ought to be. And as long as we leave the field carved up and fragmented to be pursued on an agency-by-agency, statute-by-statute basis, we lose the opportunity to tap the expertise of the person or the non-Federal entity who is already integrating the stuff and would like to have his or her solution stick as a matter of Federal law and regulation.

The last point is that the statute does set up this sounding board, a well-balanced sounding board of who, by and large, are data experts and who offer OMB or any commenter an extra view of what makes sense and what may not make sense in implementing data standards.

I see my time is almost up, but I'd like to thank the committee for an opportunity to present this testimony.

Mr. HORN. If you have another point to make, make it.

Mr. FERGUSON. Well, I'd like to make one more point about defining the tasks in electronic standard setting, because there was a comment made earlier about what the X12 standards are. It's important to reemphasize that just because there are such things as ANSI X12 standards, and there certainly are and they're very good, doesn't mean that the job is done.

Let me outline very quickly and in plain English what I would argue are the six steps that have to be performed by somebody to get us to competent electronic reporting standards.

Step one is just to list the data items you want to communicate, a list.

Step two is to create a dictionary, define the parameters for each of those items, how big is it, what's the range of values, what's the plain English meaning that you want to communicate.

The third is to take the collection of data items that you want to send, from point A to point B, and put it in an electronic package. Think of it as a lattice of pigeon holes. The X12 standards are just one kind of lattice, one kind of package for disparate data items. There are other kinds of packages, some are proprietary and some are nonproprietary. We call it a file format. And it packages what you do to carry the data from computer A to computer system B.

The X12 is already invented, so we don't have to spend a lot of time inventing packages.

The fourth step—and this is the one where there is a lot of work, as there is in assembling a dictionary at the front end. That is, one needs to write a guideline and implementation, a set of rules, if you will, for populating that package. If you're putting Whitman candies in Whitman Sampler, you want to know where to put the cherry-filled chocolates and the nut-filled chocolates and so on and so forth, so people will know where to find them. Otherwise, it's a surprise and it might not be a pleasant surprise.

But that guideline is one of the weightiest parts of the technical work to be done, and it's a perfect job for the private sector to do because they're the ones that are going to be submitting the data.

The fifth step is to simply choose a delivery method for moving the file. It could be the Internet. It could be a floppy disk. Other people take care of those standards and it doesn't have to be a big part of our task here.

And the last one is to choose an authentication and a signature or a security technique, so that you know who sent the file and so you know that it hasn't been corrupted during the transmission.

So those are the six steps. I think that's the whole ballgame here. And the legislation, the draft legislation in front of us today reallocates the duties of the parties, the senders and the Federal receivers here, so that the people who can do some of these tasks best get to do those tasks at their own initiative.

We think agencies are in the best position to draft data item lists and data dictionaries. If you need the data, the public policy argument could be made that these are the items that we need. And that's the right place to start. And the paperwork reduction clearance process is a good way, a good process to piggyback on because those things are supposed to be happening on paper today.

But the guideline development—and the selection of an X12 standard is—it's not a no-brainer, but it's a half-brainer. The standards are out there. They're relatively easy to understand. Writing the guidelines so that it works in the particular agency setting is tougher work. And I think that's appropriate again for the private sector to shoulder that effort.

Signature security issues and delivery methods again are pretty straightforward. There's no big issue there. But those are the steps. And the statute as drafted today reallocates those duties. And we think that's just a much more efficient way of doing it, rather than having the agencies try to conceive, run, operate, and pay for steps one through six on their own; and then invite the private sector to please comment along the way.

It's workable. It's why these things take 3 years. Anyway, thank you for your time.

[The prepared statement of Mr. Ferguson follows:]

TESTIMONY OF ESDX
on
ELECTRONIC REPORTING TO GOVERNMENT

Mr. Chairman and members of the subcommittee:

Thank you very much for your invitation to testify once again at today's hearing on the proposed Electronic Reporting Streamlining Act. My name is Richard Ferguson, and I live and work in Palo Alto, California as an electronics engineer and attorney specializing in information systems for compliance. I serve as volunteer Executive Director of the nation's environmental information technology association, ESDX -- the Environment & Safety Data Exchange. In October 1994 I was elected Vice-Chairman of the product data subcommittee of the national electronic data interchange (EDI) standards committee, a voluntary consensus standard-setting group known as X12. Finally, since December 1994 I've served as the elected chairman of the California industry group chartered by our California EPA Secretary Jim Strock to develop environmental data reporting standards in our state.

ESDX is a six-year-old, all-volunteer, not-for-profit association of users and makers of computer hardware and software for managing environmental and hazardous materials data, in both industry and government. More than 160 companies and even a few state environmental agencies have joined ESDX since its founding in 1990. ESDX meets three times each year for educational sessions, and to discuss industry-wide technical and business matters of collective interest. We are midway through our sixth year, meeting this week in Washington DC, with presentations by members and guests on various mechanisms for moving environmental, health and safety data over networks instead of on paper.

Most ESDX member companies began years ago to put environmental data on computers. Today they use these electronic information systems for more cost-effective management of environmental affairs.

Our ESDX members want to do more of this computer-assisted, day-to-day, environmental protection and compliance assurance work -- because it lets good environmental managers cut costs and improve performance.

All three of the organizations I work with -- ESDX, the X12-E subcommittee, and the California data standards group -- share important characteristics: they are voluntary, industry-wide groups, populated by skilled technical experts furnished by their various member organizations, mostly private-sector firms. Clearly, many private firms find it beneficial and justifiable to participate in organizations that promote nonproprietary electronic data standards. They do so because they all realize that common electronic formats allow all of us to put computers to productive use on more and more applications.

So we support the subcommittee's proposed Electronic Reporting legislation; it offers a more up-to-date, workable, and consistent Federal government-wide entry to the electronic information age.

Just yesterday, at our ESDX meeting here in Washington, we heard from the Federal EPA that it is inviting public comments on a new program to simplify data reporting and reduce duplication of data items across EPA's many different programs. This is a good idea, and we support it. Companies long ago learned to find and work around agencies' incompatible and duplicative data item reporting requirements. But this is also the Agency's fifth such attempt over the past ten or fifteen years to solve the problem within its own statutes, budgets, and information technology structure. Four prior attempts went nowhere.

Why are these regulatory programs so impervious to the application of recognized, productive information technology?

We think the answer is that these are business activities where government plays an unusually large role.

Unlike automating -- or reengineering -- transfers of data from one department to another within the same company, reengineering environmental management requires that both government and companies focus critically on specific items of data that flow back and forth between company departments and government agency offices.

Without legislation that reengineers that data-standards process, it has been difficult to bring agencies into the electronic fold.

Across all levels of government, some agencies have indeed taken some risks, and tried to convert their data reporting activities to electronic form. But for reasons of budget, statute, and damage control, they have done so in virtual isolation from each other. So today not only do we have thousands of incompatible paper forms at all levels of government -- we're already getting scores of incompatible electronic data formats and incompatible agency-generated software programs proliferating all over government.

In other words, we've been watching a kind of electronic Tower of Babel under construction, as each program office develops its own electronic language. And when it comes to agency-initiated pilot projects or remedial projects, they often have little linkage to benefits or savings among the non-Federal reporting companies.

Mr. Chairman, the proposed Electronic Reporting Streamlining Act offers a good, new way to solve these problems.

To summarize, we think that the five key features in this Act, when taken together, will change Federal Electronic Reporting prospects for the better. The proposed Act is good because it:

1. Says OK to electronic data -- and declares the use of nonproprietary electronic data formats to be an acceptable, optional, legally binding alternative to paper reports and applications. [Section 3520 (e)].

2. Just says NO to proliferation -- of incompatible data formats by multiple agencies of government in an unchecked exercise of their other statutory authorities. [Sections 3520 (b)(1), and 3521 (a)(3)(B) and (4)(B)]. We want agencies to be happy users of industry-driven information technology, not agency proprietors of miscellaneous agency-developed software and standards. The temptation is great to hand craft electronic reporting provisions that differ from program to program, bill to bill.

3. Requires prompt publication of itemized data dictionaries -- exactly the right tool for senders and receivers who want to reduce duplicative reporting and align electronic formats across programs and agencies. [Section 3521 (a)]. Today such careful lists of data items are only sporadically completed or published by agencies as they clear their various data collection forms with OMB under the Paperwork Reduction Act; and the lists are seldom available in standard electronic form.

4. Gives the ball back to the data submitters -- and reallocates to non-Federal organizations the right and power to initiate and develop the electronic formats most beneficial for reporting data to Federal agencies, rather than leaving the agencies to preempt private initiative and occupy the field. [Section 3520 (c)].

5. Creates the FEDMAC, a technically competent sounding board of experienced non-Federal data managers -- to assure a supply of balanced and realistic views of data standards and implementation as needed by OMB, the agencies, and public users of data. [Section 3520(e)].

We support this new Federal legislation. It will solve the problems and speed results, along the lines of California's innovative legislation on electronic reporting of environmental data. We support the draft language circulated by your staff in preparation for this hearing. The draft correctly addresses all of the major problems that have slowed the adoption and use of electronic data exchange wherever multiple government agencies are involved in the process.

From a technical standpoint, there are only a few steps that one must take to develop a workable standard for a given kind of data exchange.

Step One: List the data items. The process absolutely must begin with an itemized list of data elements to be conveyed from sender's computer system A to receiver's computer system B. This list requires no special computer magic; agencies were presumed to be assembling such lists for the past decade in order to clear their paper forms for data collection through OMB. As an example, Exhibit 1 to this testimony is a four-page list of data items found on four different California environmental reporting forms.

Step Two: Define and specify each item. This step turns the list into a data dictionary, telling senders and receivers the technical size and type of the data item, as well as a little or a lot about its intended meaning and use when it is digested by Computer B. The Exhibit shows some of these defining fields for each item.

Step Three: Choose a standard package for the data items. Here's the step where we cross into the jurisdiction of the computer standards wizards. Think of this package for data as a kind of electronic lattice, a set of predefined electronic pigeonholes into which we can put each and every item of data. If we use an industry-standard lattice, we know that the person who receives and unpackages the latticework of data will be able to take out each item of data and interpret its meaning in the context of the entire package. There are many such standard packaging schemes for computer data, some proprietary and some open. We call them electronic file formats. And the so-called ANSI X12 data interchange standards are just one kind of standardized package -- one that anyone is free to use without paying a royalty to the package designer. There is now a FIPS from OMB and NIST that encourages and cajoles Federal agencies to use the standard X12 packages to carry their agency electronic data items. That is a good idea, as far as it goes.

Step Four: Write a guideline or implementation of the standard. All of the predefined computer formats, or data packages, require one additional layer of fine-tuning to ensure that sender and receiver and their computers send and interpret the data correctly. Mere citation to an X12 package is not a complete specification. The size of the guideline one must write is inversely proportional to the quality of the data dictionary we started with, and to the strictness of the packaging standard. In short, sloppy dictionaries need to be fixed later by big guidelines. Similarly, loose format standards must be fixed with big guidelines. This is true for the X12 standards, or Lotus spreadsheet standards, or any other data packaging standard. The work of electronic data standards setting lies mostly in doing the dictionary and in writing and testing the guideline.

Step Five: Choose a transmission protocol. There are many different ways to move an electronic file once it has been packaged up in a standard format. It can be sent by floppy disk, or by telephone line, or by radio signals, or by the Internet. Other

people take care of those standards -- we simply need choose among the available methods, and exchange our electronic addresses for delivery and acknowledgment.

Step Six: Choose an electronic signature and security method. Once again, there are different methods available to authenticate an electronic message, and to protect its contents from corruption or disclosure. Other people take care of these standards -- we simply need to choose among them for the level of authentication and quality that we desire in specific applications.

To review, the steps are:

1. List the data items
2. Define items in a data dictionary
3. Package the data in standard format
4. Explain any leftover guidelines for using the package.
5. Choose a delivery method.
6. Choose authentication and insurance methods for delivery.

Without doing Steps One and Two well, we cannot jump to Step Three without getting into a mess of time delays and trouble later. If someone doesn't have a good existing Data Item List or dictionary, he or she won't want to be required to talk clearly with outsiders about the contents. Without senders and receivers talking clearly, we can't get the guideline task in Step Four. And without a guideline, we can't begin to address actual delivery of electronic files in Steps Five and Six.

The proposed Electronic Reporting Streamlining Act creates a new and more proper mechanism for doing these tasks. It reallocates the work required to the people best situated to take each step. Agencies take charge of the dictionary task. Non-Federal data reporters take charge of format, guideline, and delivery standards tasks. If no one steps up to this task, then agencies always retain the power to write a standard that no one else wants to work on. And OMB and the FEDMAC get to referree the occasional technical disputes that might arise.

Here we have an opportunity to improve our working relationships by improving the data flows between Federal and non-Federal organizations. In business, it is a good thing -- not exactly painless, but a good thing -- for a new computer information system to force existing departments to rethink and reengineer their data demands and paperwork procedures. We think the proposed law will bring these benefits at the Federal level, with no new level of work required -- just different and better-allocated work by all of us. We encourage the subcommittee to introduce this new law, and we offer our help with the technical matters in any way we can.

Thank you for the opportunity to appear today. I'd be happy to answer questions.

CUPA FORMS AND DATA COMMITTEE
**DRAFT** DATA ELEMENT DEFINITIONS - NOVEMBER 1, 1995
UNDERGROUND TANK DATA ELEMENTS - FACILITY/SITE INFORMATION (FORM A)
**DATA ELEMENTS REQUIRED FOR CUPA REPORTING ARE NOT SHADED**

| FORM A DATA ELEMENT | LENGTH /TYPE | DESCRIPTION/EDIT CRITERIA |
|---|---|---|
| Facility ID Number | 11 AN | 2 AN County<br>3 AN Jurisdiction - from tax code list<br>6 AN Facility Number |
| Permit Status | 2 AN | 1=new, 2=interim permit, 3 = renewal, 4=amended, 5=changed, 6=temporary closure, 7=permanent closure |
| Site name | | Collected in Business Plan data elements |
| Street address | | Collected in Business Plan data elements |
| City | | Collected in Business Plan data elements |
| ZIP code | | Collected in Business Plan data elements |
| State | | Not necessary - must be CA |
| Operator name | | Collected in Business Plan data elements |
| Cross street | | Not required by specific statute or regulation |
| Parcel number | | Not required by specific statute or regulation |
| Business phone | | Collected in Business Plan data elements |
| Owner type | 1 AN | 1=corporation, 2=individual, 3=partnership, 4=local agency, 5=county, 6=state, 7=federal agency |
| Supervisor name | 30 AN | Name of the supervisor, if the owner of the facility is a public agency. |
| Indian land | 1 AN | Y or N. Flag indicating if the facility is located on Indian reservation or trust lands |
| Business type | 1 AN | 1=gas station, 2=distributor, 3=farm, 4=processor, 5=other |
| Number of tanks | 4 N | Number of tanks on site |
| EPA ID number | | Not required by specific statute or regulation |
| Emergency contact name | | Collected in Business Plan data elements |
| Emergency contact phone | | Collected in Business Plan data elements |
| Emergency contact night phone | | Collected in Business Plan data elements |
| Secondary emergency contact name | | Collected in Business Plan data elements |
| Secondary contact phone | | Collected in Business Plan data elements |
| Secondary contact night phone | | Collected in Business Plan data elements |
| Property owner name | | Collected in Business Plan data elements |
| Property owner street | | Collected in Business Plan data elements |
| Property owner city name | | Collected in Business Plan data elements |

Exh. 1

UNDERGROUND TANK DATA ELEMENTS - TANK DATA ELEMENTS (FORM B) - OCCURS ONCE/TANK

| FORM B DATA ELEMENT | LENGTH /TYPE | DESCRIPTION/EDIT CRITERIA |
|---|---|---|
| Facility ID number | 15 AN | Unique facility ID |
| State UST number | 11 AN | 2 A County<br>3 A Jurisdiction<br>6 A Facility Number |
| Permit Status | 2 AN | 1=new, 2=interim permit, 3 = renewal, 4=amended, 5=changed, 6=temporary closure, 7=permanent closure, 8=removed |
| Permit approval | | Not required by specific statute or regulation |
| Permit approval date | | Not required by specific statute or regulation |
| Permit expiration date | | Not required by specific statute or regulation |
| Facility name | | Same as Form A |
| Tank ID | 6 AN | |
| Manufacturer of tank | 30 AN | |
| Tank installation date | 8 D | YYYYMMDD |
| Tank capacity | 7 N | |
| Tank use | 2 AN | 1=vehicle fuel, 2=petroleum, 3=chemical product, 4=oil, 80=empty, 95=unknown |
| Storage type | 1 AN | 1=product, 2=waste |
| Vehicle fuel type | 2 AN | If tank use=vehicle fuel, 1a=regular unleaded, 1b=premium unleaded, 2=leaded, 3=diesel, 4=gasahol, 5=jet fuel, 6=aviation gas, 7=methanol fuel, 99=other |
| Tank contents name | 30 AN | Name of substance stored in tank if Tank Use is not "1" |
| CAS number | 13 AN | Chemical Abstract Society (CAS) number if Tank Use is not "1" |
| System type | 2 AN | Type of tank construction - 1=double wall, 2=single wall, 3=single wall with exterior liner, 4=secondary containment (vaulted tank), 95=unknown, 99=other |
| Tank material | 2 AN | 1=bare steel, 2=stainless steel, 3=fiberglass, 4=steel clad with fiberglass reinforced plastic, 5=concrete, 6=PVC, 7=aluminum, 8=100% methanol compatible w/frp, 9=bronze, 10=galvanized steel, 95=unknown, 99=other |
| Interior lining | 2 AN | 1=rubber lined, 2=alkyd lining, 3=epoxy lining, 4=phenolic lining, 5=glass lining, 6=unlined, 95=unknown, 99=other |
| Methanol compatible | | Not required by specific statute or regulation |
| Corrosion protection | 7 AN<br><br><br>1 AN | Form allows for "check all that apply". Allowable values are Y or N for each entry. "None" is not a discrete entry, but is a logical determination when all entries are "n".<br>polyethylene wrap |

UNDERGROUND TANK DATA ELEMENTS - CERTIFICATE OF COMPLIANCE (FORM C) - OCCURS ONCE/TANK

| FORM C DATA ELEMENT | LENGTH /TYPE | DESCRIPTION/EDIT CRITERIA |
|---|---|---|
| Facility ID number | 15 AN | Unique facility ID |
| Street address | | Collected in Business Plan data elements |
| City | | Collected in Business Plan data elements |
| County | | Collected in Business Plan data elements |
| Installer certified | 1 AN | Y or N. |
| Registered engineer inspection | 1 AN | Y or N. |
| Implementing agency approval | 1 AN | Y or N. |
| Completion of manufacturer's checklist | 1 AN | Y or N. |
| Installation contractor certified by Contractors State License Board | | Not required by specific statute or regulation. |
| Other method description | 30 AN | Enter if another method was used as allowed by the implementing agency. (NOTE: The original data elements also contained a flag indicating the use of another allowed method. This has been eliminated, as a non-blank description field is identical to a Y/N flag.) |
| Oath name | 30 AN | Enter only if different from tank owner information on Form A |
| Oath address | 30 AN | Enter only if different from tank owner information on Form A |
| Oath phone | 10 AN | Enter only if different from tank owner information on Form A |
| Oath date | 8 D | YYYYMMDD |

CUPA FORMS AND DATA COMMITTEE
**DRAFT** DATA ELEMENT DEFINITIONS - NOVEMBER 1, 1995
ABOVEGROUND TANK DATA ELEMENTS
**DATA ELEMENTS REQUIRED FOR CUPA REPORTING ARE NOT SHADED**

| DATA ELEMENT | LENGTH/TYPE |
|---|---|
| Site name | Collected in Business Plan data elements |
| Street address | Collected in Business Plan data elements |
| City | Collected in Business Plan data elements |
| ZIP code | Collected in Business Plan data elements |
| Mailing street | Collected in Business Plan data elements |
| Mailing city | Collected in Business Plan data elements |
| Mailing state | Collected in Business Plan data elements |
| Mailing ZIP code | Collected in Business Plan data elements |
| Company name - part 1 | Not required by specific statute or regulation |
| Company name - part 2 | Not required by specific statute or regulation |
| Contact name | Collected in Business Plan data elements |
| Contact phone | Collected in Business Plan data elements |
| SWRCB region | Not required by specific statute or regulation |
| State | Not necessary - must be CA. |
| 1990 storage statement | Not required by specific statute or regulation |
| 1992 storage statement | Not required by specific statute or regulation |
| 1994 storage statement | Not required by specific statute or regulation |
| 1996 storage statement | Not required by specific statute or regulation |
| Number of tanks | 3 N Number of aboveground petroleum tanks > 10,000 gallons |
| Total storage capacity | 12 N In gallons |
| 1990 fees owed | For SWRCB internal use - not collected from AGT owners |
| 1990 fees paid | For SWRCB internal use - not collected from AGT owners |
| 1992 fees owed | For SWRCB internal use - not collected from AGT owners |
| 1992 fees paid | For SWRCB internal use - not collected from AGT owners |
| 1994 fees owed | For SWRCB internal use - not collected from AGT owners |
| 1994 fees paid | For SWRCB internal use - not collected from AGT owners |
| 1996 fees owed | For SWRCB internal use - not collected from AGT owners |
| 1996 fees paid | For SWRCB internal use - not collected from AGT owners |
| Refund request | For SWRCB internal use - not collected from AGT owners |
| Refund request date | For SWRCB internal use - not collected from AGT owners |
| Ref. request processed | For SWRCB internal use - not collected from AGT owners |
| Additional fees owed | For SWRCB internal use - not collected from AGT owners |

Mr. HORN. Well, we thank you. Those are very helpful comments. Mr. Roe.

Mr. ROE. Thank you, Mr. Chairman, members of the committee. I should congratulate you for holding this hearing 1 year to the day after the Paperwork Reduction Act of 1995 was signed, which was on May 22, 1995. Very briefly, because you were kind enough to invite me to testify earlier on this subject.

The Environmental Defense Fund reiterates its support for this bill in concept. And one of the most encouraging things that I've heard so far this afternoon is absolute unanimity. I don't want to preempt Mr. Snow, but I hope for him, as well, in the goal of mobilizing the private activity that was successfully mobilized in California under its AB 3537, I think everyone agrees that if we can do that, we're way ahead.

So it's a question here of method, rather than goal. And I want to report that in the several months since this committee first looked into that subject, that program, that State-level program, limited to CAL EPA and its various agencies, continues to be just as much of a success as it was when we reported to you on it the last time.

A few important general points from the environmental point of view. One is that there are two possible places where electronic data transmission breaks down—at the sending end and at the receiving end. It does no good if this process works perfectly from the sending end, but if the receiving agency or the receiving Federal entity simply isn't in shape to accept the information in electronic form—the pitcher can pitch, but if the catcher has no catcher's mit, this doesn't work. And, in fact, it would undermine the statutes in question if you authorized electronic data transfer from a sophisticated sender to an agency that it would bounce off of effectively.

So a point implicit in the draft in front of you, but that needs to be made very hard, is the notion that the agency, the receiving agencies have to be in shape to handle this data. And that link is there in your draft, but I think it can be made more explicit.

This is a point, I believe, that Ms. Katzen's written testimony on page 4 also emphasizes, although she didn't have time to reach it in her oral remarks.

And second, and I think a source of apprehension on the part of people watching this process, is that the process of turning paper data into electronic data not be allowed to alter what those data are. If you tell an agency, yes, you can ask for emissions, but you must ask for it in tons per year because that's what somebody else asks for it in, and you can't ask for it in pounds per hour, you've effectively undermined the regulation itself.

I see no intent to do that. I just want to report to the subcommittee considerable apprehension about that so that the bill that results from this process makes it clear that that isn't going to happen. When an agency wants something at a particular level of detail and a particular kind of data, the process of going electronic will not strip them of the power to impose that requirement.

The third point that I want to make has to do with what I think is the essence of the proposal that we're talking about, which is to create incentives to mobilize private sector initiative and private sector effort in the nuts and bolts, the frankly detailed and boring

work of turning paper data requirements into electronic data requirements item by item. The pages that Mr. Ferguson displays, I assure you, are only very few of a very large number of pages when you print out the data dictionary.

Right now, we have a Government monopoly over this process. We all seem to be in agreement that that is not producing the fastest or the most efficient results. But, of course, there is a danger of going all the way to an industry monopoly over this process. And the point I'm trying to make here is that that, too, would be a mistake. It's not a matter of turning this over entirely to industry.

The oversight function that Ms. Katzen was testifying about and that the chairman heard as he was being called away is critical. And for that, the oversight needs to be competent. And this is a point that I think is very important. There is, of course, in this process a risk of capture, because the parties with the economic interests to stay with this long, detailed, complex chore are the industries, and to some extent, the officials from the Federal Government who are salaried and assigned to this process.

It's critical that the other component, the public interest component, the State and local government component who are equally interested, have the means to participate effectively—not just nominally, but effectively, as this process goes on.

So to repeat my earlier testimony, I would urge the subcommittee to consider expense reimbursement, perhaps even modest funding on the technical side, so that the public interest representation and even the State and local representation is not purely nominal, because that doesn't get you where you need to go.

My time is up. I can wait for questions, or I can respond to some of the points that Ms. Katzen made as she was leaving.

[The prepared statement of Mr. Roe follows:]

TESTIMONY OF EDF on

ELECTRONIC REPORTING STREAMLINING ACT OF 1996

May 22, 1996

Mr. Chairman and members of the Subcommittee:

Thank you for inviting me to testify here today. I am David Roe of the Environmental Defense Fund. EDF's background, qualifications, and interest in this subject were described in my testimony before the Subcommittee dated October 10, 1995, which is attached and incorporated by reference.

Last October, EDF testified in support of this bill in concept, and we set out three basic points about its potential benefits and the necessary conditions for realizing those benefits. Our previous testimony applies fully to the draft language dated May 15, 1996, which is the subject of this hearing. Our testimony today reiterates EDF's support for this bill in concept and focuses on specific points that deserve attention and that in some cases, in our view, are inconsistent with the bill's purposes and intended goals.

Update on state-level experience.

Our previous testimony reported in some detail on California's experience under its AB 3537, the antecedent to this federal bill. In the intervening six months, California's experience with that process continues to be as positive as before in stimulating the development of electronic data reporting to California's environmental agencies and boards, and in mobilizing industry knowledge and resources in support of that goal.[1]

[1] In addition, the Governor's Blue Ribbon Commission on a Unified Environmental Statute, described in my previous testimony, is about to issue a final report that is expected strongly to endorse the use of electronic data interchange in the context of environmental law and regulatory compliance, including making such data available on the well-developed Cal/EPA Internet website ("http://www.calepa.cahwnet.gov/").

SPECIFIC POINTS

**1. Agencies must be able to receive and manage specific data in electronic form, as a condition of allowing that data to be reported electronically.**

This obvious point needs heavy emphasis. If data are transferred electronically to a government agency incapable of receiving and managing them in that form, then the purpose of electronic streamlining is not only defeated, but the underlying purpose of the reporting requirement itself is defeated as well. Experience suggests that the obstacle to effective electronic data transfer from private entities to government can be at the receiving end as often as it is at the sending point. If the approval of electronic data exchange standards as proposed by "non-Federal persons" (e.g., regulated industry) is allowed to get ahead of agency competence to receive such transmissions, the results would obviously be counterproductive.

Commendably, the draft language before this Subcommittee anticipates this problem and requires the Director of OMB to "ensure that agencies affected by a standard proposed under this section have the technical ability and resources to receive, exchange, and use data exchange pursuant to the standard." (§ 3520(b)(3)[p.5].) In the current draft, however, this requirement is free-standing rather than being made a condition of approval of a proposed standard. Given the precise timetable requirements set out under § 3520(c), it is important that this linkage be made explicit.

One of the most salutary effects of the AB 3537 process in California was the stimulus it created for industry to assist the relevant state agencies in achieving electronic competence. Close cooperation and, in some cases, the development of necessary or desirable software by industry for government use has been the rule. Mobilizing the same cooperative assistance at the federal level is one of the major potential benefits implicit in this bill, and it is a major means for achieving the bill's stated purposes. Making the indicated linkage between § 3520(b) and § 3520(c) would serve that goal.

**2. The electronic data dictionary is a critical task.**

In the electronic context, specifying each required data element in a published and easily accessible electronic data dictionary is a key step in facilitating electronic data interchange and in capturing the potential efficiencies of electronic data over data in paper form. A problem that has plagued early efforts to use electronic data is the Tower of Babel phenomenon: with data elements idiosyncratically defined and formatted by different companies, government agencies, and even different parts of the same government agency, the process of sorting and using data in electronic form can become nightmarishly difficult. Even a data element as apparently simple as the identity of a specific facility at a specific street address can take on numerous different electronic forms in different contexts, making it a practical impossibility even to recognize the same facility in different reports. U.S. EPA currently has a "key identifiers" project underway to resolve this problem within the agency. The data dictionary exercise, as prescribed in § 3521, is

a fuller and more effective measure toward the same end, and it includes provisions for reconciling unnecessary differences in electronic format from one agency to another.

**3. Agencies must retain the ability to receive exactly the data they need, whether in paper or electronic form.**

The process of resolving unnecessary variations in electronic format for the same data element (e.g., the identity of a reporting facility) must not be allowed to distort the nature or precision of the underlying data in question. For example, if one agency requires emissions data in tons-per-year, and another needs it in pounds-per-hour, the reconciliation process described above must not be used to force the second agency to make do with an electronic version of tons-per-year. Or, one agency may want information about chromium compounds in general, while another may need to know specifically about hexavalent chromium (a known carcinogen). Fine as these distinctions may seem to a layman, they can be critical to agency program goals, and they must not be allowed to disappear under the guise of electronic reconciliation. Nothing in the draft language would force such a result, but the point is sufficiently important that it deserves clarification.

**4. The petition process still unduly favors a small class of petitioners.**

Our previous testimony expressed concern with the "inside track" that appeared to be afforded to the earliest non-Federal petitioners. Although somewhat alleviated in this draft, the problem still remains. Under the proposed language in current form, a first-in-time petition can be displaced by a clearly superior petition only if the latter is filed within a narrow and early 30-day period ("public comment period"), and not at all by a clearly superior proposed standard originating from within an affected Federal agency. Indeed, for one full year plus 90 days, all agencies are apparently barred from proposing their own standards for electronic data interchange, no matter how close to fruition those standards might already be, or how much relevant experience the agency might already have.

The presumed goal of the prescribed petition process, following on the successful experience in California, is to stimulate both industry and government to come forward with the necessary detailed implementation standards that make electronic data interchange possible in practice. If government has a monopoly over this exercise, either agency by agency or in a centralized effort, the pace can be (and has been) extremely slow. Allowing industry to take on some of the work itself, with a reasonable expectation of reaping the benefits in the form of approved implementation standards for electronic transmission of that industry's data, is an effective and valuable stimulus to rapid progress. However, it would be a mistake to shift from a government-only monopoly to an industry-only monopoly in this area. The most productive stimulus lies in between, with the equivalent of a competitive atmosphere which takes advantage of initiative wherever it occurs. This bill deserves support in its efforts to mobilize that competitive stimulus, but further adjustment is required to keep from freezing out agency work in this area that may be well-developed, nearly complete, and of broader and more comprehensive application than a proposal from any one industry sector.

**5. Locating oversight at OMB is consistent with other recent federal legislation, but existing resources at OMB may be inadequate.**

The bill rests decision-making authority with the Administrator of the Office of Information and Regulatory Affairs in the Office of Management and Budget. This is consistent with the broad supervisory powers and authority delegated to the OIRA Administrator under the Paperwork Production Act of 1995 (S. 244), signed exactly one year ago today.[2] That law provides the Director of OMB with broad responsibility (delegated to the OIRA Administrator) to "oversee the use of information resources to improve the efficiency and effectiveness of government operations . . . ." including overall development, coordination, and oversight of "the implementation of federal information resources, management policies, principles, standards, and guidelines." 40 USC § 304(a)(1). This OMB oversight responsibility includes "the review and approval of the collection of information and the reduction of the information collection burden" 40 USC § 3504(a)(1)(B)(i); "agency dissemination of and public access to information," 40 USC § 3504(a)(1)(B)(ii); and "the acquisition and use of information technology," §3504(a)(1)(B)(vi), among other delineated tasks. The OMB Director's authority with respect to "general information resources management policy" specifically includes "the development and utilization of common standards for information collection, storage, processing and communication, including standards for . . . interconnectivity and interoperability; . . ." 40 USC § 3504(b)(2)(B). The application of this authority to electronic data interchange is made clear in § 3505(a)(3)(B)(ii), which calls for developing and maintaining a strategic plan for information resources management that includes plans for "enhancing public access to and dissemination of, information, using electronic and other formats; . . . ."

Although OMB is clearly at the center of federal policy on streamlining data reporting and capturing the efficiencies and other advantages of data reporting in electronic form, its OIRA unit is not necessarily well enough staffed or supported to carry out effectively the arbiter's role assigned to it in 3520(c) of this draft legislation. It is important that this role be well supported and meaningfully performed; if it is not, the proposed petition process becomes one that can effectively be captured by the petitioner. One possible solution could be to locate actual rulemaking authority in the individual agencies, with OMB oversight and with OMB retaining responsibility for non-rulemaking functions such as those set out in 3520(b)(2) and (b)(3).

**6. Modest funding for non-industry participation on the Data Management Advisory Committee is necessary.**

The Data Management Advisory Committee, prescribed by the bill to oversee the fairness and technical sufficiency of work in this area, including petitions for standard-setting by affected industries, properly provides for representation from both "state or local governments" and "private non-profit organizations that request and use [agency] data." These committee

[2] Public Law 104-13, signed into law on 5/22/95.

representatives are surrogates for the public at large. (All other members of the DMAC represent either obligatory senders or obligatory receivers of data under federal law.)

However, the current draft of the bill provides that such DMAC members "shall serve without federal compensation or other federal expense." § 3520(e)(4)[p.11]. As EDF pointed out in earlier testimony, these committee representatives represent the interests that do not have a financial stake in the process, and where technical resources are very unlikely to be as well developed as those of the federal data senders or the federal data receivers. The issues involved are technical, detailed, and extensive. For committee seats without a profit motive or a federal salary to sustain their occupancy, it will be quite difficult as a practical matter to find adequate representatives even at the outset — much less as the work of the committee proceeds over the course of months and years. In California, for example, on a much smaller scale and with more limited responsibilities, EDF has found itself as the sole non-profit representative on the state DMAC and has been stretched thin to maintain even a largely non-technical presence on that body.

Therefore, we strongly urge that (a) travel expenses for the private non-profit and the state or local government representatives on the proposed DMAC be provided for in the bill; (b) a reasonable per diem for the private nonprofit representatives be included, and (c) additional funding be secured to insure that both sets of representatives have the technical competence to perform the necessary function. Otherwise, the nominal public interest presence on this committee will, in practice, be only a sham.

As noted in the previous two points as well, there is a risk that the contemplated petition process could be captured by petitioners, if the intended checks and balances are unable to function. The more rigid the timetable in the petition process, the larger the potential problem is, and the more care needs to be devoted to insuring that the roles of the participants other than industry petitioners (i.e., standard-setting agencies; the arbiter for petitions; and the other public members of the advisory committee) are performed effectively.

Attachment



TESTIMONY OF EDF on
ELECTRONIC ENVIRONMENTAL DATA REPORTING

Mr. Chairman and members of the subcommittee:

Thank you for inviting me to testify here today. My name is David Roe and I am a Senior Attorney for the Environmental Defense Fund, located in EDF's West Coast office in Oakland, California. EDF has a long-standing interest and expertise in computer-based information management and its implications for environmental protection. (See "Background and Experience of EDF" below.) I have been with EDF since 1976.

Part 2 of California's AB 3537, enacted in September 1994, makes provision for electronic reporting of environmental data, including a standardized electronic format and protocol for the exchange of electronic data between regulated businesses and state regulatory agencies. Pursuant to that state statute, a pilot program is planned in two California counties, and a data management advisory committee (DMAC) has been established to advise the head of the California Environmental Protection Agency as well as to supervise and report on the pilot program. The Environmental Defense Fund is the only environmental or public interest group represented on the DMAC. In addition, on Governor Pete Wilson's so-called Blue Ribbon Commission on a Unified Environmental Statute, I co-chair the Information Subcommittee, which deals with similar issues in a larger context.

**Summary of Testimony.** In brief, EDF's state-level experience in this area leads us to make three basic points:

- The use of electronic data and computer-based information management and information analysis has high potential for simultaneously reducing regulatory costs and burdens, improving environmental protection, and increasing public confidence in the fairness and effectiveness of environmental laws.

- The degree to which these benefits can be realized depends, crucially, on public confidence that electronic data and computer-based data management systems will not be abused and will allow more, rather than less, public access to information and public oversight of the regulatory process.

- An important part of the potential benefits can be realized without any change in the underlying environmental statutes. Coordinated statutory improvements that are fully sensitive to the foregoing issues could further expand the scope of potential benefits.

Taken together, these points suggest that important benefits for all sides are readily obtainable through modern technology, and that the degree of benefit is closely related to the degree of public confidence in how that technology is being applied. As key technical details become less and less comprehensible to an ordinary member of the public, it becomes more and more important to secure public confidence through clear ground rules and through effectively self-regulating mechanisms in the design, structure and implementation of electronic information systems.

This testimony includes examples of such mechanisms. Even a preliminary step, like the one before you today, cannot be separated from this larger context. EDF believes that inadequate attention to such factors at this stage could make it impossible to realize most of the benefit that is potentially available.

The testimony below discusses the potential benefits for all parties of electronic data reporting, the necessary conditions for realizing those benefits, and the relationship of potential benefits to changes in the underlying statutes. It then offers comments on some points raised by the preliminary draft provided by staff.[1] Finally, it provides further information on EDF's background and experience with issues of data disclosure and with computer-based technology in the context of environmental protection.

**1. Potential benefits.**

Based on EDF's experience with environmental protection issues over the last two decades, and on our recent experience in California with that state's efforts to streamline environmental regulation through electronic systems (both described below), we believe that the potential benefits enumerated in the draft findings are, if anything, understated.

At the simplest level, there are obvious potential cost savings for relatively sophisticated businesses that now handle internal data electronically, and that would like to handle their reporting obligations to every level of government in the same manner. This is the constituency that has been the driving force with California's AB 3537, with the Organization of Business and Industrial Entities (OBIE), and with the draft bill[2] before you today.

For smaller and less sophisticated businesses, the potential benefits are less immediate but may be even greater. Smaller businesses often feel that regulatory requirements (including environmental requirements) are daunting in their sheer volume and complexity, whether or not actual, physical compliance will cause any significant cost or inconvenience. Being able to report

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[1] Incomplete and preliminary statutory language, based on California's AB 3537, was provided late last week by staff. EDF recognizes that the drafting process is at a preliminary stage and for that reason does not address detailed drafting issues here.

[2] See note 1.

to government (ideally, all levels of government) on a single, computer-based form could save not just money but also peace of mind.

Equally important to smaller businesses, simple computer-based information systems could make it much easier for a small business to find out what its regulatory obligations are, and to whom. The smaller the company, the larger the proportional savings in comparison to the present system, at least in a state like California where multiple jurisdictions are commonly involved in environmental and other forms of regulation. "We can't even find out what the requirements are, or which agencies we have to report to, unless we pay some lawyer $50,000," was a complaint that Gov. Wilson's Blue Ribbon Commission heard repeatedly from small-business representatives. Readier access to more reliable information on compliance requirements would also increase fairness and decrease the information advantage that larger business is currently perceived to have.

To this end, EDF has proposed that compliance-related communications from state government agencies should be considered binding, when and only when they have been made public through a computer-based, low-cost service such as the Internet, in readily accessible (e.g., searchable) form. Among other benefits, this would substantially reduce the problem of private opinion letters, informal assurances from agency officials, and other forms of "underground" regulation that is now perceived to favor companies with large legal and lobbying resources.

Of course, the potential benefits to smaller businesses would be available only to the extent that those businesses have access to sufficient computer equipment and expertise, a point discussed further below.

Most important of all, from the point of view of the public interest in environmental protection, reduced cost and increased access to compliance information have the *potential* to increase the extent of compliance within individual entities, and to expand the number of entities that are willing and able to address their compliance obligations in good faith. Reducing artificial obstacles to compliance, in the form of paperwork and information search burdens, is unquestionably in the public interest.

In addition, information itself has proven to be a powerful tool for stimulating environmental improvements and reducing risks, even in contexts outside the normal regulatory process of setting and enforcing mandatory standards. (See "Background and Experience of EDF" below.) The more certain the public can be that timely, meaningful, and accurate data are available, and genuinely retrievable, the likelier it is that reforms aimed at efficiency and flexibility in the environmental regulatory system will be found acceptable. If reporting entities are in a goldfish bowl, from the standpoint of environmental data, they are more likely to be trusted with responsibilities like those contemplated under U.S. EPA's XL Project, EPA's Common Sense Initiative, and other similar reform proposals currently being discussed. Electronic information

and public access have the potential to act as a lubricant for changes that can both improve environmental performance and reduce regulatory burdens.

Whether or not such potential benefits to the environment are actually realized will, of course, depend on numerous factors, some of which are discussed in the following section.

**2. Necessary conditions.**

Computers are mystifying to many, even to those who use them every day. Their inner workings, the languages and protocols that are the focus of this bill, mystify many more -- indeed, nearly everyone except the expert technicians who write them. Thus, as a practical matter, it is impossible to convince people that these inner workings are being "done right" through direct evidence. Publishing the codes, or holding hearings on them, or even putting public representatives on advisory committees, cannot be assumed to accomplish that goal.

At the same time, it is critical that there be high public confidence in any transition from the tangibility and comprehensibility of paper to the intangibility and mystery of electrons. Without understanding the technical details, people must be able to know that electronic data transactions are as reliable, as accountable, as enforceable, and as likely to subject wrongdoers to legal penalties as the system being supplemented or replaced. It is probably necessary that they be more so, if the public is to have the same level of confidence in the effectiveness of environmental controls as in the past.

Fortunately, such improvements are technically achievable. Unfortunately, traditional government safeguards and other traditional methods of securing public confidence in regulatory machinery will not be adequate in this context. The focus must be on sufficient *indirect* evidence that the new system is working, rather than on telling people, "You could look it up."

Some elements that would go far toward offering assurance in this context are set out below. EDF offers these in a spirit of exploration, based on our experience to date. We can *not* assure this Subcommmittee that these are a complete or sufficient set. What will be adequate will depend on the details and the implications of exactly what is proposed. EDF does believe that these elements are necessary, and that they point in the most promising direction.

A. Non-repudiation. Any entity that uses electronic reporting to satisfy legal requirements should be legally responsible for the contents of the report *as received by the government agency or other intended recipient.* In other words, errors in electronic transmission, encryption, de-encryption, reception and the like cannot be used to avoid enforcement or other legal consequences. This rule[3] insures that users will self-police against such errors using their

[3] This requirement can be imposed even in regulatory regimes where the same requirement is *not* imposed on those who report on paper. Rather than a strict requirement on all reporting entities, it is merely a condition of

technical expertise, and will institute whatever double-checking devices are appropriate, because to do so will be in their self-interest. In turn, to the public, such a rule offers strong assurance that accidental mistakes in the process of moving data electronically will be rare. The experts will guarantee it, even if the public does not know what techniques will be used.

B. Authentication. Electronic signatures should be required, from identified individuals rather than corporate entities, under the same penalty of perjury for the individual signer as with a hand-written signature. As above, only individuals who are confident in the technology will use it, because the legal risk falls on them. The public will have the comparable assurance that reports will not be casually or evasively "signed" in electronic form. (There are technical issues involved in specifying an adequate electronic signature, which DMAC is addressing.)

C. Availability. All electronically submitted reports should be made available electronically to the public through a computer-based, low-cost service such as the Internet, *simultaneously or nearly simultaneously with their receipt by the receiving agency*, in the same form and with the same accessibility (structured format, etc.) as received by the agency. The cost of doing so is trivial with electronic reports (although it might be prohibitive in paper form). This step represents a major potential *increase* in public access to reported information, at least for individuals and groups equipped to obtain it (e.g., every Internet user), and hence an increase in potential public oversight of the regulatory process. Both reporting entities and government agencies might feel an incentive to improve their performance in response.

This value of this step can be insured only through several technical safeguards:

1. Exclusive use of non-proprietary languages, formats, translators, etc. (except for encryption/de-encryption processes, which can be proprietary as long as step A. above is observed);

2. Highly structured formats to allow maximum accessibility to data (technical details are important to avoid sham accessibility);

3. Non-proprietary, inexpensive (or free) software to allow effective data searching;

4. Procedures to protect confidential business information without allowing unilateral or excessive designation of CBI by the reporting entity to delay electronic disclosure; and

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exercising the electronic option. Those who prefer not to be legally bound in the same way can simply reject the option and continue to use paper.

5. An easily findable site on the Internet, either one maintained by the government agency itself, or one to which the government agency publishes a clear guide so that search time is eliminated.

D. Availability as a condition of reporting compliance. The easiest and most certain way to accomplish the foregoing step is to put the burden on the reporting entity, by providing that electronically submitted reports *will not be deemed to have been officially received* unless and until they have also been made available to the public as described above. Again, the cost and time required to carry out this task is trivial in the electronic context, and there is therefore no reason not to impose it on users. This approach would provide even more certain oversight opportunity to the public, and strong assurance to the public that electronic reporters have nothing to hide. Thus, electronic users may be seen by the public as more likely to be complying with environmental and other requirements, rather than less. It can be imposed as a condition of using the electronic option, even if not required by the underlying statute.[4]

E. Voluntary participation. Electronic reporting must be voluntary rather than mandatory. See discussion of resource availability, immediately below.

F. Access to computer equipment and expertise. For smaller businesses wanting to use electronic data reporting, and also for members of the public wanting to access the reports when filed, there is an important issue of equipment and expertise. Inevitably, some in both groups will not have the necessary equipment. EDF's experience with small business representatives on the Unified Environmental Statute Commission in California suggests that electronic data reporting can be made available even to those with quite inexpensive and outdated equipment, and that native language (i.e., non-English-speaking computer users) may be more of a barrier to participation than equipment. However, the needs of small business deserve special attention, and their own representation in any advisory committee process.

In addition, it is likely that if a system of electronic data reporting were sufficiently cost-effective, it would attract service entities, much like accountants, that could provide smaller businesses with electronic data reporting services for a fee. The business would then not need the necessary equipment and expertise itself. This possibility needs to be kept in mind as a system is designed, so that such services are not inadvertently discouraged. An insurance, or guaranty, feature would make such services particularly marketable, and this should be facilitated.

**3. Relationship to statutes.**

One of the primary insights developed on Governor Wilson's commission to investigate improvements in environmental statutes, by EDF among others[5], was that information technology offers the promise of substantial benefits to businesses, government, and environmental protection, as discussed in section 1. above, and that such benefits can be obtained in large part *even if the underlying statutes remain in present form.* Better information transfer and information access have important and tangible value, whether or not the statutory scheme of which they are a part is rationalized or adjusted to make full use of their potential. To put it most simply: reporting data and finding data electronically saves time and money, whether the requirements of what to report are ideally designed or not.

This, in turn, suggests that such efforts can and should be undertaken independently of statutory reform. In fact, a good portion of the necessary work can be undertaken at the administrative level, using existing authority. EDF urges the Subcommittee to determine what, if any, statutory obstacles currently exist that would prevent OMB, EPA, USDA, DOE, DOI, OSHA, FDA, and other relevant agencies from proceeding in the intended direction in the absence of authorizing legislation.

In EDF's view, it is appropriate to proceed with properly designed electronic innovations now, on an accelerated timetable, and to use the experience with those innovations in practice to gauge the potential for broader improvements of the kind discussed in section 1. above.

**Specific Comments on Draft Legislation[6]**

EDF offers the following preliminary comments on specific points:

A. Findings. These should be expanded to include expressly the elements of public confidence, increased public access to data, and increased availability of public oversight of the regulatory process, discussed above.

B. Advisory Committee (Section 6). The structure of the Advisory Committee should be revised to insure adequate participation both by (i) representatives of the affected public and (ii) technical experts from government at the non-federal (i.e., state and local) level.

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[5] No final report has been issued to date, either by the Commission or by its Information Subcommittee. Hence, this testimony should not be interpreted as speaking for the Commission or for that subcommittee. See "Background and Experience of EDF" at the end of this testimony.

[6] See note 1 above.

(i) Affected Public. Adequate representation of the public interest, e.g., by representatives of non-governmental groups, is critical to the integrity of the process and to public confidence in its results. It is also the most difficult to secure, since it requires not only appropriate individuals but also resource support. EDF believes that the investment of resources and time required to create confidence on the part of such representatives, and hence in the public that relies on them, will be well worthwhile.

(ii) State/Local Representation. At least a handful of states have valuable experience to contribute; some localities may as well. EDF's most extensive experience at the state level is with California, although it is aware that Massachusetts and Illinois, among others, are active in the same field. The state/local government perspective is essential if the interests of the regulated community and of the public are to be met. An electronic data system that works only at the federal level, and is not coordinated as much as possible with state and local systems, will frustrate users and reduce benefits. Equally from the point of view of the public, public access and its benefits would be similarly compromised by access limited to federal data only.

C. Petition Process. In its current draft form, the petition process appears to favor a narrow class of favored entities, two of whom are identified by name, to the exclusion of others. This "inside track" appearance is strengthened by the virtually absolute time priority granted to the earliest non-federal entity petitioner, and the ability of that petition to displace all "similar" petitions that may be filed later. This needs to be corrected to give more opportunity to non-favored parties, and more discretion to OMB to optimize its efforts.

D. Data dictionary. EDF strongly supports the creation and maintenance of a data dictionary for all data elements or data fields required to be collected under any federal law or regulation, so that the electronic form in which such data are collected will be consistent. Not only should such a dictionary be published electronically, but in addition, provision should be made for assisting states and interested localities in making effective use of the dictionary, as well as other elements of a federally-approved electronic data transmission system.

E. Non-proprietary standardized format. In addition to the criteria of Section 71065 of California's AB 3537, the requirement that any electronic format be non-proprietary, before it can be approved for reporting to the federal government, is essential. The DMAC has made this a cornerstone of its considerations.

**Background and Experience of the Environmental Defense Fund**

For nearly twenty years, EDF has been making intensive use of computer-based analysis and computerized data management, first in the field of electric utility finance and thereafter in other environmental contexts. EDF's west coast office currently employs four full-time computer experts to work on appropriate environmental projects in the energy, water resource, toxic chemical, and transportation fields.

EDF was invited to join the Data Management Advisory Committee, set up under California's AB 3537 and is currently represented on that Committee by Dr. Anita Wolff. David Roe has also participated in DMAC proceedings.

David Roe was appointed by Governor Pete Wilson to the Governor's Commission on a Unified Environmental Statute (so-called "Blue Ribbon Commission") at its inception in May 1994. He was the only representative of an environmental group among the original appointees (although, in response to his request, additional environmental representatives were subsequently added). As a member of the Commission he urged the creation of an Information Subcommittee to explore the implications of modern information technology for reducing regulatory burdens, improving government performance, and increasing protection of the environment. He then served as co-chair of that Information Subcommittee. (The Information Subcommittee completed a draft report, but the full Commission has yet to issue a final report. This testimony therefore reflects EDF's reviews alone and should not be interpreted as reporting prematurely the views of the Subcommittee or the full Commission.)

EDF has substantial experience with the Toxics Release Inventory, established under Title III of SARA in 1986, and very intensive and extensive experience with California's Safe Drinking Water and Toxic Enforcement Act (commonly known as Proposition 65), enacted by direct voter initiative in the same year. Both of these laws rely importantly on data disclosure of certain facts regarding toxic chemicals, and both have been notably successful in reducing the amounts of toxic chemicals released by affected businesses.[7] Proposition 65 has been particularly successful in stimulating the removal of numerous types of toxic chemical exposures from consumer products, not just in California but nationwide, as a marketplace reaction to disclosure requirements[8]. The success of both TRI and Proposition 65 in stimulating large-scale reductions in the size of relevant environmental health problems is especially noteworthy, because neither law in any way *forbids*

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[7] See, e.g., Pease, W., "Chemical hazards and the public's right to know: How effective is California's Proposition 65?" *Environment* 33(10): 12-20 (1991) [comparing release data on TRI chemicals and Proposition 65-listed chemicals].

[8] See, e.g., Smith, R., "California Spurs Reformulated Products," *Wall St. Journal*, November 1, 1990, p. B1. See also U.S. Senate, Committee on Governmental Affairs, Ad Hoc Subcommittee on Consumer and Environmental Affairs, record of hearing on "Lead in Ceramic Ware and Crystal: An Avoidable Risk," March 27, 1992.

the acts in question; both laws simply require disclosure (in different forms) to the public of relevant information. Thus, both laws stand as convincing demonstrations that information by itself can be a powerful tool for environmental improvement, when the information is provided in an appropriate context and when the disclosure requirement itself is strictly enforceable. This is a tool that federal environmental policy has not yet systematically explored, despite the successes to date.

Mr. HORN. If you can stay with us, we'll hear Mr. Snow, and then we'll have a dialog with the three of you and the committee members.

Mr. Snow.

Mr. SNOW. Thank you. Mr. Chairman, I am pleased to appear before this committee to provide an organization's experience that is relevant to this proposal.

I chair the Electronic Data Interchange Development Committee of the International Association of Industrial Accidents Boards and Commissions. IAIABC membership includes workers' compensation agencies from most States, the Canadian provinces, and several countries. The IAIABC was founded in 1914 to serve as a forum for the presentation and discussion of workers compensation issues. Claim administrators routinely volunteer and participate in IAIABC endeavors.

I am also in my second term as cochair of the ANSI insurance work group for credit disability and workers' compensation. The ANSI insurance committee is one of several voluntary ANSI committees that develops electronic data standards. I am one of the primary developers of the ANSI report of injury and illness. I am also the IAIABC reporting and voting representative and coordinate our work in other subcommittees there.

The IAIABC observed what was going on in the environment and some of our observations include that the system participants of workers compensations—that includes employers, jurisdictions, both State and Federal. Claim administrators and service providers are dependent on the exchange of information between each other. Quite often, they are unfamiliar with where that information comes from, goes to, and how it's used. They're also confused by the differing terminology, the myriad of forms that are used, and all of the different and various reporting and submission requirements.

They're also perplexed about storing different information from multiple formats, retrieving and routing that information. They're often concerned that information is late, inaccurate, inappropriate for the objective, and costly to capture and process.

The IAIABC rose to the occasion in 1987. A few claim administrators worked with the State of North Carolina to develop the first electronic State report of injury. That scope was later expanded to a national effort.

In 1991, I was appointed to chair that effort and we've held meetings at regularly scheduled intervals from that period forward. We also have become participants in the ANSI process. We believe that this allows us to coordinate our development efforts with others, to utilize previous work, achieve greater consistency, and obtain fast results and greater returns.

The IAIABC mission is to improve the exchange of information among all workers compensation participants for the purpose of effecting improvements in all aspects of workers compensation systems, to benefit those receiving or providing benefits of service, or monitoring, researching, administrating, and legislating our workers' compensation systems. In other words, we're taking a very global approach.

We're a voluntary organization that provides a forum to share perspectives, to develop better working relationships, and to dis-

cuss business problems and objectives. Through this consensus process, we re-engineer the way we work together. We identify our business processes that require the exchange of data and we go through a very stringent process to define what data business needs, when it is needed, and who should be passing it to the next participant.

Our system uses information that is inherent in the business process. This is very important to the design of any EDI structure.

We also automate routine processes and manage information exchanges with very limited involvement by human activities. This allows personnel to be reallocated to more rewarding tasks requiring subjective and personal interactive skills. This system standardizes and creates data dictionaries, business and technical processes. There are several different types of reports and business uses for them within the scope of our project. Many of these reports go directly to one or more agencies. The Bureau of Labor and Statistics and Occupational Health and Safety Administration are Federal recipients of workers compensation data.

Our progress to this point, I am pleased to report, that 15 States have incorporated electronic data interchange [EDI] processes in their daily business activities. At least 10 pilots are in process to increase the number of States using EDI or the types of reports they exchange. More than 80 percent of the States are participating at this time.

In summary, IAIABC has demonstrated that the private sector recognizes and responds to private and government needs, seeks to improve efficiency and reduce costs, possesses the business and technical knowledge to make us able to do this, and uses a consensus process that includes government and business to develop the electronic solutions. We request that the Federal Government recognize development organizations, and efforts and success, such as what we have experienced.

The government should also preserve our business objectives and effective State legislation, participate in development, and adopt these standards and pass legislation that supports these efforts.

We also request that the Federal electronic data design process normalize similar business requirements and functions. I believe this is the message that Rick was trying to put across in his speech. The process should also include coordination, voluntary cooperation, and consensus development among business, State, and Federal organizations with shared interest to provide mutual efficiencies and benefits. Workplace injuries are a great example of this.

In addition, Federal efforts should use development processes and tools, such as identification of business objectives, opportunity of evaluation, process and data modeling, and definition documentation.

Finally, we request that attention be given to effective public data access. I see that my time is up, as well, Congressman.

Mr. HORN. Make your point. Don't let the clock bother you.

Mr. SNOW. And that we look to see that the use of data is used for the intended objectives of the developer and the data sources, to ensure employee claimant information confidentiality, to prohibit

misuse and unauthorized use and access to it, for competitive advantage or monetary gain.

At the present time, we believe that in the absence of a set of rules governing Federal electronic data development and alignment of these activities, we face a piecemeal program-by-program, statute-by-statute approach which could undermine successful development programs such as our own. Under the proposed legislation, echoed by points I presented here, organizations such as ANSI and the IAIABC can meet these needs of public and private interest.

We look forward to working with this committee in the future to shape this legislation. I would be very glad to take any questions.

[The prepared statement of Mr. Snow follows:]

Jeffrey Fred Snow

Chair, Electronic Data Interchange(EDI) Development Committee
International Association of Industrial Accident Boards & Commissions (IAIABC)

I am on loan to the IAIABC from a leading workers compensation carrier and report directly to the IAIABC executive director. My current salary and expenses are borne by the IAIABC.

My education includes a Bachelor of Science in Management Information Systems from the University of Massachusetts at Lowell; and a Masters in Business Administration.

I have held several business analytical and/or management positions in military, computer, and insurance organizations.

I am currently in my second term as co-chair of the ANSI Insurance Work Group for Credit, Disability, and Workers Compensation. The ANSI Insurance committee is one of several voluntary ANSI committees that develops electronic data standards. I am one of the primary developers of the ANSI Report of Injury, Illness, or Incident. I am the IAIABC voting representative and coordinate our work on other ANSI insurance and finance transactions.

IAIABC Background/Overview

The IAIABC membership includes workers compensation agencies from most states, Canadian provinces, and several countries. The IAIABC was founded in 1914 to serve as a forum for the presentation and discussion of workers compensation issues. Claim administrators routinely participate in IAIABC endeavors.

Workers Compensation System Observations

The workers compensation system participants, i.e., employers, jurisdictions (state and federal), claim administrators, and service providers are:

- dependent on each other to obtain information necessary to our business processes;
- unfamiliar with other system participant business processes that create or use our information;
- confused by differing terminology, a myriad of forms, and submission requirements;
- perplexed about storing differing information from multiple formats, retrieving, and routing information, and
- concerned that information is often late, inaccurate, inappropriate for the objective, and costly to capture and process.

The IAIABC EDI Project

In 1989, a few claim administrators worked with the North Carolina Commission to design the first electronic Report of Injury. The scope of that initiative was subsequently expanded to a national effort. In April 1991, I was appointed to chair that effort. Regularly scheduled consensus development meetings began the following month and continue to this day.

Shortly thereafter, the IAIABC became a member of, and participant in, the ANSI voluntary electronic standards development process. This allows us to coordinate our development efforts with others, utilize previous work, achieve greater consistency, obtain faster results, and greater returns.

The IAIABC mission is to improve the exchange of information among all workers compensation participants, for the purpose of effecting improvements in all aspects of workers compensation systems, to benefit those receiving or providing benefits or services: or monitoring, researching, administrating and legislating our workers compensation systems.

As a voluntary organization we provide a forum to share perspectives, develop better working relationships, and discuss business problems and objectives. Through consensus we:

re-engineer our business relationships;
identify business processes that require the exchange of data;
define each business need, as well as determine when, and who should exchange data.

We also have developed a system that:

uses information that is inherent in the business process;
associates information requirements with business processes;
automates routine processes and manages information exchanges;
allows personnel to be reallocated to more rewarding tasks requiring subjective and personal interactive skills.

This system standardizes:

information (name and define data/information);
information Sets (transactions/forms/reports);
business Processes (what report, when required);
technical processes (exchange method/format).

There are several different types of reports/transactions and business uses for them within the scope of our project. Many of these reports go directly to one or more agencies.

| | |
|---|---|
| Proof of Coverage: | notice of coverage status change |
| First Report of Injury: | notice of accident/injury |
| Subsequent Reporting: | claim event, benefit reports |
| Medical Reports: | treatment, impairment ratings, payment |
| Vocational Rehabilitation: | treatment, RTW plan, payments |
| Adjudication: | arbitration/hearing schedule, agreements |
| Acknowledgment: | transaction status, accepted/rejected, errors |

The Bureau of Labor and Statistics, and Occupational Health and Safety Administration are federal recipients of the data.

Progress: (see attached map/charts)

I am pleased to report that through voluntary participation fifteen states have incorporated EDI processes in their daily business activities. At least ten pilots are in process to increase the number of states using EDI or transaction types used in the EDI project. More than 80 percent of the states participate.

Summary:

The IAIABC has demonstrated that the private sector:

1. Recognizes and responds to private/government needs;
2. Seeks to improve efficiency and reduce costs;
3. Possesses the business knowledge and technical capability;
4. Uses a consensus process, government and business to develop electronic data solutions.

We request that the federal government recognize development organizations' efforts and success.

The government also should preserve their business objectives, and effective state legislation, participate in development, and adopt these standards, and pass legislation that supports these efforts.

We also request that the federal electronic data design process normalize similar business requirements and functions.

This process should include coordination with voluntary cooperation, and consensus development among business, state, and federal organizations with shared interests to provide mutual efficiencies and benefits (e.g. workplace injuries).

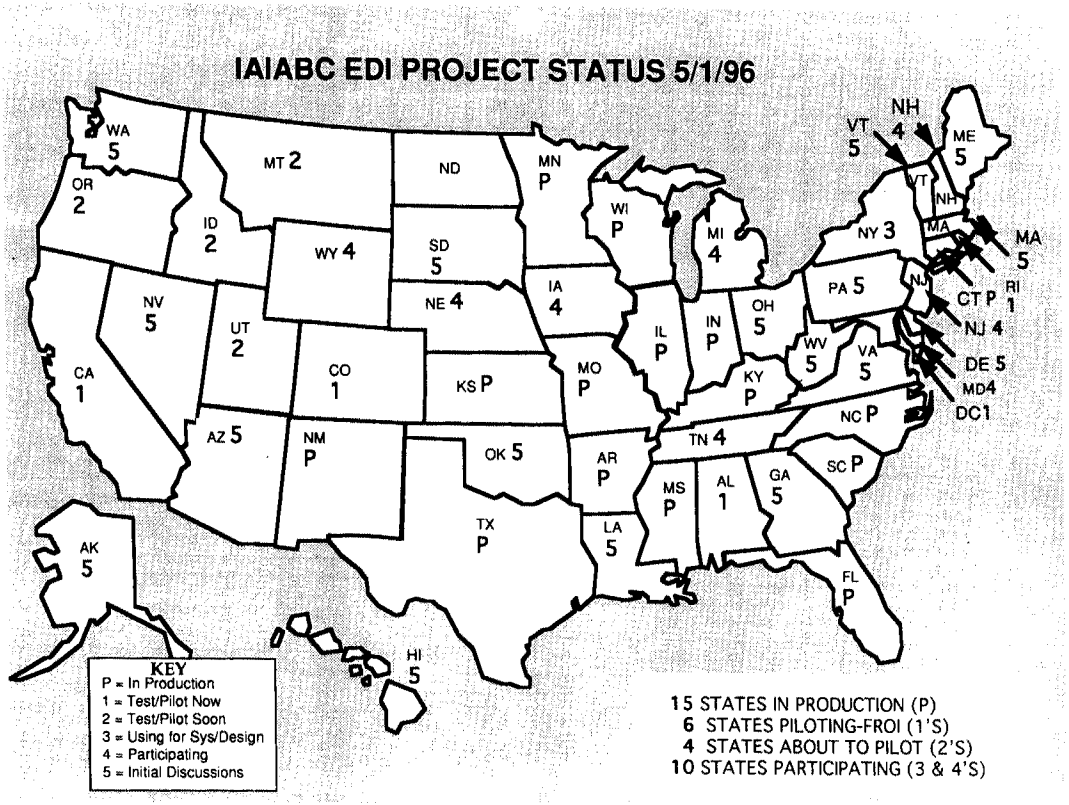
In addition federal efforts should use development processes and tools such as; identification of business objectives, opportunity evaluation, process and data modeling, and definition documentation, as fundamental requirements to become more efficient and reduce costs.

Finally, we request that attention be given to effective public data access to:

1. use the data per the intended objectives of the developers, and data sources;
2. ensure employee/claimant information confidentiality;
3. prohibit misuse, unauthorized (by data source or data manager) access to, or use of the data for competitive advantage, or other monetary gain.

In the absence of a set of rules governing federal electronic data development, and alignment of these activities, we face a piecemeal, program by program, statute by statute approach, which should undermine successful development programs. Under the proposed legislation, echoed by points presented here, organizations such as ANSI and the IAIABC can meet the needs of private and government interests.

We look forward to working with this committee to shape this legislation.


IAIABC EDI PROJECT STATUS 5/1/96
WA 5
OR 2
CA 1
NV 5
ID 2
MT 2
WY 4
UT 2
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CO 1
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NE 4
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MA 5
RI 1
CT P
NJ
NJ 4
DE 5
MD4
DC1
AK 5
HI 5
KEY
P = In Production
1 = Test/Pilot Now
2 = Test/Pilot Soon
3 = Using for Sys/Design
4 = Participating
5 = Initial Discussions
15 STATES IN PRODUCTION (P)
6 STATES PILOTING-FROI (1'S)
4 STATES ABOUT TO PILOT (2'S)
10 STATES PARTICIPATING (3 & 4'S)

REV DATE: 4/9/96

# IAIABC EDI PROJECT STATUS INSURANCE INDUSTRY

| | AR | AL | CT | CA | DC | FL | IL | IN | KS | KY | MO | MN | NC | NM | SC | TX | VA | WI | MS | OR | RI | UT | MT |
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| **AETNA** | | | | | | | | | | | | | | | | | | | | | | | |
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| SRO1 | | | | | | | | | | | | | | | | | | | | | | | |
| HARDCOPY | | | | | | | | | | | | | | | | | | | | | | | |
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| **ALEXSIS** | | | | | | | | | | | | | | | | | | | | | | | |
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| HARDCOPY | | | | | | | | | | | | | | | | | | | | | | | |
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| **AMERICAN FAMILY** | | | | | | | | | | | | | | | | | | | | | | | |
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| **CIGNA** | | | | | | | | | | | | | | | | | | | | | | | |
| FRO1 | 1 | | | 1 | | P | P | | | | | 1 | 2 | 1 | P | P | 2 | P | | | | | P |
| SRO1 | | | | | | P,1* | | | | | | | | | | P | | | | | | | P,1* |
| HARDCOPY | | | | | | | | | | | | | | | | | | | | | | | |
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| HARDCOPY | | Y | | | | | | | | | | | | | | | | | | | | | |
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| **FREMONT** | | | | | | | | | | | | | | | | | | | | | | | |
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| **GEN. ACCIDENT** | | | | | | | | | | | | | | | | | | | | | | | |
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P=PRODUCTION 1=PILOT 2=TESTING A-TESTING A=ANSIX12 FILE (OTHERWISE FLAT) *=SELECTED REPORTS ONLY

REV DATE: 4/9/96

# IAIABC EDI PROJECT STATUS INSURANCE INDUSTRY

| | AR | AL | CT | CA | DC | FL | IL | IN | KS | KY | MO | MN | NC | NM | SC | TX | VA | WI | MS | OR | RI | UT | MT |
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| **GREAT AMERICAN** | | | | | | | | | | | | | | | | | | | | | | | |
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| SRO1 | | | | | | | | | | | | | | | | | | | | | | | |
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| **ITT HARTFORD** | | | | | | | | | | | | | | | | | | | | | | | |
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| SRO1 | | | | | | | | | | | | | | | | 1 | | IP,T | | | | | |
| HARDCOPY | | | | | | | | | | | | | | | | | | | | | | | |
| **LIBERTY** | | | | | | | | | | | | | | | | | | | | | | | |
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| SRO1 | | | | | | | | | | | | | | | | | | IP,T | | | | | IP,T |
| HARDCOPY | | | | | | | | | | | | | | | | | | | | | | | |
| **KEMPER** | | | | | | | | | | | | | | | | | | | | | | | |
| FRO1 | 2 | | 2 | 1 | 2 | 1 | P | P | 1 | 2 | | P | P | P | P | 1 | 5 | P | P2 | | | | |
| SRO1 | | | | | | | | | | | | | | | | 1 | | | | | | | |
| HARDCOPY | Y | | | | | | | | | | | | | Y | Y | | | | | Y | Y | | Y |
| **SAFECO** | | | | | | | | | | | | | | | | | | | | | | | |
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| **SENTRY** | | | | | | | | | | | | | | | | | | | | | | | |
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| HARDCOPY | | | | | | | | | | | | | | | | | | | | | | | |
| **SIGFIELD** | | | | | | | | | | | | | | | | | | | | | | | |
| FRO1 | | | | | | | | | | | | | | | | | | P | | | | | P |

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REV DATE: 4/9/96

## IAIABC EDI PROJECT STATUS INSURANCE INDUSTRY

| | AR | AL | CT | CA | DC | FL | IL | IN | KS | KY | MO | MN | NC | NM | SC | TX | VA | WI | MS | OR | RI | UT | MT |
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| **TRAVELERS** | | | | | | | | | | | | | | | | | | | | | | | |
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| SRO1 | | | | | | P,A* | | | | | | | | | | | | IP,T | | | | | P,A* |
| HARDCOPY | Y | | | | | | | | | | | | Y | | Y | | | | | | Y | Y | Y |
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| **USF&G** | | | | | | | | | | | | | | | | | | | | | | | |
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| HARDCOPY | | | | | | | | | | | | | | | | | | | | | | | |
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| **WAUSAU** | | | | | | | | | | | | | | | | | | | | | | | |
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| SRO1 | | | | | | | | | | | | | | | | | | IP,T | | | | | IP,T |
| HARDCOPY | | | | | | | | | | | | | | | | | | | | | | | |
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| **WILLIS CORROON** | | | | | | | | | | | | | | | | | | | | | | | |
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| **ZURICH** | | | | | | | | | | | | | | | | | | | | | | | |
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P=PRODUCTION 1=PILOT 2=TESTING A-TESTING A=ANSIX12 FILE (OTHERWISE FLAT) *=SELECTED REPORTS ONLY

IAIABC Personnel & Associates:

| | |
|---|---|
| President: | Michael Clingman<br>Arkansas Workers Compensation Commission |
| Executive Director: | George Gomez<br>formerly with the<br>Kansas Workers Compensation Commission |
| Steering Committee Chairs: | Todd Brown, Executive Director<br>Texas Workers Compensation Commission<br>Joyce Sewell, Director<br>Utah Industrial Accidents Board |
| Active<br>Steering Committee Members: | |
| State: | Robert F. Arrigan, Judge<br>Rhode Island<br>Ann Clayton<br>Formerly Director Florida Workers Compensation Commission<br>* GOVCOM Award: "Interchange 94" for Cost Effective Services/Info Tech.<br>Gregory Krom, Director<br>Wisconsin, Workers Compensation Commission<br>Michael Lefever, Executive Director<br>South Carolina, Workers Compensation Commission<br>Robert Malooly, Chairman<br>Illinois Industrial Commission<br>Jack Urling, Judge<br>Pennsylvania Appeals Board<br>Cassey Young, Administrative Director<br>California, Workers Compensation Commission |
| Insurance: | David Dickson<br>Liberty Mutual Ins. Co.<br>Sylvia Marek<br>Kemper Ins. Co,<br>Don Grassel<br>Wausau Ins. Co<br>Gary Knoble<br>ITT Hartford Ins. Co.<br>Roger Thompson<br>The Travelers Ins. Co. |
| Associations: | Keith Bateman<br>Alliance of American Insurers<br>David Corum<br>American Insurance Association<br>Jim Decesari<br>National Council on Compensation Insurance (NCCI) |
| Insurance Bureaus: | Edward Maryonwitz, Pennsylvania Rating Bureau<br>Christine Siekiekski, Wisconsin Rating Bureau<br>Linda Hanson, Minnesota Rating Board |

| | |
|---|---|
| 1989 Consultant Companies: | Continental<br>ITT Hartford<br>Kemper<br>Liberty Mutual<br>The Travelers<br>Wausau |
| ANSI Representatives: | Dr. Martha Mc Reynolds<br>Colorado Workers Compensation Commission<br>Dr. Neil Maizlish<br>California Workers Compensation Commission<br>James Fetzer, CIGNA<br>Maureen Bock, Idaho Industrial Commission |
| ANSI Staff:<br>(non-IAIABC) | Co-Chairs X12N<br>Lee Barrett (Consulting)<br>Fred Iantorno, Mitchell International<br>Co-Chairs X12N TG1<br>Nancy Angle USAA<br>Catherine Ignas, CIGNA<br>Co Chairs X12N, TG1, WG3<br>Karen Crouch, Liberty Mutual (former)<br>Jeanie Griffith, CIGNA (current) |

EDI COMMITTEE

PURPOSE:

To promote the advantages of exchanging data between participant systems.
To promote/recommend Business & Data Interchange objectives.
To assist participants identify their business data requirements.
To establish Data Interchange standards.
To establish an organization to accomplish these purposes.

OBJECTIVES:

To unify/motivate participants to improve the Workers' Compensation environment.

To identify Workers' Compensation opportunities:

a. To improve working relationships.
b. To standardize date definitions.
c. To improve the reliability/timeliness of data.
d. To reduce operation expenses.
e. To improve Customer Service.
f. To improve management of the environment.

To establish an organization:

a. To discuss/determine Data Interchange objectives.
b. To organize activities for efficiency and prioritization of resources by participant interest.
c. To present/request/analyze environment data interchange and process requirements.
d. To develop Data Interchange solutions.
e. To institute solutions by consensus opinion.
f. To influence environmental change.

OBJECTIVES: cont.

To establish standards for:

a. Elements
b. Transactions
c. Communication
d. Edits
e. Acknowledgment
f. Management of Data Interchange

SCOPE:

Data exchanged between Workers' Compensation environment participants.
Data exchanged via electronic means or alternate methods that supports the exchange of data electronically, or provides comparable benefit.

## EDI Philosophy

The Philosophy of the EDI Committee is based on simplifying and improving the way we do business. To meet this objective the EDI Committee maintains several

1. Standardize all Data Elements: Terminology and definitions often differ from jurisdiction to jurisdiction. Our objective is to create common definitions that will allow cross jurisdiction data comparisons. Such comparisons will be useful in identifying beneficial legislation and administrative rules. This will also simplify Claims Processing business process.

2. Do Not Re-Invent the Wheel: It is not efficient to redesign what already works. Whenever our analysis of business requirements indicates that an existing standard meets our criteria and may be employed by many System participants we adopt that standard.

3. Use Codes not Text: The Workers' Compensation Industry captures more data than most industries yet it provides little benefit. Our goal is to use the data we capture to improve the interaction of the System participants and to use the data we capture to its best advantage. Common terminology will improve that, however, most of the data we capture is textual. Textual data requires human interpretation. Our philosophy is to use codes where ever possible and minimize textual data. The use of codes allows immediate analysis of the data.

4. Plan for change: As our work continues, we will become aware of business requirements not currently provided for. New business requirements are certain to arise: legislation, administrative rule, customer requirement, and our own business needs. Constant change could make EDI costly and difficult to manage. Our objective is to manage change by designing transactions and processes and using codes to provide flexibility of use. This approach allows our designs to accommodate many enhancements without redesigning the transaction. Transaction revisions will be scheduled to reduce their frequency.

5. Simplify the Reporting Requirements: Workers' Compensation data Reporting requirements appear to be jurisdiction and customer unique. From analysis, we determined that all the reporting requirements had basic commonalties. By arranging these common elements we developed a menu format that provides unique reporting requirements for any trading partner in a manner that simplifies the reporting process.

6. A Partnership Approach: Electronic Data Interchange requires that Trading Partners interact, exchange data so that the business processes of both is improved. It also implies that data quality is an important joint responsibility. To meet this requirement, a data edit process and an Acknowledgment Transaction is being designed. Under this approach each Trading Partner will reply to a Transaction, such as the First Report of Injury or Subsequent Report with an Acknowledgment Transaction. That Transaction will report acceptance or rejection, edit errors, or business information for each report. This process will assist Claim Administrators by reporting problems promptly and insuring data quality.

## Section I. DATA COLLECTION OBJECTIVES

The need for reliable information regarding workers compensation has been recognized virtually since the birth of the system. In 1914 the Commission on Workmen's Compensation Laws stated that:

> *"No real knowledge of the operation of Workmen's Compensation Acts can be acquired until complete statistics have been gathered ... injustices that may exist through the law cannot be remedied until the facts are known, and the facts cannot be known until complete statistics have been compiled."*

Later the drafters of the 1970 Occupational Safety and Health Act (OSHA) recognized the lack of suitable data and called for the effective compilation and analysis of injury statistics. Subsequently, the National Commission on State Workmen's Compensation Laws noted the deficiencies of the current level of data and stated that such failings handicapped the effective evaluation and administration of state programs.

The passage of time has not alleviated the need for uniform and reliable information regarding the operation of the workers compensation program. Time has however served to solidify the objectives of any effort to expand data collection. These objectives include:

- Measure aggregate system costs,
- Establish a uniform means to identify the causes of workplace injury/illness,
- Develop management information to measure the effectiveness of benefit delivery systems,
- Provide information for comparing experience across jurisdictional lines,
- Identify cost drivers in the system, and
- Measure the impact of legislative and regulatory change.

As the objectives for collecting workers compensation data have become more focused, there has been a corresponding recognition for the two forms of statistical data being requested.

- Rate-Setting Data - The data collected by rating organizations and insurance departments for purposes of setting rates and allocating costs to policy, class, etc. While utilized primarily for that purpose, this type of data is also collected by program administrators to monitor payments by injury type and establish the amounts paid or incurred for medical and vocational rehabilitation services.

- Management Data - Management data is comprised of those data elements which demonstrate proof of coverage, ascertain the type of claims being compensated, and measure the effectiveness of the program in terms of the timeliness in delivering benefits. This component includes basic claim data that identifies the cause, part of body affected and nature of the injury, monitors the speed and accuracy of the benefit delivery process, and tracks the issues in dispute and the flow of litigation and appeals.

While the two forms of data furnish unique perspectives of what is occurring within the system, in combination they furnish a complete description of both the efficiency of the benefit delivery system and the cost of the benefit program. There is considerable redundancy in these two forms of data. While some redundancy is unavoidable, it should be eliminated wherever possible to reduce costs and improve data reliability and consistency.

Notwithstanding the objectives of an expanded data collection capability, it is important to reaffirm the goal of achieving the collection of necessary and accurate data through the most cost effective means possible. Any effort to enhance the data collection process must weigh the need for the data versus the anticipated cost of collecting the data and ensuring that its accuracy is sufficient to meet the intended purposes.

## Section II. ENTITIES RESPONSIBLE FOR WORKPLACE DATA

While there is frequent reference to the lack of adequate and credible workers compensation data, there is no question that data is being gathered by various entities for select purposes. Each of these entities collect data for unique purposes with a focus toward either management or financial data. The following identifies the major entities engaged in the collection of workplace data and includes an abbreviated review of the purpose of the effort and the type of data being collected.

### A. Occupational Safety and Health (Federal and State)

The principal facility identified at the federal level for collecting statistics on workplace injuries or illnesses was established by the Occupational Safety and Health Act (OSHA) of 1970. OSHA requires covered employers to prepare and maintain records of occupational injuries and illnesses. Covered employers include all employers except those with less than 10 employees, or employers in low hazard industries (e.g. retail trade, finance, insurance and real estate).

The Bureau of Labor Statistics (BLS), through a sample of employers, conducts an annual occupational injury and illness survey. This survey is used to develop national occupational injury and illness estimates by the 4-digit Standard Industrial Classification (SIC) level in most industries and at the 2-digit level in most non-industrial industries. Annually published exhibits illustrate experience by nature of injury, part of body affected and injury source, and include the number of lost workday cases and the number of lost workdays.

Recordable injuries and illnesses are occupational fatalities, non-fatal occupational illnesses, or non-fatal occupational injuries which involve loss of consciousness, restriction of work or motion, transfer to another job, or medical treatment other than first-aid.

State OSHA facilities compile individual state experience for state reporting purposes, and submit the same data to the federal organization for compilation of national statistics. Data is used at both the state and federal level to target safety programs.

### B. Insurance Advisory Organizations - NCCI and Independent Bureaus

The National Council on Compensation Insurance (NCCI) is a voluntary, non-profit, advisory organization which prepares loss cost rate filings and administers the rating plans for workers compensation insurers in 32 states. Independent rating bureaus serve a similar function and are found in ten (10) states. Members of the National Council and independent bureaus include stock companies, mutual companies and competitive state funds.

Both the National Council and independent rating bureaus rely upon financial calls from member companies to establish the loss cost indications. This data is supplemented with Unit Statistical Plan data which summarizes premium and claim experience by policy for purposes of establishing rate relativities for employment classifications and determining an individual employers experience modification.

The National Council collects specific claim information through the call for Detailed Claim Information (DCI) in select states. Beginning in 1979, the NCCI initiated the data request on a sample number of lost-time cases in twelve states. In 1991 the DCI was expanded to collect more detail in terms of the type and amount of benefit payments. At the same time the call for detailed data was extended to all states in which the NCCI compiles data.

Independent rating bureaus utilize Individual Case Reports (ICR) to collect detailed information on claims that represent either a specific injury type or pass a threshold dollar amount. Information gathered from the ICR is utilized to augment rate filing data and provide select information on program experience.

C. State Workers Compensation Administrative Agencies

Many state workers compensation agencies - identified as industrial commissions, accident boards, divisions, etc. - have extended their role beyond that of dispute resolution to include monitoring the benefit delivery process, assisting injured workers in understanding their rights and obligations under the law, and collecting statistical data regarding the programs operation.

State agencies require employers, insurers and medical providers to file reports containing claim and payment activity information. This generally originates with the Employers First Report of Injury. This report provides information regarding the identification of the employer and injured worker, the time and location of the accident, and details relative to how the injury occurred, the part of body involved, and the extent of the injury.

Many states require the filing of subsequent reports which detail the time when indemnity benefits begin, the type of benefits being paid, and the amount of prior earnings subject to replacement. A number of states collect payment information on a periodic basis and a summary of payments by type of benefit when the claim is concluded. A few states also collect detailed data on medical treatment expenses and amounts paid and outcomes of vocational rehabilitation.

State agencies use this information to monitor the benefit delivery process and informally assist workers by explaining rights and entitlements under the law. Separate information is generally tracked internally to monitor the status of adjudication and dispute outcomes. Many states compile detailed data on lost-time injuries and publish annual statistical reports on claim experience.

D. Other Sources of Workplace Data

In addition to data collection that takes place by those entities previously described, independent efforts exist to workplace injury data. Two of the more prominent efforts include individual employer or insurer data systems, and independent claim surveys.

Individual employers and insurers have developed sophisticated computer systems to retrieve information in order to monitor claim experience and cost development. This data begins with the coverage information entered when the policy is issued and is supplemented with loss information filed at the time the claim is reported. This loss information is designed to capture payment data with detail at the level of benefits paid by injury type, the medical paid by procedure code, and litigation status. Additionally, these systems track development and compare experience over time.

The second source, used frequently at the state level, involves the compilation of information through survey forms. Frequently, in response to proposed legislative activity, claim surveys are conducted to elicit specific information in order to document the extent of a perceived problem. Such surveys generally focus on cases closed during a specific period of time or on claims involving select injury type claims (e.g. permanent partial disability cases). Surveys are usually conducted through a sample of cases.

Data collected both through individual employer and carrier claim files, and claim survey forms, is utilized by research organizations such as the Workers Compensation Research Institute (WCRI) or the California Workers Compensation Institute (CWCI). These research organizations identify system characteristics and develop information that assists legislators and program reformers to focus on specific problems and issues. Claim surveys are also used by regulators and statistical agencies to augment the data collected through other mechanisms.

Summary

The foregoing demonstrates in an abbreviated fashion the types and purposes of the data collected by the major entities involved including governmental entities as well as other interest groups. While each entity may be collecting data for distinct purposes, there is a significant amount of overlap in information collected during the life of the claim or period of program coverage.

In similar fashion, there is the potential for these different entities to develop jurisdictional unique terms or definitions for purposes of describing certain benefit types. As these entities develop the capability to transmit information electronically, there also exists the possibility of developing multiple data formats for the same data element.

All of these entities are interested in collecting complete and accurate data in a timely manner. The most efficient and accurate form in which to collect this information requires uniformity and standardization. Where possible, duplicate collection should be eliminated and the data needs should be analyzed to ensure that the information can be used to compare experience across jurisdictional lines.

## Section III. CURRENT DATA INITIATIVES

Recognizing the multiple purposes for which data is being collected, a number of efforts have been undertaken to refine and improve this collection capability. The International Association of Industrial Accident Boards and Commissions (IAIABC), the National Association of Insurance Commissioners (NAIC), the National Council on Compensation Insurance (NCCI) and independent rating bureaus, the Bureau of Labor Statistics (BLS), and the United States Department of Health and Human Services are the principal organizations engaged in these data collection efforts.

Through efforts that began independently, working groups from each of these organizations are beginning to work jointly to recommend the collection of certain basic data elements in order to understand and monitor developments in the workers compensation arena.

### A. The International Association of Industrial Accident Boards and Commissions (IAIABC)

The IAIABC is an association of administrators from state workers compensation agencies. One of their objectives is to develop and recommend standards for improving and strengthening workers compensation laws and their administration.

As a result of an effort that began in 1987, the Statistics Committee of the IAIABC compiled a listing of recommended management and payment data elements for state administrators to collect on each lost-time claim. This proposal was adopted by the IAIABC membership in 1990. Subsequent to that activity, the IAIABC has embarked on a project to develop standards for communicating data electronically between providers, payers, and state administrators through Electronic Data Interchange (EDI). Common formats and data reporting specifications are being developed for the First Report of Injury, the subsequent payment reports, medical information, vocational rehabilitation, and litigation activity.

This effort is being coordinated by an IAIABC staff member with representation from state administrative agencies, insurance carriers, NCCI, research organizations, self-insured employers, standards organizations and vendors. The background and current status of the EDI project will be more fully described in the following section.

### B. Workgroup for Electronic Data Interchange (WEDI)

A committee under the direction of the Secretary of the United States Department of Health and Human Services is examining standardization of medical reports and the electronic transfer of medical information for all lines of health insurance. This group has recently issued a series of recommendations regarding this standardization. The IAIABC EDI working group has entered into discussions with the WEDI task force in order to ensure that the efforts are coordinated and that the concerns for workers compensation are recognized.

Members of the EDI working group are also participating with the committee of the American National Standards Institute (ANSI) for the purpose of having the standards for workers compensation data transfer become the industry standards. ANSI has also been recognized by the WEDI task force as the appropriate organization to develop standards for transmitting all medical information.

### C. National Association of Insurance Commissioners (NAIC)

The NAIC is an association of state insurance commissioners responsible for all lines of insurance including workers compensation. The NAIC established a working group of the Workers Compensation Statistical (D) Task Force to examine the subject of workers compensation data collection. Utilizing the listing of data elements developed through a series of meetings, the NAIC adopted a Workers Compensation Insurance Data Reporting Model Regulation at their December 1989 meeting.

The model regulation provides that insurance carriers, state funds and self-insured employers are to report their statistical experience to at least one of the statistical agents designated by the Commissioner. The model regulation calls for an annual data report to be completed on a selected sample of workers compensation claims.

D. NCCI Data Initiatives

The National Council on Compensation Insurance (NCCI) - described earlier as a voluntary, non-profit, advisory organization which prepares loss cost rate filings and administers the rating plans for workers compensation insurers in 32 states - has established a number of different projects that focus of different aspects of the data collection issue. These include:

**1. Call for Detailed Claim Information (DCI)**

The call for Detailed Claim Information (DCI) is a data collection program undertaken by the NCCI whereby insurance carriers furnish specific information on a selected sample of workers compensation lost-time claims. The purpose of the DCI is to provide insight into the underlying elements inherent in the aggregate cost of workers compensation insurance.

In response to the NAIC adoption of a model data collection regulation, the NCCI restructured the DCI to accommodate additional information required as part of the model regulation. This was accomplished by a working group which included representatives of the NAIC, the NCCI, the IAIABC, standards organizations, research organizations and insurance carriers. The NCCI is implementing a quality audit program to ensure the accuracy of DCI data.

**2. Policy Issue and Capture System (PICS)**

As the foundation for its policy information data the NCCI is expanding the data it stores from the policies and endorsements issued by the member companies. The information details the effective date of coverage, the classification of employment's and the estimated payroll. In select states NCCI also provides proof of coverage information (POCS) to state workers compensation administrators.

**3. Unit Report Control (URC)**

As a part of the long range strategy to improve its data collection systems the NCCI is in the final stages of implementing a major system which provides member companies with advance listings of the unit reports that are due. The program includes a fining system for unit reports that are reported late.

**4. Unit Report Quality (URQ)**

As a companion to the URC program, the NCCI is in the initial stages of implementing a system that will edit unit report data reported by member companies, return errors to the company for correction and impose fines for errors that remain uncorrected.

E. Advisory Statistical Work Group (ASWG)

The NCCI and the independent rating bureaus cooperate through the Bureau Managers Committee to promote consistency in reporting requirements. The ASWG was formed in June of 1991 to review the unit statistical report - the document submitted by insurance companies to rating organizations to report workers compensation statistical data for ratemaking and experience rating purposes - and other related statistical reporting vehicles. The ASWG is composed of representatives from six workers compensation bureaus and seven insurance companies.

F. Occupational Safety and Health Administration (OSHA)

A working group composed of representatives from OSHA, the Bureau of Labor Statistics (BLS), state workers compensation administrators, the IAIABC, the workers compensation rating bureaus and member insurance companies is currently reviewing the different injury coding schemes that have evolved over time with the stated goal or attempting to define a standard injury coding format. This effort will permit a better interface between industry and federal data.

## Summary

This overview of ongoing data collection activities clearly demonstrates that there is both a tremendous amount of interest and activity directed to the collection of credible, accurate data in a timely manner. This activity speaks to the need for coordination in the area of workers compensation data collection.

While elements of this strategy are evolving from individual initiatives, the overall strategy is yet to be defined. Responsibility for developing this strategy has also not yet been determined.

- The ongoing collection of appropriate financial data in a timely fashion provides the opportunity to continually monitor and measure changes in the workers compensation environment. The electronic submission of data on all claims can permit comparison of experience at different points in time and across jurisdictional lines. This will afford the opportunity to identify systemic problems.

- A concluding reason to support EDI is that it will culminate in the creation of comprehensive data bases at the state level that will be standardized among states in the type and format of data being collected. This standardized format will assist benefit providers through the establishment of a single standard rather than developing systems to respond to the needs of fifty different states.

The potential for cost savings through the elimination of duplicative entry processes and the efficiencies associated with a single standard for data transfer make this project a key to controlling expenses in the rapidly rising workers compensation cost environment.

Status of the EDI Project

In March of 1991, a working group within the IAIABC proceeded with the concept of moving the data collection project into an implementation phase. The first objective was to retain a full-time coordinator to furnish guidance to the project and bring the various program participants to a common table for discussions. In September, Rob Spencer was hired for the position of IAIABC Management Information Coordinator.

At the same time, a technical working group was established - composed primarily of insurance representatives, state agency personnel, and consultants - who focused on the detail of defining the data elements and developing the data formats to be used for the electronic data transfer. This group, after reviewing all the various forms presently filed with state agencies, identified distinct phases that the project would follow. These phases reflect the various generic categories that the various state reporting forms fall. These categories include:

1. **First Report of Injury** - the initial report designed to notify the parties of the occurrence of an injury or illness. Contains basic claim information regarding the who, what, when and how of an occupational injury or illness.

2. **Subsequent payment reports** - Consists of forms that gather information when benefit payments begin, case progress information, and paid amounts by benefit type when the claim is concluded.

3. **Medical data** - Develops more refined data pertinent to the dates of service, diagnostic and procedures codes, and costs associated with providing of such care.

4. **Proof of Coverage** - Information filed with the majority of state administrative agencies that verifies the name of the insured employer and the provider of coverage.

5. **Vocational Rehabilitation data** - Monitors the incidence of vocational rehabilitation, the outcomes and the costs associated with same.

6. **Litigation data** - Reflects the incidence of disputes, issues in dispute, outcome results at various adjudication levels, and system costs related to litigation.

Each of these categories represents a separate project phase for the technical working group. The technical working group has completed the first phase - the First Report of Injury. A copy of the data reporting formats and the "hardcopy" version of the First Report is included as Attachment A. This represents Release 1 and will be the subject of further review and possible modification following actual implementation and use. A separate document containing the definition for each of the terms is separately provided in the Appendix.

## SECTION IV. IAIABC ELECTRONIC DATA INTERCHANGE(EDI) PROJECT

### Introduction

Over the past decade, many developments in computer technology have had extensive articles written about them. In recent years a technology topic that has grown in popularity and usage is EDI. It seems to be the acronym or "buzz" word of choice in many technology and insurance magazines. EDI, short for Electronic Data Interchange, represents the electronic exchange of information, without the element of human intervention.

EDI has grown out of the need to pass data quickly between trading partners and had its genesis as far back as the 1960s when magnetic media was the most effective choice available. However, due to recent improved computer and data communication technology, it has helped speed the trend toward EDI solutions. The expanded usage of EDI has resulted in greatly increased transfer of information and reduced clerical and data entry costs.

Electronic Data Interface (EDI) in Workers' Compensation represents an extension of an earlier International Association of Industrial Accident Boards and Commissions (IAIABC) project which focused on the identification of data elements for Workers' Compensation system participants to collect. This listing of recommended data elements was compiled over a period of time during which insurance regulators, state program administrators, insurance carriers, and self-insured employers, identified those articles of information that would develop a core of data elements in order to provide credible management and financial information.

The EDI stage of that project simply moves the discussion on data collection to the next natural level. After establishing a listing of recommended data elements for collection, the next issue to address is the identification of the most cost efficient and accurate manner in which to collect that data. EDI represents that next natural phase.

State workers' compensation agencies, responsible for the monitoring the benefit delivery process, represent the most practical location for collecting that data. Those agencies presently utilize file paper forms to monitor the claim process on each lost-time claim. Rather than utilizing those various forms (e.g. first injury reports, memorandum of payment, case progress reports, closed claim information, etc.), the EDI effort is intended to replace such forms through an electronic link whereby a standardized listing of data elements can be communicated electronically. EDI simply represents the use of current capabilities to effectively transmit data deemed appropriate.

### Points Favoring EDI

When proposing EDI for Workers Compensation, it is beneficial to first identify those features which favors its adoption. Those features have application whether we are discussing the employers, the carriers, or the perspective of the state agency and include the following:

- The principal reason in support of EDI is the cost efficiencies associated with same. Reduced cost can be realized through the elimination of data entry at the state agency level when the state system is directly linked to an external data source. While state agencies will realize an immediate benefit through accepting First Report of Injury electronically, subsequent payment reports filed via electronic means will represent significant savings for employers and carriers. Additional savings are connected with reduced filing space requirements and reductions in the expenditures for postage and mail sorting and delivery time.

- Along with savings associated with the direct transfer of data through electronic means, there is the separate issue of improved data accuracy. Information entered or "keypunched" a number of times is subject to error. The fewer times it is necessary to enter information, the greater will be the degree of accuracy. There is little value in collecting and utilizing data unless there is a strong assurance that the data is accurate.

The technical working group has also completed development of a similar reporting format for the subsequent payment reports. A working exhibit reflecting that effort is included as Attachment B and continues to go through the stages of refinement in order to respond to agency and data provider needs.

The final phases of the project reflects more complex issues. Collection of comparable medical detail can only be realized in those states where reporting of medical information on standardized reporting forms is mandated. A federal task force has been designated by the United States Secretary of Health and Human Services to examine standardization of medical reports and the electronic transfer of medical information. The working group is engaged in discussions with that task force in order to ensure that the efforts are coordinated and that Workers Compensation concerns are recognized.

Variations in the way the state statutes are constructed will present unique problems to the collection of vocational rehabilitation and litigation data. However, even with recognition for these difficulties, the intent is to utilize EDI to the degree possible while seeking greater uniformity in order to make comparisons across jurisdictional lines.

**Status of State Interest**

To date, the response to this project has been overwhelmingly positive. After at least one initial contact with each state, virtually every state has expressed support. Each presentation is designed to furnish a complete description of the data project and how uniform data collection represents a positive enhancement and cost savings for the state.

At this time, fifteen (15) states have moved into production. Illinois, South Carolina, Minnesota, Wisconsin, Florida, North Carolina, Connecticut, Virginia, Kentucky, Indiana, Arkansas, Missouri, Texas, New Mexico and Kansas are all engaged in receiving the First Report of Injury through EDI from select benefit providers. Several other states are engaged in pilot projects testing EDI or are prepared to do so within the next few months. These states include California, Utah, Mississippi, Rhode Island, Alabama, Oregon, Idaho and Colorado. Additional states such as New York, New Jersey, Michigan, Ohio and Georgia have expressed strong interest in moving forward with a pilot project.

What do representatives of the state agencies think about the EDI project? Duane Earles, Director for the South Carolina Workers Compensation Commission sent an electronic message to the IAIABC that stated:

> *"Effective July 6, 1993, South Carolina Workers Compensation cases added to the Aetna companies' live claims database will be reported to the South Carolina Workers Compensation Commission electronically using the IAIABC EDI standard. This step follows two months of testing through parallel databases. South Carolina has authorized the Aetna to stop the initial paper filing of First Reports of Injury.*
>
> *'Based on a weekly download, all accident reports from Aetna can be processed in less than 5 minutes, approximately the time to process a single accident report manually. Paper acknowledgments will be sent to the local claims office through the same process now in use."*

Alan Miner from the Minnesota Workers Compensation Commission echoed a similar response:

> *"As of yesterday, 6/29, we have gone live with EDI of first reports of injury with Liberty Mutual. We will continue to receive paper first reports until we can receive the employment status codes via EDI. We will send detailed error reports to the local office which will also confirm the receipt of cases.*
>
> *'We expect to be able to process about 50 cases in 30 minutes - from download until they are in the computer system. The average paper first report now takes an average of nearly 8 days to be received and keyed in, with about 6-10 minutes of work. With EDI it should take about 30 minutes from receipt until the equivalent keyed-in point, with less than 0.5 minutes of work per case."*

**Insurance Carriers and Other Entities Engaged in the Project**

At this point, the insurance carriers and other benefit administrators engaged in this project include:

| | | |
|---|---|---|
| Aetna | Hartford | Fremont |
| Alexis (TPA) | Gallegher/Basset (TPA) | Frank Gates (TPA) |
| Sedgwick James (TPA) | TX Ins. Fund | Allied |
| AIG | Kemper | SafeCo |
| Chubb | Liberty Mutual | General Accident |
| CIGNA | Travelers | Crawford & Co (TPA) |
| CNA | CUNA Mutual | Wausau |
| Continental | Willis Corroon (TPA) | Zurich/Maryland |
| Fireman's Fund | | |

Other carriers are represented through the American Insurance Association (AIA) and the Alliance of American Insurers (AAI) in project deliberations. Self-insured employers and other interest groups such as NCCI, WCRI and CWCI are likewise represented.

Two other groups merit mention; ACORD and IVANs. ACORD is an original member of the project steering committee. Additionally, ACORD has adopted the IAIABC 1A-1 (5-93) hard copy version of the First Report of Injury (FROI) form as its new ACORD-4 form. This form has been developed through a working relationship with OSHA which has classified the form as a comparable document to the OSHA 101 form.

IVANS, a computer software vendor, developed the IVANLINK software for electronic mail that is currently being used by the IAIABC. IVANS has also worked with the IAIABC in developing a PC based solution for EDI called "ClaimIX". ClaimIX allows the electronic reporting of the First Report of Injury information using the IAIABC EDI standards and hard copy. The application fully supports the IAIABC standards and is designed for employers, self-insured employers, insurance companies and state administrative agencies.

Several other software products have now been developed. Examples includes a product offered by Frank Gates (a TPA based in Ohio) who markets an ANSI translator called "Formula One and Employer Connect". Another software offering is through a company called Supply Tech (a Michigan based software company) who markets a product called XMAP and STX12 for the ANSI X12 market. There are several additional major companies offering software products and a list of these sources can be obtained from the IAIABC.

Mr. HORN. Thank you very much. I'm going to yield the first 5 minutes of questioning to the distinguished vice chairman of this subcommittee, Mr. Flanagan, the gentleman from Illinois.

Mr. FLANAGAN. I thank the chairman, and I ask unanimous consent that my statement be placed in the record.

Mr. HORN. Mr. Flanagan's opening remarks will be placed in the record.

May I ask the ranking minority member, did you have an opening statement?

Mrs. MALONEY. I certainly do and would request it be placed in the record.

Mr. HORN. Right. Both of these statements will be put up front as read. Thank you.

[The prepared statement of Hon. Carolyn B. Maloney follows:]

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May 22, 1996

OPENING STATEMENT -- REP. CAROLYN B. MALONEY

HEARING ON: "THE ELECTRONIC REPORTING AND STREAMLINING ACT" AND H.R. 3189, A BILL TO DELAY THE PRIVATIZATION OF THE OFFICE OF FEDERAL INVESTIGATIONS OF THE OFFICE OF PERSONNEL MANAGEMENT

Thank you Mr. Chairman.

Today's hearing is on two separate measures, draft legislation developed by Chairman Horn -- the "Electronic Reporting and Streamlining Act of 1996" -- and H.R. 3189, a bill introduced by Rep. Davis which would delay the privatization of the Office of Federal Investigations at the Office of Personnel Management.

Mr. Chairman, your draft legislation on electronic reporting is evidence of the seriousness with which you view this issue, and I applaud you for that. Electronic reporting has the potential to both save the government, and industry, time and money and to make the information reported more accessible to the public and government user. However, it is important that any legislation contain safeguards to assure improved public access to information and to protect businesses, particularly small businesses, from excessive financial burdens related to electronic filing.

The purpose of this proposed legislation is to establish a process for industry groups to initiate proposals for electronic filing and then to require the Office of Management and Budget to respond by establishing a rulemaking procedure for adopting an electronic data exchange standard. It is my understanding that there are some technical problems with the drafting of this bill, and that OMB would oppose it in its current form. The Chairman has indicated a willingness to work together to improve this legislation and I welcome his flexibility.

H.R. 3189 would delay the privatization of the Office of Federal Investigation in the Office of Personnel Management and calls for two studies of such a move. Mr. Chairman, this privatization is almost complete, and to halt it now might be excessively disruptive and costly. The Office of Federal Investigations is to be converted into an employee stock ownership plan corporation (ESOP) known as US Investigation Services, Inc. OPM has given Reduction in Force notices to the 720 employees of the office, and all have received job offers from the new ESOP. Indeed, 674 of them have already accepted the offer, where they will receive a salary equal to or greater than their current salary and a comparable benefit package. This is a sensible solution for both the employees and the government, and though there seems little sense in halting it now, six weeks from completion, I will listen to our witnesses with an open mind.

Thank you Mr. Chairman.

Mr. FLANAGAN. I thank the chairman. For the panel, you may all take a turn in answering this. Whenever we get into highly complicated electronic data transference methods, don't we run the danger of creating a privileged class of those who can't do it and having a really high-speed, unfair business advantage?

How can we avoid that and make it so user friendly that it could be used all the way down the line to the smallest of possible users, to include local government?

If the Federal Government finds this cumbersome and difficult, certainly the Village of Franklin Park in my district that has to deal with these difficulties from time to time is having trouble getting WordPerfect classes together.

How can we make it possible for them, too?

Mr. FERGUSON. It's a good question. We dealt with it in California and we deal with it in the X12 committee work. The single most important answer—and it's an extremely current answer is that because of the enormous interest in the Internet, because of the enormous competition that we have among computer hardware manufacturers and software manufacturers, the price for a given level of performance is dropping in this technology and the user friendliness of the technology is increasing at a given price.

So at a very rapid change in rate, computer information technology is becoming more affordable and more usable by people, whether they work for big companies or small companies.

I would like to offer one, which was even surprising even to me, one piece of business information. Small business turns out to be, as a percentage coverage number, turns out to be the biggest user and the fastest improver of its information technology, its computers, and its software. They put big companies to shame when it comes down to who is using the latest programs and who is upgrading their systems most frequently.

When your question points to this notion of an underclass or an elite class, that has probably its greatest import when it comes to the issues that Mr. Roe was describing earlier. That in the course of the standard setting process, is there a kind of an electronic wool being pulled over some group's eyes that they'll never tumble to? They'll never discover the error. Nobody will discover the error.

And I do believe that's a serious issue and one that deserves attention in this standard setting process. I would simply offer the fact that if we conduct the technical standard setting process with rapid electronic publication of the proposals on the Internet, it's very inexpensive for any member of the public to look at that kind of information on the Web today. It's a $100 hardware purchase and $5 a month. It's not a big-cost item.

To the extent that someone doesn't—is not computer literate at all and can't even engage in the debate, we always have the fallback position that information is still reported on paper. Agencies still conduct their business and will for years predominantly on paper.

So the rate at which people might be disadvantaged by this is really reduced when you look at the dropping price of technology and when you look at the fact that it's going to be a matter of years before we've truly eliminated paper.

Mr. ROE. Mr. Vice Chairman, I represent an environmental group and the interests that I'm certainly trying to focus on in this hearing are not those of industry. I don't think this would surprise Mr. Ferguson.

We find this very compelling because we've seen how it's worked in California. I also served on Governor Wilson's recent commission, which was essentially brought into being by the complaints of small business. And one of the conclusions of that commission was the positive role that electronic data reporting could have for small business, for the businesses most likely to be overwhelmed or heavily burdened by reporting requirements.

But if I can draw an analogy, it's a little bit like the dawn of the automobile age and saying, what about rich people driving cars. Our goal is not to have rich people drive cars. It's to have rich people build the roads to all of the places we want to go so everybody can drive the cars.

In electronic data format terms, that's what the topic of this hearing is about. These are roads. These are the pathways. Somebody has got to build them. We've seen in California an experiment—frankly, an experiment, but it has so far been successful—that we can get the sophisticates to build those roads. But we can all drive on them. I don't want to stick to that analogy, I want to come back to the environment.

What that means is that important data, where there is a public interest as well as a government interest in finding data out is going to be made easier by the success of the electronification—that's a terrible word. I'm sure there is a better word. The process of going electronic in the exchange of information. That's our interest. That's why I'm here.

The parameters that my testimony last time and this time set out are to try to make sure that works the way it's supposed to. This isn't automatic, but those are the interests that bring us to this table.

Mr. HORN. Mr. Snow, would you like to answer the question?

Mr. SNOW. Yes, I would, Mr. Chairman. When we do our development work, we actually look at the process being composed of 90 percent business attention. In other words, sitting down with people and asking them, what are you trying to achieve. That consumes 90 percent of the process.

Approximately 10 percent of the process is spent designing the means to achieve it. It's not really a focus on technology. Technology enables the opportunities of doing business better. That's the focus we try to go for.

By publishing what we have developed, we're encouraging the private sector—again, vendors, to create software that can be off-the-shelf solutions, which means it's not applicable just for the player with a lot of money. It can be very affordable to low-end users, as well. We're trying to make this spread and be very obtainable.

In the insurance industry especially, we're very concerned with antitrust. And we're very cautious to make sure that we're not doing anything that provides a greater advantage to one group over another. In some cases, this means just standardizing paper forms, the people who won't move off of that. But to enable it to be put

into the system through OCR. When we keep the technology away from the users, we concentrate on meeting the business requirements.

Mr. HORN. Thank you very much. I now yield 5 minutes to the gentlewoman from New York, the ranking minority member, Mrs. Maloney.

Mrs. MALONEY. Thank you very much. And I find this an extremely interesting idea. I would really like to ask, Mr. Roe, you mentioned earlier the California project on which you worked and the legislation that we talked about last October, which set up really a demonstration project. However, the legislation before us today talks about setting up standards and rulemaking. And those seem to be quite different approaches to solving the problem.

Do you think that this is the right approach to set up, the standards and rules? Or do you think a pilot project approach would work with the Department of Environmental Protection, which is your expertise?

Mr. ROE. As I've said repeatedly, we support this bill in concept and are agnostic about the exact form that it takes. The goal is to mobilize the kind of industry activity that we saw mobilized in California. There isn't only one way to do that.

Certainly, a pilot very much like the California pilot, I think could be very effective at the Federal level. It does raise the question, if it's already been demonstrated in a seventh of the country, do we need to demonstrate it again? And sometimes the answer to that question is yes and sometimes it isn't.

I would hope we could go somewhat farther. I would hope we could structure what I described earlier as an incremental process, perhaps beginning with the pilot, but at least setting the stage to go beyond that because I do think that at the Federal level, given the resources that would be involved in the private sector, it needs to be worthwhile. Frankly, there needs to be enough of a carrot in this process for an industry to come in and do the homework. Exactly how much of a carrot, I don't know. Giving it entirely over to industry, we would obviously oppose, and my testimony makes that point.

Mrs. MALONEY. Well, I'd like to support your comments that the not-for-profit sector or the citizen sector's point of view should be built into the equation.

I'd like to ask, Mr. Snow, could you explain to me what is it that you see is the main goal of this proposed legislation? What is the main goal of this legislation, as you see it?

Mr. SNOW. The primary point that I'm very interested in is the sponsorship of organizations such as the IAIABC and ANSI to continue taking the lead and developing electronic data interchange and solving business requirements.

I think it's the emphasis on that sector doing the development is what appeals to us most.

Mrs. MALONEY. I'd like to ask, Mr. Roe, what do you see as the main goal of this proposed legislation?

Mr. ROE. Mobilizing private knowledge, initiative, and resources to do a lot of very boring technical work that will get us faster to electronic data transmission without letting that get out of hand, without the electronic wool being pulled over anyone's eyes.

If I could just add, Congresswoman, I wouldn't be sitting here even suggesting that it was possible if it were not for a successful version of that having taken place over the course of years in California. So I know it can be done and the groundwork that's been laid there has not pulled the wool over people's eyes. It's been quite effective in meeting that goal.

Mrs. MALONEY. Mr. Ferguson.

Mr. FERGUSON. The goal is to reallocate the work required to go from step one to step six, as I discussed earlier. I think plainly the correct task for the Government agencies to do is a very careful definition of the data items that they want to receive electronically. And the industry reporting non-Federal groups—and I include State and local governments, not just private industry—are far and away better equipped with the resources and the insight to do the standard setting activities themselves.

Mrs. MALONEY. What do you see as OMB's role in this? It seems to me that the goals seem to be to interact, just to give the example that you did, with the Environmental Protection Agency and the private sector and the Environmental Defense Fund and other like groups. What is the role of OMB? Second, do you see this as trying to set up a binding situation on agencies, secondary statement?

I'd like to ask, Mr. Roe, what do you see is the role of OMB, having had your experience in California, as I understand you were part of that project?

Mr. ROE. Someone needs to referee. It can't be a matter of simply saying to industry, you write the standards and we'll rubberstamp them. Ms. Katzen, when she was here, made that point both orally and in her written testimony. We completely agree with that.

The only question is, who is in the best position to referee and under what ground rules? The reason that there is a data management advisory committee in this draft legislation, and there was in California, was to put some technical heft behind that referee so that it wasn't just one person who couldn't possibly keep up with this.

But part of my earlier testimony focused on the need to make that a meaningful process.

The other point that's in my written testimony is that several Federal statutes have squarely put OMB in the oversight position for Federal Government paperwork reduction activities. This is clearly part of that, so it would be an odd mismatch if they were completely out of the loop.

I think the question that was left hanging when Ms. Katzen had to leave was exactly what is the balance between overall supervision and calling each ball and strike.

Mrs. MALONEY. Do you see this as binding, setting up a binding situation on the agency?

Mr. ROE. I'm not sure what you mean by binding in that what we're talking about is——

Mrs. MALONEY. Well, as they set up process, it's binding on the agency. You have it as written, OMB and the private sector setting this up. And once they set it up, is it binding on the agency?

Mr. ROE. Well, I hope what it is is it authorizes electronic data transmission in a form which is the only form you're allowed to use. It doesn't mandate electronic data transmission. It says, if you

want to go electronic, here are the pigeon holes and the shape and the size and the definition of the pigeon holes into which you must place this data electronically. So it's not binding in the sense that you have to go electronic. It is binding in the sense that if you want to, this is the way you have to.

If you don't get that, then there is nothing in it for the participants, I think.

Mrs. MALONEY. Thank you very much. The chairman is the fastest voter I've ever met. I'm going to go vote. He runs faster than I do.

Mr. HORN. Let me just ask the panel one question. I think that perhaps Mr. Ferguson has the most experience with it, but it's a legitimate concern. And in the bill, which we have not yet put in, we're trying to get the best ideas we can. And after going through this dialog, we would obviously welcome all of your thoughts as people that are deeply immersed and knowledgeable in this area before we send the draft around the House.

There has been concern about the danger that if you do some of this, you will favor particular hardware makers by imbedding some advantage in the regulatory process because they've been involved with it. And I guess there's a case—I don't know if you want to talk about it, Mr. Ferguson—in terms of where we're trying to get a nonproprietary system.

And you can get it in just some particular computers where there is an architecture that is quite different than others. Therefore, the software related to that architecture, if that's where the agency and the private sector sort of landed in the development, would give really an exclusive to that particular area.

I don't know if you want to expand on that. And I'd welcome any other thoughts.

Mr. FERGUSON. Sure. There are two different responses, which I think are helpful to cover the question completely. One—and this is kind of an old story. I don't think we have to worry about it a whole lot now, but it's instructive, it's illuminating. It's that if none of the parties makes explicit data dictionary items and nonproprietary formats—formats you don't have to pay a royalty to anybody to use.

If nobody makes those things explicit, then it turns out that the software package, the larger software package that you write becomes a kind of de facto standard. The software becomes the de facto data dictionary.

And in past years, that's happened by accident or on purpose. And once software becomes the standard, particularly if the government attaches its blessing to it, it's great for a vendor. I think people in the industry side have tumbled to that game and we don't see a whole lot of it nowadays, but it's a good lesson to remember.

Part of the answer to that is focus properly at the front end of this task on defining the data dictionary and the data standards.

Mr. HORN. When you finish your answer, the committee will be in recess for about 15 minutes.

Mr. FERGUSON. And I'd simply argue that one of the reasons that all of the witnesses here talked about the ANSI X12 committee—the reason that we have an ANSI X12 committee is that companies themselves don't want to lock in any one vendor. So we have this

giant consensus committee that develops nonproprietary packaging formats. So we virtually eliminate this kind of proprietary lock-in if we've done a good job of data dictionary and if we use the nonproprietary packaging system known as X–12.

I'm sure there is a game that can be played there somewhere in a very narrow sense. But industry has tumbled to this and the game is pretty fair in the private sector committee just the way it is.

[Recess.]

Mr. HORN. I just want to thank the panel. We have a few questions here that the staff might well send to you. As I say, I'd like to wrap up the draft within the next week. So Mr. Brasher, to my left here, your right, is the professional staff member in charge of this area. He will be in touch with you. Please give us your thinking, because we've got to grind it out in legislative lawyer-like language so nobody will understand what anybody is doing. But we want those thoughts, and you've made some excellent ones. So I thank you all for coming.

We might followup with a few questions if you won't mind answering them in writing. You're still under oath.

We now will go to the next panel, which is Congressman Phil English of Pennsylvania. And we welcome you here, Mr. English, one of the hardest working members of the freshman class, able, distinguished. What else can I say about you, Phil?

## STATEMENT OF HON. PHIL ENGLISH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. ENGLISH. Well, I'm not going to stop you now, Mr. Chairman. Feel free to improvise.

Mr. HORN. Proceed. When you're done, you're welcome to join us up here on the dais and question all of the witnesses. That's a courtesy we also extend in this subcommittee.

Mr. ENGLISH. Thank you, Mr. Chairman. I appreciate the opportunity to appear here before this subcommittee of the Government Reform and Oversight Committee. I appreciate your interest in this subject, which is of great interest to my constituency and a number of the people who are from western Pennsylvania.

I want to thank you for allowing me to appear before this subcommittee to express my concerns with the Office of Personnel Management's employee stock ownership plan for its Office of Federal Investigations.

Last month, U.S. Investigation Services, Inc., entered into a contract to provide investigation services for OPM. Having the Federal information processing center in my district, I represent 256 OFI employees who are affected by this transition and remain very interested in what OPM is trying to accomplish.

Since the very beginning, I have not been satisfied that OPM's task has been in the interest of the taxpayers. OPM has repeatedly produced back-of-the-envelope figures and charts to prove that the ESOP will cost less and save more. Yet, last year, at a previous Government Reform and Oversight Committee hearing, a representative from the Office of Management and Budget testified that there was no serious financial methodology behind the OPM proposal.

Furthermore, OMB chose not to require OPM to complete a standard A–76 cost savings comparison. For those unfamiliar with an A–76, it is an assessment used to test the legitimacy of any privatization effort. To pass, the A–76 must demonstrate a savings of at least 10 percent to compensate for the costs and risks of contracting out.

I believe that OPM was allowed to avoid the A–76 because these savings to the taxpayer could not be documented. After the hearings, Senator Specter, Senator Santoram, and myself subsequently pressed the Appropriations Committee to delay the ESOP until OPM could prove that its plan made financial sense.

We succeeded in placing legislative provisions in our reconciliation package, forcing OPM to conduct a better cost-benefit analysis and requesting the GAO to do a review of their analysis. Earlier this year, OPM complied and released an analysis completed by three midwestern academicians.

As the former chief internal auditor of the third largest city in our commonwealth and as an individual with some modest experience in privatization, I looked forward to the new analysis. I have to confess I was disappointed. I had hoped that OPM would have produced what I hoped would be a more serious review. But, as before, OPM's efforts seemed less concerned about producing an accurate and viable business plan and more interested in slavishly implementing an assignment outlined originally in Vice President Gore's national performance review.

As demonstrated by today's hearing, there are still, in my view, too many questions about USIS' costs, its possession of sensitive information, and whether the American public will be better off after OFI has been privatized. For the OFI employees in western Pennsylvania, I am also concerned what contingency plan might exist should USIS fail.

Based on my experience and my concerns about the ESOP, I joined Representative Tom Davis and became an original cosponsor of House Resolution 3189, which has been referred to this subcommittee. This bill provides for a needed timeout before OPM hastily, and in all probability irreversibly dismantles OFI. OPM has embarked into terra incognito. I believe the taxpayers and the OFI employees in my district deserve a better course.

Thank you, Mr. Chairman. Again, I appreciate your interest in this topic and the opportunity to testify today.

[The prepared statement of Hon. Phil English follows:]

May 22, 1996

Testimony of Rep. Phil English
Before the Government Reform and Oversight Subcommittee

Thank you for allowing me to appear before the subcommittee to express my frustrations with and skepticism for the Office of Personnel Management's Employee Stock Ownership Plan for its Office of Federal Investigations. Last month, US Investigations Services, Inc. (USIS) entered into a contract to provide investigations services for OPM. Having the Federal Information Processing Center (FIPC) in my district, I represent 256 OFI employees who are affected by this transition and remain very interested what OPM is trying to accomplish.

Since the very beginning, I have not been satisfied that OPM's task has been in the interest of the taxpayers. OPM has repeatedly produced "back-of-the-envelope" figures and charts to prove that the ESOP will cost less and save more. Yet, last year, at a previous Government Reform and Oversight hearing, a representative from the Office of Management and Budget testified that there was no serious financial methodology behind the OPM proposal. Furthermore, OMB chose not to require OPM to complete a standard A-76 cost-savings comparison. For those unfamiliar with an A-76, it is a test used to assess the legitimacy of any function to be contracted out. To pass, the A-76 must show a savings of 10% to compensate for the costs of contracting out. I believe that OPM was allowed to avoid the A-76 because these savings to the taxpayer could not be produced.

After the hearings, Senator Specter, Senator Santorum, and myself subsequently pressed the Appropriations Committee to delay the ESOP until OPM could prove that its plan made

financial sense. We succeeded in placing legislative provisions forcing OPM to conduct a better cost-benefit analysis and requesting GAO to do a review of their analysis. Earlier this year, OPM complied and released an analysis completed by three Midwestern academics.

As the former chief internal auditor of the third largest city in my state, Erie, and with some small experience with privatization, I looked forward to the new analysis. I was ultimately disappointed, I had hoped that OPM would have produced a more serious review. But, as before, OPM's seemed less concerned about producing an accurate and real business plan and more interested in carrying out promptly an assignment outlined originally in Vice President Gore's National Performance Review.

As demonstrated by today's hearing, there are still too many questions about USIS's costs, its possession of sensitive information, and whether the American public will be better off after OFI has been "privatized". For the OFI employees in Northwestern Pennsylvania, I also am concerned what contingency plans exists should USIS fail.

Based on my experience and my concerns about the ESOP, I joined Rep. Tom Davis (R-VA) and became an original co-sponsor of HR 3189. This bill provides for a needed time out before OPM hastily and, most likely, irreversibly, dismantles OFI. OPM has embarked on course to a point unknown. I believe the taxpayers, and the OFI employees in my district, deserve a better destination.

Mr. HORN. We thank you. Let me just put in the record at this point a very fine statement that Senator Paul Simon has submitted. We'll put it in following your remarks here on this very issue. He has some very pertinent points here that we all need to discuss. And he does note here to everyone, to support H.R. 3189, your bill. So we thank him for that. And it will go in the record as if read.

[The prepared statement of Senator Paul Simon follows:]

United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, DC 20510-6275

Paul Simon
U.S. Senator

**STATEMENT OF SENATOR PAUL SIMON BEFORE THE HOUSE GOVERNMENT REFORM AND OVERSIGHT SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION AND TECHNOLOGY**

May 22, 1996

Mr. Chairman and Subcommittee Members:

I appreciate the opportunity to submit a written statement regarding the plan to privatize the Office of Federal Investigations (OFI) at the Office of Personnel Management (OPM), and I thank you for taking the time to conduct this important hearing.

For over forty years, OFI has been responsible for conducting background investigations for potential employees of various agencies within the federal government, including the Department of Energy, the Department of Justice and the Treasury Department. Overall, OFI conducts about 40% of all federal background investigations for positions ranging from bureaucratic responsibilities to high ranking jobs requiring substantial security clearances. In my view, shifting this responsibility to the private sector raises a host of extremely important questions which must be fully considered before the decision to privatize is made.

First, we must ensure that our national security is not in any way jeopardized by a move to privatization. Currently, OFI does background checks on individuals that will ultimately have access to top secret information, including weapons systems and nuclear energy data. We need to ask ourselves if we want a private investigator to be responsible for this sensitive task. If the answer is yes, certainly we need to carefully review the safeguards needed to ensure that our national interests remain secure.

The ability of private firms to maintain the privacy of sensitive records is another area that needs to be looked at closely. A private contractor would potentially have the ability to amass large quantities of information on government employees. We must ensure that privacy can be protected before we move forward with privatization.

We must also ensure that quality investigations will continue to be conducted. The federal government currently uses private investigators for a very small fraction of background checks. The only experience with private investigators on a large scale produced numerous investigations that were not up to standard, or, even in a fraction of cases, were falsified. This must not happen again. Again, while OPM is confident that quality will not suffer, I have yet to see enough evidence to convince me that quality can be maintained.

It is also important to ask ourselves if private investigators will be able to provide the best available information to government agencies. Will they have difficulty obtaining vital information from law enforcement officials? In a preliminary study, GAO determined that law enforcement officials may be reluctant to give out sensitive information to private investigators. In fact, of 12 states contacted by the GAO in March, 1996, six responded that they would not or could not provide data to private contractors. Certainly, this has the potential to present great problems. If private investigators will not necessarily be able to access all of the information they need, it will be very difficult for them to provide the federal government with complete, accurate and quality investigations.

I sent a letter to a number of federal agencies asking for their input on the effect of privatization. In response to my inquiry, I was told that privatization could cause disruptions to operations and that the quality of investigations could suffer. I urge my colleagues to think carefully about the negative impact that may be created by privatization.

I have asked the GAO, as part of their ongoing cost-benefit analysis, to address my concerns and report their findings to me as soon as they can. I have received preliminary drafts from the GAO indicating that many of my concerns indeed deserve further study. The GAO is in the process of finalizing their report, and I think, at the very least, that it would be prudent for OPM to delay privatization until the report is complete. If the GAO concludes that there are potential problems with privatization, we should fix them before we move forward in this important area. My comments are not meant to imply that private contractors cannot perform top quality investigations while also ensuring privacy and protecting our national security. It is certainly conceivable that they could. However, before this decision is made, we must be sure that adequate study of the potential impact has been completed and that sufficient safeguards are put in place. A move to complete privatization before this is done would not be wise.

In January, I introduced legislation (S. 1532) to prevent privatization from occurring for two years, during which time OFI would be prohibited from reducing its number of full-time employees. In addition, the bill would require OPM and the GAO to issue a comprehensive report detailing the likely effect of

privatization on all of the issues that I have addressed. My legislation is virtually identical to Representative Davis's bill (HR 3189) that the Committee is looking at today.

I urge all of you to support HR 3189. While I certainly support the goals of the Clinton Administration's National Performance Review, and applaud efforts to eliminate government waste, federal investigators employed by the government have served all of us extremely well, and we should proceed with great caution before changing this role. Again, I thank you for the opportunity to present my views on this important issue.

Mr. HORN. We do not have any other Members here, so I don't think there are any questions of you. You can join us as our guest up here. You're free to ask the rest of the witnesses questions. So we will now move to panel three, which is the distinguished Director of the Office of Personnel Management, Mr. James B. King. And he is accompanied by Mr. Richard A. Ferris, Associate Director, Investigations Service, and Ms. Lorraine Lewis, the general counsel of the Office of Personnel Management.

As you know, based on your testimony to different committees and subcommittees, we do have the tradition of swearing in all witnesses and all Members of Congress, to obviously tell the truth, or we don't listen to anyone.

[Witnesses sworn.]

Mr. HORN. The clerk will note that all three witnesses affirmed. Mr. King, please proceed.

**STATEMENT OF JAMES B. KING, DIRECTOR, OFFICE OF PERSONNEL MANAGEMENT, ACCOMPANIED BY RICHARD A. FERRIS, ASSOCIATE DIRECTOR, INVESTIGATIONS SERVICES, AND LORRAINE LEWIS, GENERAL COUNSEL**

Mr. KING. Mr. Chairman, I hope you'll excuse my slightly raspy voice. I'm not sure if it's the allergies or the tail end of some kind of a flu I've had for a couple of weeks.

Mr. HORN. I have the same thing. It could be all of the above. One of my classmates noted when we came here in 1992 that Washington has every tree in America. So you can't escape.

Mr. KING. Mr. Chairman and members of the subcommittee, thank you for this opportunity to discuss with you the privatization of OPM's Office of Federal Investigations, which is about to begin a new life as the U.S. Investigations Services, Inc. And this would be the first employee stock ownership plan, or ESOP, created by the Federal Government and its employees.

Because I have not appeared before your subcommittee before, let me tell you just very quickly a little about the Office of Personnel Management and its management approach. Our current budget request is a 27-percent reduction from our fiscal year 1993 S&E budget of $118,400,000. On a full-time equivalent employment for fiscal year 1997 will be 3,486, down more than 43 percent from the 6,208 FTE's when this administration took office.

And when I first met you, Mr. Chairman, I believe it was at one of our national public administration associations.

Mr. HORN. It was the National Academy of Public Administration.

Mr. KING. NAPA. And, Mr. Chairman, I think at that time, a number of people thought that this wouldn't happen and couldn't happen within a 3-year time period. And it's coming to pass, God willing.

The creation of U.S. Investigations Services, Inc., USIS, has been part of our effort to create a smaller agency. But we do so with the respect and concern for our employees. The issue today is whether the privatization of OPM's investigations unit should be delayed pending further study. As of today, 677 of those employees have accepted employment with USIS, and two have declined.

In other words, of those who have indicated a decision, more than 99.7 percent will join USIS. We have always known that these workers had the talent to make the ESOP work. Now, we know they have the will. And I am happy for them, and we believe that they deserve a chance to prove what they can do.

The creation of USIS is part of a historic downsizing of Government that President Clinton and the Congress mandated in the Workforce Reduction Act of 1994, which called, as you know, Mr. Chairman, for a reduction of the Federal work force by 272,900 positions. OPM and its predecessor, the Civil Service Commission, have carried out investigations for other agencies since the 1950's. We provide this service on a reimbursable basis operating with a revolving fund.

The unit is supposed to operate on a self-sufficient basis, but because of changing market conditions, over nearly a decade, it was never out of debt. Its accumulated deficit by the end of 1993 had reached nearly $24 million and was still climbing at that time.

When we learned these facts in December 1993, we had no choice but to issue RIF notices on March 1, 1994, that would eliminate about 443 jobs for investigators and support staff. This action was necessary to achieve a balance between current workload and staff resources and to stop the trend toward increasing deficits.

These reductions went into effect in 60 days. There were congressional hearings on that action at that time.

In December 1994, the President announced plans for the second phase of the reinvention of government, which included the privatization of our investigations unit. Privatization offered a fourth option in addition to attrition, buyouts, and reductions in forces, or RIF's, for reducing the Federal work force.

We at OPM set three criteria for the privatization of our investigations unit.

One, to continue to provide seamless high-quality service to our customers.

Two, to do what was best for the American taxpayer.

And, three, to do what was best for our employees.

These three criteria led us to consider an ESOP which would permit our employees to continue to do the work as part of an employee-owned nongovernmental organization.

We contracted with ESOP Advisors, Inc., for a study of the feasibility of such a plan. Their report, issued almost 14 months ago on March 31, 1995—do you see the chronology, Mr. Chairman? As we did the checkmarks, as we went down through this entire process over this time period. I bring your attention to that on your left, sir.

They concluded that the ESOP was feasible, but only if the new company was granted a sole source contract for no less than 3 years and if a substantial number of current employees elected to accept employment with the ESOP.

After an extensive review of the available options, and after frank but friendly discussions with our employees, who recommended that we proceed, our decision was that it was in the public interest to privatize the investigations unit by creating an Employee Stock Ownership Plan, or ESOP.

Mr. Chairman, I bring the committee's attention to the second and smaller paragraph. The privatization was announced by the President in 1994. We went to our group, as you could see. And we had two options. Employee owned in the privatization, which was the ESOP. Or work for another organization in the private sector. Those were the options after the decision was made to privatize.

So I don't want to mislead you, Mr. Chairman, nor the committee into having you think that any discussion after privatization discussion necessarily affected that decision. It was a question of how it would be done, not if privatization would be done. So that any discussion shouldn't in any way distort the employees voting or discussion that was clearly laid out before them, Mr. Chairman.

We believe that the new privatized organization, freed from some unnecessary restraints of Government operation, would be more able to respond to the changing market conditions. And, by the way, that was the critical issue historically.

In June 1995, OPM contracted with Marine Midland Bank to act as trustee to establish the ESOP. Marine Midland, working with American Capital Strategies, Inc., a capital investment company, and the respected Washington law firm of Arnold & Porter, carried out fair, face-to-face negotiations over a period of several months. On March 9 of this year, we notified the Congress that we intended to enter into a sole source contract with USIS after waiting the required 30 days.

We signed the contract with USIS on April 12. The new company will begin operations on July 7. It will continue to offer our customers the highest standards of quality and integrity. But we'll give them the seamless transition we sought, as did our customers and no disruption of service.

OPM will maintain a small staff, about 16 in Washington and at least 24 in Boyers, PA, to provide policy guidance, oversight, and contract management of USIS.

I might add, Mr. Chairman, that Boyers will be the headquarters of the new USIS corporation. Some 230 of the newly privatized employees will continue to work there, along with the new executives who will direct the corporation. So not one job was lost, and there will be additional jobs brought into the area, Mr. Chairman.

To meet privacy and security concerns, no information will be made available to USIS unless OPM is confident that access to that information is consistent with OPM's internal security requirements and the Privacy Act and other legal requirements and constraints.

Cases completed by USIS will be subject to the same type of review that we perform on investigations conducted by other agencies' personnel or by private contractors.

Last November, we commissioned a cost-benefit study to provide an independent assessment of the benefits and costs of the ESOP plan. Among other conclusions, the contractor, Kormendi/Gardner Partners, estimated savings of at least $20 to $25 million over the first 5 years of the ESOP's operations.

These savings are anticipated in three main areas.

One, savings realized as USIS achieves operating efficiencies, which should allow OPM to charge lower prices to Government agencies for investigation services.

Two, by substantial reductions in the Government's pension liabilities.

And, three, because USIS will pay taxes to the Federal Government on its earnings.

Concerns have been raised as to whether States could release information to USIS as a contractor. We do not expect this to be a problem, Mr. Chairman. It will be OPM that is requesting the records through its contractor. And State and local and criminal justice agencies are legally obligated to comply with such requests by OPM for purposes of determining eligibility for access to classified information or assignment or retention in sensitive national security duties.

Mr. Chairman, some members of our investigation staff are resisting this decision to privatize and hoped it would be reversed. But I believe that insofar as they accept the fact of privatization, they realize that the ESOP is the best option for everyone involved in this effort. The fact that more than 99 percent of those who have thus far responded to the request are accepting jobs at USIS truly suggests that they share that view, also. These employees will continue doing the same work at the same or better pay and benefits. They will own the company and share in whatever successes it achieves. They will also share in the risks, of course.

But we believe their prospects for success are extremely good. They have the benefit of the sole source contract that was recommended to us by ESOP Advisors, Inc., 14 months ago and the opportunity to expand to non-Federal markets previously denied to them. Mr. Chairman, that, too, is a critical factor.

We consider this a highly satisfactory arrangement. Certainly some critics have complained and will continue to complain that our actions have been too generous. In fact, this ground-breaking privatization not only reflects our determination to deal fairly with our employees, it will save the taxpayers millions of dollars and is clearly in the public interest.

USIS is a bold experiment that not only serves our employees, our customers, and the taxpayers, but is moving us toward a smaller, flatter, more efficient and market-driven Government of the future. We really truly urge your support and the committee's support for this historic venture.

I thank you, Mr. Chairman. My colleagues and I will be glad to take your questions. Mr. Ferris, who is at my left, is the Acting Associate Director for Investigations at OPM. To my right is our general counsel, Lorraine Lewis. Mr. Chairman, if there are any questions you would like to ask, we'll be glad to respond.

[The prepared statement of Mr. King follows:]

STATEMENT OF
JAMES B. KING, DIRECTOR
OFFICE OF PERSONNEL MANAGEMENT

before the

HOUSE SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION AND TECHNOLOGY

on

H.R. 3189, A BILL TO DELAY
THE PRIVATIZATION OF OPM INVESTIGATIONS

Mr. Chairman and members of the subcommittee.

Thank you for this opportunity to discuss with you the privatization of OPM's Office of Federal Investigations, which is about to begin a new life as US Investigations Services, Inc., the first Employee Stock Ownership Plan, or ESOP, created by the federal government.

The immediate question is whether this action should be delayed pending further study.

I strongly advise against such delay. There has been a great deal of study and the program is ready to start operations and to demonstrate what it can do.

Let me note one recent development. Early this month about 720 members of our investigations staff received job offers from USIS, at salary and benefits similar to what they had received in government, and were asked to respond by last Friday, the 17th of May.

Thus far, 674 of those employees have accepted employment with USIS and only two have declined. In other words, of those who have indicated their preference, more than 99.7% will join USIS.

We have always known that these workers had the talent to make the ESOP work. Now we know that they have the will. I am happy for them and I believe they deserve a chance to prove what they can do.

The creation of USIS is part of the historic downsizing of government that President Clinton and Congress mandated in the Workforce Reduction Act of 1994, which called for a reduction of the federal workforce by 272,900 positions.

OPM and its predecessor, the Civil Service Commission, have carried out investigations for other agencies since the 1950s. We provide this service on a reimbursable basis, operating with a revolving fund.

The unit is supposed to operate on a self-sufficient basis, but because of changing market conditions, over nearly a decade, it was never out of debt and accumulated a deficit that, by the end of FY 1993, had reached $24 million and was still climbing.

When I learned these facts, in December of 1993, I had no choice but to issue RIF notices on March 1, 1994, that would eliminate about 443 jobs for investigators and support staff -- in order to achieve a balance between current workload and staff resources and to step the trend toward increasing deficits.

These reductions went into effect in 60 days. There were Congressional briefings and hearings on the action at that time.

In December of 1994, the President announced plans for the second phase of the reinvention of government, which included the privatization of our Investigations unit.

Privatization offered a fourth option, in addition to attrition, buyouts, and reductions in force, or RIFs, for reducing the federal workforce.

We at OPM set three criteria for the privatization of our Investigations unit.

-- To continue to provide high-quality service to our customers;

-- To do what was best for the American taxpayer; and

-- To do what was best for our employees.

These criteria led us to consider an ESOP, which could permit our employees to continue to do the work as part of an employee-owned, non-governmental organization.

We contracted with ESOP Advisors, Inc., for a study of the feasibility of such a plan. Their report, issued on March 31, 1995, concluded that the ESOP was feasible, but only if the new company was granted a sole-source contract for no less than three years, and if a substantial number of current employees elected to accept employment with the ESOP.

After an extensive review of the available options, and after frank discussions with our employees, who recommended that we proceed, our decision was that it was in the public interest to privatize the Investigations unit by creating an Employee Stock Ownership Plan, or ESOP.

We believe that the new, privatized organization, freed from some of the necessary restraints of a government operation, would be more able to respond to changing market conditions.

In June of 1995, OPM contracted with Marine Midland Bank to act as trustee to establish the ESOP. Midland Marine, working along with American Capital Strategies, Inc., a capital investment company, and the respected Washington law firm Arnold and Porter, carried out fair, face-to-face negotiations, over a period of several months, that led to the contract that was eventually signed between OPM and USIS.

The new company, USIS, will begin operations on July 7.

It will continue to offer our customers the highest standards of quality and integrity, and will give them the seamless transition we sought, with no confusion or disruption of service.

OPM will maintain a small staff -- about 16 in Washington and at least 24 in Boyers, Pennsylvania -- to provide policy guidance, oversight and contract management of USIS.

To meet privacy and security concerns, no information will be made available to USIS unless OPM is confident that access to that information is consistent with OPM's internal security requirements and Privacy Act and other legal constraints.

Cases completed by USIS will be subject to the same type of review we perform on investigations conducted by other agencies' personnel or by private contractors.

Last November we commissioned a cost-benefit study to provide an independent assessment of the benefits and costs of the ESOP plan. Among other conclusions, the contractor, Kormendi/Gardner Partners, estimated savings of at least $20 to $25 million over the first five years of the ESOP's operation.

These saving are anticipated in three main areas:

-- In savings realized as USIS achieves operating efficiencies and can charge lower prices to government agencies for investigations services;

-- By substantial reductions in the government's pension liabilities; and

-- Because USIS will pay taxes to the federal government on its earnings.

Mr. Chairman, I am aware that some members of our Investigations staff resisted the decision to privatize and hoped it would be reversed.

But I believe that, insofar as they accept the fact of privatization, they realize that the ESOP is the best option for everyone involved in this effort.

The fact that more than 99% of those who have thus far responded are accepting jobs with USIS, suggests that they do share that view.

The employees will continue doing the same work, at the same or better pay and benefits. They will own the company and share in whatever success it achieves -- and we believe their prospects for success are extremely good. They have the benefit of the sole-source contract that was recommended to us by ESOP Advisors, Inc., fourteen months ago, and the opportunity to expand their business to non-federal markets previously denied them.

We consider this a highly satisfactory arrangement. Certainly some critics have complained -- and will continue to complain -- that our actions have been too generous.

And yet this ground-breaking privatization not only reflects our determination to deal fairly with our employees, it will save the taxpayers millions of dollars, and is clearly in the public interest.

Mr. Chairman, a great deal of thought and work have gone into this new employee-owned corporation. It is a bold experiment that not only serves our employees, our customers, and the taxpayers, but is moving us toward the smaller, flatter, more efficient, more market-driven government of the future.

Thank you.

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Mr. HORN. Let me start in with a few. You just mentioned there are savings. Where are those savings coming from?

Mr. FERRIS. The cost-benefit study done by Kormendi/Gardner identified savings in three areas. One, the reduction in prices to OPM's customers. Two, the savings realized through not having to pay the number of pensions for as long. And three, taxes that the new company would have to pay.

Mr. HORN. The company is going to pay taxes. And you say that the cost of investigation to the agency will go down?

Mr. FERRIS. Yes, sir.

Mr. HORN. There has been a reimbursement policy under the old system?

Mr. FERRIS. We operate under a revolving fund, yes, sir.

Mr. HORN. What generally have been those costs? How have they been figured?

Mr. FERRIS. The revolving fund is a fund that has to break even by law. So we cannot make excessive profits or we cannot lose money. So typically, we try to shoot for a break-even approach on that.

Mr. HORN. Well, give me an idea of the fees. What have they been charging the agency for an investigation and clearance of one of its personnel? Is that time or is it an average of what your total costs are? Do you pick a figure, in other words, regardless of whether it takes 5 hours or 25 hours to investigate?

Mr. FERRIS. We have a wide variety of products.

Mr. KING. Mr. Chairman, if you would like, we can answer the most expensive to the least expensive.

Mr. HORN. Sure.

Mr. KING. It's a wide range of products that we would be glad to give to the committee.

Mr. HORN. Sure.

Mr. KING. What's the most expensive? That would be your top secret clearance.

Mr. FERRIS. Three thousand nine hundred and ninety-five dollars.

Mr. HORN. What was that again?

Mr. FERRIS. Thirty-nine ninety-five.

Mr. HORN. Thirty-nine ninety-five, like Sears Roebuck. I notice here the staff has OPM charges $4,200 for a single scope background check, twice what private industry would charge for Federal agencies.

Mr. FERRIS. I believe our top price is $3,995.

Mr. HORN. At the current time?

Mr. FERRIS. Yes, sir.

Mr. HORN. So the savings are partly then in the price to the agencies. Where are you getting the savings? Usually they're in labor intensive areas, which the investigation services is or any civil service agency I can think of. It's labor intensive. And that means you're talking what you pay the workers, what are the pensions, what are the benefits, et cetera. Was there a study by some neutral consultants as to what the situation was as it was previously administered in a more traditional civil service way even though it had a revolving fund and it could bill back the charges

and you had to break even versus going into privatization? Was there such a study?

Mr. FERRIS. The study that was done was based on OPM's current operating conditions and prices.

Mr. HORN. Was there any projections made by the consultant? Who was the consultant, by the way?

Mr. FERRIS. Kormendi/Gardner Partners.

Mr. HORN. Could we spell that for the court reporter?

Mr. FERRIS. K-o-r-m-e-n-d-i, slash, G-a-r-d-n-e-r.

Mr. HORN. They looked at what you were doing now or previously under the system. Then, did they get into what privatization would mean as an option?

Ms. LEWIS. Yes, sir, they did. They looked at the costs and the expenditures under the current system, the civil service system. And they compared it to the costs and the expenditures that will be projected in the contract, the contract that OPM has awarded to USIS. So it was a direct comparison of costs under the current system to costs under the contract. And there were three different estimates made.

The most conservative estimate over the 5-year period, as I think one of the items on the chart reflects, is the $20 to $25 million in savings.

The GAO draft report, that has been prepared that OPM is in the process of responding to, ultimately makes as a final statement, this statement. GAO says, we have no reason to question the Kormendi/Gardner's cost study's general conclusion that privatization would be likely to produce a net savings to the Government in the long term.

So, ultimately, Kormendi/Gardner has found savings; GAO has found savings. There may be some differing agreements as experts can disagree, as to the costs and how costs are spread as cost savings to the taxpayer.

Mr. HORN. Did they in the consultant report have charts and tables that related to, one, the costs under the old system; two, projected costs under the new system, the ESOP; and, what those savings would be? Can I find it in that study? Does staff have it, No. 1? Let's submit the study to the staff.

What I'd like are the relevant pages put at this point in the record, which relate to the question I asked, which is, where are the savings coming from? As I say, in a labor-intensive group, you're talking direct labor cost, you're talking benefit costs. And I just want to see when you say we're going to get savings under this system, are we taking it from the benefits? Are we taking it from the direct labor costs? Are we simply taking it from getting rid of all of the administrators that aren't doing anything?

Mr. KING. There is a combination, and we'd be glad to supply that to you, where it's broken out by figures. I'd like to make sure they're precise.

Mr. HORN. Very good. Let me now yield 5 minutes to the gentlewoman from New York, Mrs. Maloney, the ranking minority member.

Mrs. MALONEY. Would you clarify the $25 million in savings that you were talking about?

Mr. KING. Yes; It came in three areas.

Mr. FERRIS. The $20 to $25 million was ranged and it characterized it as reasonable. One was a reduction in prices OPM charged to its customer agencies. Two was the savings to the pension plan by taking 690 people out of it. And third was taxes that the company would pay.

Mr. KING. By the way, in the plan, also, I should tell you some of the things that weren't there. We took the most conservative figures we could take. For example, by making this kind of a transfer, we didn't cost in the avoidance of unemployment costs and other ancillary costs of that nature. But we will get to you with what we did use, which, as I say, is extremely conservative.

As I say, the folks who have reviewed it—GAO has reviewed it and others have—they generally agreed that it is correct. It is the way they project it and sometimes the way they post it. But we'll share it and give the committee all of the numbers.

Mrs. MALONEY. Some people have suggested that the Investigations Service is inherently a government function. Do you agree with that? If not, explain to us why you do not.

Mr. KING. Could I ask general counsel?

Ms. LEWIS. Yes, Mrs. Maloney. Circular A–76, OMB circular, sets out the criteria for what is inherently a governmental function. We have examined this function, the different pieces of the Investigations function, and determined that the fact finding, the fact gathering function, which is what the investigators do in large part out in the field, that that is not an inherently governmental function. In fact, that's been borne out at a minimum for the last 10 years.

We have agencies like the FBI, the National Security Agency, the DEA, the INS, all using contractor employees to perform the fact-finding function.

There are other functions that are a part of this Investigations Service that are inherently governmental. Certainly any agency's actual adjudication of whether someone is suitable for Government employment or is eligible for a security clearance—and that is an inherently governmental decision and must be made by a Federal employee. But the basic function here that is represented by the contract with USIS is the fact gathering, fact finding that will be put together so that OPM and the agency can afford it.

Mrs. MALONEY. So it's fact finding and not decisionmaking.

Mr. KING. That's correct.

Mrs. MALONEY. There have been questions raised about the ability of contractor personnel to obtain the certain law enforcement record information from State and local agencies, as well as from some Federal agencies like the FBI. If that is the case, won't that limit the adequacy of the contractor reports? Is there any truth to that statement?

Mr. FERRIS. One of the conditions, if I can call it that, that was put on this when it first started came from Justice. And they said, if this is going forward, OPM would be required to maintain a shell or a cadre of people to deal specifically with the FBI. At the present time, OPM sends tapes to the FBI, which they've run to give us our fingerprint search results. That would not be discontinued in this plan. OPM would still send those tapes and still receive the results.

We've had ongoing discussions with the Bureau. And to this point, they've been in agreement with the process that we've set up and will continue to cooperate with us.

Mr. KING. And it maintains the integrity of the entire process, which I believe is the basis of your question. And I don't mean to second guess you.

Mrs. MALONEY. And there isn't any trouble in getting the record information from State and local agencies?

Mr. KING. There hasn't been any yet, has there?

Mr. FERRIS. We believe that we're going to be able to do that, that the USIS will be able to do that. There is a statute which says that State and local governments have to give OPM law enforcement information that's to be used in the determination of a security clearance or access to classified information.

Ms. LEWIS. Mrs. Maloney, if I may add, as I said, in the last decade of history of contractor operations, working for the Federal Government, looking to State and local government for information, we are unaware of any problem. This question has been—I respectfully submit, this is a red herring. This question has been out there.

We have talked to other agencies that use contractor employees. Their contractors don't have a problem. If there is any issue that comes up with regard to any individual State, you can bet you OPM would be immediately on the phone to talk to the appropriate supervisor in the State and local government, or whomever, to get the matter resolved.

Mrs. MALONEY. I understand that the contract with USIS allows them to use information developed under the work they do for OPM in their non-Federal work. Can you please explain this arrangement? Is this typical of contracts that other agencies have with the private sector investigation services?

Mr. KING. They will be allowed to use the information that we gather, that is gathered for OPM subject to some very strong strictures and subject to consent or a waiver on the part of the subjects of investigation.

Mrs. MALONEY. I understand that the Investigations Service has eliminated the deficit and is now operating in the black. Is that true?

Mr. KING. As of March 30, which will be, as you know, the halfway point in the fiscal year, we were still $300,000 in debt. But we have recovered substantially from the $37 million that we were in the hole 2 years ago.

Mrs. MALONEY. Some people have raised with the minority staff that private sector push for profit results in cutting corners and inadequate investigations. In overseeing the OPM delegation of investigations, have you seen any indication of this?

Mr. FERRIS. Are you talking about the contract with USIS and what we're going to hold them accountable for?

Mrs. MALONEY. Yes.

Mr. FERRIS. Incorporated in the contract by reference is the OPM investigator's handbook or manual, which has the standards under which current OPM investigators operate. Also in the contract, USIS will be held accountable to the very same quality standards that OPM has today for its employees.

Mr. KING. Could I respond to your previous question which you asked if it's operating, I think the logical extension of that is: Well, if it's operating, if you would, in the black or moving in that direction, isn't that a healthy thing and why would you change it? This is similar to having your office on a flood plain. Every time the water goes up, we get wiped out.

Because of the restrictions that we have within Government and we're set up to operate as a business, if you think of us as an accordion that should expand and contract and be driven by market forces, we are incapable of responding in a timely fashion to market forces as quickly as they occur. Therefore, we have the valleys and the peaks. We can't respond to good news any better than we can respond to bad news. Whereas, in a business opportunity, you'll expand rapidly and contract.

That is not the design, as you know, of our system. So everything is geared as response to the market when, point in fact, we cannot respond to the market. And that would give the opportunity. And that's why the ESOP is so attractive at this moment. We have a functioning unit. It is trained and capable. And it can go out there and expand and contract and be the senior people in there. So if there is any contraction, this group isn't affected.

Mrs. MALONEY. Thank you very much. I have no further questions.

Mr. HORN. Mr. Davis.

Mr. DAVIS. I have an opening statement. I would ask unanimous consent that it be put in the record.

Mr. HORN. Without objection.

[The prepared statement of Hon. Thomas M. Davis follows:]

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11TH DISTRICT, VIRGINIA

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# STATEMENT OF CONGRESSMAN TOM DAVIS REGARDING H.R. 3189 -- A BILL TO ALLOW FOR APPROPRIATE GAO REVIEW OF THE PROPOSED PRIVATIZATION OF THE OFFICE OF FEDERAL INVESTIGATIONS

Wednesday, May 22, 1996
1:30 pm 2154 Rayburn HOB

I would like to thank Chairman Horn for holding this hearing and giving all of us an opportunity to review H.R. 3189, a bill I am sponsoring that would delay the privatization of the Office of Federal Investigations (OFI) of the Office of Personnel Management (OPM). Let me begin by emphasizing that this bill enjoys bipartisan support in the House and a companion bill was sponsored by Senator Simon (D - IL) in the other body. This hearing is not about partisanship or Administration-bashing, rather, we are here today to openly discuss and review a proposal that has raised concerns across party lines and in both the private and public sectors. I value my working relationship with OPM and look forward to continuing to work with the Administration in the same results-oriented, good government manner that has characterized our work together on successful initiatives ranging from procurement reform to the Unfunded Mandates Reform Act.

As most of us here today are well aware, the OFI is responsible for performing background checks on Federal employees and applicants. Federal agencies granting security

clearances must comply with the same security standards for background investigations, which are overseen by the Information Security Oversight Office (ISOO), within the Executive Office of the President. All background checks that are in compliance with these requirements are subject to OPM's authority. To conduct these investigations, agencies can currently either use OPM investigators, or can employ a private sector contractor after obtaining delegation authority from OPM.

I am surprised that the Subcommittee on Government Management, Information, and Technology has not been consulted by OPM on their privatization plans. This subject directly relates to the jurisdiction of this subcommittee, which includes all proposals to reorganize the executive branch, financial management issues, and procurement policy. Clearly, the Administration's proposal to transfer a major federal function to the private sector via a controversial sole-source contract falls squarely within the jurisdiction of this subcommittee.

While I applaud the Administration's willingness to review various federal functions for potential cost savings, I have several concerns about this particular proposal. I have heard from private industry and individuals about potential abuses of the procurement system and from federal workers concerned about the impact on their positions. Questions raised include: 1) the potential costs of outsourcing this important function; 2) the security and privacy of background checks for Federal employees; and 3) the granting of a sole-source contract to the newly created private entity for the first five years of its existence.

I have met with OPM officials and visited the large Office of Federal Investigations facility

in Annandale, Virginia in an effort to resolve my many concerns before introducing this legislation and calling for this hearing. Unfortunately, my inquiries have raised far more troubling questions than comforting answers. Let me briefly summarize OPM's previous responses to these questions:

- First, OPM has repeatedly emphasized that this proposal enjoys the widespread support of the current OFI employees. When I asked for a show of hands at a meeting with approximately 40 OFI employees, only two employees expressed support for the proposal -- and this support was premised on the belief that the privatization was a "done deal" and that it was time for them to make the best of a tough situation. The overwhelming majority expressed strong objections to the proposal and raised a variety of specific policy and personal reasons for opposing the plan. When I made inquiries in an effort to reconcile this overwhelming employee opposition, on the one hand, with OPM's public position, on the other, that the employees support the proposal, I learned that OPM was relying on a remarkable questionnaire. This questionnaire apparently posed all OFI employees with the following question: would you prefer to see OFI privatized with no job security for current employees or would you prefer that the privatization occur using the Employee Stock Ownership Plan (ESOP) approach combined with job security for all current employees? When the vast majority of respondents indicated a preference for job security, OPM announced that this represented overwhelming support for the privatization.
- OPM has also argued that it is simply too late for any change in this proposal to occur. Reduction- In-Force notices have gone out to employees and complex contracts have been signed -- in effect, the train has left the station. I disagree. I believe that the integrity of

our civil service and of our federal procurement process is too important to yield to an arbitrary schedule that was never provided to this subcommittee for appropriate review and comment.

Finally, OPM has argued that if this experiment fails they are ready to pull out of the contract and return this function back to the federal government. I am not satisfied with this proposed safety valve. First, if this proposal fails, our federal workforce will likely be tainted by the presence of unqualified individuals hired without adequate background investigation. We may never be able to get a handle on that problem and it is difficult to quantify the costs of numerous unqualified individuals -- many perhaps with criminal records or other identifiable character flaws -- who are allowed to enter federal service. In addition, if this proposal fails due to a lack of proper planning by the Administration or due to a lack of time for Congress and the GAO to conduct proper oversight, then it will inevitably have a negative effect on all other privatization proposals. I believe that privatization may be an effective tool to implement when appropriate -- that is, when it does not involve an inherently governmental function and when it can be shown to provide improved service to the taxpaying public at a lower cost. As the subcommittee with primary jurisdiction over most privatization proposals, we have an obligation to see that a valuable management tool not be needlessly tainted by hasty executive branch action. I believe that we should take every possible step to avoid rolling the dice when the integrity of the federal workforce is at stake.

Now, allow me to briefly summarize my bill. H.R. 3189 would simply delay the privatization of the OFI for two years, and require that two reports be produced analyzing the

proposal in the intervening period. The two reports would be compiled by OPM and the General Accounting Office (GAO). This delay would allow for a thorough study of the potential impact of this proposal on federal employees and private contractors.

I am pleased that this subcommittee has committed itself to hearing from experts in government and the private sector about privatizing OFI. I am confident that this hearing will produce an open and frank discussion of the merits of delaying this proposal.

Again, I would like to thank Chairman Horn for holding this hearing on this important topic.

Mr. DAVIS. It's fairly lengthy, but I want to get right to the questions. Let me just ask you of this accordion syndrome, does this mean that after this is privatized the first year, the employees could be laid off and expand and contract?

Mr. KING. No, because we have a barebones operation right now. We're dealing with the smallest number of people that have come into Government in recent history, as far as actual background clearances. And they have that contract and they're operating well.

Mr. DAVIS. So you're not overstaffed right now.

Mr. KING. No, not right now. But they will have an opportunity, a marketing opportunity, because right now they're restricted by law.

Mr. DAVIS. But if you're not overstaffed right now and you want to privatize this sector——

Mr. KING. Or we can wait for the flood and then back here and I'll be chastised for running us into bankruptcy. I came within a hair's breadth of going into antideficiency which is, as you know, a criminal act. And it was because we couldn't respond to the market. We had all of the folks on it and we couldn't make the appropriate moves.

Mr. DAVIS. But you can always privatize parts of what's going on without affecting the current workers, couldn't you?

Mr. KING. Presently, so we're talking about contracting out?

Mr. DAVIS. Sure.

Mr. KING. You can contract out.

Mr. DAVIS. Well, that would solve it real quick, wouldn't it? You keep the current employees. They stay there. And if the workload expands, couldn't you go out and contract it?

Mr. KING. Again, one of the things we looked at, our commitment, is this intrinsically Government working? Can we make our Government smaller, more effective, and more responsive to the public? We can't under the present structure. We can under an ESOP and meet the needs of our employees.

How do we put a human face on reengineering and downsizing?

Mr. DAVIS. Where else does the ESOP work? Where else in the Government have you done this?

Mr. KING. This would be the first one, sir.

Mr. DAVIS. So we aren't sure if it works or doesn't work, are we?

Mr. KING. Well, you know it will work because there are 10,000 of them out there in the private sector, but there is something else, also. One of the difficulties is that we are being watched by virtually every Government agency. There is the walk that we've taken that we've recorded. It is not a walk that most agencies would like to make. It's been expensive. It's been bone grinding. It's been one particular study after another and discussion.

By the way, it's been worth every step, sir.

Mr. DAVIS. You want to know what I think is driving this? First of all, the office isn't in disrepair, is it?

Mr. KING. Pardon me?

Mr. DAVIS. The current office is working fine, isn't it?

Mr. KING. It is working in the flood plain at this moment; yes.

Mr. DAVIS. Any major cost overruns right now? Is it losing money for you?

Mr. KING. No, we are managing it.

Mr. DAVIS. Is it well managed?

Mr. KING. I believe it is.

Mr. DAVIS. It's not broken now, is it?

Mr. KING. It will be.

Mr. DAVIS. Why?

Mr. KING. Because the first time we get flooded, we're going under. We know that. That's what's been the cycle. And this organization has not been able to deal with expansion or contraction. The nature of the business doesn't let that happen, Congressman. I wish it did. Flexibility is not one of the strengths of civil service, sir. It is rigid.

Mr. DAVIS. Well, it just seems to me, it's not losing money, it's not in disrepair. There are no cost overruns. If you have an additional workload, you're at flood plain, which means it's not going to go any lower at this point.

Mr. KING. It shouldn't, sir.

Mr. DAVIS. So you're not facing layoffs in the future with current workers. What we're talking about is how you handle the increase. You have to staff up for that increase.

Mr. KING. That's correct.

Mr. DAVIS. Or you could, in fact, privatize part of that increase on an incremental basis for some of these areas and go out to the private sector and let them compete. But at least the existing employees, it doesn't sound like there is any need to let them go. That's what I'm hearing. I mean, where's the flood?

Mr. KING. I think in this, Congressman, to be candid, in the ideological terms of this, I am committed to working toward a smaller Government, a more effective Government, and a market-driven response to it. What I'm looking for is a system, again with a human face, that deals with the realities of downsizing of Government. And, by the way, our agency has lived with it. That's why, Mr. Chairman, in my opening statement, I commented that we will be 45 percent smaller than we were 3 years ago. We've lived with freezes, attrition, buyouts, and RIF's.

What we'd like to do is to give people an opportunity to go outside of Government and to prosper. This is a golden opportunity. This is truly the human face and a human dimension on what the future is going to be as we downsize Government if we're decent about it.

There is no question that right at this moment the organization is well managed, Congressman. I'm not debating that. We know, though, from past history and the cycles we've been through, that we will not be able to respond and the difficulties will return. And is there a better way to manage it? The answer is, yes, sir.

Mr. DAVIS. Let me say something, first of all, because I have a great respect for you. I'm sorry I didn't read my opening statement, because, frankly, I want to look forward to working with you on a number of other issues. So I understand.

Mr. KING. You've been wonderful and you know it, sir.

Mr. DAVIS. I just want to make that clear. I've met with some of the employees. Some of them live out in the northern Virginia area. Mr. Moran, Mr. Wolfe, and I have. But I've really looked at this.

I was in the private sector for 15 years prior to coming to Government for a contractor. We did a lot of work. And as the head of the county government in Fairfax, we made some mistakes when we overprivatized, trying to see these things. And we had egg in our face.

All we're asking here is this subcommittee has not been part of these deliberations prior to this. We have been completely circumvented. We are very interested in privatization. What legislation calls for is, frankly, more study so that all of us can be maybe as comfortable with this as you are before we proceed.

I've got a few other questions I want to get through. What is going to prevent agencies from hiring their own Federal employees to perform background checks? Is there a limitation?

Mr. KING. Again, I think on the combination of the law, where 40 percent of our business is with the Department of Energy. And that's required by legislation to use OPM.

Ms. LEWIS. Yes. Under several Executive orders, OPM and previously the Civil Service Commission are responsible in Government to oversee a great bulk, about 40 percent, of the Government's background investigations. We do have certain agencies for many years who have requested delegations, who have been granted those delegations. Some of those do their own background investigations. Others contract.

Mr. DAVIS. Let me ask this question. Are you aware of any agencies or senior agency officials who have raised any concerns about using a private firm with this ESOP spinoff to perform background checks?

Mr. KING. Initially, yes.

Mr. DAVIS. Could you provide us with copies of any documents that would reflect those concerns?

Mr. KING. Yes; but I also think that the early documents and the later ones right now, we have an agreement. I can't think of any agency we don't have agreement with.

Mr. DAVIS. But the question is, how long does the agreement last? You may be able to persuade them right now to put the happy face on it.

Mr. KING. We're facing 3 years with a contract, as you know, for the launching and the catapulting, if you will, off our deck. It's an organization that we believe will fly. Then we will both have some experience in handling this. And that will go into the regular bidding procedure after the third year.

Mr. DAVIS. Are you familiar or anybody up there—I don't know if you would be, Mr. King. Are you familiar with the various State and local regulations, fees, licenses, and permits governing private sector investigative firms? Do you know if the new entity, U.S. Investigations, plans on meeting the Commonwealth of Virginia licensing requirements?

Mr. FERRIS. USIS has copies of all of the State requirements. They are working the issue. My expectation is that they will do whatever they need to do to be legally operable.

Mr. DAVIS. You haven't done it, but you think you can handle it?

Mr. FERRIS. Pardon me?

Mr. DAVIS. You haven't done it, but you think you can handle it? You think you can handle these requirements?

Mr. FERRIS. Yes, we think they can.

Mr. DAVIS. What's the value of the equipment, the trained personnel, the exclusive nature of the contract that's being given to this new private firm? If the firm fails, who pays and how is the taxpayer protected?

Mr. KING. The contracts are basically a piecework contract arrangement. It's at this time valued at about $53 million annually, am I not correct?

Mr. FERRIS. That's correct.

Mr. KING. But it's based on piecework. As you produce a case, you get paid.

Mr. DAVIS. But doesn't equipment get conveyed with this?

Mr. FERRIS. That's correct, Government-furnished equipment.

Mr. DAVIS. Which usually doesn't happen when you contract.

Mr. KING. We're leasing it, so that we'll recover it. The appraised value of the equipment and the street value, as you know, are two widely different things. We've all been at Goodwill where we made out what we thought the value of the jacket we donated was for IRS and what we would have gotten in a lawn sale. It's very, very different.

And in this particular case, we're working on a lease arrangement, where we recover 100 percent, virtually 100 percent or all of it.

Mr. FERRIS. OPM is going to recover 100 percent of its cost.

Ms. LEWIS. Yes, sir, and Congressman Davis, Government-furnished equipment is indeed a very common aspect certainly to large government contracts.

Mr. DAVIS. These GSA schedules.

Ms. LEWIS. And the contracting laws permit that.

Mr. DAVIS. Thinking about all of the functions that the Federal Government, ranging from national defense, border patrol, law enforcement, to market promotion overseas, sugar subsidy, tobacco crop insurance subsidies, property and equipment lease management, the wide range of functions conducted by the Federal Government—I know you addressed this issue earlier. Would you classify the background investigation of Federal workers as inherently governmental or not inherently governmental, or somewhere in between?

Mr. KING. I believe that the particular area that we're talking about can be nongovernmental.

Mr. DAVIS. It can be. Could it also be governmental? I mean, is this an in-between area?

Ms. LEWIS. No; it is not.

Mr. KING. By the way, not in my mind at this moment with the work we do, sir.

Mr. DAVIS. Can you shed some light on the various private consultants that work on this privatization proposal, what their role was, how much they charge for their services, what will be their ongoing involvement in the enterprise? If you could specify maybe the address the role of the two firms, Arnold and Porter and Marine Midland Bank? And if you don't have that, you can get it for the record. And will Marine Midland continue to be actively involved in the management of the new entity?

Ms. LEWIS. I think we could certainly provide all of that for the record. The trustee contract was awarded to the Marine Midland Bank, who utilized the two entities, Arnold and Porter, the law firm, and American Capital Strategies, to assist in carrying out their fiduciary duty to represent the OPM employees in this process. And that was basically completed. Their work was completed with the contract award.

It's my understanding that the company, U.S. Investigations Service, is looking to Marine Midland to perform the trustee function for the ESOP.

Mr. DAVIS. Would that be competitively bid? Or is that just kind of a deal that goes along with it?

Ms. LEWIS. That would be a process that is arranged in the private sector. So the rules of competition do apply to Government entities, but the private sector may choose to do it differently.

Mr. DAVIS. But they've been set up here because they were involved in getting this thing set up, so they would probably be handed the ball?

Ms. LEWIS. That would be up to the USIS to make that decision.

Mr. DAVIS. Did you check all of the consultants for a conflict of interest in a national security perspective that worked on this? Any checks on that?

Ms. LEWIS. We are not aware that there were any issues that came up.

Mr. DAVIS. That's all I wanted to know.

Mr. FERRIS. If I might, sir, there are some folks working on behalf of the company now in our Boyers, PA, facility that are preparing to install cabling and software systems and the like for the new company. We are doing investigations on those people.

Mr. DAVIS. Thank you. How do you propose to conduct performance evaluations to ensure that the high standards are maintained in the background investigations process?

Mr. FERRIS. The contract holds the company accountable for the same quality standards that OPM has at the present. There were two ways it would monitor that. One would be a review of a portion of USIS cases to make sure that they meet OPM standards.

Second, USIS will be required under the contract to send out forms to witnesses who have been contacted by USIS investigators. These are the forms we use now to check on our own people. They would ask the subject or the witness questions such as, did the investigator present his or her credential? Was there any significant derogatory information discussed? So on and so forth. Those will be returned to OPM.

Mr. DAVIS. I guess the thing that concerns me on this is, what's driving this whole process? Why in the world would a group that has traditionally been very good with Federal employees all of a sudden come up with this proposal? And I'm driven by the fact that everybody is trying to get their FTE rates down. And somehow there is no real savings here, certainly not over the first year, according to GAO. And over the long haul, I've got some questions that in the analysis lead me to wonder if there is any savings at all. And I'll get to those questions in a minute.

But the fact that there is an effort to reduce FTE's so that political leaders across the political spectrum can go out and say, look

at the number of Federal employees. Is that driving this thing? Is there any part of that? There is also, of course, you're always constantly encouraged to reinvent Government and to try new strategies. And there is nothing wrong with that. But in this particular case, where you have a group that seems to be doing a good job and aren't losing any money.

Mr. KING. Congressman, it's a very good question. We took over an organization that was bankrupt. It was on its backside. It had been there for years. We've restored it to health. We went through—well, I won't even go through what we went through to get there. I would not wish that on any other director. And I wouldn't wish it on the people who were there and had to live through it.

The problem is it's systemic. We cannot respond to the market place in an appropriate, professional, and businesslike fashion. This will protect our employees. It will give them the kind of stability and security they're not going to have otherwise. But it is in the taxpayers' interest, because it is going to save money.

By the way, no one, but no one—GAO, the independent folks have done it, very conservative figures—disagree it will save money. The discussion can be, how much. But the question is not whether it will save money. The answer to that is yes.

Mr. DAVIS. I'm going to get to that in a minute.

Mr. KING. That's a resounding yes.

Mr. DAVIS. Under your analysis of flexibility and moving with the tides and the floods and this kind of thing, what agency can't use that argument to go out and privatize?

Mr. KING. How many operate in a revolving fund? This organization was virtually not functioning in a business sense. Yes; it's been restored. But it's been restored until the next cycle. It will be victimized again.

Mr. DAVIS. Let me read from the draft GAO report. It says, we believe there is a problem in using the current prices as those the Investigations Service would charge Federal customers in the future.

This is on page 4 of the results, page 4. It instructs them to use the costs associated with the most efficient organizations as the basis for cost comparisons with potential contractors. However, OPM established the investigative service in 1994 on the basis of historical operations, including the need to make up certain deficits incurred by OPM in the past.

As such, the conclusion is, the prices OPM gave the consultant for use in the cost study did not reflect the investigative service at its most efficient.

So you're comparing not apples to apples, but apples to maybe something else—bloated apples, I guess would be the way to put it.

And then it goes on, it says, although OPM may not have been required to make an efficiency assessment of the Investigations Services, we believe it would have been prudent to do so, especially since OPM had information that raised doubts about the accuracy of this price estimate. For example, the OPM inspector general reported in 1994 that OPM had been unable to accurately forecast

the investigative work load and adjust staffing levels accordingly, which contributed to an operating deficit.

The inspector general also reported that the investigative service has been burdened with an excessive share of OPM's overhead charges.

According to the report, these factors led to an operating deficit and the need for the investigative service to raise prices in order to eliminate the deficit.

You can talk the savings all you want, and I can almost put anything together that will have savings compared to that cost base.

Ms. LEWIS. Congressman, it's my understanding—and this is still a draft report and OPM has been asked to respond to it, and we will do so.

Mr. DAVIS. Do you have any response today?

Ms. LEWIS. Yes, we do. It's my understanding that should GAO have decided to analyze this in a different fashion based on different information, it's my understanding from our Investigations Service that all of the information GAO would have needed to perform another analysis was available to GAO, and it did not do so. As you read here, GAO's draft makes an assertion about what would or wouldn't have been prudent. But certainly it was not required.

Mr. DAVIS. It's not required, but it's not a question of whether it's required. It's a question of what's fair. When we really want to sit down and compare, are we being fair realistically about what we're comparing?

Ms. LEWIS. But, ultimately—and experts can disagree.

Mr. DAVIS. Sure, and we seem to be disagreeing, and that's fine.

Ms. LEWIS. We very much respect the GAO experts. And I believe they very much had great communication with and respect for Kormendi/Gardner, our independent contractor. But, ultimately, the bottom line is that on page 6 of their report, despite different assumptions, despite professional disagreements, this proposal will save the taxpayers money. And that is a fundamental conclusion that is sitting in GAO's report. And we wholeheartedly disagree with. And any delay to study this further on the cost side is ultimately going to eat into those savings.

Mr. DAVIS. Well, it says, despite our reservations on the pricing data, we have no reason to question the cost of the general conclusion that privatization would likely produce a net savings to the Government in the long term. Whatever that is.

But they say it's important to recognize that any new business faces many uncertainties that can affect profitability.

Mr. KING. Very few businesses get launched, get the catapult off the deck of life that this particular business is going to get as a catapult.

Mr. DAVIS. We'll be back. We're going to recess the hearing to go vote. We'll be back. Thanks.

[Recess.]

Mr. HORN. While Mr. Davis is voting, let me ask a few questions here. And then I will have Mr. Davis presiding. I would like to have you stay, Mr. Director, to hear the next panel, so we can have a dialog with you and the committee after we get some of the facts there. Now, if you want to delegate it to your two colleagues, OK.

Mr. KING. I would appreciate that, Mr. Chairman.

Mr. HORN. I do want OPM to listen to the next panel and I want the committee to then engage your people or you or whoever. We want it on the record. Then we'll followup with various questions.

Mr. KING. That's excellent. Thank you for that flexibility, Mr. Chairman.

Mr. HORN. What I want to discuss is, as I listened earlier, the thought came to me. I've had a lot of problems with some personnel systems all of my life. The Federal one is the least of the problems, but it's got plenty of problems. The State of California system matched anything the Federal Government could dream of in terms of bad personnel systems. Some of those we were able to change as they applied to the California State University where we finally made judgments based on merit work and related management pay to management accomplishments and so forth and so on.

What I'm curious about is, the uniqueness of the agency that we're discussing here, how many other groups like this within the Civil Service have an expansion and a contraction based on the work load? And to what degree is the Office of Personnel Management asking Congress to change some of the laws that have inhibited flexibility? I know you look at these things very diligently. In other words, did you come up with recommendations and ask Congress to change some of the laws if we're part of the problem?

Mr. KING. The issue on this was the first step that was taken. Was this particular function governmental? That was the first thing we had to look at. We've already explained the management problems.

And the answer to the actual investigation, the gathering of the information was, no, it did not have to be governmental. That was No. 1.

No. 2, it was nongovernmental and that is the commitment, to downsize the Government. We've identified that. We operate on a revolving fund, as you're familiar with, Mr. Chairman. That is, we must earn our own keep for that particular operation. I think when Mr. Davis was talking earlier, he set up the format that a number of our expenses were rather high because we were paying for past debts substantially.

What I was suggesting to Mr. Davis at that time was that the difficulty was that those debts come back and then they're passed on to the taxpayers through agency costs that wouldn't have to be that high because we wouldn't be in debt if we could manage our work load and the personnel for that work load in an appropriate manner. And the only part here that we can't manage appropriately is that field investigation staff, which is not intrinsically governmental.

I'm philosophically committed to having a smaller Government, and again at less cost than the positive effect it has on our taxpayers. So we can give them a superb product at less cost and at the same time, Mr. Chairman, provide the people who work for a living and those families the security of a corporation that they wouldn't have under the circumstances we have and still meet those other criteria. This seemed to be the best approach.

And that's really why we took it on and looked at it the way we did. In order to manage the real costs that were suggested by Mr.

Davis is that we have to have an organization that doesn't go into debt to start with, to find itself on the edge of bankruptcy and then try to recover by jacking its prices up. So that's really where we're coming from on this whole issue.

I think the thing we should remember is putting it in context. This organization had been in debt for 9 years. I mean, this is not a new phenomenon. Through very good times, Mr. Chairman, and some very difficult times—I'm talking about volume of work provided. It wasn't based on, "Let the good times roll," sir.

It was that the lack of that ability to manage effectively with this kind of a work force that didn't work. Can it work? We've identified the areas clearly that should be done governmentally. Absolutely correct. That should be governmental. It is a smaller core.

Mr. HORN. Well, obviously, this organizational entity does give you flexibility so that you don't have to go into debt, you don't have to raise the charges. But the way you get flexibility is have flexibility of retaining or not retaining personnel. Is that not true?

Mr. KING. That is correct in this instant case.

Mr. HORN. Are there other cases throughout the Federal executive branch that have a similar contraction and expansion situation?

Mr. KING. I'm sure there must be, Mr. Chairman, but I'm nowhere near as intimately familiar as I am with this one. And I'm not familiar with their funding sources. As I said, I hadn't really run into a revolving fund in my career in 25 years in Government. I had done reimbursable work and other things, but nothing quite like this.

Mr. HORN. Well, that was one of the things, as I remember, the first or second Hoover Commission suggested way back in the late 1940's and early 1950's. And I believe the Pentagon has a number of revolving funds. Is any of the staff that accompanies you aware of some of these other situations in the executive branch?

Ms. LEWIS. I believe the GSA building fund operates on a revolving-fund basis. I think it's called the DBOF or something in the Defense Department and is something comparable. As you know, all of the components of the Defense Department is being very heavily focused on for purposes of privatization option.

The General Services Administration, as well, back in December 1994, at the same OPM was starting the implementation of this privatization, also has been taking a hard look at its operations for privatization. So these are the kind of entities that very much lend themselves to privatization options. And this one, both in terms of the interest of the Director in ensuring a soft landing for the OPM employees, a very family-friendly approach, and the seamless transition for our customer agencies and ultimately the savings that will accrue to the taxpayer. This is the most ripe entity for privatization perhaps in Government today.

Mr. HORN. I would ask this of the Director. Do you see in this experiment a way to get more flexibility throughout the executive branch, so that when you've got rising need for a particular program you can reflect that in your personnel decisions. When you have a contraction based on changes in the clientele and their needs that we're there to serve, that you can make appropriate changes?

Mr. KING. There are a number of different authorities that gives you certain flexibility. What we're suggesting, though, is to maintain the integrity of a particular operation. We believe it should be maintained and given an opportunity that we can deal with. Again, in this case, we believe this could be a nongovernmental and should be a nongovernmental activity. We believe we can launch it. We can be of help to it. And at the same time, we can reduce the prices and we can reduce the size of Government.

And that was really the objective here. You can save money and have a smaller unit. Again, to identify those areas—by the way, we have been through this process. As we said, we downsized on the privatization. With our training, we moved to work for another. We privatized last July. By the way, it was a much simpler process.

And for others, we had to RIF and do out-placement. Mr. Chairman, when we did our out-placement, we out-placed beyond 90 percent of our people. So we really do understand the process of working within and putting people to work both in the public and the private sector. What we tried to do is maintain the integrity of a particular unit that we believe is very, very good. We think it's staffed with excellent people. We'd like to maintain that organization, but move it into a nongovernmental unit that can better serve the people of the United States. And we believe this is the way we can do it and still give them the stability, and if you would, the human face and the family friendly through the stability of this type of an organization.

One thing maybe we failed to mention. They own the company. The employees will own the company at the end of the day. This is a stock company in which they will own 90 percent of the stock. That's why I'm saying it's so different. That this is an opportunity for them. A chance to bring prices down, a chance to reduce our Government and the numbers of people who are involved in it. And nobody, but nobody who studied it has argued as to savings.

The discussion is, how much do you save? Mr. Chairman, I don't think any of us would want to go to anyone who pays taxes and say, we're having an argument. We don't want to act because we don't think it saves you enough money.

There's no offsetting costs. We don't see a downside on cost. And nobody has yet identified a downside on costs. There is an upside and this is the moment to capture it. And every day we delay, we lose that particular capture.

Mr. HORN. I can understand it. I guess my thought is that it isn't enough just to downsize Government. There's got to be a reason. You've got to continue to give excellent service, service that's accomplished in a timely way, benchmarks, if you will, on performance. And not just processes of people filling slots and don't know why they're there or aren't doing it very well.

And I simply say this. If we are learning something from all of these experiments, we ought to apply it to the other parts of the executive branch, not necessarily this particular one. But it seems to me—well, let me ask you. I know you're a busy person, but have you ever had a chance to glance or look at Paul Light's book entitled, "Thickening Government," in which he examines every administration from Eisenhower up? Right there, you see what's wrong

with the executive branch. They have thickened out in all of these management and staff areas.

And the question is: Why don't we get policy formulation? You don't need many people for that. And get down to the people doing the hard work and the job. And get rid of all of these MBA's and everything else that are overstuffing all human organizations.

Mr. KING. Mr. Chairman, the first thing we did when we came into the organization—and this is OPM total—was we reduced our management by 40 percent. And we continue to work like that.

Mr. HORN. Because usually they're about four times what they should be. Well, I'm going to turn the chair over to Mr. Davis. I have to leave for another meeting.

Mr. DAVIS. I just have a couple of followup questions. I know you're all busy, and I appreciate your being here. Just a couple of questions. When OPM, I think, originally emphasized this proposal, they enjoyed the widespread support of the current OFI employees. Is that still the assertion?

Mr. KING. Which? Prior to privatization or after the decision to make it?

Mr. DAVIS. The decision.

Mr. KING. The decision was made in December 1994. Since that decision was made, we moved forward to give our employees the option.

Mr. DAVIS. Is the decision a popular decision?

Mr. KING. No, I haven't run into anything where there's change unless it's an increase in salary where people are happy with change. Possibly other people have had other experiences.

Mr. DAVIS. I just want to make sure. Obviously you make the change and you say, you're out in the street or you're part of this. Who is not going to be for that? But then there is a recognition that this is not a popular change with the OFI employees?

Mr. KING. I would certainly think that any time you're separating anyone from their workplace, it would not be popular. And I would assume that this is consistent with that profile, overwhelmingly.

Mr. DAVIS. Let me ask finally, I guess. You talked about the flood plain. I was in local government for many, many years. And we understood flood plains and building in a flood plain. There's a 10-year floor plain, 100-year flood plain. Different rules apply. What is the flood plain here? Is this flood going to come back in next year? Is it going to be 5 years? What's your best guesstimate?

Mr. KING. Ours works in reverse. Our flood often, when I got there, the flood was the withdrawal of the number of investigations that needed to be done; the enormous costs involved in separation; and the enormous costs in even negotiating separations.

Mr. DAVIS. I understand.

Mr. KING. So that was certainly very much a part of it. And then addressing the major change that had to be made. And then saying, as we looked at it then, what would be the best way? First, does this type of work have to be governmental? That was the first question we asked. And the answer was no.

The next question was: Are there parts of it that are governmental? The answer was yes. There are parts that are governmental.

Can we separate them? The answer to that was yes.

And then we proceeded ahead as to where we could be of help to our employees, because we understood the implications. I did. I came out of a mill town where—by the way, we were competitive to the end. It never went south. It went directly to Bangladesh. So I truly do understand the implications of what it was to go through layoffs. And I candidly didn't think I was coming to Washington to be one of the mill owners that we had worked for.

So I was particularly sensitive to any issue that would affect people from being separated from their life's work and the implications of that both in economic and social terms. That's why the models we designed were extremely lean and extremely conservative.

You had asked an earlier question where you asked about our costs and how we had built in the failure of the past. What we want to do is ensure the American people never have to pay again for failure of the past. That we can bring the costs down. We can manage with a very capable group at this time and continue the integrity of that group into the future.

And our hope is—what strikes me, and you've said it very well, Congressman. Isn't it extraordinary at this stage that this is the first ESOP to come forward out of all of the possibilities in Government? Part of it is that the process that we go through is so excruciating, not too many people are willing to volunteer to start down that road. There are much easier ways to make Government smaller. I happen to think a number of those ways do not have the human face we've tried to put on all of this.

Mr. DAVIS. I don't think there is any question that, with the mandate to reduce FTE's that this is really coming down from above. I think that has driven part of this. And I think that's too bad. Because both parties do it. And they get driven by somehow the number of employees tells you how efficient you are. You and I both know that's not true. You take a look at the best value you can get for the dollars you're paying and sometimes you privatize and sometimes it's in-house. But the number of employees isn't the determination of that. And I think you really have tried to do the best you can given that mandate from above. But I'm not sure I have ever agreed that eliminating a certain number of employees is in itself an objective that we should applaud.

Mr. KING. I couldn't agree with you more, Congressman. But it's that classic question I think that Lincoln once answered when he was asked how long a man's legs should be. And he suggested they should be long enough to touch the ground. How large should Government be? Large enough to perform the functions it should perform.

Mr. DAVIS. That people are willing to pay for.

Mr. KING. In this case, we understood, because for the first time—by the way, when I was there 1 year, Congressman, one of the questions I got asked at my year-end review is: How did I feel to be a failure as an administrator? My budget had gone down. The number of people who reported to me had gone down. The traditional value system was on expansion, not a contraction. It wasn't on customer service and it wasn't on the market.

It was making the largest possible organization I could have. I would like to be one of those folks who says, as you do, proudly say

to the American people, you are getting your dollar's worth from all of our employees, whether they be public or private. And I believe we can say that at OPM. I give no apologies. And I'm very, very proud of the people who are there.

Mr. DAVIS. Let me just say that I probably disagree with you on this particular item, but I think you have one of the toughest jobs in Washington outside of chairing the District of Columbia Subcommittee. You do, and I think you're performing it admirably.

Mr. KING. Thank you, sir.

Mr. DAVIS. I'm going to pursue this further, but I appreciate your being full and open and honest about the assumptions you've made and the sensitivity you've tried to show to employees along the way. I just wanted to express that for the record.

Mr. KING. I wouldn't like this hearing to end without thanking you for our support on our reemployment center and the work that we've done and the grants that we've received. When I talked about a human face on some of the difficulties we're facing, you've helped paint that face. So I would like you to know how deeply we appreciate your efforts, Congressman.

Mr. DAVIS. Thank you very much. Ms. Lewis and Mr. Ferris, thank you as well for being here.

For our next panel, we have Herb Saunders, who is the chairman of Varicon International; and Deborah Apperson, the senior investigator, Office of Federal Investigations at OPM. As you know, it's the policy of this committee to swear witnesses in before they testify.

[Witnesses sworn.]

Mr. DAVIS. Ms. Apperson, you can begin. Thank you both for being here.

## STATEMENTS OF DEBORAH ABRAHAM APPERSON, SENIOR INVESTIGATOR, OFFICE OF FEDERAL INVESTIGATIONS, OFFICE OF PERSONNEL MANAGEMENT; HERBERT F. SAUNDERS, CHAIRMAN, VARICON INTERNATIONAL; AND IVAN PETRIC, CHIEF STEWARD, AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES

Ms. APPERSON. Thank you for allowing me to be here. I hope I'll be able to address a couple of comments that Director King made. You have my statement. It's rather lengthy. I am going to do a short version of that. Members of the subcommittee, thank you for inviting me to testify today.

I've addressed a number of serious issues surrounding the privatization of the Office of Federal Investigations. My statement to you now emphasizes to some of those issues and relates to several more. And, also, I want to correct an error I made on page 8. That is, that the Marine Midland Bank's partial foreign ownership is with a bank in Hong Kong, not Shanghai.

The decision to privatize the FOI stems from the Vice President's Reinventing Government Initiative, REGO, in which it was recommended that agencies able to do so should also be permitted to conduct their own background investigations of potential candidates. This is a very important statement, because nowhere does REGO compel or direct agencies to conduct their own investiga-

tions. And nowhere does it say that the agencies must hire contractors to do so.

I have copies written to our former associate director when this privatization was announced from the Department of Energy, the INS, the Department of Treasury, the U.S. Postal Service and the Nuclear Regulatory Commission that decry and question the privatization and speak to the potential and serious ramifications of such a move.

Mr. DAVIS. You can slow down. You're going fast, but you can slow down.

Ms. APPERSON. I was told I only had 5 minutes. Great. As I said in my prepared statement to you, professional security personnel across the Government are adamantly against the privatization. Their cries, however, have fallen on the deaf ears of the political appointees who run their agencies.

At the behest of Director King in his June 7, 1995 memo to the executive branch's Presidential Management Council, they have been admonished to, quote, unquote, speak with one voice. The wagons have been circled for one reason and one reason only. Political expediency and this administration's agenda to reduce the number of full time equivalents, FTE's, in the Federal Government at any cost.

The potential cost of privatizing our program should not be measured in dollars, but in the potential damage to our national security, Privacy Act protections, quality control and the fitness and suitability of our Federal work force. Reducing the Federal bureaucracy is important and I am absolutely in support of this administration's and Congress's efforts to ensure that the taxpayers of this country truly get the most mileage for their tax dollars.

However, the rights to shrink the Government should absolutely not be done without scrupulously and thoroughly studying the ramifications and implications of the downsizing of any program such as ours, whose mission we and others believe is inherently governmental and vital to our national security.

Also, when a program like ours has risen to the near zenith of our customer agencies' performance expectations and is doing so in the cost efficient manner that it is, why replace it. As you, Representative Davis, told us last month when you visited our Annandale office, if it ain't broke, don't fix it.

We also feel that the measure of our program's success should not be counted in dollars but in the hundreds of thousands of Federal employees and Federal contractors who work for agencies that have cleared them for access to information from confidential to secret compartmented, based on the comprehensive background investigations that the employees of the OFI take both personal and national pride in doing.

It should also be measured in the numbers of individuals who are not hired by the Federal Government to work in sensitive decisions, because the same thorough background investigations developed and resolved every potentially disqualifying issue in the individuals' backgrounds that precluded hiring them in the first place.

And it is here that you do not want to short the investigative process by worrying that an investigator is spending far too much time, read money and profit, developing and resolving serious is-

sues. And that, frankly, is the fear and financial reality of privatizing our program. Would you want the CIA, the NSA, the FBI, the State Department, and the Defense Investigative Service to operate this way when conducting their respective background investigations? I, for one, would not.

This is what will happen when USIS' bottom line is profit and productivity versus quality and integrity. And you can rest assured that the first investigators that will be let go from USIS will be those who develop far too many issues in someone's background, which will consequently contribute to the company's short term and long run solvency and profitability.

The fact that we have just 2 months ago come out of a nearly $40 million deficit in our revolving fund with a demoralized and increasingly shrinking staff of investigators who worked without awards or promotions for over 2 years speaks to the quality, dedication and integrity of our staff. Our investigators in this agency are some of the finest investigators, indeed civil servants, in the Government. Our Washington investigators alone are overwhelmingly comprised of individuals who are hired as outstanding scholars, several who have not only their bachelor's degrees, but also master's degrees.

The collective professional reputation of our staff nationwide is second to none. And our customer agencies know that. We have traditionally lost our investigators over the years to the many customer agencies we serve, because in dealing with the same people day in and day out, the agency professionals realize the caliber of the people serving in our ranks and eagerly hire them for other jobs, most often in the criminal investigator and personnel security fields. And that is what is occurring now and will continue to occur as the sunset of the Office of Federal Investigators draws ever closer to July 7.

USIS will not be comprised of the same outstanding staff in the OFI now, but only a majority of those individuals who have yet to find other Federal employment or are compelled by their geographic location and lack of other Federal and private employment opportunities to find other work, such as in Boyers, PA, where there is virtually no other job market.

I, myself, have already turned down one job. And that was one that was offered to me last year as a personnel security specialist with the INS. I declined the job to come back and fight this initiative, because I so strongly believe that this privatization is a very grave mistake. I also happen to love my job and I am not alone in my convictions as a number of my colleagues sitting behind me today is just a representative sample of those who feel the same way.

Director King continues to tout this privatization as a seamless one and it is anything but that. The Director also continues to say that the ESOP will provide the flexibility to better respond to the fluctuating caseloads that routinely occur in our program and on a yearly basis.

But what he is not telling you is that we are doing that now. Since our RIF of 400 investigators 2 years ago, we have had to supplement our full-time staff with individual contract investigators, some of whom were RIFees from 1994, who are now helping us

with our current caseload nationwide. This has allowed us to very successfully address the ever in flux caseload and has even allowed our own investigators to be detailed to other agencies to assist in their various missions and to conduct fact finding investigations for a number of other agencies, including the District of Columbia's Department of Corrections and the International Trade Commission.

This is a very important point, because as other agency budgets shrink, they will not have the FTE's to conduct the types of investigations we are doing now, because, as we understand it, all of these investigations can only be done by other Federal entities under the Economics and/or the Intergovernmental Cooperation Acts, which may in fact prohibit USIS from tapping into those same markets.

Finally, Executive Order 12968, Access to Classified Information, was signed by the President in August of last year. This order requires for the first time, among other things, uniform standards for granting security clearances and uniform standards for investigation and adjudication of those clearances. The Executive order was a necessary and proper one. And it is amazing to me how, with the stroke of one pen, personnel security is strengthened, and with the implementation of this REGO initiative, it is fully gutted.

Mr. Chairman, members of the subcommittee, I could go on ad nauseam, but not in the 5 minutes time allotted here. You have my prepared statement and you have heard my additional comments. I can only reiterate what I said in my statement, and that is, please support Representative Davis' bill to delay this privatization until all of the concerns in both this bill and a similar bill introduced by Senator Simon be fully and thorough addressed. Our country's national security deserves no less.

Mr. DAVIS. Thank you, Ms. Apperson.

Ms. APPERSON. And if I have the opportunity, I would like to make some counterpoints to Director King's comments.

[The prepared statement of Ms. Apperson follows:]

**Deborah Abraham Apperson**
Senior Investigator
Office of Federal Investigations
U.S. Office of Personnel Management

Mr. Chairman and Members of the Subcommittee:

I thank you for your invitation to speak to the issues enumerated in H.R. 3189, a bill to delay the privatization of the Office of Personnel Management's Office of Federal Investigations. I must emphasize, however, that I am not speaking as an official representative of OPM, but as a concerned taxpayer, citizen and investigator whose views represent the overwhelming majority of investigators in the Washington, D.C. area duty stations, as well as duty stations across the country, not to mention the other OFI employees located in our Federal Investigations Processing Center (FIPC) in Boyers, Pennsylvania.

I have come here today to speak publicly about the numerous concerns that the 700+ OFI employees have with respect to the privatization of what we believe is a vital and inherently governmental function related to the national security. I am here alone to address the many concerns because my coworkers fear, rightfully or wrongfully so, that they will experience some form of retaliation either as current federal employees or as potential employees with OFI's predecessor, the ESOP known as U.S. Investigations Services, Inc., or USIS. Because I chose on clearly defined philosophical grounds to refuse the offer USIS extended to me just this past week, I have nothing to lose with respect to future employment with the company and I am currently pursuing other Federal employment opportunities.

Besides representing the views of my soon-to-be-RIFed coworkers, I am also speaking for a number of the 40+ OFI employees whose jobs will remain federal after the privatization, but who are also afraid to speak and have confided that it would be professional suicide to do so. You should not be surprised to know, too, that many of the employees orchestrating this privatization have privately expressed both their dismay at, and disapproval of, this initiative, but know that they must carry out this Administration's mandate to Director King.

When various agency personnel security professionals learned of this hearing today, they also privately offered their support and bemoaned the fact that they could not be here to publicly voice their concerns, as it would be professional suicide for them, too. It is no secret that the Administration has fairly successfully circled the political wagons at our various customer agencies and muted the voices of those career professionals in the personnel security field who are acutely aware of the disastrous results waiting on the near horizon with the privatization of the OFI.

There was one recent and notable exception to the circling, however, and that was the Department of the Treasury. In response to a letter that Senator Simon sent to the Departments of Treasury, Justice and Energy in September 1995, Treasury missed its cue to "speak with one voice" as Director King admonished the Executive

Branch to do in a June 7, 1995 memo to members of the President's Management Council. In the October 5, 1995 response from Treasury to Senator Simon (provided with my statement), Assistant Secretary Linda L. Robertson enumerates the many concerns that Treasury has with the privatization of the OFI, not the least of which are quality control, higher case costs, agency liability for improper conduct by contract investigators, lack of access to criminal history information by nongovernment investigators and the fact that Treasury was informed that the FBI would not provide contract investigators with access to investigative files due to their sensitivity or classification.

Another agency who has grave concerns about our privatization is the Immigration and Naturalization Service, one of our largest customer agencies who also hapens to be in the midst of its largest recruitment and hiring effort ever. This agency initiative alone has placed an unprecedented demand on OFI for thousands of background investigations on the new hires, contractor hires and reinvestigations on its current staff that will continue well into FY 1997. Currently, OFI is continuing to meet the quality and timeliness needs of the INS, particularly with respect to its expedited requests for background investigations in 35 days or less.

Despite our continued outstanding performance not only to the INS, but also to our other 100+ customer agencies, commissions, committees and departments, the INS is most skeptical of the "seamless transition" that our Director continues to publicly tout in press releases and advisories to our customer agencies. Consequently, in a letter dated April 1, 1996 (also provided with my statement) from INS Commissioner Doris Meissner to Director King, the Commissioner asked for the Director's "personal assurance" and "firm commitment" that the OFI would continue to provide the level of service it now provides once the privatization occurs on July 7, 1996. The Commissioner requested that if "such a commitment cannot be made, we request OPM approval for INS to acquire its expedited background investigations from a provider other than OPM."

The concern of the Commissioner is a very real one, as her Office of Security counts among its staff 14 former OFI investigators and personnel security staff who well understand the need for the OFI to remain federal in order for the INS's unprecedented recruitment and hiring effort to be a successful one. Director King's April 29th response to the Commissioner (also provided with my statement) was his same trite and politically correct one, that is, "We still anticipate the transition to privatization, to occur early in July, will be a "seamless" one."

Let me address that weary phrase at this time, as it is important. The Director has no choice but to continue assuring our customers that this will be a seamless transition, as he has to allay the

fears of those professional personnel security employees who know better but are afraid to speak. In the Virginia and Maryland duty stations alone, we have lost 1/3 of our investigators (including our former chief and one secretary) since April 1995. Of the 25 staff that have left, the majority of them have gone to other Federal agencies, in fact, most of them to the INS. It should also be noted that, historically, some of the most complex and derogatory investigations that the OFI conducts have been in Washington, D.C.

Now that we have our RIF notices in hand, we are entitled to priority placement in other Federal jobs and, you can rest assured, the SF-171s are beginning (actually, continuing) to fly around this town. While the Director continues to say that USIS will be primarily comprised of the same cadre of quality investigators the customer agencies know and respect, it is a bit disingenuous since USIS plans to have a 33% complement of contractors who will not be as well trained and prepared as those of us with many years on board and a vast institutional knowledge of the program that comes only with tenure and on-the-job training.

For the investigators around the country, job prospects are better than they are for the several hundred FIPC employees in Boyers, where job prospects are virtually non-existent. The fact that the vast majority of OFI employees recently accepted their job offers with USIS gives the appearance of a seamless transition from a pure manpower standpoint, but the fact is that employees are continuing to look for other Federal jobs even with USIS offers in hand.

A recent survey of our local investigators (the results of which I will be happy to provide) regarding their views on this privatization, is indicative of the feelings of the majority of investigators across the country who have never been surveyed as to their true feelings. And, why? Because this agency does not want the truth of this privatization to prevail.

While the issue of contracting out investigations is at the very heart of this privatization, let me address a few problems relevant to the use of contractors. I do not mean to denigrate contractors in general, as indeed, OPM is currently contracting with individual contract investigators, some of whom are retired and previously RIFed OFI investigators. However, given the disastrous results of a major contracting effort at OPM in the mid-1980s in which there was over-billing, double-billing, falsified investigations, innumerable deficient reports with respect to quality and coverage, just to name a few of the problems, I, and many others, have grave concerns with respect to using contractors to conduct background investigations.

Without proper, intensive training of contractors, not to mention the quality control and oversight that we have over our own investigators, the chance for a host of the same problems we

encountered in the 1980s still remains. My biggest concern is with the fact that when you are trying to produce a background investigation cheaper than your competitors, you will cut costs and corners and quality will suffer, plain and simple. In the Civil Service Subcommittee hearings held last year by Representative Mica, ADC, Ltd. and Varicon International provided testimony and sang their virtues loudly and strongly. I expect they will do the same today as, quite frankly, I know they have some excellent contractors working for them as they both count former OPM investigators among their own.

If both companies claims to their high level of integrity, quality and cost-effectiveness are to be believed, why is it that ADC is not even licensed to do business in the Commonwealth of Virginia as required by the Commonwealth's Department of Criminal Justice Services (DCJS)? Not only is the company not licensed currently in the state, it has not been licensed in the state since it began operating here a few years ago.

The same check run on ADC through the DCJS on May 20, was also run on Varicon. To Varicon's credit, it is, and has been, properly licensed since its inception. However, because Virginia has one of the most onerous licensing requirements in the country, there are further registration and training requirements which each contractor in the company must have, and neither ADC nor Varicon is in full compliance with the state requirements. Virginia also has some extremely hefty fines for violations of its licensing requirements, but they are not often imposed as the DCJS is more intent on bringing companies and individuals into compliance than punishing those who are not. The cost of doing business in Virginia is rather steep, and some of the costs are yearly ones which, if borne by the companies, are going to drive the price of investigations up, thereby costing the taxpayers more money when the contractors figure that overhead into their bids. The alternative is to continue to operate illegally which begs the question of what else might these two companies (or any company) do that is unethical?

None of these licensing requirements are necessary if you are a local, state or federal government investigator, thus another reason to delay,if not halt altogether, the privatization of the OFI. And, given the fact that Virginia has no reciprocity with any other state, if we were to bring detailees in from another state when we become USIS (as we do now when workloads are high in one area and low in another), they would be operating illegally. According to the director of DCJS, none of the states have reciprocity with one another. Also according to the DCJS director, a number of companies in Virginia have falsely spread the rumor that if you are doing investigations on contract to the federal government, you are exempt from the licensing, registration, training and compliance requirements. This is unequivocally inaccurate.

At this time, neither OPM nor the new executives of USIS have a concrete plan to have every investigator across the country properly licensed/trained and/or registered by the start-up of the company on July 7, which is one more reason to delay this privatization until the issues in Representative Davis's (and Senator Simon's) bill are thoroughly resolved. Subjecting individual investigators to possible fines due to the failure of USIS to provide for proper licensing beforehand is simply unacceptable and improper, not to mention illegal.

With respect to the various federal contracts that Varicon and ADC have with some federal agencies, let's examine just one and that is the one Varicon has with the DEA. If the DEA is so happy with its contract investigations with Varicon, why is it that the DEA Administrator does not allow Varicon to do the background investigations on its agents, leaving that task instead to DEA agents themselves? If the quality of the investigations Varicon provides to the DEA is that outstanding, one might conjecture that Varicon would be doing all of the DEA's investigations.

It is also interesting to note that the FBI (who uses individual retired FBI agents as contract investigators) has a procedure whereby when any investigation being conducted by a contractor turns significantly complex and/or derogatory, the cases are pulled back and reassigned to its own agents. And, while the CIA also uses contractors to conduct background investigations on its contract staff only, the agency uses only CIA employees to conduct the backgrounds on its own employees.

Addressing the quality aspect of contract investigations, OPM was involved in a quality control initiative in which it reviewed the background investigations of one local contractor whose cases, upon initial submission for review, were over 50% deficient and had to be returned for additional work. The deficiency rate of OPM's own investigations is typically under 1%.

Having been one of several senior investigators in my office over the years who has reviewed cases completed by both contractors and OPM investigators, the deficiency rate of the contractors versus the OPM investigators has been most disproportionate, with the latter having a far smaller number of problems requiring a redo of the case. Even more telling in the quality, however, is the amount of derogatory information and number of issues that the OPM investigators develop versus that which the contractors develop. When contractors are paid piecemeal, and are being paid for how quickly they turn around a case, the incentive to dig a little harder, locate the best possible sources, and develop and resolve the issues all too often gets lost in the bottom line, that being profit.

A similarly high deficiency rate like the one I just described was noted several months ago when OPM detailed several investigators to

the DEA security office to review its contract cases done by Varicon. The investigators were surprised by the number of deficient reports that had to be resubmitted to Varicon for additional information, all with the concurrence of the DEA staff who supervised the OPM detailees. The investigators also noted what we have known all along and what the GAO has shown in one report already, that being the lack of access to many law enforcement records from a host of jurisdictions around the country. Many of the reports submitted by Varicon contained investigator notes explaining that the lack of certain law enforcement coverage was soley due to contractors being unable to have access to various police department record information. Thus, it is patently dishonest for Herbert Saunders to claim, as he did in his statement before the Civil Service Subcommittee last year that, "We have access to all local and state police records."

This type of deceipt might well explain why I have in my possession law enforcement checks from the Washington D.C. Metropolitan Police Department that Varicon contractors with DEA credentials fraudulently obtained while doing background investigations for the Small Business Administration. Instead of showing on the Criminal History Request forms that the requesting agency was the SBA, the contractors took it upon themselves to represent themselves as DEA agents doing backgrounds for the DEA when they were actually DEA contractors conducting backgrounds for the SBA.

Privacy Act protections, as well as safeguarding of the reports themselves, are two other important concerns. A recent incident brought to my attention well illustrates the dangers inherent in using contractors who work from their homes and public facilities versus government employees who have access to government space and equipment.

Three weeks ago, on May 1, when we had gathered in our Annandale office to receive our RIF notices, one of our investigators arrived at the office with a copy of a background investigation that she handed over to one of my fellow senior investigators. The investigator explained that she was copying some notes for one of her law school classes on a public copier at a local printing company on northwest Connecticut Avenue in Washington, D.C. when she raised the hood of the copier and found a background investigation replete with derogatory testimonies from some of the sources in the investigation. Attached to the investigation was a contractor billing invoice for his services rendered. The senior investigator who was given the investigation turned it over to the proper personnel security authority in our agency who then turned it over to the agency for whom the contractor was working, the CIA.

Perhaps the most salient point I can make at this juncture, is that the **United States is the only country in the NATO Alliance that contracts out its background investigations.**

One final and important component of this privatization is the reputed cost savings of this initiative to the taxpayers. When Director King decided to spin us off from OPM in December 1994, as part of Vice President Gore's Reinventing Government initiative (REGO), an agency task force was developed to consider the best way to spin off investigations. Five models were developed that ranged in cost from $9.2 million to $93.5 million. The model that was chosen for implementation was "OPM the Contract Manager" at a cost of $63.8 million. This became the model that eventually led to formation of the ESOP, and ultimately, USIS.

From that point on, everyone from the Office of Management and Budget, to the GAO to OPM to a private company, began analyzing the cost of this privatization in an attempt to figure the savings to the taxpayers. Depending on whom one believes, the cost savings ranges from none to $30 million. Take the greatest projected cost savings from one entity, $30 million, and subtract it from $63.8 million, and well, you figure the math and the "savings." As a taxpayer who does believe in getting the most for my tax dollars, and supports the privatization of any number of government services and programs, I resent the notion that this proposal is going to do anything to lessen my tax burden.

Most importantly, prior to when Director King decided to spin us off, this program was drowning in red ink. To his credit, however, he appointed a new associate director who RIFed us, rightsized us, reinvented us, froze all promotions, travel and awards and initiated a number of other cost control measures to stop the hemorrhaging in our revolving fund. The results? Well, in an unprecedented turnaround of cash flow, the remaining investigators **pulled out of a nearly $40 million deficit in less than two years.**

In fact, around March of this year, we paid off the debt and are now accruing a surplus in the revolving fund which will allow, in fact, compel us to reduce agency case costs since the revolving fund must operate within certain parameters which prohibits it from accruing or losing too much money in any given three year cycle.

If what the OFI has accomplished is not the epitome of Vice President Gore's REGO initiative, as well as reflective of the desires of this Congress to give the taxpayers the biggest bang for their buck, than I don't know what is. If the Vice President really wanted to capitalize on the success of his initiative, he would bestow upon the OFI its coveted hammer award and showcase it as the poster child of REGO, rather than jettisoning this immensely successful, cost effective and inherently governmental program.

When the Washington investigators were visited by the CEO of USIS just last week, he was peppered with many important questions by various investigators. He displayed his prowess for artful dodging and brilliant obfuscation of our questions. One thing that was made crystal clear throughout his presentation, however, was his

dogged determination to enlighten us to the fact that he was doing everything he could to ensure the profitability of USIS. The main way he was planning to do this was to grow the company and expand the services of USIS well beyond the background investigations that we do now. Listed on a transparency on our overhead projector was a list of potential, untapped markets to "backfill" our federal workload. Somewhere between workers comp cases and EEO investigations was the item "Shopping Services."

Since none of us were at all clear as to just what potentially fantastic money maker this was, we asked for clarification from our new leader. The answer? He explained that there was a tremendous need for mystery shoppers who operate undercover in department store chains to gather information for store management as to various aspects of their internal, retail operations. What our new CEO did not make quite clear though was just what our precise duties would be - plain clothes secret shopper missions or covert price comparisons on merchandise.

We as Federal investigators have in our official job descriptions the phrase "other duties as assigned," but this was not quite what we had in mind when we took our oaths of office to fulfill the duties of our positions. Furthermore, while most of us have a sublime sense of the ridiculous, we truly believe that our customer agencies do not want to know that we will be splitting our time between their background investigations and our secret shopping forays into Macys. We also wonder how the taxpayers will view our use of government cars and equipment in the pursuit of non-federal contract work.

Many, including Director King, feel that the recent changes to Federal security and suitability requirements and the privatization of the OFI are merely casualties of the "Peace Dividend." It was prophesied that when the Cold War ended, full-field investigations and resultant security clearances would become increasingly unnecessary. However, if we have learned nothing from recent, post-Cold War tragedies like Waco, Lockerbie, the World Trade Center and Oklahoma City, it is that the United States still faces serious threats both from within and outside of its borders. The Iron Curtain has fallen, only to be replaced by terrorists, militias, industrial spies, and computer saboteurs. Several groups are on record saying that it is their intent to infiltrate the federal government and destroy it from within. John Walker and Christopher Boyce testified to the ease with which they falsified and/or manipulated the background investigations upon which their security clearances were based. (None of the backgrounds which, I might add, were conducted by OPM.) And, if this were not enough, many of us find no comfort in the fact that the controlling interest in our trustee, Marine Midland Bank, is held by a Shanghai bank.

National defense, security, and the fitness and suitability of the

Federal workforce are not commodities like hammers, ashtrays, and space toilets to be traded on the open market and sold to the lowest bidder. Who among us is willing to take the risk of letting a Timothy McVeigh "slip through the cracks" in order to save a few dollars by cutting corners?

I cannot stress enough the importance of the bill in front of you now that requests a delay of the privatization of the OFI until a thorough review of the feasibility and desirability of any such privatization is undertaken. The GAO has been working for a number of months now on both a cost benefit analysis of this privatization, as well as a report addressing Senator Simon's concerns regarding national security, privacy issues, quality control and contractor access to vital records, such as law enforcement checks. Issues concerning the Privacy Act and the question of whether or not the FBI will allow access to its records when the OFI privatizes have yet to be answered for the final GAO report.

Also, at the request of one of the House's own committees, OPM's Inspector General's Office has recently begun an inquiry focusing on a number of the financial aspects of this privatization. On behalf of my colleagues at the OFI, as well as the security professionals at every one of our customer agencies, not to mention the taxpayers of this country, I implore this committee to support Representative Davis's bill and delay this headlong, blind rush to privatization before the numerous issues addressed herewith are sufficiently and thoroughly resolved.

Mr. Chairman, this concludes my prepared statement. Thank you for inviting me to speak to the Subcommitee on this important matter. I would be happy to respond to any questions you or the other members may have for me.

United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, DC 20510-6275

September 14, 1995

The Honorable Robert E. Rubin
Secretary, Department of the Treasury
1500 Pennsylvania Avenue NW Room 3419
Washington, D.C. 20220

Dear Secretary Rubin:

I am writing regarding the decision made by the Administration to privatize the OPM's investigative division, the Office of Federal Investigations (OFI) by January, 1996.

This decision raises many concerns which I feel need to be addressed before we proceed with privatization. For example, will privatizing this function have an impact on our national security? Will the quality of investigations be maintained? Will privacy of potential employees be protected? These and other similar questions must be thoroughly reviewed in order to ensure that privatization will actually enhance rather than hinder this important function.

I intend to ask the General Accounting Office (GAO) to study these issues, and am hopeful that the conference report for the Treasury and Postal Service Appropriations bill will include language that clearly demonstrates the interest of Congress in these issues as well.

As a customer of the OFI, the Department of the Treasury is in a unique position to comment on the proposed move to privatization. I would greatly appreciate your views on what impact such a transition might have on your agency, and on the investigations process in general. Any comments or concerns that you might be able to contribute are welcome.

Thank you in advance for your attention to this matter. My best wishes.

Cordially,

Paul Simon
United States Senator

PS/dme
cc: Linda L. Roberson
Asst. Secretary for Legislative Affairs and Public Liason

DEPARTMENT OF THE TREASURY
WASHINGTON

500

ASSISTANT SECRETARY

October 5, 1995

1995 OCT 26 AM 8:25

The Honorable Paul Simon
Committee on the Judiciary
United States Senate
Washington, D.C. 20510-6275

Dear Senator Simon:

I am responding to your September 14, 1995, letter to Secretary Rubin in which you asked for Treasury's views on the possible impact of privatizing OPM's Office of Federal Investigations (OFI) by January 1996.

As every appointment in Treasury is made subject to investigation, either for security and/or suitability purposes, the Department is a substantial user of OPM-OFI investigative services, even for those Treasury bureaus which are authorized by OPM to conduct their own investigations. In Fiscal Year (FY) 1995, OPM conducted 2,199 Background Investigations for the Department, at a cost of $1,882,961. Other investigative products provided to Treasury by OPM included 18,175 Special Agreement Checks, 8,265 National Agency Checks, and 11,346 National Agency Check and Inquiries (NACI) investigations. The total cost paid by Treasury to OPM in FY1995 was $3,283,100.

We understand that if OFI is privatized, it will be given sole source authority to conduct investigations for its former customers for a three- to five-year period. Although we believe that disruptions to agencies will be minimal during this time, we are concerned about potential conflicts of interest with OFI continuing to have authority to determine whether agencies can conduct their own investigations or to contract out for such services, and in the process compelling agencies to disclose all aspects of its investigative operation to what is in effect a competitor in the same field.

Following the sole source period, we feel that market forces will take over and there will be significant disruptions to the operations of the Treasury Department. Treasury bureaus without their own investigative capability will be forced either to contract for their investigations (with OFI or a competitor) or seek assistance from another bureau with investigative capability. It is unlikely that with current FTE ceilings, the Department could absorb the investigative workload now performed by OFI. Also, OFI's investment and advances in data processing have increased efficiency in investigative processing which have provided direct benefits to user agencies. The NACI investigation, which OFI conducts in a nearly completely automated fashion, is an investigation of unequaled cost-

effectiveness, at $67 per investigation. Over 11,000 NACIs were conducted by OFI for the Department in FY1995, and I doubt that any other investigative entity could have done this.

Other problems will also present themselves. Training and qualifications of contract investigators will not be uniform, resulting in credibility/quality problems. The costs for quality control and oversight of contract investigators will have to be borne by each agency, thereby offsetting any savings that privatization might provide, and uniformity and standardization of investigative scope and the quality of investigations will be adversely affected. Reciprocity of investigations will be impacted due to the possibility of poor quality and a repeat of abuses which occurred during a similar OPM initiative in 1985. There is also an issue of agency liability for improper conduct by contract investigators.

Access to criminal history information by nongovernment investigators at the local level will be jeopardized, and we are informed that the FBI will not provide contract investigators with access to investigative files due to their sensitivity or classification.

Also, OPM currently maintains a large central database and repository of all civilian investigations, with links being established to the Department of Defense's investigation database, and we see potential national security problems with contractors having access to this information.

The Department's relationship with OFI has been of great benefit to us, and it is hoped that it can continue in a similar fashion. I hope this is responsive to your concerns.

Sincerely,

Linda L. Robertson

Linda L. Robertson
Assistant Secretary
(Legislative Affairs and Public Liaison)

[redacted]

[redacted]

Immigration and Naturalization Service

[redacted]

Office of the Commissioner

425 I Street NW.
Washington, DC 20536

APR - 1 1996

The Honorable James B. King
Director
U.S. Office of Personnel Management
1900 E Street NW.
Washington, DC 20415-0001

Dear Mr. King:

The Immigration and Naturalization Service (INS) is in the midst of an unprecedented recruitment and hiring effort that began in Fiscal Year (FY) 1994 and will continue into FY 1997. Congressional action on INS' FY 1996 budget request has resulted in a total new budget authority of $2.56 billion and 25,366 positions for INS.

During FY 1996, INS plans to recruit to fill 3,204 new positions. Additionally, INS will be recruiting to fill 1,695 positions that were authorized but not filled at the end of FY 1995, and that were provided as a result of reprogramming by Congress. INS' total recruitment and hiring effort, combined with attrition hiring, a comprehensive ongoing reinvestigation program, and significant increases in contractor personnel requiring background investigations, will result in unprecedented demands for Office of Personnel Management (OPM) investigative services in FYs 1996 and 1997.

The timely completion of background investigations is absolutely essential to the accomplishment of INS' hiring goals. The OPM has advised agencies that it will privatize its investigative function on or about July 7, in a "seamless transition" that will not disrupt agency operations. Nevertheless, the unprecedented hiring effort underway at INS and the close scrutiny we are facing in this regard leaves me concerned about the serious adverse impact any diminishment of investigative services would cause at this critical juncture.

Therefore, we are requesting a firm commitment that OPM will continue to meet INS' need for expedited background investigations during FYs 1996 and 1997. We need your personal assurance that OPM will continue to complete all our expedited background investigation requests in 35 days or less, despite our unprecedented demand for this level of service. If such a commitment cannot be made, we request OPM approval for INS to acquire its expedited background investigations from a provider other than OPM. We have presented our concerns to the Department of Justice, which concurs with this request. While we are pleased with OPM's overall service delivery and expect the privatization effort to succeed, INS must have a guaranteed plan for acquiring expedited background investigative services to ensure that the Administration's immigration initiatives are met.

[redacted]



Since June 1994, INS has benefitted from an interagency agreement whereby OPM completes certain key elements of background investigations on Border Patrol Agent applicants and provides INS the results of these preliminary background checks immediately upon completion. The OPM has consistently met its timeliness standards under this agreement and, as a result, INS has been able to appoint new Border Patrol Agents quickly with minimal risk. While Border Patrol Agent hiring will continue at a high level during FYs 1996 and 1997, INS also plans to hire many new Officers in other occupations during this period. I would like to expand our interagency agreement to cover the other occupations in our Officer Corps as well.

I welcome the opportunity to discuss this matter with you. I am available at 202-514-1900, or your staff can contact Kenneth E. Lopez, Director of Security, at 202-514-9615, in this regard.

Sincerely,

Doris Meissner

Doris Meissner
Commissioner

UNITED STATES
OFFICE OF PERSONNEL MANAGEMENT
WASHINGTON, D.C. 20415

APR 29 1996

OFFICE OF THE DIRECTOR

The Honorable Doris Meissner
Commissioner
U.S. Department of Justice
Immigration and Naturalization Service
425 I Street, N.W.
Washington, DC 20536

Dear Ms. Meissner:

First, Doris, please accept my condolences in the loss of your husband, Charles. I pray that you may receive comfort and strength during this time of sorrow.

Thank you for your letter of April 1, 1996, in which you seek assurances that privatization of the Office of Personnel Management's (OPM) investigations unit will not result in any diminishment of investigative services currently provided to the Immigration and Naturalization Service.

You state you are pleased with OPM's overall service delivery, and that OPM has consistently met its timeliness standards under an interagency agreement whereby OPM completes certain key elements on Border Patrol applicant investigations and provides INS the results of these preliminary checks upon completion.

The contract between OPM and the employee owned company, US Investigations Services, Inc., (USIS) became effective on April 12. We still anticipate that the transition to privatization, to occur early in July, will be a "seamless" one. Increases in your workload have been offset by reduced receipts from other OPM customers, so we have not been pressed by workload volume. We expect this pattern to continue, and that the new company's performance will meet your requirements.

We are aware of the unprecedented INS recruitment and hiring initiatives, an effort we have supported not only through being your investigative arm, but by providing assistance to applicants in their preparation of forms and in applicant screening. I have asked Mr. Richard Ferris, Acting Associate Director for Investigations, to work closely with your Director of Security and staff to ensure that OPM and USIS continue to be your provider of choice.

Sincerely,

James B. King
Director

# STATUS REPORT ON PRIVATIZATION OF INVESTIGATIONS FUNCTION

Office of Personnel Management

May 22, 1996

## INVESTIGATIONS PRIVATIZATION

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| Sept 93 | National Performance Review recommends the examination of the investigations function |
| Dec 93 | Investigations losses reach record levels |
| Dec 93 & Jan 94 | "Town Meetings" held with OPM employees announcing the necessity of reductions in force (RIFs) |
| Feb 94 | OPM revolving fund budget nears anti-deficiency if immediate RIF action is not initiated |
| Mar 94 | New Associate Director is appointed to head Investigations Group. Notice of RIF sent to over 400 investigations employees |
| May 94 | OPM RIF's 443 investigations employees as part of a business plan for recovery |
| Dec 94 | President announces Investigations will be privatized |

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| Jan 95 | OPM meets with security chiefs and determines that agencies want OPM to retain central role |
| Feb 95 | OPM considers various privatization options |
| Mar 95 | ESOP feasibility study completed |
| Mar 95 | OPM Director meets with President's Management Council |
| Apr 95 | OPM surveys employees for interest in pursuing an ESOP company |
| Jun 95 | OPM contracts with a trustee to set up the ESOP company |
| Jun 95 | Hearings held by House Civil Service Subcommittee on privatization of investigations |
| Jul 95 | Trustee begins in-depth analysis for the ESOP |
| Jul 95 | GAO begins study of privatization |
| Nov 95 | OPM awards a contract for an independent cost-benefit analysis of privatization through the formation of an ESOP |

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| Mar 96 | Cost benefit analysis shows the ESOP would save at least $20 to $25 million over a five year period |
| Apr 96 | Contract signed with USIS |
| Apr 96 | Draft GAO report received on issues surrounding the privatization of Investigations Service |
| May 96 | RIF notices sent to affected OPM employees and job offers made to them by USIS within 24 hours |
| May 96 | OPM's General Counsel briefs Interagency Advisory Group on Investigations' ESOP status |
| May 96 | OPM's Human Resources personnel brief affected Investigations employees on severance pay, retirement benefits, etc. |
| May 96 | USIS' CEO briefs affected employees on the ESOP company operations and benefits |
| Jul 6, 96 | RIF effective date |
| Jul 7, 96 | USIS begins operations |

Mr. DAVIS. We'll give you some chances during the question and answer period. I think Mr. Saunders has a different perspective. It may be the same outcome, at least at this point, but a different perspective. His company, Varicon, is located in Falls Church, I understand. Whereabouts in Falls Church?

Mr. SAUNDERS. Bailey's Crossroads.

Mr. DAVIS. It's in the 11th. Thank you very much for coming today.

Mr. SAUNDERS. Good afternoon, or is it perhaps evening. My name is Herbert F. Saunders. I am chairman of Varicon International, a Falls Church, VA security firm, whose primary business is providing personnel investigative services or background investigations to U.S. Government clients.

I have more than 40 years of experience in this business, 30 with the Government. And since my retirement in 1984, another dozen or so with Varicon.

Our company has been conducting BI's for the Drug Enforcement Administration [DEA], for the past 5 years. Other current Government clients include the GAO, the SBA, the National Security Agency [NSA], and former clients include the U.S. Customs Service and the Department of Commerce.

I greatly appreciate the opportunity to express my views on the OPM's creation of an ESOP to perform BI's of Federal employees. First, let me say that I fully support the concept of privatization as outlined in the Vice President's National Performance Review. Those of us in private industry who do this work would welcome OPM's ESOP, USIS, in the competitive market place. Competition is good for all of us. It keeps prices down and forces us to continually sharpen our skills.

However, I do not support OPM's implementation of the concept. I do not think that OPM's creation of a sole-source environment that will require most Government agencies to send their work at more than twice the cost to USIS represents the dollar savings and the privatization that the Vice President had in mind.

In fact, I should tell you that Varicon and another local contractor who does this kind of work, MVM, Inc., have jointly filed litigation against OPM in U.S. District Court. We have charged, among other things, that the sole-source environment is a violation of the Competition in Contracting Act, and that OPM failed to take the necessary legal steps required of a U.S. Government entity establishing a corporate agent as required by the Government Corporate Control Act.

Apparently your group is not the only group that was bypassed by OPM.

Nor can I support H.R. 3189. This represents a return to status quo, whose problems of high prices, revolving fund deficits, and lack of timely response have all been well documented painfully in the past. Additionally, I think even Mr. King would admit that, without a major increase in investigative personnel, the Office of Federal Investigations of OPM will be hard pressed to handle the Government's caseload given the major reduction in force that OPM's investigative group took last year.

Let me move on to the issue of national security. I should note that among those who employ private contractors, such as myself,

to conduct background investigations are the NSA, the U.S. Customs Service, the DEA, and two major agencies within the intelligence community. These are not exactly non-sensitive agencies.

In addition, neither FBI nor the State Department nor Department of Defense employ OPM. The first two use private investigators under independent contracts, while DOD employs a mixture of these and staff investigators. As far as I can tell, none of these agencies has any problems with quality assurance.

As for cost, it suffices to say that OPM charges the Government about $4,200. That's my figure. Mr. Ferris said $3,995. Whether it's $3,995 or $4,200, I can tell you that private industry does the same kind of work for well less than half of that number. That $4,200 figure that I gave you or $3,995, take your pick, is for a single scope background investigation, the standard for access to top secret material.

On one occasion, OPM announced that USIS will charge the same as OPM. That statement was made very recently. Another very recent statement said by OPM that USIS will raise OPM prices by 3 percent.

In summary, I believe that the solution to this frustrating problem is true privatization in a competitive marketplace, which includes USIS and offers individual agencies in the U.S. Government the opportunity to choose the entity that best meets their BI needs in terms of professional capability, ability to meet timeliness requirements and costs.

Once again, thank you for the opportunity to express my views.

[The prepared statement of Mr. Saunders follows:]

DATE: May 22, 1996

TESTIMONY OF: HERBERT F. SAUNDERS

TO: HOUSE COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT'S SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION AND TECHNOLOGY

GOOD AFTERNOON. MY NAME IS HERBERT F. SAUNDERS. I AM CHAIRMAN OF VARICON INTERNATIONAL, A FALLS CHURCH, VIRGINIA SECURITY FIRM WHOSE PRIMARY BUSINESS IS PROVIDING PERSONNEL INVESTIGATIVE SERVICES OR BACKGROUND INVESTIGATIONS (BI) TO U.S. GOVERNMENT CLIENTS. I HAVE MORE THAN 40 YEARS OF EXPERIENCE IN THIS BUSINESS, 30 WITH GOVERNMENT, AND SINCE MY RETIREMENT IN 1984, ANOTHER 12 WITH VARICON.

OUR COMPANY HAS BEEN CONDUCTING BI'S FOR THE DRUG ENFORCEMENT ADMINISTRATION (DEA) FOR THE PAST FIVE YEARS. OTHER CURRENT GOVERNMENT CLIENTS INCLUDE THE GENERAL ACCOUNTING OFFICE (GAO), THE SMALL BUSINESS ADMINISTRATION (SBA) AND THE NATIONAL SECURITY AGENCY (NSA). FORMER CLIENTS INCLUDE THE U.S. CUSTOMS SERVICE AND THE DEPARTMENT OF COMMERCE.

I GREATLY APPRECIATE THE OPPORTUNITY TO EXPRESS MY VIEWS ON THE OFFICE OF PERSONNEL MANAGEMENT'S (OPM) CREATION OF AN EMPLOYEE STOCK OWNERSHIP PROGRAM (ESOP) TO PERFORM BI'S OF FEDERAL EMPLOYEES.

TO BEGIN, LET ME SAY THAT I FULLY SUPPORT THE CONCEPT OF PRIVATIZATION AS OUTLINED IN THE VICE PRESIDENT'S NATIONAL PERFORMANCE REVIEW. THOSE OF US IN PRIVATE INDUSTRY WHO DO THIS WORK WOULD WELCOME OPM'S ESOP, U.S. INVESTIGATIONS SERVICE, INC.

(USISI), IN THE COMPETITIVE MARKETPLACE. COMPETITION IS GOOD FOR ALL OF US. IT KEEPS PRICES DOWN AND FORCES US TO CONTINUALLY SHARPEN OUR SKILLS.

HOWEVER, I DO NOT SUPPORT OPM'S IMPLEMENTATION OF THE CONCEPT. I DO NOT THINK THAT OPM'S CREATION OF A SOLE SOURCE ENVIRONMENT THAT WILL REQUIRE MOST GOVERNMENT AGENCIES TO SEND THEIR WORK (AT MORE THAN TWICE THE COST) TO USISI REPRESENTS THE DOLLAR SAVINGS AND THE PRIVATIZATION THAT THE VICE PRESIDENT HAD IN MIND. IN FACT, I SHOULD TELL YOU THAT VARICON AND ANOTHER LOCAL CONTRACTOR WHO DOES THIS WORK, MVM, INC., HAVE JOINTLY FILED LITIGATION AGAINST OPM IN U.S. DISTRICT COURT. WE HAVE CHARGED, AMONG OTHER THINGS, THAT THE SOLE SOURCE ENVIRONMENT IS A VIOLATION OF THE COMPETITION IN CONTRACTING ACT (CICA) AND THAT OPM FAILED TO TAKE THE NECESSARY LEGAL STEPS REQUIRED OF A U.S. GOVERNMENT ENTITY ESTABLISHING A CORPORATE AGENT, AS REQUIRED BY THE GOVERNMENT CORPORATE CONTROL ACT.

NOR CAN I SUPPORT H.R. 3189. THIS REPRESENTS A RETURN TO STATUS QUO, WHOSE PROBLEMS OF HIGH PRICES, REVOLVING FUND DEFICITS AND LACK OF TIMELY RESPONSE HAVE BEEN WELL DOCUMENTED IN THE PAST. ADDITIONALLY, I THINK EVEN MR. KING WOULD ADMIT THAT WITHOUT A MAJOR INCREASE IN INVESTIGATIVE PERSONNEL, THE OFFICE OF FEDERAL INVESTIGATIONS OF OPM WILL BE HARD PRESSED TO HANDLE THE GOVERNMENT'S CASE LOAD, GIVEN THE MAJOR REDUCTION IN FORCE THAT OPM'S INVESTIGATIVE GROUP TOOK LAST YEAR.

LET ME MOVE ON TO THE ISSUE OF NATIONAL SECURITY. I SHOULD NOTE THAT AMONG THOSE WHO EMPLOY PRIVATE CONTRACTORS TO CONDUCT BACKGROUND INVESTIGATIONS ARE THE THE NATIONAL SECURITY AGENCY (NSA), THE U.S. CUSTOMS SERVICE (USCS),THE DEA AND TWO MAJOR

AGENCIES WITHIN THE INTELLIGENCE COMMUNITY. THESE ARE NOT EXACTLY NON-SENSITIVE AGENCIES. IN ADDITION, NEITHER FBI, STATE DEPARTMENT NOR DEPARTMENT OF DEFENSE EMPLOY OPM. THE FIRST TWO USE PRIVATE INVESTIGATORS UNDER INDEPENDENT CONTRACTS, WHILE DOD EMPLOYS A MIXTURE OF THESE AND STAFF INVESTIGATORS. AS FAR AS I CAN TELL, NONE OF THESE AGENCIES HAS ANY PROBLEMS WITH QUALITY ASSURANCE.

AS FOR COST, IT SUFFICES TO SAY THAT OPM CHARGES THE GOVERNMENT ABOUT $4,200 FOR A SINGLE SCOPE BACKGROUND INVESTIGATION, THE STANDARD FOR ACCESS TO **TOP SECRET** MATERIAL. THIS IS MORE THAN TWICE WHAT PRIVATE INDUSTRY CHARGES FOR THE SAME WORK. ON ONE OCCASION, OPM ANNOUNCED THAT USISI WILL CHARGE THE SAME AS OPM; ON ANOTHER THEY STATED THAT USISI WILL RAISE OPM PRICES BY THREE PERCENT.

IN SUMMARY, I BELIEVE THAT THE SOLUTION TO THIS FRUSTRATING PROBLEM IS TRUE PRIVATIZATION IN A COMPETITIVE MARKETPLACE WHICH INCLUDES USISI AND OFFERS INDIVIDUAL AGENCIES IN THE U.S.GOVERNMENT THE OPPORTUNITY TO CHOOSE THE ENTITY THAT BEST MEETS THEIR BI NEEDS IN TERMS OF PROFESSIONAL CAPABILITY, ABILITY TO MEET TIMELINESS REQUIREMENTS AND COST.

ONCE AGAIN, THANK YOU FOR THE OPPORTUNITY TO EXPRESS MY VIEWS.

Mr. DAVIS. Thank you very much. Let me ask each of you, in a sense, you're each coming at what the Government has done in this case, from what OPM has done from a different angle. But there is no reason that, at the time of the floods that Mr. King spoke about, they couldn't, instead of staffing up at that time, go out temporarily and supplement what they would need with professional investigators, with privates that they could put into some of the holes in here that would not violate areas where you generally have some sensitivity to have Government investigators as opposed to private. Will each of you agree with that?

Ms. APPERSON. I absolutely agree. As I said, we're doing that now. I think we have—Director King's handlers have more of the—since I have none. They have more of these.

Mr. DAVIS. I don't think you need a handler. You're doing pretty good.

Ms. APPERSON. Thank you. I take that as a compliment. I believe there is like 60 investigators nationwide right now that are supplementing contract investigators, personal PIC'ers we call them, personnel investigation contractors, that are helping with the workloads here in Washington, as a matter of fact, and other parts of the country, New York and the Southwest quadrant of the country where we have many, many border patrol applicants at this time.

Mr. DAVIS. And when the flood comes, you could do even more of that if you were afraid about staffing internally and then having to lay people off. There is nothing to stop that.

Ms. APPERSON. Correct.

Mr. SAUNDERS. Incidentally, when the flood comes, there is nothing to stop OPM from seeking the assistance in the private sector. However, the question is whether they would do that. One format through which they could do it would be to issue delegations of authority to certain agencies to contract out. But, traditionally, getting those delegations of authority is like pulling teeth. And they have made recent statements in the past year or so that no further delegations of authority would be permitted. And those wayward souls who are out there would be encouraged forcibly to return to the fold.

So the question is whether they're willing to do it.

Mr. DAVIS. But that would be a solution.

Mr. SAUNDERS. Absolutely.

Mr. DAVIS. One of Varicon's problems, and any private contractor, is the fact that this is basically being sole sourced. And if you talk about savings, if you assume you're comparing apples to apples—and I'm not assuming that. But assume you're comparing apples to apples. That is, the new ESOP plan versus what's currently provided saves money. But in point of fact, you could probably save even more money if you were to just go ahead and privatize.

Mr. SAUNDERS. I think so, because if whatever their price is for a single scope BI—let's say $4,100 is an average, I guess, of $3,995 and $4,200. And they imply that they will reduce those figures or those costs as time passes. What is the incentive to reduce your costs when you have a monopoly? When I've got the market cornered, why would I reduce my costs?

Let's face it. The costs are not going to be reduced. They're going to expand. And that is not a savings for the Government.

Mr. DAVIS. Ms. Apperson, can you describe what happens under the current system at OFI when an investigator uncovers incriminating evidence regarding a job applicant? What's the process? What are the safeguards to make sure that such evidence is not ignored and kept in the appropriate confidential manner?

Ms. APPERSON. Well, one, because we're under no—there are some time constraints. We have critical deadline dates that we must make for the agencies or make every effort to make. And right now, we're doing that quite successfully.

If we have derogatory, seriously derogatory information in the background investigations, we are able to pursue, to the extent that we need to pursue, every possible lead to resolve any information. There is no—money is not the cost factor there to getting a thorough and complete background investigation. It's giving the agencies an investigation that will allow them to properly adjudicate the case and determine whether or not someone should be hired and/or given access to sensitive information or whatever the criteria.

Mr. DAVIS. Is there a different process a private contractor would handle in terms of doing this? Do you see a different outcome if this is either privatized through a company like Mr. Saunders or through the current ESOP proposal?

Ms. APPERSON. That's absolutely my contention, when the bottom—the solvency of USIS or any other company is—when the bottom line is profit, you're going to cut those corners. And I gave an example of that in the licensing requirements that Varicon International, ADC, and I would rather imagine several other companies in the State of Virginia have circumvented. And I don't know if that's to cut down costs or what.

But I'm concerned that our own ESOP may well do that. They have nothing to get us licensed and registered and in compliance with the State laws or the Commonwealth of Virginia's laws. There was some lipservice given to it last week when our new CEO visited our office, but there is no concrete plan to have that done before we are operating as USIS on July 7.

Mr. DAVIS. Mr. Saunders, let me just get your perspective from a private company. Is there anything that Government investigators have a hand up on that perhaps a private company would not in terms of these investigations in any of these areas that have been talked about?

Mr. SAUNDERS. Not really, because we don't operate on little Mickey Mouse identification cards. I have 450 investigators, for instance, spread throughout the United States who carry DEA credentials. They are identified as contract investigators operating on behalf of DEA. And they are not denied criminal records. They are not denied access to any other records. They are operating as essentially Government employees.

And I want to comment on Ms. Apperson's licensing business. She is obviously confused. Varicon is a Virginia corporation. I am licensed to do business in the State of Virginia. I am not licensed in other States. I do not need to be licensed in other States. My investigators carry U.S. Government credentials. And they do not

require a license to operate in the State on behalf of the U.S. Government.

If I'm doing a private investigative case, that's a different matter. I use a local investigator who is privately licensed in that State. She mentioned ADC. ADC is not a Virginia corporation. There is no reason for them to be licensed here. It's a New Mexico corporation. They are presumably licensed there. And they do not need to be licensed elsewhere in the United States as long as their investigators are carrying U.S. Government credentials.

So that's one of the many allegations that she parades in her statement. And I'm used to this. I'm not a rookie crossing swords with OPM. I'm used to being peppered with a variety of half truths and no truths and kernel truths. And that's one of the many that just doesn't hold any water.

Ms. APPERSON. May I respond to that?

Mr. DAVIS. Sure.

Ms. APPERSON. Mr. Leon Baker, the head of Department of Criminal Justice Services, with whom I've been in contact with a number of times for over a year now, has made it quite clear—and that's why I have this in my statement. That it does not matter that you are an investigator with credentials that appear to be Federal or federally issued, whatever, if you are doing business in the Commonwealth of Virginia as a private investigator, whether it be on contract to the Federal Government, a State government or a local government, there are various—and I have these requirements with me. There are various compliance, registration, and training requirements that your investigators do not have, because I've spoken to several of them.

These are just some of my concerns in terms of the ways that companies will get around cutting costs.

Mr. SAUNDERS. The FBI doesn't meet those standards, either. In fact, the FBI is currently pursuing litigation contesting Department of Criminal Justice's edict that their people need to be private investigators.

Mr. DAVIS. We don't need to resolve that here. Let me just ask either of you if you have any comments with Director King's testimony, if there is anything that stood out there that maybe you would like to address that we didn't ask before? I'll ask Mr. Saunders first and then go to you, Ms. Apperson.

Mr. SAUNDERS. I think there are a number of things that stood out. I don't know that we have time here. That struck me. I don't want to use this word, dissembling, but there is a pattern here of beating around the bush and portraying all OFI employees as avidly interested in this program and supporting it assiduously when, in fact, my sources don't imply anything remotely close to that. And, apparently, Congressman, your sources don't, either.

Mr. DAVIS. I think his sources were the same at the end, did you notice?

Mr. SAUNDERS. I think so. We're talking to the same people perhaps. And there are a lot of them.

Mr. DAVIS. The old saying, don't kid a kidder.

Mr. SAUNDERS. The other thing is that since this began, and it seems like it's been going on forever. OPM operates with a rather cavalier attitude that they can do whatever they please. They spent

money on Midland Bank. They spent money on these ESOP people who are nothing but private people under contract to them. And they tout their responses as bible.

They bypassed your committee in an arrogant, cavalier way. And they're trying to buffalo the rest of us one more time. I think those are the things that strike me about their style.

Mr. DAVIS. Thank you. Ms. Apperson.

Ms. APPERSON. With respect to the revolving fund, there are parameters. And I'm not expert in this, but as I understand it, there are parameters which prohibited from accruing, are losing too much money within—I believe it's a 3-year cycle. And when, in fact, we are making money, not only does that allow us, it compels us to reduce the costs to the agencies of our background investigations. That's one important point.

With respect to you I had asked, Congressman Davis, if Director King was aware of any agencies right now that were considering asking for their delegations of authorities to be restored. I have attached the INS letter to my statement, where Commissioner Mizner asks Director King in April of this year that she be given a firm and solid commitment that we would continue to meet the timeliness and quality demands of their impression recruiting effort that they are undergoing right now.

They have also asked that if we cannot, that they be allowed to go outside of OPM to have others conduct their background investigations.

Furthermore, with respect to this, I've read the contract and the business plan. I didn't understand a lot of it. But one thing that was clear was there was language in there saying that OPM would do everything it could to make sure that the delegations of authority stayed with this new company, that they would not pull back those delegations of authority. But there is an out that the director or subsequent director would have to, if the agencies, I guess, holler and scream loudly enough, that they could get out of the USIS contract and find and seek their own investigators.

I believe there was one other comment. The police checks. In fact, I believe there is one lady here in the audience today who is on detail to the DEA, reviewing the very background investigations that Varicon does for the DEA. There were innumerable, innumerable investigations that were done where the investigators had noted out specific law enforcement coverage that could not be obtained by contract investigations. This is a matter of fact. It's not an allegation.

We know from the Department of the Treasury's letter that I attached to my statement, according to what Treasury was told back in October when they responded to this letter, request from Senator Simon to answer some questions, it was Treasury that apparently had information from the FBI that they were not going to continue to provide us with record information that we now receive and are vital to our background investigations.

This has not been resolved and I understand that GAO has yet to hear from the FBI definitively on this. And they have also yet to hear from OMB on a number of questions regarding Privacy Act concerns.

Mr. DAVIS. Thank you very much. I think those are my initial comments. I'd like to ask the gentlelady from New York if she has any questions at this point.

Mrs. MALONEY. I'd just like to ask, Ms. Apperson, you seem to believe in your statement that investigators are an inherently governmental function. Do you also believe that OPM should pull back the various delegations of authority that it has given several agencies to conduct or contract investigations?

Ms. APPERSON. No, I'm not. I believe that we should be doing virtually all of these background investigations; or some Federal investigative entity to give us the controls and the quality oversight and everything that you don't have in a contract operation.

I don't believe the delegation of authority should be given to other agencies, but that's not my decision to make. And it has been. And whether it's been successful or not, you'd have to ask those agencies that have asked for their delegations.

Mrs. MALONEY. I'd like to ask, Mr. Saunders, one of the allegations we hear against the privatization of investigations is that the pressure for profits causes agencies to cut corners. Do either of you believe that private investigations, whether done by USIS or your particular company or any company, are of a lower quality?

Mr. SAUNDERS. That's absurd nonsense. If I were interested primarily in profit, I never would have served the U.S. Government for 30 years. That's just nonsense. It's demeaning.

Mrs. MALONEY. So you think a private firm can do just as well as government?

Mr. SAUNDERS. We do the best we can regardless of the profit level. I'm not in this for the money. I'm in this to continue to serve my country in a private capacity. I'd like to do the very best job I can. None of us is perfect. We do the best we can. We want to give the government every value for their nickel. And to suggest that we would cheat, lie or steal or circumvent for profit is a scurrilous observation by somebody who ought to know better.

Mr. DAVIS. You can mark him down as undecided on that.

Mrs. MALONEY. It has been contended that USIS, which is now a private firm.

Ms. APPERSON. I feel the potential for abuses there.

Mrs. MALONEY. Mr. Saunders said he doesn't see any abuses in a private firm.

Ms. APPERSON. We agree to disagree. I don't mean from the integrity of the work force, but it's going to be from Phil Harper, our CEO, on down, who is going to say, get these out. We're not producing widgets. We're producing very extremely important background investigations on people who—I could tell you stories. And I've shared some generically with Representative Davis, of people who are trying to infiltrate this Government, militia types of members.

There are many, many people in the 15 years that I've been doing this, there are many, many people that are attempting to get jobs in the Government that are very frightening and very scary. And when we have the ability, as investigators now, without worrying about the bottom dollar, the bottom line on each case, when we have the ability to totally resolve issues, develop issues, get every possible, potentially valuable source that we need to do this, we're

not going to—there is not going to be the slippage through the cracks that you've seen with other agencies.

I have to proudly say OPM has never had a spy case. The CIA can't say that. The State Department can't say that. The FBI can't say that. We have some outstanding investigators. That's what we do. That's our primary focus.

And my concern with USIS, and again in my statement, one of things that our CEO put up on a transparency last week when he was visiting our office, between workers' comp cases and EEO cases, was the term, shopping services. Every one of the investigators in the room were looking at each other like, what are shopping services. And he said that it's a large, untapped market where mystery shoppers or secret shoppers would go into department store chains and comment on internal and retail operations. Covert price comparisons we guess. I don't know.

That's frightening. That's not what I took my oath of office to do, nor any of my compadres back here. This is now what we should be using government cars and equipment for. This is not about what national security is about. It's very disturbing to me.

Mrs. MALONEY. One of the panelists earlier testified that, whether it's USIS or the Government or Mr. Saunders' organization or whatever organization, you are being charged to go out and get information. And then it was given to someone who then made the evaluation of whether or not this person was a militia person or whatever, trying to infiltrate the government to use the example that you gave. So it was purely an informational background check that then the information was put forth.

Is that a fair assessment of the activities?

Ms. APPERSON. That's rather simplistic, but, yes, we gather information. There is no doubt about it. But the information that we gather and the purpose we're gathering it for is extremely important. It's not like going out and deciding the price of what this hammer will cost versus this hammer. It's a different fact gathering missions.

Mrs. MALONEY. But it's a fact-gathering mission. I'd like to ask Mr. Saunders something. It has been contended by some that USIS will not have access to some of the records it needs to conduct its investigations, and consequently the reports will be inadequate. Does your agency face this type of problem?

Mr. SAUNDERS. I think I've got your question. I was just sitting here musing, wondering who would want to steal OPM's secrets. But that's neither here nor there, I guess. There are some problems in getting access to some records. And I can document that for you fairly precisely, I think. There are, for instance, four States that come to mind who traditionally have been reluctant to provide criminal data to, other than FBI people essentially is what it amounts to.

Those States are New York, Massachusetts, Maryland, and Georgia that come to mind. There may be one or two more.

We at Varicon went to both Maryland and Georgia and said, hey, we are operating on behalf of the U.S. Government, a law enforcement agency—in this particular case, DEA, which is not my only client, I might say. And, therefore, we should have access. And

both of those States agreed, so that my investigators get criminal records from the States of Georgia and Maryland.

At gunpoint, you cannot get Massachusetts or New York to provide criminal records to anybody, including on occasion, I think, the FBI. They simply don't have the time. They are so inundated with fighting crime that they don't have any record guys who can sit in there and pass out records. You can't get the records from them.

Mrs. MALONEY. What do you do in that case? Do you get the FBI to intercede for you? What do you do in that type of case?

Mr. SAUNDERS. In that case, there are several options. In the case of Maryland, for instance, Maryland said, we don't want to give the records right to you, but we'll give them to DEA.

So we submit the check and they send the results directly to DEA, which suffices.

Now, if you cannot get access to a police department criminal record, there are other sources. The agency itself, who is sponsoring that contract, can simply run an NCIC check on their own. Private industry can't do that, but a government agency can. It can run a national criminal indices check where all felonies are recorded. It's an FBI repository essentially. Across the State, felonies are recorded.

The second option is you can simply go to the criminal court system. And the records there are open to the public. If somebody has been convicted of a felony, it's on record in the criminal court. You don't need to go to the police department.

So there are ways to get around those several exceptions. The other 46 or so States, as far as I know—and we operate in all of them—I don't know of an instance where we have been denied any criminal records.

So I would think that the USIS will be faced with the same problems or lack of problems in getting access as we are.

Mrs. MALONEY. So they would face the same problems that you do.

Mr. SAUNDERS. I think they'll face a bigger problem, because traditionally police are not supposed to give criminal records to anybody, even a Government agency that is not in the law enforcement business. I don't represent the Department of Agriculture. I'm glad I don't. These people will.

How you represent the Department of Agriculture as a law enforcement agency and get criminal checks, I don't know. I don't know. So I think they can anticipate some problems there. I don't think any homework has been done on that.

Ms. APPERSON. May I speak to that? I can assure you that we won't be falsely using our credentials as several investigators who work on contract to Varicon——

Mr. SAUNDERS. That's a charge that is news to me. I'd like to see you document it. If I find somebody who has done that, he would be on the street looking for work with you tomorrow.

Ms. APPERSON. I have sanitized versions of that.

Mr. SAUNDERS. Let me have them. Don't make allegations. Just give them to me.

Ms. APPERSON. And I believe that this committee can request that, and that OPM can provide that. I can give them the road map to get there. DEA contractors for Varicon used their credentials to

conduct law enforcement checks in the D.C. Department of Corrections for the SBA. That is simple fact. We have that information on record. We would be more than happy to provide it to you.

Mrs. MALONEY. I have no further questions. Thank you, Mr. Chairman.

Mr. DAVIS. It looks to me the problem with what OPM is trying to do is, on the one hand, they're being kind from upstairs for to try to look at a reduction of FTE's. And then on the other hand, they still have a heart and want to look after the employees. They're trying to have it both ways.

But if you want to save money and you don't feel that the current system does it, then you really ought to go to the private sector and do it that way. And that would argue for what you're doing, Mr. Saunders. And it doesn't protect the employees that way, but it would be a true privatization. You get the best price and you let the market set the price instead of some artificial deal.

On the other hand, if the employees are doing a good job, as he seems to admit they are, and the problem is in managing the ebbs and flows of the work load, it seems to me that you stay with your employees. And if you want to manage the ebbs and flows, there are other ways of doing that than having to staff-up each time and fire people each time.

In trying to steer between this cherubness of keeping your employees, but not making employees, you end up, instead of creating a horse, you create a camel.

So each of you have come at it in a different way with really different perspectives on this, but I think it would attack the problem. Do we have a camel here that really is not going to be the most efficient way to operate that we might do?

So I greatly appreciate each of you taking the time to testify today. I think you've both given thoughtful testimony. You've really hit it from different angles, but I think that's going to be helpful for the committee, because our committee, frankly, is made up of people from both sides of the issue. This is neither fish nor fowl. This is new and experimental.

If you're going to do it, what's the hurry? Why not study it and look at it a little more and make sure that it's going to work if that's the opportunity. And, frankly, for employees who want to go into the private sector, there are plenty of opportunities out there if you're a good wide-awake inspector, to go out there and work your way up, start your own company or whatever, without having to do it in this way.

So I think you have highlighted the problem. I understand where Director King is coming from and the pressures that he's trying to react to. In fairness to him, I think he's trying to look after the people that he's being forced to let go. But in the end, does that drive the issue, or does the dollars drive the issue? So I appreciate everybody coming. I think if there's no other questions that come before the committee, we'll stand in adjournment. We'll keep the record open for 30 days. Let's keep it open for 2 weeks if there's anybody else.

Mr. PETRIC. Mr. Davis, can I approach?

Mr. DAVIS. This is a member from the AFGE. We'd be happy to have a statement in the record. You're not on the list.

Mr. PETRIC. I did not bring anything for the record. I just wanted to make a 10-second comment.

Mr. DAVIS. If there is no objection, we'd be happy to. No objection?

Mrs. MALONEY. No objection.

Mr. HORN. No objection.

Mr. PETRIC. My name is Ivan Petric. I am the chief steward for the American Federation of Government Employees, AFGE Local 32 at OPM. On behalf of the OPM investigators, we object to OPM's privatization and the ESOP contract. As has been indicated here, we believe that the information is inflated and that the employees basically should remain with OPM as investigators doing the job that they're destined to do. I appreciate taking the opportunity to speak before the Congress and to be heard regarding these issues.

Thank you.

Mr. DAVIS. Thank you very much. Once again, anybody, any statements you'd like to put in the record, the record will remain open. Again, we thank everybody for your time in staying with us.

[Whereupon, at 5:53 p.m., the subcommittee was adjourned.]

[Additional information submitted for the hearing record follows:]

INSERT 1

For your convenience, we have attached a copy of the complete report by Kormendi/Gardner Partners regarding the benefits and costs of the privatization of OPM's Investigations Service. We would call to your attention in particular the tables on pages 2 and 18.

# THE BENEFITS AND COSTS OF THE ESOP PRIVATIZATION OF THE OFFICE OF PERSONNEL MANAGEMENT INVESTIGATIONS SERVICE

*MARCH 5, 1996*

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# THE BENEFITS AND COSTS OF THE ESOP PRIVATIZATION OF THE OFFICE OF PERSONNEL MANAGEMENT INVESTIGATIONS SERVICE

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## *EXECUTIVE SUMMARY*

This report analyzes information and data provided by the Office of Personnel Management ("OPM") regarding the planned privatization of its Investigations Service through the establishment of US Investigations Services, Inc. ("USIS"), an employee-owned company (an "ESOP") that will contract with OPM to provide investigations services for OPM's client federal agencies. We also analyzed information and data provided by Marine Midland Bank, which is to be the ESOP Trustee, and by American Capital Strategies, Ltd. ("ACS"), the Trustee's Financial Advisor.

We received the full cooperation of OPM, Marine Midland Bank and ACS, and available data and documentation were provided as requested. It is our judgment that the available data are useful and reliable in the circumstances for business planning and for the purposes of this report, and that the cost and revenue estimates for USIS that we were provided are reasonably accurate and useful in the circumstances.

We conclude, based upon the information and data provided to us, that the proposed privatization will cost the federal taxpayers considerably less than the current arrangements for providing investigations services to OPM's client federal agencies. The principal categories of savings to the taxpayers are as follows:

- **Price Reductions** Compared to current OPM pricing for investigations products, USIS plans to reduce prices charged to OPM, and OPM plans to pass the price reductions through to its client agencies.

- **Corporate Income Taxes** USIS will be a for-profit corporation. Although its form of organization is tax favored, its profits are not entirely tax sheltered, and the USIS business plan provides for significant payments of federal corporate income taxes.

- **Pension Savings** The federal government will realize substantial savings from reduced retirement annuity payments to the employees whose federal employment will be severed when they become employees of USIS. (From the employees' perspective, the value of their share ownership in USIS stock is an offset to their reduced pension benefits.)

The principal cost to the federal taxpayers of the ESOP privatization is the severance pay to the employees whose federal employment will be terminated. This amount must be deducted from the amounts of the above categories of benefits to determine the net savings to the taxpayers from the privatization.

The following tables summarize the analysis and calculations detailed in the body of the report. The first table presents our estimates of the present values[1] of the amounts of each of the principal components of the benefits and costs of the privatization. The second table sets forth range estimates for the total net present value of the savings from the privatization. As presented there, we estimate that the ESOP privatization will save the federal taxpayers at least $15 - $20 million and perhaps as much as $120 million, with a reasonable estimate of the savings being in the range of $80 - $100 million.

**Table ES-1**

**OPM-IS PRIVATIZATION**
**BENEFIT AND COST ESTIMATES**
**PRESENT VALUE BY CATEGORY**

| BENEFIT AND COST CATEGORIES Benefit = (+) Cost = (-) | | Initial 5 Years | Beyond 5 Years |
|---|---|---|---|
| | | (Millions) | |
| Price Reductions | (+) | $8 - $13 | $35 - $70 |
| Federal Income Tax Receipts | (+) | $5 - $10 | $10 - $20 |
| Reduced Pension Costs | (+) | $10 - $15 | - |
| Severance Payments | (-) | ($8) | - |
| TOTALS | | $15 - $30 | $45 - $90 |
| ALL YEARS TOTAL | | $60 - $120 | |

**Table ES-2**

**OPM-IS PRIVATIZATION**
**RANGE ESTIMATES OF**
**TOTAL NET PRESENT VALUE**
**OF SAVINGS**

| | Conservative | Reasonable | Optimistic |
|---|---|---|---|
| | (Millions) | | |
| Initial 5 Years | $15 - $20 | $20 - $25 | $25 - $30 |
| Beyond 5 Years | $45 - $60 | $60 - $75 | $75 - $90 |
| TOTALS | $60 - $80 | $80 - $100 | $100 - $120 |

[1] All present value reported in this analysis were calculated pursuant to Office of Management and Budget guidelines.

## I. INTRODUCTION

This report examines cost savings to the government that will occur by transferring the Office of Personnel Management's Investigations Service ("OPM-IS") to the private sector. We seek to measure whether contracting out this service, on the terms and conditions bargained, will be to the financial advantage of the U.S. Government. To provide this measure of benefits we examine the structure of the transaction and compare how the future provision of OPM-IS services under private management and employee ownership will compare with equivalent services provided under government management and ownership.

## II. THE PROPOSED PRIVATIZATION

OPM-IS provides background investigation services to a wide range of U.S. Government agencies. Two broad types of services are provided: field investigations and record checks. Field services, because they require investigators to go into the field and interview individuals, are more expensive. Both services are offered with different levels of detail as specified by the client agency, and the client can choose between 35, 75, and 120 day service for field investigations. Under government ownership, services are provided to client agencies of the federal government and the agencies pay OPM-IS for the services. At the end of the fiscal year, either a surplus is earned or there is an operating deficit. For example, in 1993 and 1994 losses were $20.1 and $13.8 million, respectively; while in 1995 OPM-IS net income was $20.7 million due to the success of turnaround initiatives implemented beginning in fiscal 1994 and a one-time large order increase by a client agency. The cumulative OPM-IS revolving fund deficit stood at about $14 million at the end of fiscal 1995.

The privatization of OPM-IS is to be accomplished by OPM contracting with US Investigations Services, Inc. ("USIS") for these services. USIS is to be established as part of this privatization as a corporation owned by its employees. They will acquire ownership of shares in USIS primarily through participation in an Employee Stock Ownership Plan ("ESOP") administered pursuant to the Employee Retirement Income Security Act of 1974. A shell unit consisting of a small number of employees will remain within OPM to serve as the point of contact with client agencies, administer the contract with USIS and maintain essential databases that could not reasonably be maintained outside the government. All other current OPM-IS employees will simultaneously be terminated from federal service and offered employment by USIS. The proposed USIS contract has a three year initial term. OPM will have the right to extend the contract for up to two additional years.

It is our understanding that the products currently offered by OPM-IS will continue to be offered, but that quantities ordered by client agencies generally are expected to decline over time due to reduced federal government demand. In addition, USIS will attempt to develop and deliver new

products in the investigative services field to private corporations and state and local governmental units, some of which OPM-IS is prohibited from providing. These new products, while they contribute to the economic viability of USIS and to society in general, are not a direct source of benefit to the government. The government benefits only indirectly to the extent that these services afford a source of efficiency in spreading fixed costs over a larger base, thus enabling lower prices to be charged to the client federal agencies.

The ongoing services that we consider are shown in Table 1.[2]

**Table 1**

| OPM-IS INVESTIGATIONS SERVICES | | |
|---|---|---|
| **SERVICE** | **ACRONYM** | **OPM-IS ID** |
| NATIONAL AGENCY CHECK | NAC | 6B |
| NATIONAL AGENCY CHECK AND CREDIT | NACC | 6B |
| NATIONAL AGENCY CHECK AND INQUIRIES | NACI | 2B |
| NATIONAL AGENCY CHECK, INQUIRIES AND CREDIT | NACIC | 2B |
| PERIODIC REINVESTIGATION | PRI | 11C |
| PERIODIC REINVESTIGATION AND RESIDENCE COVERAGE | PRIR | 12C |
| PERIODIC REINVESTIGATION FOR SBI/NSD-63 | PRIS | 13C |
| MINIMUM BACKGROUND INVESTIGATION | MBI | 15C |
| LIMITED BACKGROUND INVESTIGATION | LBI | 20A,B,C |
| BACKGROUND INVESTIGATION | BI | 25A,B,C |
| UPDATE FROM PREVIOUS BI -36 | BDI36 | 26A,B,C |
| UPDATE FROM PREVIOUS BI -60 | BDI60 | 28A,B,C |
| SINGLE SCOPE BACKGROUND INVESTIGATION (NSD-63) | SBI | 30A,B,C |
| UPDATE FROM PREVIOUS SBI-36 | SDI36 | 31A,B,C |
| UPDATE FROM PREVIOUS SBI-60 | SDI60 | 33A,B,C |
| REIMBURSABLE SUITABILITY INVESTIGATION | RSI | -- |

It is our understanding that these services will be provided by USIS using essentially the same inputs -- employees and capital goods -- as currently employed by OPM-IS.

[2] OPM-IS also conducts update and upgrade investigations, essentially subsets of its basic types, because of a break in service (update) or movement of an employee to a higher sensitivity or risk level. These investigations together are projected to number less than 700 per year.

## III. ANALYSIS OF NET PRIVATIZATION BENEFITS TO THE GOVERNMENT

Benefits to the government in the provision of services accrue either because more services can be obtained for the same per unit cost, or because a given level of service can be obtained at a lower per unit cost.

Analytically we represent this in the following manner. Let $B_t$ represent the value per unit of investigative services to the government; let $Q_t$ be the quantity of such services provided at time t, and let $c_t^G$ be average cost per unit incurred under government ownership and production. The value of the enterprise to the government is

$$[1] \quad V_t^G = \sum_{t=1}^{\infty} (1 + R)^{-t} \{(B_t - c_t^G) Q_t\} - F_t^G$$

where $F^G$ represents the current value of future obligations accrued but not paid at date t, and R is the discount rate. If the facility is run by the private sector and its output purchased by the government at price, p the value to the government is

$$[2] \quad V_t^P = \sum_{t=1}^{\infty} (1 + R)^{-t} \{(B_t - p_t) Q_t + \tau \cdot (\Pi_t^P + \Pi_t^{New}) \} - F_t^P$$

There are three components to the government's benefit under private ownership. The first is the difference between the value that the government attaches to each unit of the service and the price that the private sector charges to produce this service. Second, if the private sector makes a profit from providing this service, a portion of it is returned to the government through federal taxation of profits, as are taxes on profits accruing to new products.[3] Third, the present value of current obligations may differ if private sector operations have greater opportunities than government operations. For example, the costs of providing a pension plan might be lower if private sector firms can invest in securities having higher yields than government debt.

The difference in value between the two forms of ownership is

$$[3] \quad Gain = V_t^P - V_t^G = \sum_{t=1}^{\infty} (1 + R)^{-t} \{ (c_t^G - p_t) Q_t + t \cdot (p_t - c_t^P)(Q_t + Q_t^{New}) \} + (F_t^G - F_t^P)$$

[3] We abstract from the issue of state and local profit taxes, taxes which ordinarily do not apply to federally owned facilities.

Evaluating the gain to the government from transferring operations to the private sector requires evaluating each component of [3] -- differences in cost per unit of service, the profit generated by private sector operation, and differences in previously accrued costs.

Forecasts of future demand for OPM-IS services, as presently provided, indicate substantial declines in the coming years. This suggests that the major benefit will come from providing services at lower costs. Given the structure of the transaction that will transform OPM-IS into USIS, there are three sources of benefits to the government.

The first and most direct source of benefits is through cost efficiencies brought about through better organization and more effective usage of resources. For example, because individuals have a stake in the profitability of USIS, they may complete existing tasks faster, and with less wastage of purchased inputs.

The second source of benefits derives from cost efficiencies brought about by entry of USIS into markets that previously were unavailable to OPM-IS. By providing profitable outlets for new services, USIS allows the spreading of fixed costs across a larger business, resulting in lower costs to the part of the business previously operated by OPM-IS. Since OPM-IS could not have entered these markets as a government entity, the organizational change is a cost efficiency that should be credited. This is likely to be significant. Current estimates place new business at less than 1% of revenues in 1996 but have it growing to 14% by the end of three years, and to 28% by the year 2000. Benefits derived from new business appear in two ways. The first is the reduction in prices charged to the government brought about by cost reductions. In addition, this new business generates profits that would not have been earned before, and the taxes that must be paid on these profits count as a benefit to the government.

The third source of gains to the government is the reduction in federal pension liability brought about by the severance of the OPM-IS employees' federal service. The federal defined benefit retirements plans are the Federal Employees Retirement System (FERS) for workers hired after 1983 and the Civil Service Retirement System (CSRS) for workers hired earlier. Under the structures of both plans, the age and seniority mix of the OPM-IS employees is such that the government will save a considerable amount in reduced future annuity payments to the terminated workforce. In effect this reflects the changed nature of the employees' compensation package. That is, part of the compensation to workers who move to USIS will be in the form of ownership of USIS stock. If USIS is a success these shares will appreciate in value substantially.

Finally, a cost to the government of the privatization is the total amount of the severance payments to the USIS employees.

We examine each of these sources of gain and cost to the government in turn. Because benefits and costs come at different dates in the future, we report all dollar amounts in constant 1995 dollars.[4]

### A. Analysis of Privatization Benefits to the Government - Price Reductions

For the services described in Table 1 there is an historical record of prices for fiscal years 1993 to 1995, and the proposed contract with USIS specifies a pricing schedule for fiscal years 1996 to 2000. For 1993 to 1995 we have the actual units provided by service type, and for the period 1996 to 2000 we have forecasts of future demand. These data are shown in Table 2 (prices)[5] and Table 3 (quantities).

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[4] Present values are calculated using a 7% real discount rate pursuant to the Office of Management and Budget's Circular No. A-94, Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs ("Circular A-94"), Section 8b(1), p. 9. This is the highest real discount rate among those recently suggested by OMB. *See, e.g.*, Revisions to Appendix C to Circular A-94 dated Feb. 1995 and Jan. 1996. Using a lower real discount rate would raise the estimates of net savings to the government reported in the text.

[5] The prices that USIS will charge OPM are fixed in the proposed OPM-USIS contract. These "net" prices equal approximately 75% of the posted prices to the client agencies for most investigative products during the first year of the USIS contract. The 25% retention is to compensate OPM for the costs of the OPM-IS functions to be retained within the OPM "shell" unit. OPM expects to maintain this 75/25 ratio in future years as the USIS "net" prices decline. If OPM decides to charge relatively higher or lower prices to the client agencies, however, this will simply shift federal funds between one part of the government and others. This would affect the costs of investigative services for client agencies, but would not impact taxpayer costs. Table 2 reports future prices to the clients based on the 75/25 ratio.

**Table 2**

| PRICES FOR INVESTIGATIVE SERVICES, 1993-2000 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
| **SBI** | | | | | | | | |
| **35 day** | $3,150 | $3,925 | $3,995 | $3,995 | $3,995 | $3,625 | $3,415 | $3,415 |
| **75 day** | $2,850 | $3,600 | $3,600 | $3,600 | $3,600 | $3,255 | $3,065 | $3,065 |
| **120 day** | $2,700 | $3,425 | $3,425 | $3,425 | $3,425 | $3,065 | $2,905 | $2,905 |
| **BI** | | | | | | | | |
| **35 day** | $2,850 | $3,600 | $2,995 | $2,995 | $2,995 | $2,995 | $2,775 | $2,665 |
| **75 day** | $2,575 | $3,300 | $2,750 | $2,750 | $2,750 | $2,750 | $2,505 | $2,400 |
| **120 day** | $2,400 | $3,100 | $2,575 | $2,575 | $2,575 | $2,575 | $2,375 | $2,265 |
| **LBI** | | | | | | | | |
| **35 day** | $1,850 | $2,325 | $2,195 | $2,195 | $2,195 | $2,195 | $2,195 | $2,195 |
| **75 day** | $1,550 | $2,000 | $1,995 | $1,995 | $1,995 | $1,995 | $1,995 | $1,995 |
| **120 day** | $1,400 | $1,825 | $1,895 | $1,895 | $1,895 | $1,895 | $1,895 | $1,895 |
| **MBI** | $250 | $325 | $350 | $350 | $375 | $375 | $375 | $375 |
| **PRI** | $275 | $350 | $395 | $395 | $395 | $395 | $395 | $395 |
| **PRIR** | $475 | $600 | $995 | $995 | $995 | $995 | $995 | $995 |
| **PRIS** | $675 | $1,000 | $1,295 | $1,295 | $1,295 | $1,295 | $1,295 | $1,295 |

Sources: 1993 - 1996: Billing Rates Effective 10/1/92, 10/1/93, 10/1/94, 10/1/95 as provided by OPM.
1997 - 2000: Projected based on Section B.1, "Schedule of Items," proposed USIS contract with OPM.

**Table 3**

**QUANTITIES OF INVESTIGATIVE SERVICES**
**(1993 - 1995 = Actual, 1996 - 2000 = Forecasts)**

| | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|---|---|
| **SBI** | | | | | | | | |
| **35 day** | 2,229 | 1,609 | 1,522 | 1,320 | 1,110 | 1,077 | 1,044 | 1,029 |
| **75 day** | 6,361 | 3,171 | 2,757 | 1,517 | 1,874 | 1,874 | 1,818 | 1,790 |
| **120 day** | 1,943 | 1,670 | 1,754 | 1,598 | 1,519 | 1,474 | 1,429 | 1,407 |
| **Totals** | **10,533** | **6,450** | **6,033** | **4,435** | **4,503** | **4,425** | **4,291** | **4,226** |
| **BI** | | | | | | | | |
| **35 day** | 605 | 480 | 3,771 | 1,530 | 2,721 | 2,721 | 2,640 | 2,596 |
| **75 day** | 711 | 435 | 791 | 640 | 442 | 379 | 368 | 362 |
| **120 day** | 5,563 | 4,323 | 3,451 | 3,740 | 2,813 | 2,414 | 2,342 | 2,302 |
| **Totals** | **6,879** | **5,238** | **8,013** | **5,910** | **5,976** | **5,514** | **5,350** | **5,260** |
| **LBI** | | | | | | | | |
| **35 day** | 755 | 513 | 731 | 735 | 570 | 553 | 537 | 528 |
| **75 day** | 1,041 | 508 | 432 | 420 | 351 | 341 | 331 | 326 |
| **120 day** | 11,542 | 5,769 | 6,005 | 6,445 | 5,261 | 5,103 | 4,950 | 4,868 |
| **Totals** | **13,338** | **6,790** | **7,168** | **7,600** | **6,182** | **5,997** | **5,818** | **5,722** |
| **MBI** | **3,148** | **3,388** | **2,252** | **2,425** | **2,132** | **2,068** | **2,006** | **1,973** |
| **PRI** | **4,712** | **6,164** | **2,407** | **2,575** | **2,312** | **2,242** | **2,175** | **2,140** |
| **PRIR** | **642** | **2,421** | **2,008** | **2,855** | **2,563** | **2,487** | **2,413** | **2,363** |
| **PRIS** | **11,182** | **11,629** | **12,900** | **7,500** | **7,609** | **7,381** | **7,160** | **7,044** |

Source: Marlowe-97 Report of American Capital Strategies, Ltd. ("ACS"), Dec. 12, 1995, p.3.

Using these data on prices and quantities we can construct a measure of overall price inflation for these services. Variable weight indices, like the GNP deflator, measure the price index by:

[4] $$VWINDX_t = \{P_t \cdot Q_t\} / \{P_{(t-1)} \cdot Q_t\}$$

We compute the rate of increase of prices as $(P_t - P_{t-1}) / P_{t-1}$. Because revenues in any year equals the vector product $P_t * Q_n$ the percentage change in revenues is defined as $(dP/dt) / P_t + (dQ / dt) / Q_t$, and we can compute an index of quantity changes as the residual obtained by subtracting the percentage change of prices from the change in revenues. This provides a convenient way of discussing the market for investigative services. These estimates are shown in Table 4.

**Table 4**

**PERCENT CHANGES IN REVENUES, PRICES AND QUANTITIES 1994 - 2000**

| | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|---|
| REVENUE GROWTH | - 6.25% | 22.78% | -21.46% | -2.21% | -4.24% | -4.25% | -1.68% |
| PRICE CHANGE | 29.01% | 10.92% | -1.60% | 0.68% | -1.41% | -2.34% | -0.51% |
| QUANTITY CHANGE | -35.26% | 11.86% | -19.86% | -2.89% | -2.82% | -1.91% | -1.08% |

Source: Computed from Tables 2 and 3.

Between fiscal years 1993 and 1995 price increases averaged 1.6% annually for the economy as a whole (as measured by changes in the CPI-U) while prices for OPM-IS products increased on average by about 20%[6]. Thus real prices for investigative services rose by about 18% per year. Some of this increase represents one-time price adjustments brought about by initial under-pricing of the service, but it is difficult to measure which products had such increases and which price increases were the result of higher costs. This contrasts with the proposed USIS contractual prices, which are to decline between 1996 and 2000 by over 1% per year in real terms.

For our analysis we must make assumptions about OPM-IS' pricing, costs, and profits or losses in the future if the proposed privatization were not to occur. With respect to prices, the recent record, as noted above, is that OPM-IS prices have increased at a rate well in excess of the general rate of inflation. OPM-IS costs have generally kept pace with revenues, but with a lag -- revenue increases and decreases have been followed a year or so later with corresponding cost increases and decreases. Since 1981, years of "losses" -- increases in the revolving fund deficit -- are matched in number by "profitable" years, and over these 14 years (through FY1995) OPM-IS has losses averaging $1 million per year.[7]

Based upon this information, we have elected the relatively conservative assumptions that OPM-IS would operate at zero profits (rather than continuing its history of losses), that its price increases would not exceed the rate of inflation (as opposed to its recent sharp increases), and that its cost increases would similarly match the general rate of inflation. Thus, we assume both no losses and constant pricing in real terms.

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[6] While OPM prices increased on average in 1993 and 1995, there were some price reductions also. For example, pricing for most of the BI and LBI products declined from 1994 to 1995.

[7] Investigations Revolving Fund Income and Cost FY1982 - FY1995, OPM.

As discussed earlier, if the privatization occurs, there will be a shell unit in OPM to administer the contract and perform certain functions. In our analysis, we assume that the shell unit will operate at zero profit at the pricing in Table 2. The historical information discussed above and the cost category forecasts contained in the USIS business plan suggest that this is a reasonably conservative assumption. Most of the shell unit's costs are pass throughs of direct costs, such as for GSA leases and vehicles, telephones, mail service and FBI user fees. The actual shell unit overhead costs are small compared to these direct cost pass throughs.

To measure the total savings to the government we calculated the difference between the prices that OPM-IS would have charged for each service, and the amounts that USIS has contracted to charge, and multiplied it by the expected quantity of each service to be provided in the years 1996 - 1998. These quantities are then summed across all of the existing services. The results are presented in Table 5.

**Table 5**

**SAVINGS DUE TO LOWER PRICES**
**1996 - 2000**

| | 1996 | 1997 | 1998 | 1999 | 2000 | Beyond |
|---|---|---|---|---|---|---|
| **Costs at OPM Prices** | $73,785,323 | $74,080,514 | $69,008,336 | $67,124,819 | $66,128,172 | $66,128,172 |
| **Costs at USIS Prices** | $73,321,705 | $73,489,164 | $66,793,978 | $63,054,099 | $62,685,250 | $62,685,250 |
| **Difference** | **$463,618** | **$591,350** | **$2,214,358** | **$4,070,471** | **$3,442,922** | **$52,627,525** |
| **PV ($1995)** | **$433,288** | **$516,508** | **$1,807,576** | **$3,105,533** | **$2,454,756** | **$35,067,942** |

Sources: OPM-IS costs are computed from current OPM-IS prices and the quantities shown in Table 3; USIS costs are computed using prices shown in Table 2 and quantities shown in Table 3.

In present value terms the first three years of USIS operation will generate $2.8 million of cost savings, with the annual savings increasing in later years. Including the two option years, the total is $8 million. Beyond the year 2000, the present value of price reductions, assuming the same competitive pricing as in 2000, is approximately $35 million. If competition lowers prices further by 5%, the present value of the cost savings would be closer to $70 million.

## B. Analysis of Privatization Benefits to the Government - Taxes Paid by USIS

As described in equations [2] and [3] above, the government further benefits by the additional taxes that are generated by the private company USIS. These taxes have two components: first there are taxes generated from profits on existing products, and, second, from taxes on new product profits. We assume that in the absence of the transfer that OPM-IS would have produced zero "profits" to the government. These figures are shown in Table 6.

**Table 6**

**PROJECTED FEDERAL INCOME TAX PAYMENTS BY USIS (000's)**

| | 1996 | 1997 | 1998 | 1999 | 2000 | Beyond | Totals |
|---|---|---|---|---|---|---|---|
| Current Products | $3,147 | $2,380 | $1,531 | $964 | $730 | $11,159 | $19,911 |
| PV ($1995) | $2,941 | $2,079 | $1,250 | $735 | $520 | $7,435 | $14,961 |
| New Products | $ 18 | $ 223 | $ 417 | $715 | $975 | $14,904 | $17,252 |
| PV ($1995) | $ 17 | $ 195 | $ 340 | $545 | $695 | $9,931 | $11,724 |
| Totals | $ 3,165 | $ 2,603 | $ 1,948 | $1,679 | $1,705 | $26,062 | $37,162 |
| PV ($1995) | $ 2,958 | $ 2,274 | $ 1,590 | $1,281 | $1,216 | $17,366 | $26,685 |

Source: Marlowe-97 Report, Income Statement Projections for USIS, with and without new products, ACS, Dec. 12, 1995, p.29.

A total of $7.7 million of federal income taxes -- $6.3 million from existing products and $.6 million from new products -- are projected to be paid over this three year period. Discounting back to 1995 yields a present value of $6.8 million. Including the two option years, the total is $9.2 million. Beyond the year 2000, the present value total would be approximately $17 million. If profitability is lower in the first three years, or if some of the profitability relates to new products replacing existing private sector profits, the numbers would be correspondingly lower.

## C. Analysis of Privatization Benefits to the Government - Reduced Pension Costs

Transferring OPM-IS to the private sector will result in a savings to the government with respect to its defined benefit pension plans for some workers, and an increase in costs for others. Workers who would not have retired for several years but who are eligible now for an annuity will find it optimal to begin collecting it as soon as USIS exists, and this will increase pension costs to the government. Conversely, workers who are not yet eligible to receive an annuity will generate pension cost savings as discussed below. The composition of these effects varies by retirement system.

Described generally, workers who are members of the Federal Employees Retirement System (FERS) who retire at age 62 or later receive an annual payment equal to a multiplier of 1.1%[8] times years of service times high-3 year average pay.[9] Members of the Civil Service Retirement System (CSRS) have a slightly more complicated defined benefit plan. Also described generally, service up to 5 years generates a multiplier of 1.5%; each year of service between 5 and 10 years generates a multiplier of 1.75%, and each year of service over 10 years generates a multiplier of 2%. Annuity payments have a COLA adjustment so that they are indexed against inflation.

Savings arise for two reasons. First, the amount of the annuity is based on current high-3 average pay, which is stated in nominal terms. This will be lower for terminated workers because they will forego nominal pay raises and because workers would have had higher real wages as they advanced through the OPM-IS wage distribution. Second, the multiplier itself will be lower because a worker's completed years of service will be lower.

Again described generally, "normal" optional retirement constraints faced by workers are mainly three: retirement at age 55 with 30 or more years of service, retirement at age 60 with 20 years of service, and retirement at age 62 with five years of service. In addition, workers terminated involuntarily, as will be the case for OPM-IS, can take an "early retirement" immediate annuity at age 50 with 20 years of service or at any age with 25 years of service.

For those terminated OPM-IS employees who qualify for an immediate annuity under either the optional or early retirement rules, it is to their advantage to take it. They can receive it even while employed at USIS, and there is no advantage to them from delaying their annuity payments. Thus, to calculate the net reduction in the government's pension liability from the privatization, we must account for the costs attributable to these immediate retirees.

To compute the net benefit to the government we assumed that retirement, but for the privatization of USIS, would have occurred at age 62.[10] We then forecast what high-3 pay would be using data on gender, age, years of service, current pay and retirement system for those currently employed at OPM-IS.[11] With this estimate of the annual annuity we used standard mortality tables to compute the expected cost of providing this annuity. We assumed that the workers would leave government service between now and their retirement age of 62 only if they died. Thus, we discount

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[8] If years of service are less than 20 the multiplier is 1% rather than 1.1%.

[9] High-3 average pay is the highest average basic pay the employee earned during any three consecutive years of service.

[10] Some workers will retire before 62, and some, as evidenced by the existing workforce, will retire later, even when they are eligible to receive an annuity at an earlier date.

[11] In recognition of privacy concerns, individual employees cannot be identified from these data.

benefits by the probability that an existing worker will live to retire at 62.[12] We next calculated the implied annuity assuming that credited service ends at the end of calendar year 1995. Cost savings are the difference between the two calculations.

OPM provided data on the basic characteristics of the workers involved. These data are summarized in Table 7.

**Table 7**

| CHARACTERISTICS OF OPM-IS WORKFORCE | | | |
|---|---|---|---|
| **Characteristic** | **FERS** | **CSRS** | **Totals** |
| **Male / Female** | 36.4% / 63.6% | 60.5% / 39.5% | 46% / 54% |
| **No. of Employees with** | | | |
| **Service <= 5 years** | 24 | 4 | 28 |
| **> 5 and <= 10 years** | 210 | 4 | 214 |
| **>10 and <= 15 years** | 163 | 6 | 169 |
| **>15 and <= 20 years** | 32 | 62 | 94 |
| **>20 and <= 25 years** | 9 | 109 | 118 |
| **>25 and <= 30 years** | 2 | 85 | 87 |
| **>30 and <= 35 years** | 0 | 31 | 31 |
| **>35 and <= 40 years** | 0 | 11 | 11 |
| **>40 years** | 0 | 2 | 2 |
| **Yrs. Average Service - Now** | 10.2 | 23.9 | 13.4 |
| **Yrs. Average Service - at Age 62** | 38.2 | 38.6 | 38.5 |

Source: Data provided by OPM

To characterize the salary structure at OPM-IS, we fit a regression model of annual salary and years of experience separately for men and women.[13] Based on these regressions and on the age distribution of the workforce, we calculate high-3 earnings at retirement for USIS employees given terminations in 1995 and retirement at the earliest eligible point in time, and the implied annuity payments to be as shown in Tables 8a and 8b. The data are arrayed by 5-year groupings of experience - 0 = 0-5 years, 5 = 5-10 years, etc.

[12] Individuals who die before retirement receive the same benefit under both plans.

[13] We distinguish between men and women because of their differential life expectancies.

**Table 8a**

**PREDICTED RETIREMENT ANNUITY BY YEARS OF SERVICE AND GENDER FERS PARTICIPANTS**

| Males | | | | | Females | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Years of Service | Avg. Age | No. | High-3 Earnings | Annuity | Years of Service | Avg. Age | No. | High-3 Earnings | Annuity |
| 0 | 37 | 2 | $15,324 | $421 | 0 | 31 | 22 | $9,351 | $257 |
| 5 | 33 | 66 | $15,553 | $1,283 | 5 | 35 | 144 | $12,291 | $1,014 |
| 10 | 41 | 59 | $22,380 | $3,077 | 10 | 37 | 104 | $14,899 | $2,049 |
| 15 | 48 | 24 | $30,836 | $5,936 | 15 | 44 | 8 | $20,713 | $3,987 |
| 20 | 46 | 7 | $31,966 | $7,912 | 20 | 49 | 2 | $26,768 | $6,625 |
| 25 | 48 | 2 | $37,111 | $11,226 | 25 | NA | 0 | NA | NA |
| 30 | NA | 0 | NA | NA | 30 | NA | 0 | NA | NA |
| 35 | NA | 0 | NA | NA | 35 | NA | 0 | NA | NA |
| 40 | NA | 0 | NA | NA | 40 | NA | 0 | NA | NA |

Source: Computed from employment data provided by OPM.

**Table 8b**

**PREDICTED RETIREMENT ANNUITY BY YEARS OF SERVICE AND GENDER CSRS PARTICIPANTS**

| Males | | | | | Females | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Years of Service | Avg. Age | No. | High-3 Earnings | Annuity | Years of Service | Avg. Age | No. | High-3 Earnings | Annuity |
| 0 | 60 | 1 | $30,876 | $13,339 | 0 | 39 | 3 | $11,931 | $3,901 |
| 5 | 33 | 3 | $15,553 | $6,719 | 5 | 31 | 1 | $10,881 | $3,558 |
| 10 | 47 | 2 | $26,868 | $11,607 | 10 | 43 | 4 | $17,887 | $5,849 |
| 15 | 44 | 19 | $27,299 | $11,793 | 15 | 40 | 43 | $18,337 | $5,996 |
| 20 | 47 | 58 | $32,954 | $14,236 | 20 | 45 | 51 | $23,698 | $7,749 |
| 25 | 50 | 69 | $39,442 | $17,039 | 25 | 48 | 16 | $28,533 | $9,330 |
| 30 | 55 | 26 | $49,814 | $21,520 | 30 | 52 | 5 | $35,130 | $11,488 |
| 35 | 60 | 10 | $62,531 | $27,013 | 35 | 62 | 1 | $51,573 | $16,864 |
| 40 | 62 | 2 | $71,264 | $30,786 | 40 | NA | 0 | NA | NA |

Source: Computed from employment data provided by OPM.

Thus, in Table 8a we predict that a male with 15-20 years of credited service (who on average is 48 years old in FERS) would retire (in this case at age 62) with high-3 year earnings of $30,836 and an annual annuity of $5,936. These values are measured in 1995 dollars, and reflect the loss of purchasing power of the retirement annuity due to 3% per year inflation.

Using standard mortality tables, we calculate that each dollar of an annuity will require $9.77 for males (and $10.95 for females) to cover future payments. That is, the value of the weighted sum of $1 multiplied by the probability of living to age x conditional on having survived to age 65 is $9.77 for males and $10.95 for females.

Reducing these values to present values as of 1995 yields the results shown in Tables 9a (FERS) and 9b (CSRS).

**Table 9a**

**PRESENT VALUES OF ANNUITIES BY GENDER AND YEARS OF SERVICE FOR RETIREMENT AT AGE 62 (FERS)**

| Males | | | Females | | |
|---|---|---|---|---|---|
| Years of Service | Present Value | Frequency | Years of Service | Present Value | Frequency |
| 0 | $621 | 0.45% | 0 | $253 | 5.00% |
| 5 | $1,434 | 15.07% | 5 | $1,310 | 32.88% |
| 10 | $5,989 | 15.86% | 10 | $3,034 | 27.96% |
| 15 | $18,852 | 7.67% | 15 | $9,527 | 2.56% |
| 20 | $33,837 | 2.42% | 20 | $22,317 | 0.69% |
| 25 | $55,252 | 0.71% | 25 | $0 | 0.00% |
| 30 | $0 | 0.00% | 30 | $0 | 0.00% |
| 35 | $0 | 0.00% | 35 | $0 | 0.00% |
| 40 | $0 | 0.00% | 40 | $0 | 0.00% |

**Table 9b**

**PRESENT VALUES OF ANNUITIES BY GENDER AND YEARS OF SERVICE FOR RETIREMENT AT AGE 62 (FERS)**

| Males | | | Females | | |
|---|---|---|---|---|---|
| Years of Service | Present Value | Frequency | Years of Service | Present Value | Frequency |
| 0 | $100,150 | 0.32% | 0 | $8,112 | 0.96% |
| 5 | $7,508 | 0.96% | 5 | $4,288 | 0.32% |
| 10 | $34,362 | 0.65% | 10 | $15,987 | 1.29% |
| 15 | $28,293 | 6.17% | 15 | $13,350 | 13.96% |
| 20 | $42,146 | 20.07% | 20 | $24,292 | 17.65% |
| 25 | $62,298 | 29.87% | 25 | $35,941 | 6.93% |
| 30 | $295,839 | 15.14% | 30 | $58,319 | 2.91% |
| 35 | $371,362 | 6.86% | 35 | $253,145 | 0.69% |
| 40 | $423,231 | 1.47% | 40 | $0 | 0.00% |

The present value of annuity payments, adjusted for the probability of living to retirement (age 55, 60 or 62 whichever is feasible for the worker) and reduced to present value as of 1995 averaged $5,515 across all men and women covered under the FERS plan. For workers covered under CSRS the average present value of annuity payments is $118,288. The disparity is large, in part because CSRS annuities are more generous than FERS, and in part because CSRS participants are older than FERS participants and therefore will receive benefits sooner.

Had OPM-IS remained with the government so that these workers would retire on average at age 62, the same calculations yield a present value of annuity payments of $36,684 for FERS participants and $114,381 for CSRS participants. Total pension savings based on a workforce of 754, 40 of whom remain at the shell unit and are therefore unaffected, are calculated as:

| | | | |
|---|---|---|---|
| | ($ 36,684 - $ 5,515) X 440 employees | = | $13,714,360 |
| + | ($114,381 - $120,388) X 274 employees | = | -$ 1,646,044 |
| | Net Gain | | $12,068,316 |

### D. Total Net Benefits to the Government

Combining all three sources of benefits to the government and subtracting OPM's estimate of $8.4 million in severance costs yields :

**Table 10**

| SUMMARY OF BENEFITS AND COSTS OF PRIVATIZATION | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Source of Benefits or (Costs)** | **1996** | **1997** | **1998** | **1999** | **2000** | **Beyond** | **Totals** |
| **Price Reductions** | $0.4 | $0.5 | $1.8 | $3.1 | $2.5 | $35.1 | $43.4 |
| **Federal Corporate Income Taxes** | $3.0 | $2.3 | $1.6 | $1.3 | $1.2 | $17.4 | $26.7 |
| **Reduced Pension Costs [14]** | $12.1 | | | | | | $12.1 |
| **(Severance Pay)[15]** | ($8.4) | | | | | | ($8.4) |
| **Totals** | $7.1 | $2.8 | $3.4 | $4.4 | $3.7 | $52.4 | $73.8 |

## IV. SENSITIVITY ANALYSIS AND RANGE ESTIMATES OF NET BENEFITS

In this Section we present an analysis of the sensitivity of our results to changes in the assumptions underlying our net benefit estimates. We also develop range estimates based upon alternative scenarios that can be characterized as conservative, reasonable and optimistic.

### A. Sensitivity Analysis

There are three sources of benefits to the government. These are reduced prices for investigative products, income tax receipts from the new private company, and reduced pension liabilities. We rely with respect to each on certain assumptions. The most important assumptions, and the consequences of changing them, are as follows.

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[14] Pension savings are reduced future pension liabilities spread across many years in the future. The table reports a single present value for these savings.

[15] Severance payments will commence in 1996, but a significant portion will continue into 1997. Discounting the 1997 costs would reduce the present value of the severance pay below the $8.4 million reported in the table.

**Price Reductions**

- We assume that the real price reductions in the proposed USIS contract will in fact occur. Higher prices seem quite unlikely. Lower prices, however, which could result from negotiations over exercise of the government's options for years four and five, would increase benefits dollar-for-dollar discounted to present value and weighted by product quantity.

- Future quantities of investigative products are as forecasted. Greater or lesser quantities would correspondingly increase or decrease the benefits from price reductions proportionately.

- We assume that OPM-IS product costs and pricing would be constant in real terms in the absence of the privatization. If OPM-IS costs were to rise or fall in real terms, benefits would also rise or fall in a dollar amount equal to the present value (weighted by product quantities) of the deviation from the assumption.

**Corporate Income Taxes**

- We include in our measure of this source of benefits the USIS business plan estimate of future taxes on both new products and on existing products. In both cases a deviation from plan would affect our estimate of benefit by the amount of the present value of the deviation.

- For the new product portion of the gain in tax receipts, we assume that new products introduced by USIS would not displace other products (and hence the tax dollars from profits that those products generated) from the market. A change in this assumption (discounted to present value) would reduce benefits dollar for dollar.

**Reduced Pension Costs**

- Workers are assumed to retire - - but for the privatization of USIS -- at age 62. Increasing this to age 65 would increase the estimated gain to the government, while reducing it to age 55 would lower the estimated gain.

- We have assumed that the real value of deferred annuities will decline by 3% per year due to inflation. If inflation is actually higher, the benefit to the government increases.

## B. Range Estimates

The analysis in Section III presented the methodology for estimating reasonably conservative point estimates of net benefits. The range estimates for each of the four categories of benefits and costs in Table 11 were obtained by considering alternative scenarios, both more conservative and more optimistic. For example, during the initial 5 years, if OPM-IS would in fact incur its historical $1 million annual deficit, then the corresponding estimate of savings from price reductions would be closer to $13 million than to $8 million. An example in the other direction is that, if USIS is less profitable than the forecast during the initial five years, tax receipts could be closer to $5 million than $10 million.

**Table 11**

**OPM-IS PRIVATIZATION**
**BENEFIT AND COST ESTIMATES**
**PRESENT VALUE BY CATEGORY**

| BENEFIT AND COST CATEGORIES<br>Benefit = (+) Cost = (-) | | Initial 5 Years | Beyond 5 Years |
|---|---|---|---|
| | | (Millions) | |
| Price Reductions | (+) | $8 - $13 | $35 - $70 |
| Federal Income Tax Receipts | (+) | $5 - $10 | $10 - $20 |
| Reduced Pension Costs | (+) | $10 - $15 | - |
| Severance Payments | (-) | ($8) | - |
| TOTALS | | $15 - $30 | $45 - $90 |
| ALL YEARS TOTAL | | $60 - $120 | |

The "conservative," "reasonable" and "optimistic" estimates in Table 12 divide the ranges developed in Table 11 into thirds. Based upon the information available to us, the sensitivities discussed above of the estimates presented in Section III to alternative assumptions, and our assessment of the business risks and opportunities facing USIS, it is our judgment that Table 12 presents an accurate summary assessment of the net benefits that can be expected from the proposed privatization.

**Table 12**

| OPM-IS PRIVATIZATION RANGE ESTIMATES OF TOTAL NET PRESENT VALUE OF SAVINGS | | | |
|---|---|---|---|
| | Conservative | Reasonable | Optimistic |
| | (Millions) | | |
| Initial 5 Years | $15 - $20 | $20 - $25 | $25 - $30 |
| Beyond 5 Years | $45 - $60 | $60 - $75 | $75 - $90 |
| TOTALS | $60 - $80 | $80 - $100 | $100 - $120 |

## APPENDIX - INFORMATION AND DATA RESOURCES

(Source is Office of Personnel Management unless otherwise indicated)

**Print Resources:**

1. Case Price Letter [FIN No. 95-4], August, 1995
2. Case Price Letter [Letter No. 94-5], June, 1994
3. Case Receipts / Production by Type and Agency for FY1992 - FY 1995
4. Circular Number A-94: Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs, 10/29/92, Executive Office of the President, Office of Management and Budget
5. ESOP Privatization Feasibility Report, 3/31/95, ESOP Advisors, Inc.
6. Estimated Investigations Service Costs to Oversee ESOP Company
7. Investigation Service Production of Fieldwork Cases
8. Investigations Cost Per Case as of 9/30/95
9. Investigations Group Statement of Operations FY1991 through FY1994
10. Investigations Revolving Fund Income and Cost FY1982 - FY1995
11. Investigations Service Organization Chart
12. Investigations Service Revenue and Expenses FY1994
13. Investigations Service Revenue and Expenses FY1995
14. OPM Investigative Products and Services Sheet
15. Revisions to Appendix C of OMB Circular Number A-94, Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs, 2/95 and 1/96, OMB
16. Revolving Fund Financial Plans for FY1994 - FY1998 for Investigations & IRM Services [Inv. No.: 95-9], and excerpts of Revolving Fund Financial Plans for FY1990 - FY1997
17. Solicitation OPM-96-RFP-03343RDH to Marine Midland Bank, the ESOP Trustee (the "Trustee"), for investigative services for Office of Personnel Management ("OPM")
18. Various OPM pamphlets and booklets describing the Civil Service Retirement System and Federal Employees Retirement System
19. Various "Marlowe-97" business planning spreadsheet printouts prepared for the Trustee by the Trustee's Financial Advisor, American Capital Strategies, Ltd. ("ACS")
20. Marketing Plan, ACS, 2/27/96
21. Financing and Business Plan, ACS, 2/27/96
22. Proposed OPM contract with US Investigations Services, Inc.

**Electronic Data:**

1. Investigations Service contract prices, quantity estimates and income by type of investigative service

2. Investigations Service employee information a/o 11/30/95 (age, years of service, retirement system type, salary, gender)

INSERT 2

In June 1995, OPM contracted with a Trustee, the Marine Midland Bank, to establish the ESOP company and to negotiate a contract for the investigative services between the new ESOP company and OPM. The trustee was required under the contract to establish the employee stock ownership trust, incorporate the new company, develop business plans for the new company, prepare financial projections, develop a marketing plan, develop employee compensation plans, and negotiate a contract with OPM for the new company to provide investigative services. Marine Midland formed a privatization team with American Capital Strategies (ACS), a Bethesda, Maryland based investment banking firm which specializes in majority employee buyouts and privatization to serve as financial advisor and investment banker to the Trustee and with Arnold and Porter, a Washington, D.C. based law firm to serve as legal advisor to the Trustee.

The contract with Marine Midland was completed with the signing of a contract between OPM and the new ESOP company, US Investigations Services, Inc. (USIS, Inc). It is our understanding at this time that Marine Midland will continue to serve as the Trustee for the USIS, Inc. employee stock ownership plan, and that Arnold & Porter may be retained by USIS, Inc. for legal representation for that corporation. We are unaware of any specific role contemplated for ACS, but any involvement by these entities with or for USIS, Inc. would be as a result of arrangements made strictly between those entities and USIS, Inc.

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