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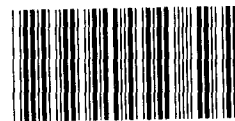
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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
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STATEMENT OF
ROBERT M. GILROY, SENIOR ASSOCIATE DIRECTOR
PROCUREMENT, LOGISTICS AND READINESS DIVISION
BEFORE THE
SENATE COMMITTEE ON VETERANS' AFFAIRS
ON
OFFICE OF MANAGEMENT AND BUDGET
CIRCULAR A-76



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Mr. Chairman and Members of the Committee:

We are here at your request to assist you in your oversight review of Office of Management and Budget (OMB) Circular A-76. It is our understanding that the Committee is particularly interested in the cost of its implementation versus potential cost savings within the Veterans Administration's (VA) Department of Medicine and Surgery and the effect contracting out will have on the provision of medical care by VA. Because GAO has not done any reviews which address these issues, the Committee has requested GAO to respond to two related areas of interest.

--First, you desire information which provides the historical perspective on Circular A-76.

--Second, you have asked that we cite examples of the types of reviews we have made concerning the implementation of the Circular, and the results of these reviews.

HISTORICAL PERSPECTIVE

ON CIRCULAR A-76

Government competition with private enterprise has long been a controversial issue. For over 40 years, congressional

committees have made many studies of the extent to which the Federal Government has competed with private enterprise in commercial or industrial activities.

In 1932, a special House committee made the first extensive study which found several commercial or industrial activities, created expressly for World War I needs, still in existence. Although the committee recommended terminating many of these activities, the Government expanded many of them and established new ones.

After World War II, congressional committees again directed their attention to commercial or industrial activities being performed by the Government as carryovers from the war years. Although military operations were their initial concern, studies of commercial activities of some civilian agencies were soon underway. The general finding of these studies was that the Government was involved in many unnecessary and nonessential competitive activities and that efforts should be made to discontinue any activity that the private sector could provide with reasonable convenience and at fair and reasonable prices.

In September 1952, the Department of Defense (DOD) issued the first in a long series of directives detailing policy and

instructions for commercial or industrial facilities operated by the military departments. The directive stated a policy against retaining and operating such facilities where required needs could be effectively and economically met by existing facilities of any other military department or by private commercial facilities. It also required the military departments to survey and justify continuation of existing facilities and restricted the establishment of new facilities.

In establishing the Commission on Organization of the Executive Branch of the Government in 1953, 1/ the Congress stated that it was its policy to eliminate nonessential services, functions, and activities which were competitive with private enterprise. In 1955, this Commission issued a series of reports which contained many recommendations designed to eliminate or substantially decrease those Government activities which were competing with private enterprise, and it urged the use of private contract services. One of these reports 2/

1/Public Law 83-108, 67 Stat. 142.

2/Subcommittee Report on Business Enterprises of the Department of Defense, June 1955.

points out several reasons why the Government should not do anything that the people are able to do for themselves. The reasons given were:

"It has been demonstrated over the years that the private enterprise system has been the best way to organize and develop the economic resources of our Nation. This system has resulted in the maximum production of goods and services with the minimum effort, * * *.

"* * * To the extent that Government engages in business enterprises, the base for taxation is reduced and larger taxes must be levied on individuals and industry. * * *

"* * * In private industry the initiative of individuals has been developed to a greater extent than in governmental activities. In private industry, it is possible to provide more adequate incentives in many instances and thus encourage new ideas and improvements, still maintaining competitive costs."

"* * * political control of what are essentially economic activities does not produce the effective results in Government business enterprises that are produced by the competitive and profit motives of private industry."

President Eisenhower's budget message of January 21, 1954, was apparently the first public statement of executive branch policy on Government competition with private enterprise. It stated:

"This budget marks the beginning of a movement to shift * * * to private enterprise Federal activities which can be more appropriately and more efficiently carried on in that way."

In January 1955 after months of study, the Bureau of the Budget (the predecessor of OMB) initiated a program to curtail some of the Federal Government's commercial or industrial activities. The policy of the executive branch subsequently evolved through four directives--three bulletins and one circular. 1/

1/Bulletin No. 55-4, Jan. 15, 1955.

Bulletin No. 57-7, Feb. 5, 1957.

Bulletin No. 60-2, Sept. 21, 1959.

Circular No. A-76, Mar. 3, 1966:

Transmittal Memorandum No. 1, Aug. 30, 1967.

Transmittal Memorandum No. 2, Oct. 18, 1976.

Transmittal Memorandum No. 3, June 13, 1977.

Transmittal Memorandum No. 4, Mar. 29, 1979.

Transmittal Memorandum No. 5, Sept. 26, 1980.

Although the basic policy of relying on the private sector to supply the Government's needs has remained the same, the guidelines and implementing procedures have been modified.

During the period in which the bulletins were in effect, several of the principal changes included the following:

--The policy emphasis was originally directed toward eliminating or preventing Government commercial activities. It was later recognized that, under certain circumstances, there might be compelling reasons which made it advisable or necessary for a Government agency to provide products or services for its own use.

--Under the initial phases of the program, procurement from commercial sources was strongly advocated without a comparison of relative costs unless the agency head concluded that the product or service could not be purchased on a competitive basis and at a reasonable price. This was later modified to recognize that, in some instances, commercial sources should be subject to competitive disciplines, including the possibility of Government production for its own use.

OMB, in 1966, departed from its original practice of issuing bulletins and issued OMB Circular A-76. Primarily, OMB wanted to restate the policy in a circular because a bulletin was generally considered to be a less permanent directive.

Circular A-76 and the three transmittal memoranda issued through 1977 reaffirmed the policy in the previous bulletins of general reliance on the private enterprise system. It identified, however, five circumstances of national interest under which agencies were authorized to provide needed products or services with their own resources. Further, it did not generally require agencies to make cost comparisons to support contracting-out decisions.

In March of 1979, OMB issued Transmittal Memorandum No. 4 and the cost comparison handbook (Supplement No. 1), and in September of 1980, issued Transmittal Memorandum No. 5. The effect of these revisions is to establish a three-part statement of basic philosophy: (1) Government reliance on the private sector is a valid principle, (2) certain functions are inherently governmental in nature and must be performed in-house, and (3) the taxpayer is entitled to economy in Government and cost comparisons are appropriate as criteria. Other major changes made in 1979 include a definition of governmental functions, a

listing of Government commercial or industrial activities that normally should be contracted, and a narrowing of the criteria for exceptions to the policy. Further, it generally requires that agencies make cost comparisons to support contracting-out decisions and that the savings through contracting should represent at least 10 percent of the estimated Government personnel costs.

EXAMPLES OF TYPES OF REVIEWS AND RESULTS

Our reports over the years have generally demonstrated a need for more effective implementation of the A-76 policy by the executive branch. They do not, as you might expect, support a broad conclusion that one method of performance (Government or private sector) is always preferred over the other. They do demonstrate that circumstances vary and each situation requires individual analysis.

DOD has devoted considerable time and effort to implementing the A-76 policy, and, consequently, most of our reports concern that agency. These reports involve a wide assortment of functions, ranging from individual types of services (aircraft fueling; airfield marking; custodial; food; guard; keypunch; laundry and drycleaning; maintenance of aircraft, construction

equipment, family housing, and motor vehicles; ocean cargo handling; supply, etc.) to total installation support for a number of services.

Basically, our more recent reviews have involved evaluations of either the propriety of a specific contracting-out decision at a given location or a more comprehensive review of an agency-wide or Government-wide nature, possibly involving several types of commercial or industrial activity. Our work in the first category is almost exclusively the result of constituency requests from individual members of the Congress and generally involve a detailed evaluation of an agency-prepared cost comparison.

A few examples of this type of work are as follows:

--We reviewed the contracting out decision of laundry services at Wright-Patterson Air Force Base, Ohio. We agreed that contracting out was more economical than in-house performance and estimated a substantially higher savings than the Air Force primarily because it had understated the number of in-house employees needed. (PSAD-80-17, December 7, 1979.)

--We reviewed the contracting out of 19 installation support functions at Fort Gordon, Georgia. The functions included, among others, maintenance, supply and service, transportation, and housing. We again agreed that contracting was more economical but estimated a reduced savings generally because the Army had overstated the number of cooks needed in the dining facilities. (PLRD-81-9, April 1, 1981.)

--In another request, we reviewed the contracting out of custodial services, laundry and drycleaning, and refuse collection at the U.S. Military Academy, West Point, New York. We agreed with contracting for the latter two activities but not for the custodial services. After making certain adjustments to the comparison, we concluded that the estimated savings were then less than the minimum required by OMB to justify contracting out. While the Army did not agree with our overall conclusion, it did agree that it had erred in its contracting procedures and agreed to make a new cost comparison. (PSAD-81-4, December 4, 1980.)

Our more comprehensive reviews are typically reviews of broad issues surrounding the A-76 program or reviews of major functions of a commercial or industrial nature.

A few examples of this type of work are as follows:

--We reviewed 12 DOD conversions to contractor performance to find out how much contracting out was taking place because of personnel ceilings, wage differentials between Federal blue-collar and contractor employees, and other significant influences. This work was done in response to concerns expressed by the Senate and House Committees on Armed Services. The functions we reviewed covered such activities as laundry and drycleaning, motor vehicle maintenance, aircraft maintenance, and total installation support of an ammunition plant.

We found that (a) the most significant reason for contracting out was that contractor costs were lower than in-house costs, (b) contractors' costs were lower because they planned to use fewer employees and pay lower wages, (c) although civilian personnel ceilings did not appear to be the primary reason for contracting out, the military services did use the A-76 program to reduce their

work force, and (d) questionable cost comparison practices influenced some decisions to contract out. (PLRD-81-19, April 22, 1981.)

--At the request of the Subcommittee on Defense, House Committee on Appropriations, we reviewed a sample of 18 conversions by DOD of a variety of activities covered by Circular A-76. One of our primary objectives was to determine whether decisions to contract out might have been different if subsequent contractor price increases and performance shortfalls were known before the contract awards were made.

Most of the conversions did not result in performance shortfalls, but we did find unsatisfactory contractor performance was experienced on 5 of the 18 conversions. However, where contract price increases occurred, they generally seemed to be justified. In addition to the five unsatisfactory performance cases, we found that one conversion decision was based on an incomplete statement of work which was used as the basis for the cost comparison. While it is possible that if the information we found after the fact had been known before the contract awards were made, different decisions might have been

made on these six cases, however, history doesn't provide alternatives. Unsatisfactory contractor performance was generally attributed to one or more of the following factors: high personnel turnover rate; unreasonably low staffing level resulting from a buy-in; untimely, improper, and/or poor quality work; too few skilled technicians; and inadequate training. (PLRD-81-58, August 26, 1981.)

--We performed a review which shows that the General Services Administration (GSA) is spending several million dollars more per year than is necessary to clean office buildings. Because of high wages and low productivity, GSA spent, in four regions studied, over 50 percent more to clean offices with its own custodians than with contractors, and almost twice what GSA landlords paid to clean Federal leased space. GSA is slowly converting to contract cleaning, but at the present rate this will take about 15 years. During this time, GSA may spend about \$250 million more than necessary to provide cleaning services with its more costly, less productive custodians.

We recommended that GSA make the comparative cost studies required by Circular A-76 to determine whether cleaning

services should be provided by its in-house staff or by contract personnel, and implement the results. We also recommended that GSA take specific actions to foster greater productivity and reduce costs of contract cleaning. (AFMD-81-78, August 24, 1981.)

--We performed another review which disclosed that Federal agencies use contractors, including consulting service contractors, to do work that we believe Federal employees should do because the work involves basic management decisions. The Departments of Energy and Defense, for example, used contractors to substantially determine or influence national energy policies, and identify requirements for national defense. Although contractors may not be making final decisions, we are concerned about the extent to which contractors are influencing agencies' control of Federal programs and policies.

Ironically, while some Federal agencies were using contractors for work that should be done in-house, they were also using Government employees to provide commercial services that contractors could provide in many cases at a lower cost.

We recommended that the Congress and OMB improve oversight and management of the Federal contract work force. (FPCD-81-43, June 19, 1981.)

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In closing, we would like to say that although its implementing guidelines could be strengthened, GAO supports the general policy precepts set forth by Circular A-76.

In 1978, we recommended, as did the Commission on Government Procurement in 1972, that the Congress establish a national policy relating to reliance by the Federal Government on the private sector to provide needed goods and services. (PSAD-78-118, September 25, 1978.) Without a firm national policy, the future of the A-76 program will be a repetition of the past--confusion, controversy, and ineffective implementation. The policy must be stable and must appropriately balance many issues of national significance. It needs both legislative and executive branch endorsement and support.

Mr. Chairman and Members of the Committee, this completes our formal statement. I will be happy to respond to any questions you may have at this time.