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COMPETITIVE SOURCING

**Implementation Will Be
Challenging for Federal
Agencies**

Statement of David M. Walker
Comptroller General of the United States





Highlights of [GAO-03-1022T](#), a testimony before the Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia, Committee on Governmental Affairs, U.S. Senate

Why GAO Did This Study

In May 2003, the Office of Management and Budget (OMB) released a revised Circular A-76, which represents a comprehensive set of changes to the rules governing competitive sourcing—one of five governmentwide items in the President's Management Agenda. Determining whether to obtain services in-house or through commercial contracts is an important economic and strategic decision for agencies, and the use of Circular A-76 is expected to grow throughout the federal government.

In the past, however, the A-76 process has been difficult to implement, and the impact on the morale of the federal workforce has been profound. Concerns in the public and private sectors were also raised about the timeliness and fairness of the process for public-private competitions.

It was against this backdrop that the Congress enacted legislation mandating a study of the A-76 process, which was carried out by the Commercial Activities Panel, chaired by the Comptroller General of the United States.

This testimony focuses on how the new Circular addresses the Panel's recommendations reported in April 2002, the challenges agencies may face in implementing the new Circular A-76, and the need for effective workforce practices to help ensure the successful implementation of competitive sourcing in the federal government.

www.gao.gov/cgi-bin/getrpt?GAO-03-1022T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact William T. Woods at (202) 512-8214 or woodsw@gao.gov.

COMPETITIVE SOURCING

Implementation Will Be Challenging for Federal Agencies

What GAO Found

The revised Circular A-76 is generally consistent with the Commercial Activities Panel's principles and recommendations, and should provide an improved foundation for competitive sourcing decisions in the federal government. In particular, the new Circular permits greater reliance on procedures in the Federal Acquisition Regulation—which should result in a more transparent and consistently applied competitive process—as well as source selection decisions based on trade-offs between technical factors and cost. The new Circular also suggests the potential use of alternatives to the competitive sourcing process, such as public-private and public-public partnerships.

However, implementing the new Circular will likely be challenging for many agencies. Foremost among the challenges that agencies face is setting and meeting appropriate goals integrated with other priorities, as opposed to arbitrary quotas. Additionally, there are potential issues with the streamlined cost comparison process and protest rights. The revised streamlined process lacks a number of key features designed to ensure that agency sourcing decisions are sound, including the absence of an appeal process. Finally, the right of in-house competitors to file a bid protest at GAO challenging the sourcing decisions in favor of the private sector remains an open question.

For many agencies, effective implementation will depend on their ability to understand that their workforce is their most important organizational asset. Agencies will need to aid their workforce in transitioning to a competitive sourcing environment. For example, agencies will need a skilled workforce and adequate infrastructure and funding to manage competitions; to prepare the in-house offer; and to oversee the cost, quality, and performance of whichever service provider is selected.

Guiding Principles for Sourcing Policy

Federal sourcing policies should:

1. Support agency missions, goals, and objectives.
2. Be consistent with human capital practices designed to attract, motivate, retain, and reward a high-performing federal workforce.
3. Recognize that inherently governmental and certain other functions should be performed by federal workers.
4. Create incentives and processes to foster high performing, efficient, and effective organizations throughout the federal government.
5. Be based on a clear, transparent, and consistently applied process.
6. Avoid arbitrary full-time equivalent or other arbitrary numerical goals.
7. Establish a process that, for activities that may be performed by either the public or the private sector, would permit public and private sources to participate in competitions for work currently performed in-house, work currently contracted to the private sector, and new work, consistent with these guiding principles.
8. Ensure that, when competitions are held, they are conducted as fairly, effectively, and efficiently as possible.
9. Ensure that competitions involve a process that considers both quality and cost factors.
10. Provide for accountability in connection with all sourcing decisions.

Chairman Voinovich, Ranking Member Durbin, and Members of the Subcommittee:

I am pleased to be here today to participate in the subcommittee's hearing on competitive sourcing, one of five governmentwide initiatives in the President's Management Agenda. The Office of Management and Budget (OMB) recently released a new Circular A-76, which represents the most comprehensive set of changes to the rules governing competitive sourcing since the initial Circular A-76 was issued in 1966. As agencies implement the revised Circular and the initiative outlined in the President's Management Agenda, they will need to develop strategies to address the challenges they inevitably will face in implementing this significant change in their operations.

Today's hearing occurs at a critical and challenging time for federal agencies. They operate in an environment in which new security threats, demographic changes, rapidly evolving technologies, increased pressure for demonstrable results, and serious and growing fiscal imbalances demand that the federal government engage in a fundamental review, reassessment, and reprioritization of its missions and operations. Federal agencies are increasingly relying on enhanced technology and a range of technical and support services to accomplish their missions. Consequently, it is important for agencies to consider how best to acquire and deliver such capabilities—including, in some cases, who the service provider should be.

Determining whether to obtain services in-house, through contracts with the private sector, or through a combination of the two—in other words, through insourcing, outsourcing, or, in some cases, cosourcing—is an important economic and strategic decision for agency managers. In the past, however, the government's competitive sourcing process—set forth in OMB Circular A-76—has been difficult to implement. The impact of the A-76 process on the morale of the federal workforce has been profound, and there have been concerns in both the public and private sectors about the timeliness and fairness of the process and the extent to which there is a “level playing field” for conducting public-private competitions. While Circular A-76 competitions historically have represented only a small portion of the government's service contracting dollars, competitive sourcing is expected to grow throughout the federal government.

It was against this backdrop that the Congress enacted legislation mandating a study of the government's competitive sourcing process.¹ This study was carried out by the Commercial Activities Panel, which I chaired. My comments today will focus on how the new Circular addresses the Panel's recommendations with regard to providing a better foundation for competitive sourcing decisions and the challenges that agencies may face in implementing the new Circular A-76. I will also highlight the need for effective workforce practices to help ensure successful implementation of competitive sourcing.

New Circular Provides an Improved Foundation for Competitive Sourcing Decisions

In April 2002, following a yearlong study, the Commercial Activities Panel reported its findings on competitive sourcing in the federal government. The report lays out 10 sourcing principles and several recommendations, which provide a road map for improving sourcing decisions across the federal government. Overall, the new Circular is generally consistent with these principles and recommendations.

The Commercial Activities Panel held 11 meetings, including three public hearings in Washington, D.C.; Indianapolis, Indiana; and San Antonio, Texas. At these hearings, the Panel heard repeatedly about the importance of competition and its central role in fostering economy, efficiency, and continuous performance improvement. Panel members heard first-hand about the current process—primarily the cost comparison process conducted under OMB Circular A-76—as well as alternatives to that process. Panel staff conducted extensive additional research, review, and analysis to supplement and evaluate the public comments. Recognizing that its mission was complex and controversial, the Panel agreed that a supermajority of two-thirds of the Panel members would have to vote for any finding or recommendation in order for it to be adopted. Importantly, the Panel unanimously agreed upon a set of 10 principles it believed should guide all administrative and legislative actions in competitive sourcing. The Panel itself used these principles to assess the government's existing sourcing system and to develop additional recommendations.

¹ Section 832, Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001, P.L.106-398 (Oct. 30, 2000).

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8. Ensure that, when competitions are held, they are conducted as fairly, effectively, and efficiently as possible.
9. Ensure that competitions involve a process that considers both quality and cost factors.
10. Provide for accountability in connection with all sourcing decisions.

A supermajority of the Panel agreed on a package of additional recommendations. Chief among these was a recommendation that public-private competitions be conducted using the framework of the Federal Acquisition Regulation (FAR). Although a minority of the Panel did not support the package of additional recommendations, some of these Panel members indicated that they supported one or more elements of the package, such as the recommendation to encourage high-performing organizations (HPO) throughout the government. Importantly, there was a good faith effort to maximize agreement and minimize differences between Panel members. In fact, changes were made to the Panel's report and recommendations even when it was clear that some Panel members seeking changes were highly unlikely to vote for the supplemental package of recommendations. As a result, on the basis of Panel meetings and my personal discussions with Panel members at the end of our deliberative process, I believe the major differences between Panel members were few in number and philosophical in nature. Specifically, disagreement centered primarily on (1) the recommendation related to the role of cost in the new FAR-type process and (2) the number of times the Congress should be required to act on the new FAR-type process, including whether the Congress should authorize a pilot program to test that process for a specific time period.

As I noted previously, the new Circular A-76 is generally consistent with the Commercial Activities Panel's sourcing principles and recommendations and, as such, provides an improved foundation for competitive sourcing decisions in the federal government. In particular, the new Circular permits:

- greater reliance on procedures contained in the FAR, which should result in a more transparent, simpler, and consistently applied competitive process, and
- source selection decisions based on trade-offs between technical factors and cost.

The new Circular also suggests the potential use of alternatives to the competitive sourcing process, such as public-private and public-public partnerships and high-performing organizations. It does not, however, specifically address how and when these alternatives might be used.

If effectively implemented, the new Circular should result in increased savings, improved performance, and greater accountability, regardless of the service provider selected. However, this competitive sourcing initiative is a major change in the way government agencies operate, and successful implementation of the Circular's provisions will require that adequate support be made available to federal agencies and employees, especially if the time frames called for in the new Circular are to be achieved.

Challenges in Implementing Competitive Sourcing

Implementing the new Circular A-76 will likely be challenging for many agencies. Our prior work on acquisition, human capital, and information technology management—in particular, our work on the Department of Defense's (DOD) efforts to implement competitive sourcing²—provides a strong knowledge base from which to anticipate challenges as agencies implement this initiative.

² U.S. General Accounting Office, *Best Practices: Taking a Strategic Approach Could Improve DOD's Acquisition of Services*, [GAO-02-230](#) (Washington, D.C.: Jan. 18, 2002); U.S. General Accounting Office, *Information Technology: DOD Needs to Leverage Lessons Learned from Its Outsourcing Projects*, [GAO-03-37](#) (Washington, D.C.: Apr. 25, 2003); U.S. General Accounting Office, *A Model of Strategic Human Capital Management*, [GAO-02-373SP](#) (Washington, D.C.: Mar. 15, 2002); and U.S. General Accounting Office, *Acquisition Workforce: Status of Agency Efforts to Address Future Needs*, [GAO-03-55](#) (Washington, D.C.: Dec. 18, 2002).

Foremost among the challenges that agencies face is setting and meeting appropriate goals that are integrated with other priorities. Quotas and arbitrary goals are inappropriate. Sourcing goals and targets should contribute to mission requirements and improved performance and be based on considered research and sound analysis of past activities. Agencies will need to consider how competitive sourcing relates to the strategic management of human capital, improved financial performance, expanded reliance on electronic government, and budget and performance integration, consistent with the President's Management Agenda. At the request of Senator Byrd and this subcommittee, we recently initiated work to look at how agencies are implementing their competitive sourcing programs. Our work is focused on goal setting and implementation strategies at several large agencies.

DOD has been at the forefront of federal agencies in using the A-76 process and, since the mid-to-late 1990s, we have tracked DOD's progress in implementing its A-76 program. The challenges we have identified hold important lessons that civilian agencies should consider as they implement their own competitive sourcing initiatives.³ Notably:

- competitions took longer than initially projected,
- costs and resources required for the competitions were underestimated,
- selecting and grouping functions to compete were problematic, and
- determining and maintaining reliable estimates of savings were difficult.

DOD's experience also indicates that agencies will have difficulties in meeting the time frames set out in the new Circular for completing the standard competition process. Those time frames are intended to respond to complaints from all sides about the length of time taken to conduct A-76 cost comparisons—complaints that the Panel repeatedly heard in the course of its review. The new Circular states that standard competitions shall not exceed 12 months from public announcement (start date) to performance decision (end date), with certain preliminary planning steps to be completed before a public announcement. Under certain conditions, there may be extensions of no more than 6 months. We welcome efforts to reduce the time required to complete these studies. Even so, our studies of DOD's competitive sourcing have found that competitions can take much longer than the time frames outlined in the

³ U.S. General Accounting Office, *Competitive Sourcing: Challenges in Expanding A-76 Governmentwide*, [GAO-02-498T](#) (Washington, D.C.: Mar. 6, 2002).

new Circular. Specifically, DOD's most recent data indicate that competitions have taken, on average, 25 months. It is not clear, however, how much of this time was needed for any planning that may now be outside the revised Circular's time frame. In commenting on OMB's November 2002 draft proposal, we recommended that the time frame be extended to perhaps 15 to 18 months overall, and that OMB ensure that agencies provide sufficient resources to comply with Circular A-76. In any case, we believe that additional financial and technical support and incentives will be needed for agencies as they attempt to meet these ambitious time frames.

Finally, federal agencies and OMB will be challenged to effectively share lessons learned and establish sufficient guidance to implement certain A-76 requirements. For example, calculating savings that accrue from A-76 competitions, as required by the new Circular, will be difficult or may be done inconsistently across agencies without additional guidance, which will contribute to uncertainties over savings.

Potential Issues with Streamlined Cost Comparison Process

The prior version of Circular A-76 provided for a streamlined cost comparison process for activities with 65 or fewer full-time equivalent (FTE) employees. Although the revised Circular also provides for a streamlined process at comparable FTE levels, the revised streamlined process lacks a number of key features designed to ensure that agencies' sourcing decisions are sound.

First, the prior version of the Circular contained an express prohibition on dividing functions so as to come under the 65-FTE limit for using a streamlined process. The revised Circular contains no such prohibition. We are concerned that in the absence of an express prohibition, agencies could arbitrarily split activities, entities, or functions to circumvent the 65-FTE ceiling applicable to the streamlined process. Second, the 10 percent conversion differential⁴ under the prior Circular has been removed for streamlined cost comparisons. The Panel viewed this differential as a reasonable way to account for the disruption and risk entailed in converting between the public and private sectors. Third, the streamlined process requires an agency to certify that its performance

⁴ The conversion differential is the lesser of 10 percent of the most efficient organization's personnel-related costs or \$10 million over all the performance periods stated in the solicitation. The conversion differential is added to the cost of performance by a nonincumbent source.

decision is cost-effective. It is not clear from the revised Circular, however, whether the term “cost-effective” means the low-cost provider or whether other factors may be taken into account (such as the disruption and risk factors previously accounted for through the 10 percent conversion differential).

Finally, the revised Circular has created an accountability gap by prohibiting all challenges to streamlined cost comparisons. Under the prior Circular, both the public and the private sectors had the right to file appeals to ad hoc agency appeal boards. That right extended to all cost comparisons, no matter how small or large (and to decisions to waive the A-76 cost comparison process). The new Circular abolishes the ad hoc appeal board process and instead relies on the FAR-based agency-level protest process for challenges to standard competitions, which are conducted under a FAR-based process. While we recognize that streamlined cost comparisons are intended to be inexpensive, expeditious processes for relatively small functions, we are nonetheless concerned that the absence of an appeal process may result in less transparency and accountability.

Protest Rights

Another accountability issue relates to the right of in-house competitors to challenge sourcing decisions in favor of the private sector—an issue that the Commercial Activities Panel addressed in its report. While both the public and the private sectors could file appeals to the ad hoc agency appeal boards under the prior Circular, only the private sector had the right, if dissatisfied with the ruling of the agency appeal board, to file a bid protest at GAO or in court. Under the previous version of the Circular, both GAO and the Court of Appeals for the Federal Circuit held that federal employees and their unions were not “interested parties” with the standing to challenge the results of A-76 cost comparisons. The Panel heard many complaints from federal employees and their representatives about this inequality in protest rights. The Panel recommended that, in the context of improving the federal government’s process for making sourcing decisions, a way be found to level the playing field by allowing in-house entities to file a protest at GAO, as private-sector competitors have been allowed to do. The Panel noted, though, that if a decision were made to permit the public-sector competitor to protest A-76 procurements, the question of who would have representational capacity to file such a protest would need to be carefully considered.

An important legal question is whether the shift from the cost comparisons under the prior Circular to the FAR-like standard competitions under the

new one means that the in-house most-efficient organization (MEO) should now be found eligible to file a bid protest at GAO. If the MEO is allowed to protest, there is a second question: Who will speak for the MEO and protest in its name? To ensure that our legal analysis of these questions benefits from input from everyone with a stake in this important area, GAO posted a notice in the *Federal Register* on June 13, 2003, seeking public comment on these and several related questions. Responses were due July 16, and we are currently reviewing the more than 50 responses that we received from private individuals, Members of Congress, federal agencies, unions, and other organizations. We intend to reach a conclusion on these important legal questions in the coming weeks.

Effective Human Capital Practices Will Be Key to Successful Implementation of Competitive Sourcing

For many agencies, effective implementation of the new Circular will depend on their ability to understand that their workforce is their most important organizational asset. Recognizing this, the Panel adopted a principle stipulating that sourcing and related policies be consistent with human capital practices that are designed to attract, motivate, retain, and reward a high-performing workforce. Conducting competitions as fairly, effectively, and efficiently as possible requires sufficient agency capacity—that is, a skilled workforce and adequate infrastructure and funding.

Agencies will need to build and maintain capacity to manage competitions, to prepare the in-house MEO, and to oversee the work—regardless of whether the private sector or MEO is selected. Building this capacity is important, particularly for agencies that have not been heavily invested in competitive sourcing previously. Agencies must manage this effort while addressing high-risk areas, such as human capital and contract management. In this regard, GAO has listed contract management at DOD, the National Aeronautics and Space Administration, the Department of Housing and Urban Development, and the Department of Energy as an area of high risk. With a likely increase in the number of public-private competitions and the requirement to hold accountable whichever sector wins, agencies will need to ensure that they have an acquisition workforce sufficient in numbers and abilities to manage the cost, quality, and performance of the service provider.

In our prior work—notably in studying the lessons that state and local governments learned in conducting competitions and in private-sector outsourcing of information technology services—we found that certain strategies and practices can help ensure the success of workforce

transitions when deciding who should provide the services they perform.⁵ In general, these strategies recognized that the workforce defines an organization's character, affects its capacity to perform, and represents its knowledge base. When an agency's leadership is committed to effective human capital management, they view people as assets whose value can be enhanced through investments.

Agencies can aid their workforce in transitioning to a competitive sourcing environment if they:

- ensure employee involvement in the transition process; for example, by clearly communicating to employees what is going to happen and when it is going to happen;
- provide skills training for either competing against the private sector or monitoring contractor performance;
- create a safety net for displaced employees to bolster their support for the changes as well as to aid in the transition to a competitive environment, such as offering workers early retirement, severance pay, or a buyout;
- facilitate the transition of staff to the private sector or reimbursable provider when that is their choice and assist employees who do not want to transfer to find other federal jobs; and
- develop employee retention programs and offer bonuses to keep people where appropriate.

Recognizing the workforce as an asset also requires agency officials to view competitive sourcing—whether it results in outsourcing, insourcing, or cosourcing—as a tool to help ensure we have the right people providing services in an effective and efficient manner. The Panel recommended that employees should receive technical and financial assistance, as appropriate, to structure the MEO, to conduct cost comparisons, and to create HPOs. However, it is unclear whether agencies will have adequate financial and technical resources to implement effective competitive sourcing programs or make needed improvements.

The administration has proposed the creation of a governmentwide fund for performance-based compensation. However, most federal agencies lack modern, effective, credible, and validated performance management systems to effectively implement performance-based compensation

⁵ U.S. General Accounting Office, *Privatization: Lessons Learned by State and Local Governments*, [GAO/GGD-97-48](#) (Washington, D.C. Mar. 14, 1997); [GAO-02-230](#); and [GAO-03-37](#).

approaches. Importantly, a clear need exists to provide assistance both to government employees to create MEOs that can compete effectively and to agencies to promote HPOs throughout the federal government, especially in connection with functions, activities, and entities that will never be subject to competitive sourcing. Assistance is also needed in helping to create the systems and structures needed to support the effective and equitable implementation of more performance-based compensation approaches. As a result, we believe consideration should be given to establishing a governmentwide fund that would be available to agencies, on the basis of a business case, to provide technical and financial assistance to federal employees to develop MEOs and for creating HPOs, including the creation of modern, effective, and credible performance management systems.

Conclusion

While the new Circular provides an improved foundation for competitive sourcing decisions, implementing this initiative will undoubtedly be a significant challenge for many federal agencies. The success of the competitive sourcing program will ultimately be measured by the results achieved in terms of providing value to the taxpayer, not the size of the in-house or contractor workforce or the number of positions competed to meet arbitrary quotas. Successful implementation will require adequate technical and financial resources, as well as sustained commitment by senior leadership to establish fact-based goals, make effective decisions, achieve continuous improvement based on lessons learned, and provide ongoing communication to ensure that federal workers know and believe that they will be viewed and treated as valuable assets.

Mr. Chairman, this concludes my statement. I will be happy to answer any questions you or other Members of the subcommittee may have.

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