

**Statement by George Finley  
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I appreciate this opportunity to provide comments to the Blue Ribbon Commercial Activities Panel on various competitive sourcing issues, including Office of Management and Budget (OMB) Circular A-76, public-private competitions, and the Federal Activities Inventory Reform (FAIR) Act.

Today, many companies view the A-76 process as being so intrinsically unfair that they refuse to bid on A-76 procurements. That is unfortunate because it deprives the Government of valuable competition and because many of those companies have excellent business practices that could contribute to improved infrastructure efficiency.

Fortunately, many of my business counterparts have taken a less extreme view. While they may decline to bid some A-76 solicitations because of the intrinsic bias in favor of the Government, these procurements still represent an important potential source of new business for many companies. Therefore, when they are persuaded that the competition will be reasonably fair, they will go after A-76 opportunities, albeit on a highly selective basis. But the words “reasonable” and “fair” are the key to the whole process.

## **BACKGROUND**

Certainly, relying on the private sector for services is not a new concept. Back in World War II, private support was standard. It was only during the Cold War when we experienced a huge buildup of Government operations that we came to think of Government support as the norm. In a sense, we’re now going “back to the future.” Over the past decade, we’ve begun to look for new opportunities to contract out and privatize. There are many examples of successful transitions, including food establishments, grounds maintenance, and water treatment plants at our defense facilities. And, we’ve privatized the security police and civil engineering functions at many civilian facilities. We’ve gradually extended private support to cover the entire range of service and support functions.

### **A. Rewards are well worth the effort**

There are many advantages we can realize as a result of privatization and outsourcing. The Government can become entangled in its own power, stifling creativity and productivity. Government agencies responsible for supplying goods and services often miss out on the innovations stimulated by the global market.

We should look at outsourcing and privatization as an opportunity, not a crisis, and keep an open mind to constructive alternatives and new possibilities. As an old Chinese proverb says, “man who says it cannot be done should not interrupt man doing it.”

Outsourcing is a response to practical considerations such as budget cuts and fewer people. But more fundamental, it’s the right thing to do. We’re responding to American taxpayers who demand and deserve fair value for the Government’s expenditures. It’s yet another way of exercising an increased level of stewardship over the public purse.

### B. What it's all about

Outsourcing and privatization are not about cutting services. Neither is it a question of doing “more with less.” And we are certainly not talking about a loss of capability. It is about changing who provides the service. It's about becoming more efficient, saving money and, in the case of the United States military, maintaining combat capability and improving performance and readiness.

Competitive sourcing offers several advantages. By competing current in-house staff commercial activities against the private sector, Federal agencies are forced to look at how they perform their missions and incorporate new and innovative methods to reduce time and cost. The end result, whether a current service stays in-house or converts to contract, is improved performance, more efficient use of resources, and savings that can be used for modernization.

The U.S. private sector's restructuring experiences of the last decade yield an important lesson that is worthy of mention. Concentrating on core expertise and spinning off the rest contributes to the bottom line. In the Pentagon's case, the “bottom line” is measured in terms of readiness and modernization. Outsourcing and privatization can do for defense what it did for America's leading edge businesses – free up resources to concentrate on core competencies. In the end, the Federal government must accept this undeniable fact – when it comes to running commercial-type operations and services, the private sector has “built a much better mousetrap.”

### C. Workforce Issues

The role of retraining and job placement is a vital one – and it is an area in which the services industry is ready and willing to assist.

The ability of the acquisition workforce to implement and embrace change hinges on the training and assistance that accompanies it. And it hinges on the degree to which that training is based on, and communicates, a real-world understanding of the competitive commercial marketplace. Because of the importance of outsourcing issues to the Government procurement process, we recommend that procurement officials be provided with special training in the requirements of the A-76 process

Ironically, at the same time extensive cultural and process changes are being mandated through acquisition reform, the acquisition workforce is being reduced without a corresponding reduction in workload required by the “old system.” Moreover, fiscal support for education and training is coming under extreme budget pressure. We also may reach a crisis as talented acquisition individuals begin to retire; if not addressed, there is expected to be a gap within five years of trained and experienced high-level acquisition personnel. This is particularly critical because there are certain functions that are inherently governmental and, therefore, Government personnel must perform.

Certainly, contractors do not have a “warehouse” of people just waiting to take over the job. A study done by the National Commission of Employment Policy (NCEP), a branch of the Department of Labor, indicates that over half of the workers on outsourced Government functions went to work for the private sector firm, while twenty-four percent of the workers were transferred to other jobs and seven percent retired. The study concluded that less than seven percent of the workers needed to find new employment.

Taking care of Government workers who are impacted by outsourcing decisions is an issue the private sector takes very seriously. Former Government workers affected by a conversion of their jobs to contract are typically offered a “right of first refusal,” under which the workers are given first priority for employment for those jobs for which they are qualified. In many instances, persons previously stymied in their desire for promotion find that conversion to contract provides upward mobility they did not previously enjoy. Contractors are not typically bound by seniority in making employment decisions. As a result, contractors can often make dramatic improvements in a workforce just by selecting less senior persons (often those with high

career motivation and energy) for supervisory and key technical positions. This infusion of fresh enthusiasm can invigorate a workforce even when the workforce as a whole remains relatively unchanged due to “right of first refusal” protections. Another positive aspect of conversion to contract that is almost always overlooked is that former Government employees become far more employable in a variety of private industry jobs after working in a “transition” environment on a Government services contract, thus helping with future career advancement.

Finally, in many instances, the contractors’ benefit programs are equivalent or even superior to those enjoyed by Government employees. The one area where contractors cannot “compete” pertains to paid time off. But, responsible contractors understand that satisfied customers depend, to a considerable degree, upon satisfied employees. All responsible contractors treat benefits management as an important element of good labor relations.

### **GENERAL ISSUES TO CONSIDER**

In those circumstances where agencies elect to conduct public-private competitions, the process used should be kept as high-level and streamlined as possible, avoiding the excessively detailed, overly mechanistic, aspects of the current A-76 procedure.

Areas where there are clear differences between industry and Government operating structures should be identified and addressed in such a manner that results in true cost comparability. Further, the fundamental difference in contract type should be addressed. While a private offeror may be competing for a fixed-price contract, the public offeror in effect always competes for a cost-plus contract. The public sector offeror does not have to bear a financial consequence for an underestimate of the amount of work involved.

The general issues that need to be understood in order to improve the process include:

- The process used to account for costs requires total “visibility.” It is absolutely critical that a Government-wide activity-based cost accounting system or generally accepted practice be established to assure that federal cost proposals truly reflect all relevant direct and indirect costs. Only after such an accounting practice is adopted, in conjunction with other steps, will public-private competitions have the potential to be conducted fairly.
- The system should incorporate all costs (including the costs of quality assurance, technical monitoring of the performance of such functions, liability insurance, employee retirement and disability benefits, and all other overhead costs). This would also include the “time value of money”, including depreciation and amortization, as well as otherwise unaccounted for labor costs, such as the use of military personnel. The foregoing examples do not represent an exhaustive listing of direct and indirect cost deficiencies.
- An activity-based cost accounting system, or other generally accepted practice, alone is not enough to ensure taxpayers are getting fair public-private competitions. There are a number of other areas that must be addressed. Comparisons of public and private bidders must be “normalized”, or adjusted, to reflect unique elements on both sides, such as indemnification premiums and state and local taxes for private sector contractors. Areas where there are clear differences between industry and Government operating structures, which would complicate standard accounting practices, should be broken out and either resolved or taken off the table. In addition, all binding areas on contractors, where there are differences between treatment of these for industry and Government, should be identified and attempts to resolve those differences should be made (except where they do not apply, *i.e.*, commercial).
- Cost savings should not always be viewed as the only objective. Other factors play a role in obtaining what is the *best value* for the taxpayer. These non-cost factors include: enhanced

performance at the same or lesser cost, access to innovation, reduced manpower footprint, implementation of ISO quality standards, etc.

- Meaningful performance and service levels must be incorporated into the overall performance requirements. This is in addition to the utilization of performance-based work statements in all cases, as well as the incorporation of performance penalties, which have equivalent impact on both public and private sector performers. Currently, the Government is not being held to the same procurement disciplines and risks as industry offerors.
- Past performance is not being evaluated for Government MEO proposals under the current process. It is not true that the Government has no valid past performance records. Individuals by position are being proposed in the MEO. These personnel have performance records. Therefore, just as contractor key personnel are evaluated, so should be the Government's personnel. Further, there are often records to document program cost overruns and schedule slippages in past Government performance. There are also records demonstrating the accomplishments of training or other services against specific goals. These records should be reviewed and evaluated as part of a value judgment of the Government proposal.
- It is critically important to ensure the independence of the source selection board. Recent cases point to what the private sector has known for some time. The current process for public-private competitions has not addressed sufficiently the inherent conflict of interest found in some Government source selection boards. The process has allowed the activity being studied for possible outsourcing to conduct the procurement and act as the source selection authority for the award. Government personnel involved in evaluating the procurement should be required to declare any interest in the competing offers and if an employee (or close family member) is or will be affected by the procurement personally, that employee should not be in a position to influence the award decision.
- In its most common form, the concern over loss of flexibility is that replacement of military or Government civilians with contractor personnel will make it more difficult (or even impossible) to quickly respond to changing missions and priorities. The belief often expressed is that a senior officer has better control of a military or Government civilian workforce. With a properly designed contract, and selection of a responsible contractor, flexibility is actually enhanced. Contractors typically have better control of their civilian workforce simply because it is so much easier for contractors to eliminate poor performers and to adjust staffing. There is also a commonly held – and incorrect view – that contractors don't deploy. This is not accurate. During the Gulf War, contractors remained with their customer units and helped achieve the success of the mission. Contractors maintain war reserve materiel and, in each instance, these contractor employees are already "deployed" to the AOR. Similarly, contractors have been in Somalia, Bosnia, and virtually all other recent contingency operations. During the Vietnam War, contractors were a major source of support in country. During WWII, contractor pilots flew mission critical supplies into North Africa and over the Burma Hump. By taking care of many logistics functions, contractors free up military personnel for those duties that cannot, or should not, be performed by civilians.
- Another oft-heard concern is that contractors do not deliver the same standards of quality and performance as an all-government workforce. But, typical award fee scores for responsible contractors are in the high 90% range. Many leading contractors have ISO 9000 certified quality management systems and take the matter of quality very seriously. That's just good business. Furthermore, a contractor's workforce is often comprised of a large proportion of retired officers and senior enlisted personnel, whose discipline and commitment to the service are undiminished. They have been trained to high military standards and they understand what it takes to support the mission.

## MISPERCEPTIONS

Government service contractors have played an important role in supporting our Government agencies in a cost effective and responsive manner. However, there are many false beliefs or misperceptions that have been raised regarding private sector Government contractors. Industry's specific concerns are detailed in the attached white papers (attachments 1-3). Briefly, they include:

- *The first assertion is that Government service contractors have few rules and achieve savings by paying their employees less. Industry Perspective: The Federal procurement process is a complicated web of laws and regulations requiring companies doing business the Government way to implement unique systems for accounting, quality assurance, production and management. Also, the Government service contract industry is governed by a host of wage laws, among them the Service Contract Act (SCA). Under the SCA, the Government provides wage rates for a variety of employees in addition to requiring money to be spent on fringe benefits. Violations of the Service Contract Act can result in fines and debarment.*
- *The second assertion is that lowest cost always assures long-term performance and best value. Industry Perspective: Best Value is generally represented by the most advantageous offer, its affordability, and a long-term commitment to performance and innovation, which in the end provides a customer the flexibility to buy precisely what it needs. Unfortunately, most public-private competitions conducted under OMB Circular A-76 do not achieve these objectives since competitions are conducted under a Two-Step selection process, which ultimately focuses solely on the lowest proposed overall price/cost. Most Government agencies now realize that lowest cost does not assure superior performance and innovation or long-term partnerships and commitment.*
- *A third assertion is that once a private sector company wins a public-private competition, their performance is never reviewed and there is no more competition on that contract. Industry Perspective: Past performance is an increasingly important evaluation factor in selecting the best private sector competitor – ensuring that the Government selects a firm with a proven track record for providing quality service in a timely manner. Additionally, contract performance including, but not limited to cost, schedule and quality are reviewed quarterly and contract incentives are based on established performance metrics. If the contract is a multi-year contract (e.g., 3 or 5 years), the incumbent contractor is subject to annual reviews and audits before an option year can be exercised. Finally, the recompetition factor not only helps drive down subsequent contract costs, but helps spur process innovation and efficiency. In most cases, these recompeted workloads have been refined in scope and there is an established cost and performance baseline on which offerors' bids can be evaluated.*

## FAIR ACT IMPROVEMENTS

Voluntary efforts to obtain information on agency commercial activities necessary to do reviews of whether a Government program was critical to an agency's mission, as recommended by former Vice President Al Gore's National Performance Review (NPR), never met with much success. Mr. Franklin Raines, before leaving the Office of Management and Budget (OMB), issued a memo requesting all Federal agencies to develop a list of the activities they perform. However, like the A-76 policy itself, this request was not mandatory and cooperation from the Federal agencies widely varied. This eventually led to the enactment of the *Federal Activities Inventory Reform (FAIR) Act*. This statute represented a true compromise between all parties involved and is an excellent tool for the OMB and the agencies to effectively manage the performance of commercial activities, using all methods available to the Federal government. The Act embodied some of the key principles outlined, at the time, by the OMB: to achieve the best deal for the taxpayer; be fair and equitable to all interested parties and be considered in view of the Government's overall reinvention effort.

The FAIR Act also turned the “Raines” memo request into a mandate, ensuring a process that will thoroughly identify and categorize all activities currently being performed by the Government. In other words, it requires the Federal government to do what business and taxpaying families do everyday: to take stock of how they can best direct their scarce resources. The FAIR Act clearly delineates between activities identified as inherently governmental versus non-inherently governmental and reiterates a long-standing policy of the Federal government to rely on the capabilities of the private sector. While this policy, embodied in the OMB Circular A-76, is almost 50 years old, there are still activities that are not inherently governmental which the Government itself continues to perform. By focusing on those activities, the FAIR Act will help the Federal government focus on its core missions and responsibilities rather than competing with its own citizens – and it furthers the on-going efforts to streamline the Federal government.

Competition is a key ingredient of the FAIR Act, which states *"each time that the head of the executive agency considers contracting with a private sector source for the performance of such an activity, the head of the executive agency shall use a competitive process to select the source."* In my view, and the view of my colleagues, a competitive process can mean public-private (A-76), privatization **or** direct conversion to the private sector (using either FAR Part 15 competitive procedures or FAR Part 12 commercial items procedures).

Industry believes that Congress intended the FAIR Act’s provisions to have broad and continuing coverage over all agencies and all methods available to the Federal government for managing its procurement of commercial activities. The specific implementation elements of the act that should be addressed through regulation or review of the FAIR Act are as follows:

- **FAIR Act Information Inadequate for Detailed Review.** The information provided in the Federal agency Fair Act inventories is inadequate to describe the positions and functions listed in sufficient detail that a non-Government interested party, within the meaning of the FAIR Act, could determine the suitability of the classification codes assigned. There also is no way to determine what functions or activities were omitted by the various agencies or service branches, or the total number of other positions that may not be included for the activities identified in order to validate the accuracy of the list.
- **FAIR Act Classification Misused.** Agencies have classified such a high proportion of the total positions as being “other than eligible for competitive sourcing” that it calls into the question the entire inventory. Lacking supporting detail and rationales for the classifications, industry cannot determine which classifications are reasonable and which are not.
- **FAIR Act Classification Inconsistent.** There are many instances of apparent inconsistency where functions, which are contracted to private industry at one location, are classified as ineligible for competitive sourcing at other locations. Where positions have been classified exempt from competition due to public law or executive decision, no supporting detail citing the claimed basis of exemption has been provided. And, in many cases, positions have been rolled-up into single large categories. Such aggregated numbers are of little help in reviewing the inventory – these generic codes should be broken down into the specific functions as called for in Appendix No. 2 to OMB Circular A-76 Supplemental handbook.

To address these issues, I would recommend that the following specific actions be taken:

1. Incorporate the requirements of the Raines Memo (May 12, 1998) into the FAIR Act inventories (*i.e.*, include ‘inherently governmental’ on the inventory to improve the accuracy of the inventory data provided). I recognize that OMB has taken a step in this direction by requiring agencies to require this information when submitting their inventories to OMB. However, this information will not be publicly available, except through a Freedom of Information Act (FOIA) request; and

it is doubtful that a FOIA request could be considered within the challenge period allowed under the FAIR Act.

2. Standardize the format and ensure that each agency has included all the information required.
3. Require the inclusion of more complete data in the inventories. This would include a brief description of each activity on the inventory, as well as more information on the nature of the activity (such as the functions performed and identity of the sub-agency in which the activity is located), beyond the simple listing of the OMB function code number and title.
4. Provide a rationale for any exemptions noted, and specifically clarify the policy on “small, exempt” functions.
5. Allow challenges to the Reason Codes – these were not mandated by the FAIR Act, but rather are a creation of the Office of Management and Budget.

Industry also remains that the DOD Depots were exempted from this legislation. This issue should be addressed during the panel’s review.

### **CONCLUSION AND RECOMMENDATIONS:**

The FAIR Act and other ongoing strategic sourcing initiatives are aimed at helping management identify those programs that do not support agency strategic plans under the Government Performance and Results Act (GPRA) – and to help the agency identify those programs that do not support core missions. Full implementation of these policies would allow the Federal government to shed non-core functions and redirected scarce human capital to core agency programs. The end result is a more efficient and effective Government that is better able to serve the American public.

In conclusion, in addition to the FAIR Act implementation recommendations listed above, the following specific recommendations on agency activities and competitive sourcing issues should be considered:

- Focus on an agency’s core missions.
- Revise depot maintenance rules.
- Require all A-76 procurements to be conducted at the major command level to eliminate local bias.
- Prohibit participation on an SSEB by any Government employee whose own job, or that of a close family member, is affected by the public-private competition.
- Require the preparation of an Independent Government Estimate (IGE) for every solicitation. If necessary, hire consultants to prepare these estimates. However, the objective of an IGE will be thwarted if the IGE is prepared by the in-house staff. (But any consultant used in preparing that estimate should not also be used to help prepare the MEO bid.)
- Unambiguously define “best value” in each solicitation.
- Mandate that the so-called “second bite” process will not be used to lower an MEO bid.
- Federal agencies and the military services need to take the time to do a “lessons learned” from the various types of A-76 procurements.

Also attached is a supplemental list of existing policy guidance and statutes that require review or repeal to ensure fair and uniform implementation of future competitive sourcing and privatization initiatives (see attachment #4).

## ATTACHMENT (1)

### *Requirements on Service Contractors What is the Government Oversight on the Private Sector?*

**Issue:** The Federal procurement process is a web of complicated laws and rules requiring companies doing business the “Government way” to implement unique systems for accounting, quality assurance, production and management. While these laws and implementing regulations protect the Government from cases of fraud and abuse – and ensure “full and open competition” there is an associated cost to the taxpayer. These requirements equally apply to the service industry.

**Background:** Several inaccurate assertions have repeatedly been made about the services industry. There is a misperception that service contractors achieve savings by paying their employees less – and that there is little, or no, oversight of Government service contractors. This is misleading and wrong.

To begin with, the service contract industry is governed by numerous wage laws; Federal regulations relating just to employment laws with which Government contractors comply cover over 4,000 pages of print. Chief among these is the Service Contract Act (SCA). Under the SCA, the Government determines wage rates for employment categories in addition to requiring expenditures for fringe benefits. Violations of the Service Contract Act can result in fines and/or debarment.

Under the SCA, service contractors are required to:

- Pay the minimum monetary wage listed in the applicable wage determinations;
- Pay a bona fide fringe benefit or equivalent at the hourly cost listed in the wage determination;
- Prohibit services from being performed under conditions controlled by a prime contractor or a subcontractor which are unsanitary or hazardous or dangerous to the health or safety of the service employees;
- Keep detailed records for all employees who perform services under the prime contract for a period of three years from the date of completion of work on the prime contract;
- Include the standard subcontract clauses in all subcontracts that describe the requirements of the SCA;
- Review subcontractor pay practices to ensure their compliance with SCA (and the prime can be debarred on the basis of non-compliance by a subcontractor);
- Give notice to all service employees, either directly or by posting the wage determination in a prominent location, of the applicable minimum monetary wage applied to their occupational classification and the fringe benefits requirements; and
- Respect collective bargaining agreements in place (for successor contracts).

According to the implementing regulations in the Federal Acquisition Regulation (FAR), all solicitations for service contracts must include the requirement that employees of service contractors be paid the same Federal Grade Equivalence (FGE) in wage rates, and be given the same in fringe benefits, as if that contractor employee was employed by the Federal contracting agency. In addition, private sector Government contractors must abide by the Fair Labor Standards Act, the Occupational Safety and Health Act and numerous other statutes. Private firms also pay Federal, State and local taxes and comply with various socio-economic laws (e.g., small business subcontracting goals) – a requirement not imposed on in-house Government activities.

Additionally, the Government does not face, either qualitatively or quantitatively, the same risks as a commercial contractor (e.g., on issues relating to termination for default, absorption of cost overruns or potential Civil False Claims penalties). Nor does the Government need to comply with cost accounting standards or the Truth in Negotiation Act, which require Government contractors to comply with detailed standards and provide certified cost and pricing data.

Furthermore, Government activities are not held to the same standard of past performance as the private sector when competing to perform the work. Within DOD, private contractor's past performance, by policy, accounts for at least 25% of every award decision.

Finally, private sector Government contractors are subject to pre-award audits, and quarterly/annual post-award audits as specified by the contract. Violations of the contract can lead to financial penalty or termination for default. The same is not true for Government in-house work.

**Impact on Government Acquisition:** According to a recent General Accounting Office audit (Reference: DOD Competitive Sourcing, Effects of A-76 Studies on Federal Employees' Employment, Pay and Benefits Vary, March 2001), contractors and defense officials agree that personnel reductions are key to achieving reduced costs from A-76 competitions. But this is NOT achieved through slashing wages. The GAO report noted that Government and contractor officials *"use a variety of techniques to minimize the number of personnel needed to perform a function. These techniques include limiting proposed activities to the streamlined requirements detailed in the performance work statement, substituting civilian for military workers, designing a new work process, multiskilling (employees performing more than one skill) and proposing modern methods and equipment to complete the tasks."*

The GAO report also noted that contractors actively recruit displaced and retired workers because these individuals have the experience to perform the work. GAO stated that *"employees that go to work for a contractor may have a different salary than what they had with the Government, which could be higher or lower. Salaries and benefits for most employees that provide services on Government contracts are based on the pay and benefit wage scales established pursuant to the Service Contract Act."* Therefore, any perceived problems should be addressed through the SCA wage and benefits determination process.

Contractors do not have a "warehouse" of people just waiting to take over the job. A study done by the National Commission of Employment Policy (NCEP), a branch of the Department of Labor, indicates that over half of the workers on outsourced Government functions went to work for the private sector firm, while twenty-four percent of the workers were transferred to other jobs and seven percent retired. The study concluded that less than seven percent of the workers needed to find new employment.

Outsourcing both saves money and provides the Government needed personnel flexibility to refocus valuable assets on higher priority missions.

## ATTACHMENT (2)

### *A-76 Competitions Does Today's Two-Step Process Achieve Best Value?*

**Issue:** Best Value is generally represented by the most advantageous offer. Best value, affordability, and a long-term commitment to performance and innovation provide a customer the flexibility to buy precisely what it needs. Unfortunately, most public-private competitions conducted under OMB Circular A-76 do not achieve these objectives since competitions are conducted under a Two-Step selection process, which ultimately focuses solely on the lowest proposed overall price/cost. Many Government agencies now realize that lowest cost does not assure superior performance and innovation or long-term partnerships and commitment. Today's challenge is how the Federal government acquires services in order to maximize performance, innovation and competition, and most often at a savings.

**Background:** Whether buying life cycle product support for a weapons system or simply acquiring a support service, "best value", as defined in FAR 2.101 means *"the expected outcome of an acquisition that, in the Government's estimation, provides the greatest overall benefit in response to the requirement."* Many have argued that "best value" is, by its very nature subjective. Others believe "best value" may not mean the same thing in every instance, but there is no reason why Government, like the commercial sector, should not be able to define, with reasonable precision, what "best value" means on a specific solicitation. Unfortunately, in A-76 two-step competitions the Government often selects a private sector offeror proposing the highest staffing, purportedly representing "best value." But the highest staffing does NOT necessarily represent "best value." Staffing, cost reductions and innovations that bring efficiencies DO represent "best value."

The Department of Defense has begun to define other factors of importance. For example, the "draft" DoD Product Support Guide, entitled A Program Manager's Guide To Buying Performance states that, *"Life cycle product support management is directed at ensuring and continuously improving the operational effectiveness of weapon systems for the warfighter. A continuous challenge . . . is to provide a ready, technologically superior weapon system capability that meets the warfighter's evolving requirements. This task includes the life-cycle management of warfighter requirements, continuous monitoring of the performance of the weapon system, the assessment of how well actual performance matches warfighter requirements, the identification and insertion of technology enhancements and the continual refinement of the "best value" product support solutions."*

Additionally, the December 2000, DoD Performance-Based Services Acquisition Guidebook states, *"It is the policy of the Department of Defense that, in order to maximize performance, innovation and competition, often at a savings, performance-based strategies for the acquisition of services are to be used whenever possible. While not all acquisitions for services can be conducted in a performance-based manner, the vast majority can. Those cases in which performance-based strategies are not employed should become the exception."*

**Impact on Government Acquisitions:** Today, most public-private competitions for the acquisition of services continue to be acquired under a two-step process. In the first step, the Government conducts a competition among private sector offerors, generally based on some "best value" proposition. During the second step, the selected "best value" offeror's price is compared to that of the Government's most efficient organization (MEO) in accordance with the OMB Circular A-76 Supplemental Handbook. Essentially, the lowest price, then, wins. This two-step process is universally viewed by the private sector, and by an increasingly number of public sector agencies as unfair and certainly not capable of acquiring the "greatest overall benefit in response to the requirement" as defined by FAR 2.101. Further

this process does not consider the MEO's management plan, technical approach including past performance, quality plan, transition plan, long-term performance risk and/or in some cases their subcontract plan. Additionally, the overall realism and affordability of all proposals must be considered not simply the lowest cost based on a single factor – generally projected FTEs.

Retaining the current Two-Step competitive process will actually decrease competition and access to innovative solutions. Today, many Federal outsourcing efforts receive no bids from the private sector. The Government must understand that companies have finite Bid and Proposal (B&P) budgets which are based on the company's revenue base and prescribed General and Administrative (G&A) rates. This annual B&P budget is not unlike the Government's operating budget in that it is planned well in advance and based on the anticipated market place, potential opportunities and known competitors. Companies conduct bid/no bid decisions based on a decision matrix and the uncertainty of the Two-Step process increasingly is being viewed as an unwise investment.

To illustrate, the A-76 Two-Step process requires a company to spend between \$250K to \$1.0+M in B&P on a solicitation with a generally ill-defined requirement/performance work statement and a selection and contract structure, which is often equally vague. This coupled with an 18-24 month acquisition schedule that normally slips several months before actual award increases risk and cost of proposal. When the private sector decides to participate in a major A-76 solicitation, competition is fierce with as many as five private sector competitors, which lessens the probability of win to 20-30%. Assuming there is no protest as a result of the first competition, the "winning" competitor now faces a second competition with the Government's MEO. This second step is a simple cost comparison with a built-in \$10M or 10% cost advantage for the MEO. Given today's Government win percentage of 57% this further reduces the private sector's overall win probability to between 10 and 12%. Bottomline, there is little incentive for private sector companies to participate in initial A-76 competitions under a two-step process.

Industry believes that the Government must adopt an acquisition process that communicates measurable outcomes rather than directs performance processes. In other words, define the service requirement in terms of performance objectives and provide the offerors (public or private) the latitude to determine how best to meet those objectives. Key to achieving these goals is a Performance Work Statement (PWS) that describes the requirement in terms of measurable outcomes rather than by prescriptive methods. These measurable performance standards define what is acceptable performance including cost schedule and quality and a plan on how performance will be measured. When applicable, incentives including award-term contracts should be used to encourage performance that exceeds standards. A performance-based approach to outsourcing will not only achieve greater savings it will at the same time assure life-cycle management of customer requirements, continuous monitoring of the system/functional performance, the assessment of how well actual performance matches requirements, the identification and insertion of technology enhancements and innovation and finally, the continual refinement of the "best value" solutions.

## ATTACHMENT (3)

### *Continuous Competition for Outsourced Contracts Are Workloads Won by the Private Sector Subject to Review or Recompetition?*

**Issue:** There remains a perception that once a private sector company wins a public-private competition their performance is not reviewed and there is little incentive for introducing innovation since there is virtually no threat of the contract ever being recompeted.

**Background:** To fully understand this issue one must examine both initial public-private competitions under OMB Circular A-76 and recompetitions of previously outsourced workloads.

Initial public-private competitions are often problematic. This is because the performance work statement (PWS) includes inadequate workload baselines. Also, as was noted in the “best value” paper, the two-step competitive process does not maximize performance, innovation or cost savings since ultimately, the winning offer is solely based on lowest manpower cost with a built-in advantage to the public sector Most Efficient Organization (MEO). For these reasons many highly qualified companies refuse to bid on initial A-76 competitions. However, within the private sector there is aggressive competition *each time* the contract comes up for rebid. In most cases, these recompeted workloads have been refined in scope and there is an established cost and performance baseline on which offerors bids can be evaluated. Recompetitions, unlike initial competitions, are generally based on best value (including innovation and efficiencies), not simply lowest manpower cost – and offer the best value to the taxpayer.

It is also important to remember that next to a good specification (including reliable workload data), there is nothing more critical to the evaluation of offers (public or private) than a competent, thorough, and responsible Independent Government Estimate (IGE) of the manpower and non-labor resources needed to successfully perform the specified work with minimum risk of unsatisfactory performance. Unfortunately, an IGE is seldom done. Or, if one is prepared, it is typically seriously flawed because it was based on factoring from the staffing and other resources of the existing contract. Clearly, if the existing contract is not optimized, any IGE produced by such factoring will also be sub optimal. Ideally, a responsible IGE should be derived from a thorough work breakdown structure estimate that is zero-based and which reflects an appreciation of modern commercial practices.

Despite opinions to the contrary, reviews of proposals and actual performance of Federal government contracts outsourced to the private sector under OMB Circular A-76 are regular and extensive.

- First, past performance is an increasingly important evaluation factor in selecting the best private sector competitor – ensuring that the Government selects a firm with a prove track record for providing quality service in a timely manner.
- Second, contract performance including, but not limited to cost, schedule and quality, are reviewed quarterly and contract incentives are based on established performance metrics.
- Third, if the contract is a multi-year contract (*e.g.*, 3 or 5 years), the incumbent contractor is subject to annual reviews and audits before an option year can be exercised.
- Fourth, incumbent contractors have a vested interest in performing well and introducing innovation. If they do not perform well and even become complacent, their competitors will be “hot on their heels” to win the contract under the scheduled recompetition. Bad performance may also result in contract termination and/or documentation of a history of bad performance, which hinders the contractor’s ability to win additional work.
- Finally, this recompetition factor not only helps drive down subsequent contract costs, but helps spur process innovation and efficiency.

A continuing criticism of these type of contracts is perceived cost growth. Unfortunately, the lack of a certified cost accounting system within the Government contributes to this issue – although most private sector Government contractors must comply with detailed cost accounting standards (or, in the case of commercial companies, follow commercially acceptable accounting practices). Additionally, changes in workload scope, after the contract has been awarded, are hard to document without an adequate initial workload baseline. Again, an Independent Government Estimate (IGE) becomes a baseline for justifying future scope growth driven by changing requirements and/or evaluating cost adjustments. An adequate baseline also allows visibility to contract cost growth due to Department of Labor wage determination increases or expanded scope of work.

**Impact of Government Acquisition:** Once workload has been outsourced, and as the contract matures, the workload data becomes better defined and documented under the contract. During recompetition, this enables additional contract elements to be bid as firm fixed-price, rather than cost plus, which is more advantageous to the Government.

Recompetition among private sector competitors on contracts that have been outsourced under A-76 continues to cut costs and create efficiencies for the Federal government.

***POLICY GUIDANCE AND STATUTES NEEDING REVISIONS***

**The policy guidance requiring review and revision to ensure fair and uniform implementation of future competitive sourcing, outsourcing & privatization initiatives includes, but are not limited to:**

- OMB Circular A-76, "Performance of Commercial Activities," August 4, 1983
- DOD Instruction 4100.33, "Commercial Activities Program and Procedures," September 9, 1985
- DOD Directive 4100.15, "Commercial Activities Program," March 10, 1989
- Government Performance and Results Act (GPRA), 1993
- OMB Circular A-76 Revised Supplemental Handbook, "Performance of Commercial Activities," March 1996 including OMB Transmittal Memoranda relative to these procedures
- Department of the Army Regulation (AR) 5-20, "Commercial Activities Program", 1 October 1997
- Department of the Navy (DON) Competitive Sourcing Handbooks: "Succeeding at Competition" and "Business Unit Definition and Analysis Guide", 31 December 1997
- Department of the Army Pamphlet (DA PAM) 5-20, "Commercial Activities Study Guide", 31 July 1998
- Chief of Naval Operations Instruction (OPNAVINST) 4860.7C, "Commercial Activities Program Manual", 7 June 1999
- Department of Defense Strategic and Competitive Sourcing Programs Interim Guidance, April 3, 2000 (issued by the Under Secretary of Defense for Acquisition, Technology and Logistics)
- Department of the Air Force, Headquarters Air Education and Training Command (AETC) Pick-a-Base Action Plan, 1 Jan 2000
- Department of the Air Force Instruction (AFI) 38-203 (Draft), "Air Force Commercial Activities Program Instruction"
- OFPP Best Practices Guide to Performance-Based Service Contracting Independent Review Guide

**Those statutes that should be repealed include:**

15 U.S.C. 3704(b)

Prohibits outsourcing of the functions of the National Technical Information Service

10 U.S.C. 2461

Requires notice to Congress of all DOD A-76 studies, and mandates public-private competitions

10 U.S.C. 2462

Requires contract award to the Government if the Government is "low bid," thereby prohibiting the application of best value principles to such procurements; this provision should be repealed or, alternatively, amended to replace the terms "low cost" with "best value"

10 U.S.C. 2463

Requires semi-annual report to Congress of all conversions of workload at DOD involving more than 50 full time equivalents (FTEs)

10 U.S.C. 2464

Limits the contracting out of logistics support activities to 50 percent of the total workload. This provision should be repealed. At a minimum, however, a change should be made that would base the workload calculations on the facilities utilized rather than personnel; this is necessary in order to fulfill DOD's and Congress' vision of partnerships and innovative teaming arrangements

10 U.S.C. 2465

Prohibits the contracting out of firefighting and guard services at DOD facilities

10 U.S.C. 2466/2469

Limits the contracting of depot maintenance workload and requires public-private competitions for workloads exceeding \$3 million

10 U.S.C. 4532/9532

Mandates use of Government factories and arsenals

40 U.S.C. 490(c) or Section 507 of P.L. 100-440

Prohibits GSA from contracting for guard, elevator, messenger or custodial services

16 U.S.C. 668(d)

Prohibits the Fish and Wildlife Service from outsourcing the management and operations of wildlife refuges