

GAO

Testimony

Before the Subcommittee on Civil Service,
Committee on Government Reform and
Oversight
House of Representatives

For Release on Delivery
Expected at
9:00 a.m. EDT
Thursday
June 15, 1995

**PRIVATIZING OPM
INVESTIGATIONS**

Implementation Issues

Statement of
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Federal Human Resource Management Issues
General Government Division



063833/154470

Privatizing OPM Investigations: Implementation Issues

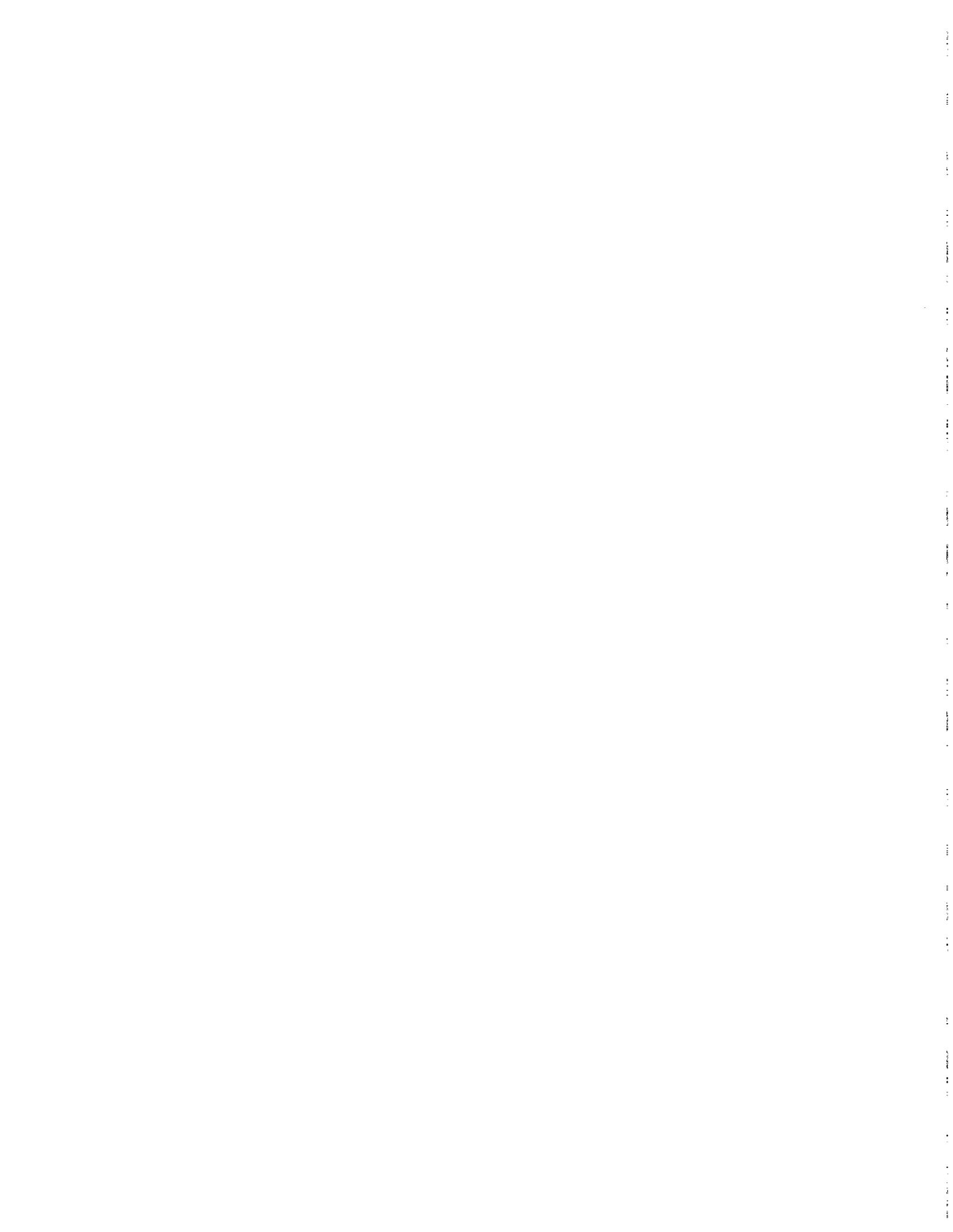
Summary Statement by
Timothy P. Bowling, Associate Director
Federal Human Resource Management Issues

As requested by the House Committee on Government Reform and Oversight's Subcommittee on Civil Service, GAO is reviewing OPM's proposal to privatize its investigative function. OPM is giving consideration to the establishment of a private corporation owned by former employees of its Investigations Service through an Employee Stock Ownership Plan (ESOP).

OPM's privatization initiative raises two basic questions. Should the investigative function be considered "inherently governmental", or can it be appropriately performed by a non-federal organization? If it is determined that this function can be appropriately performed by a non-federal organization, is conversion to an ESOP feasible?

With regard to the first question, certain aspects of the investigative function do not appear to be inherently governmental and, therefore, could be legitimately privatized. However, decisions regarding an individual's suitability for employment or eligibility for security clearances should be made by federal officials.

A business plan describing the implementation of the ESOP has not yet been developed. Therefore, several issues pertaining to the feasibility of the proposed ESOP have not yet been addressed. First, it is unclear whether there would be cost savings as a result of this privatization effort. Second, it is unclear whether ESOP employees would have the same access to sensitive data maintained by federal, state, or local law enforcement agencies as is currently available to OPM investigators. Third, while employees have indicated a willingness for OPM to obtain additional information about forming an ESOP, there is no information available on whether they would be willing to eventually become a part of the proposed organization. In short, sufficient work to fully demonstrate that the ESOP proposal is a good one has not yet been done.



Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the Office of Personnel Management's (OPM) proposed privatization of its Investigations Service, which was formerly known as the Office of Federal Investigations. As you know, OPM is considering privatizing this function through the establishment of a private corporation to be owned by former Investigations Service employees through an Employee Stock Ownership Plan (ESOP). The stated purposes of OPM's privatization initiative are to (1) permit agencies more autonomy in meeting their investigations needs, and (2) achieve cost savings through increased competition among providers of investigative services.

As you requested in mid-April, we are reviewing this proposal in order to assist the Subcommittee in its deliberations on OPM's plans. Both the proposal and our review of it are preliminary, and my remarks today are based on work we have been able to do in the past 6 weeks.

Thus far, an OPM contractor has completed a feasibility study, at a cost of about \$108,000, which indicated that this type of activity could be converted to a private sector operation. However, the contractor's study said that the potential for future success of this proposed new company could only be assessed after the preparation and analysis of a detailed business plan. OPM has recently awarded a contract for the services of a trustee who, among other things, is responsible for developing this business plan.

There are two basic questions to be addressed with regard to OPM's privatization initiative. First, should the investigative function be considered "inherently governmental" or can it be appropriately performed by a non-federal organization? Second, if it is determined that this function can be appropriately performed by a non-federal organization, is conversion to an ESOP feasible?

IS THE INVESTIGATIVE FUNCTION INHERENTLY GOVERNMENTAL?

The Federal Acquisition Regulation, which is the primary federal procurement regulation governing the acquisition of supplies and services, provides that a contract may not be awarded for the performance of an inherently governmental function (FAR 37.102(b)).

In November 1991, we issued a report on our evaluation of whether service contractors were performing inherently governmental

functions.¹ We recommended that the Director, Office of Management and Budget (OMB), clarify OMB's guidance to agencies on what constitutes an inherently governmental function. Following our report, OMB issued guidance in September 1992 supplementing OMB Circular A-76 to assist agencies in determining what functions fall within that category.² This guidance defines an inherently governmental function as an activity "that is so intimately related to the public interest as to mandate performance by Government employees. These functions include those activities that require either the exercise of discretion in applying Government authority or the making of value judgements in making decisions for the Government."

The guidance states that gathering information for or providing recommendations to an agency are not normally inherently governmental functions. It also includes an illustrative list of functions that are considered to be inherently governmental and states that activities that commit an agency to a particular decision or course of action are inherently governmental. The guidance specifically identifies the selection of individuals for federal government employment as an example of a function that would be considered inherently governmental.

Based on the OMB guidance and our analysis, it appears that investigative functions confined to the gathering and reporting of information to federal agencies could legitimately be privatized. However, decisions regarding an individual's suitability for employment or eligibility for clearances should be made by federal officials.

IS CONVERSION TO AN ESOP FEASIBLE?

A business plan describing the implementation of the proposed ESOP has not yet been developed. As a result, several issues regarding the feasibility of an ESOP have not yet been fully addressed.

Cost Savings Are Uncertain

Although OMB estimated a \$30 million savings by privatizing OPM's investigative and training functions, it is uncertain whether the proposed ESOP would achieve greater financial stability and cost savings for the government than OPM's current method of providing investigative services. Also, based on OPM Inspector General

¹Government Contractors: Are Service Contractors Performing Inherently Governmental Functions? (GAO/GGD-92-11, November 18, 1991.)

²OMB Policy Letter 92-1, "Inherently Governmental Functions," September 23, 1992.

(IG) reports and our analysis, the deficit that has been attributed to the Investigations Service revolving fund--about \$30 million--is questionable.

Previous IG reports have noted several deficiencies in the management of OPM's investigative activities. For instance, the IG reported that OPM has not been able to accurately forecast its investigative workload and adjust staffing levels accordingly. Also, the IG noted that OPM's investigative services had been burdened with an excessive share of OPM's overhead charges.

Our work confirmed the IG's finding that OPM appeared to be charging an excessive share of overhead to investigative services. Although this activity requires a low level of oversight and is intended to be self supporting, we found that the cost of common OPM services such as staff support were charged to investigative services based on a flat rate rather than on the actual cost of the services provided. To illustrate, under OPM's current methodology, the overhead allocation rate is determined based on the Investigation Service's total expenses as a percent of OPM's total budgetary obligations. During fiscal year 1994, this calculation yielded a rate of 19 percent for total overhead charges--a percentage that we consider to be high in view of the low level of common services and oversight attention required for this activity.

The amount of overhead allocated to the investigations function has a considerable effect on the fund's financial position and, in all likelihood, has contributed to the fact that with the exception of fiscal year 1991, OPM has consistently reported a deficit for investigative services every year since fiscal year 1986. During fiscal year 1994, for example, the fund reportedly incurred an \$11.8 million deficit. However, before overhead charges of \$18.3 million were applied, the fund's revenues exceeded expenses by \$6.5 million.

Because of issues such as the above, it is difficult to determine whether greater cost savings could result from privatizing this activity than would result from improved management or the application of a more realistic overhead charge. Also, care needs to be taken to be sure that OMB's savings estimate is clearly understood. OMB's estimate is not based on an analysis of how costs could be reduced or revenues could be increased by privatizing the investigative function. Rather, the \$30 million figure was derived by estimating the savings from privatizing both OPM's investigative and training functions. According to OMB, this figure was arrived at by assuming that annual savings would be 4 percent of OPM's investigations and training expenses, including overhead, over a 4-year period. OMB said the 4 percent figure was based on rates of savings found in earlier studies on the results of contracting out other federal functions.

Using fiscal year 1994's investigations operating expenses of \$88 million as the base and applying the 4 percent annual savings figure, we estimated that the investigations' portion of the savings would be about \$14 million over a 4-year period. Additionally, this reported savings could be inflated since the \$88 million would have included some amount of questionable overhead charges.

We also noted that OMB's methodology did not include:

- estimated conversion costs of approximately \$54 million comprised primarily of the deficit (\$30 million), severance pay and unemployment assistance for terminated employees (\$9.8 million), and the cost of completing work in process (\$11 million);
- contract costs of \$108,000 to complete the feasibility study; and
- contract costs that will be incurred by the trustee in developing the business plan.

Access to certain data could pose a problem for private investigators

Another unanswered question concerns the willingness of state and local law enforcement agencies to share data with a private organization such as the proposed ESOP. We have been told by all three state law enforcement agencies we have contacted so far that if the function is privatized, they would be reluctant to provide ESOP investigators access to the criminal history records of persons who are under investigation. According to these officials, they were concerned that they would have no control over what a private organization would do with such information once it had been obtained. Similarly, at the federal level, officials from the Departments of Justice and the Treasury said they would be reluctant to share sensitive data with private contractors.

Although we have not yet had the time to do extensive work in this area, we thought it was important to call this matter to your attention during these oversight hearings. To provide a definitive answer to this question, it would be useful to evaluate the experiences of agencies, such as the Customs Service and the Drug Enforcement Administration, that have contracted out for investigative services.

Employee interest in an ESOP is uncertain

The success of an ESOP could be adversely affected if employees from OPM's Investigations Service do not participate in the new organization to the extent OPM anticipates. The contractor that

performed the feasibility study has stated that a substantial portion of OPM's investigative staff would need to participate in the ESOP if it is to function effectively. However, we have found no clear evidence that sufficient OPM employees would be willing to participate in such an endeavor. In this regard, the OPM feasibility study pointed out that, historically, the process of transferring commercial functions performed by federal employees to the private sector has been slowed by strong resistance from federal employees.

To date, OPM Investigations Service employees have expressed an interest in having OPM obtain more information about the ESOP, but nothing more. The positive expression of interest about exploring the ESOP idea is not surprising, given the fact that OPM's Associate Director for Investigations, in a memorandum to investigations staff dated April 20, 1995, stated that this function would be spun off to the private sector by the end of 1995. The memorandum also said that if there was not enough interest in exploring the ESOP privatization option, privatization by some other means would occur.

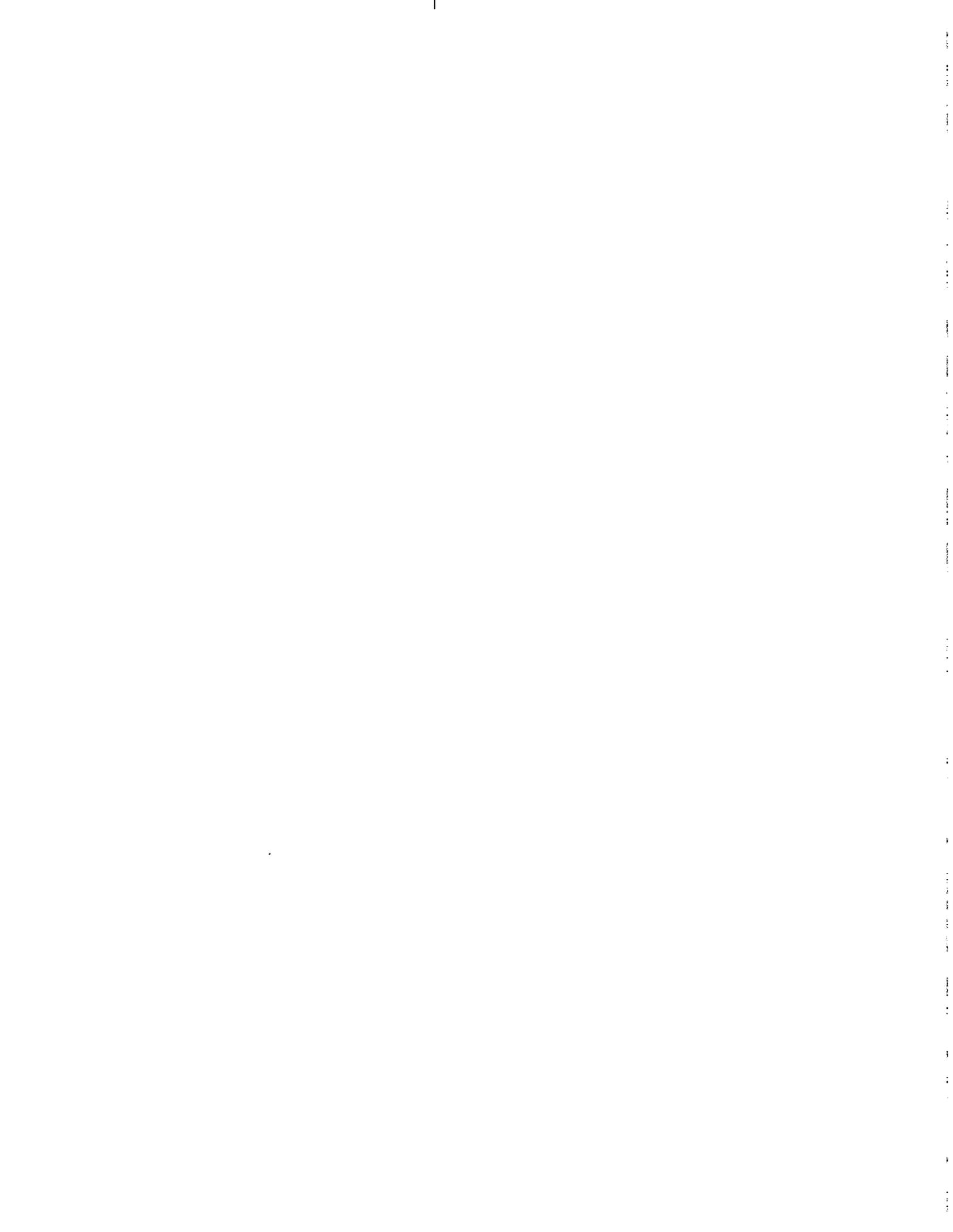
There is no information available on whether staff who indicated a willingness to have OPM explore the ESOP idea would have that same willingness to become a part of it. In fact, over 200 employees have contacted us to express their opposition to privatization.

Also, we are not aware of any work that has been done to determine whether the physical location of the employees who elect to join the ESOP would be compatible with the investigative workload the ESOP is expected to have. Currently, OPM investigators work either out of OPM regional offices or their homes. If only a small number of investigators elect to stay in an area where there is a large investigative workload or vice versa, persons from other areas may be asked to relocate. No information is available on whether this scenario might occur or on whether the ESOP employees would be willing to move.

In summary, Mr. Chairman, sufficient work to support the position that the ESOP proposal is a good one has not yet been done. In this regard, I will also point out that present plans do not appear to us to offer alternatives to the ESOP proposal or provide satisfactory analysis of the potential effect of an unsuccessful ESOP.

Mr. Chairman, this concludes my prepared statement. I will be pleased to respond to any questions you or the members of the Subcommittee may have.

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