

**IG-98-001**

**AUDIT  
REPORT**

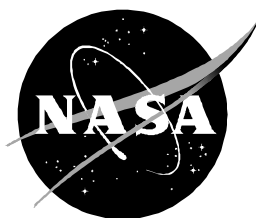
**RAPID ACTION**

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**APPLICATION OF OMB CIRCULAR A-76  
TO DESKTOP OUTSOURCING**

**December 19, 1997**

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National Aeronautics and  
Space Administration

**OFFICE OF INSPECTOR GENERAL**

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# APPLICATION OF OMB CIRCULAR A-76 TO DESKTOP OUTSOURCING

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## ***BACKGROUND***

In July 1996, the NASA Chief Information Officer (CIO) and Associate Administrator for Procurement formed a management team and a requirements team to assess the outsourcing of desktop computing. The management team defined "desktop computing" to include hardware, software, local area networks, and customer support. The management team studied three options concerning desktop computing: (1) "business as usual," (2) consolidation, and (3) outsourcing.

The assessment resulted in a report called the *Business Case for Outsourcing of Desktop Computers* (Business Case), dated October 24, 1996. The Business Case concluded that desktop outsourcing could produce cost savings and other nonquantified benefits. Accordingly, it recommended that NASA consolidate its desktop management responsibilities at a designated lead center, and outsource its desktop requirements. The NASA Administrator concurred with the management team's recommendations. The CIO then formed another team (called the Outsourcing Desktop Initiative for NASA, or ODIN team), to refine the original desktop cost baseline. NASA issued the final request for proposals (RFP) from potential outsourcing vendors on November 28, 1997. NASA expects to award the contract during the third quarter of Fiscal Year 1998.

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## ***OVERALL EVALUATION***

NASA has mistakenly concluded that cost comparison requirements as set forth in OMB Circular A-76, Performance of Commercial Activities (hereinafter called A-76), do not apply to its plan to outsource desktop computers. While NASA officials cited several reasons why they believe A-76 does not apply to the outsourcing initiative, we believe these reasons do not exempt NASA from the A-76 requirements. Beyond not complying with the OMB regulation, NASA may enter into desktop outsourcing contracts without assurance that outsourcing will produce cost savings. In accordance with A-76, NASA should develop an in-house cost estimate based on the Agency's Most Efficient Organization, and compare this cost estimate with offeror proposals to determine whether NASA should outsource its desktop requirements. Details follow.

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**OMB CIRCULAR  
A-76**

The general policy of the Government, as stated in A-76, is to rely on commercial sources to supply the products and services the Government needs, unless a cost comparison demonstrates that in-house performance is more cost effective. In this regard, A-76 establishes Federal policy regarding the performance of commercial activities. The Revised Supplemental Handbook to A-76, dated March 1996, sets forth procedures for determining whether an agency should contract for commercial activities, or perform such activities in-house using Government facilities and personnel. A-76 and the Supplemental Handbook include the following provisions:

- Whenever commercial sector performance of a Government operated commercial activity is permissible, the agency shall compare the cost of contracting and the cost of in-house performance, to determine who will do the work.
- Supplemental Handbook -- Part II, contains detailed guidance on the conduct of cost comparisons and how to determine an agency's Most Efficient Organization (MEO). The MEO refers to the agency's in-house organization and may include a mix of Federal employees and contract support. In identifying and developing the MEO, the agency may consider management reinvention, consolidation, re-engineering, personnel classification, market and other analyses. The MEO is the basis for all agency costs used in the cost comparison.
- Conversion without cost comparison can occur when:
  - The agency can obtain fair and reasonable prices through competitive award, and
  - the agency can reassign all directly affected Federal employees serving on permanent appointments, to other comparable Federal positions for which they are qualified.

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***NASA MANAGEMENT  
BELIEVES A-76 IS  
NOT APPLICABLE***

The NASA CIO advised the OIG that NASA does not consider A-76 applicable to the outsourcing initiative. NASA's Outsourcing Guide and Benefit-Cost Model (used as a guide in preparing the Business Case) states that *"Outsourcing as envisioned in these guidelines is going one step further than a typical A-76 study by having management of these functions performed outside of NASA, while oversight of key performance metrics is provided by NASA."*

In response to an OIG Request for information, NASA's CIO expressed his belief that A-76 cost comparison requirements do not apply to the desktop outsourcing initiative. He cited several reasons:

- The activities covered in the NASA outsourcing initiative are activities that A-76 defines as commercial activities that should not be performed by the Government.
- NASA already contracts for a large portion (80 to 90 percent) of this activity with the private sector. This portion is not subject to A-76.
- The remaining portion of the activity is being performed by NASA civil service employees. A-76 provides that commercial activities of 11 or more full time equivalent (FTE) staff may be converted to contract, without cost comparison, if (a) fair and reasonable prices can be obtained through competitive award, and (b) all directly affected Federal employees serving on permanent assignments are reassigned to other comparable Federal positions for which they are qualified. Current plans are to reassign any affected individual to a position for which they are qualified.

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***NASA MANAGEMENT  
REACHED WRONG  
CONCLUSION***

We believe NASA erred in determining that A-76 is not applicable to the desktop outsourcing initiative. Our comments follow regarding the CIO's response.

- We agree that the IT activities covered in the NASA outsourcing initiative are commercial activities. That in itself, however, does not remove the outsourcing initiative from coverage under A-76. Indeed, A-76 sets forth Federal policy for the performance of commercial activities. It states a preference for "the Government to

rely on commercial sources to supply the products and services the Government needs." [paragraph 4.a] However, "[w]henver commercial sector performance of a Government operated commercial activity is permissible, in accordance with this Circular and its Supplement, comparison of the cost of contracting and the cost of in-house performance shall be performed to determine who shall do the work," [paragraph 5.a], and "Government performance of a commercial activity is authorized if a cost comparison prepared in accordance with . . . the Supplement demonstrates that the Government is operating or can operate the activity . . . at an estimated lower cost than a qualified commercial source." [paragraph 8.d]

- That NASA already contracts out 80 to 90 percent of its desktop activity is not sufficient to avoid A-76 cost comparison requirements. The outsourcing proposal includes work that NASA personnel now perform. There is no *prima facie* authorization to convert that portion of the activity just because a high percentage has already been converted.
- The CIO cites the exemption for "Activities of 11 or More FTE," at Part I, Chapter 1, paragraph D.6, Supplement. To use the exemption, NASA must meet both conditions: fair and reasonable prices through competitive award, and reassignment of all directly affected Federal employees. We are not convinced that NASA can fulfill these conditions, for the following reasons.

(1) NASA has not shown that it can obtain fair and reasonable prices through competitive award; only the cognizant contracting officer can make this determination. Such a determination was not evident as the Business Case reflected only limited useful information from potential outsourcing vendors.

(2) That NASA can reassign all employees to comparable positions for which they are qualified is speculative. NASA has neither identified the specific



FTEs that will be affected, nor the positions to which the FTEs would be assigned. In this regard, we asked the NASA CIO by memorandum dated July 25, 1997, to identify the number of civil servants, by location, who would be reassigned to NASA's core activities as a result of desktop outsourcing. The CIO requested 6 weeks to assemble and provide the requested data.

The Business Case indicates that desktop outsourcing will allow NASA to reassign 496 FTEs to its core activities. The Business Case study derived this figure by computing the ratio of desktop computers serviced by the Payload Network Branch at the Kennedy Space Center, to the number of civil servants in that organization. A NASA official advised the OIG that the data from the Payload Network Branch was the most representative data available to NASA in terms of such a ratio. About 77 percent of the civil servants in the branch were "direct" employees whose jobs a contractor presumably would perform under an outsourcing contract. If NASA reassigns 77 percent of the total FTEs identified by the Business Case to NASA's core activities, then NASA will need to fill about 380 positions ( $.77 \times 496$  positions), to satisfy the "reassignment" requirement under A-76.

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***CONCLUSION***

NASA has mistakenly determined that A-76 does not apply to its desktop outsourcing initiative. Without an A-76 study and comparison, NASA can not ensure that the decision to outsource desktop computers will result in cost savings.

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***RECOMMENDATION***

NASA should develop an in-house cost estimate according to the Revised Supplemental Handbook to OMB Circular A-76, and compare this cost estimate with offeror proposals to determine whether NASA should outsource its desktop requirements.

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**MANAGEMENT'S  
RESPONSE**

Management did not concur with the recommendation, stating that the draft rapid action report reflects a misunderstanding of A-76 and its application to the Outsourcing Desktop Initiative for NASA (ODIN). Management further stated that:

A-76 requires a cost comparison before an agency converts a "commercial activity" to contract. To qualify under A-76, a "commercial activity" must be operated by the Federal agency and produce a product or service. NASA acquires its desktop and communications products and services almost exclusively through the private sector. ODIN will continue private sector provision of desktop and communication services, as well as asset management. If NASA's current asset management function and accompanying resources for these environments were separated from their organizations, these resources could not operate a "commercial activity" to produce the needed products and services, i.e., ODIN, to support NASA. Consequently, NASA's existing resources are not a "commercial activity" and A-76 does not require a cost comparison. A-76 clearly did not contemplate comparing the cost of a diffuse civil servant activity with a defined, discrete contractor task.

Management also stated that even if it applied A-76 to ODIN, NASA is not required to perform a cost comparison according to Chapter 3, Part I, Revised Supplemental Handbook, A-76 (March 1996). Management cited A-76 paragraph D6, Chapter 1, which states that:

Commercial activities may be converted . . . , without cost comparison if fair and reasonable prices can be obtained through competitive award and all directly affected Federal employees serving on permanent appointments are reassigned to other comparable Federal positions for which they are qualified.

The NASA Chief Information Officer (CIO) stated that it is incumbent upon the contracting officer for the master contracts, and the contracting officers for the delivery orders, to make judgments about the fairness and reasonableness of the prices offered, as required by the FAR. In the former case, it will also be up to the Center Director of the Goddard Space Flight Center to select those

vendors for contract award who represent the best value to the Government - not necessarily the lowest price. Similarly, each Center Director or Institutional Program Office Associate Administrator will perform the same best value analysis for their delivery orders. The NASA CIO said he expected these source selection officials to make prudent programmatic and business decisions with all the information in-hand.

In the area of staffing, management stated that Agency human resources policy is to avoid any reductions in force. Staff reductions resulting from other downsizing efforts have successfully been accommodated through attrition, reassignment, and retraining. Management said it expects these methods will allow the Agency to avoid displacing Federal workers as a result of ODIN implementation.

The NASA CIO stated that "Industry is replete with examples where companies expected significant cost savings through outsourcing but ultimately realized that other synergistic and less quantifiable benefits were the true benefits of outsourcing." Further, even without cost savings, the other benefits alone would have vastly improved NASA's information technology environment and NASA's ability to manage it. Finally, the CIO stated that the rapid action report did not recognize the other benefits and management's prerogative to make decisions on other than a cost basis.

Management's response is included in its entirety at Appendix B.

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***EVALUATION OF  
MANAGEMENT'S  
RESPONSE***

Following issuance of the draft OIG report on August 27, 1997, we obtained additional relevant information from the former CIO, other NASA officials, and the OMB. This information has confirmed our position that A-76 applies to NASA's plans to outsource its desktop requirements. Also, as noted below, NASA can be exempt from A-76 Cost Comparison requirements by committing to reassigning all affected NASA employees to comparable positions. Additional information follows.

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***APPLICATION OF A-76  
TO ODIN***

In his September 11, 1997, response to the draft report, the former CIO said A-76 did not apply to the outsourcing initiative because NASA's existing desktop resources do not represent a commercial activity. The CIO's position directly contradicts his earlier stated

position to the OIG in which he said that "Clearly, Information Technology activities covered in the NASA outsourcing initiative are activities that A-76 defines as commercial activities . . ." OMB advised the OIG that, contrary to the CIO's written response to the draft report, NASA's desktop computing is a commercial activity, and A-76 applies to the desktop outsourcing initiative.

Appendix 1 to the Revised A-76 Supplemental Handbook provides updated guidance and, we believe, confirms the OIG position. It defines commercial activity as follows:

A commercial activity is the process resulting in a product or service that **is or could be** [emphasis added] obtained from a private sector source. Agency missions may be accomplished through commercial facilities and resources, Governmental facilities and resources **or mixes thereof** [emphasis added], depending upon the product, service, type of mission and the equipment required.

Attachment A to OMB Circular A-76 provides examples of "commercial activities" including automatic data processing (ADP) services, and ADP equipment installation, operation, and maintenance.

ODIN is to be an entirely new contract, and it includes both the current contractor and civil servant activities. Accordingly, for cost comparison purposes, NASA should not separate desktop support currently provided by NASA civil servants from the portion currently provided by contractor employees. Since a portion of the desktop activity is to be converted from government to commercial performance, under an entirely new contract, we believe A-76 provisions apply to the entire activity.

The NASA CIO stated that NASA expects to realize other benefits from desktop outsourcing. While other benefits may accrue to NASA, such benefits are not relevant to determining whether A-76 provisions apply to the desktop outsourcing activity.

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***EXEMPTION FROM  
A-76 COST  
COMPARISONS***

NASA may be eligible for an exemption from the A-76 cost comparison requirement if it satisfies each of two conditions. These are:

- (1) The agency can obtain fair and reasonable prices through competitive award.
- (2) The agency can reassign *all* directly affected Federal employees serving on permanent appointments to other comparable positions for which they are qualified.

Regarding the first condition, OMB has advised that the General Service Administration's plans to assist agencies in outsourcing their desktop requirements, in effect, establishes that NASA can indeed expect fair and reasonable prices. Accordingly, NASA has met the first condition.

OMB stated that NASA can satisfy the second condition only if it unequivocally commits to reassigning all affected NASA employees to comparable positions. The mere expectation that NASA will reassign all affected employees is not sufficient to satisfy this condition. If NASA does not fully comply with the second condition, it risks adverse employee actions.

If NASA unequivocally commits, in writing, to reassigning all affected NASA employees<sup>1</sup> to comparable positions, then NASA will have satisfied each of the prerequisites for exemption from A-76 cost comparison requirements. Such a commitment would satisfy the intent of the OIG recommendation and allow the recommendation to be closed.

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<sup>1</sup> NASA will need to reassign about 40 civil servants to other comparable positions. The 380 FTE positions cited in this report represented the number of personnel that NASA could reassign to its core activities, using NASA's methodology for computing the total number of FTE personnel that outsourcing could affect. The smaller number (40), provided in response to an OIG questionnaire received after the draft rapid action report was issued to management for comment, represents the number of individuals that NASA expects it would have to reassign.

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***OBJECTIVES***

The overall objective of the ongoing audit is to determine the adequacy of NASA's outsourcing study and analysis; specifically, it will determine whether NASA has:

- Based its outsourcing analysis on current, accurate, complete, and relevant cost data;
- Used appropriate and consistent methodology in analyzing the various options identified; and
- Adequately considered alternatives to outsourcing.

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***SCOPE AND  
METHODOLOGY***

We reviewed OMB Circular A-76 (Performance of Commercial Activities) and the Revised Supplemental Handbook to A-76. Also, we obtained legal advice from the OIG's Associate Attorney-Advisor and conferred with an OMB official having cognizance for A-76. We also interviewed various NASA officials and queried the NASA CIO regarding his rationale for not performing a cost comparison according to A-76. The NASA CIO's response is cited earlier in this report.

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***AUDIT FIELD  
WORK***

Audit field work began in March 1997, and continues at several NASA centers and NASA Headquarters. We are performing the audit according to generally accepted government auditing standards.

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