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Report to James T. McIntyre, Director, Office of Management and Budget; by D. L. Scantlebury, Director, Financial and General Management Studies Div.

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Office of Management and Budget (OMB) Circular A-76 states that, as national policy, the Government should rely on private enterprise to provide commercial or industrial products and services, with specific exceptions. OMB's Office of Federal Procurement Policy (OFPP) is concerned over the limited extent to which agencies have implemented the policy as it relates to their automatic data processing (ADP) requirements. The capabilities of the data processing services industry were studied to determine whether obtaining such services from this source is both feasible and in the best interest of the Government and the industry. Findings/Conclusions: A nationwide survey of 348 data-processing-services companies indicated that lack of qualified personnel and investment capital difficulties limited many firms' ability to expand enough within 12 months to meet Federal agencies' large-scale data processing requirements. However, given adequate leadtime and a reduction in the administrative burden of responding to Government proposals, many firms could develop the capacity to accommodate more of the Federal Government's data processing needs. According to management officials of 31 firms, the net benefit of in-house operations generally outweighs the net benefit of relying on commercial ADP firms. The OFPP has undertaken a comprehensive study of Circular A-76 which has delayed issuance of proposed supplemental guidance for the ADP area. Recommendations: Once the basic Circular A-76 is revised, the OFPP should study the situation in the ADP area and consider the industry's capabilities to meet Federal data processing needs. The OFPP should then develop and issue policy guidance for Federal agencies to follow in decisions to acquire data processing services from commercial sources or by in-house performance. (RRS)

0-9168
REPORT BY THE U.S.

General Accounting Office

Shifting The Government's Automatic Data Processing Requirements To The Private Sector: Further Study And Better Guidance Needed

A General Accounting Office nationwide survey of the automatic data processing services industry showed that many firms were limited in their near-term ability to meet significant quantities of Federal agencies' large-scale data processing requirements. Careful consideration of the industry's present and future capabilities by the Office of Federal Procurement Policy within the Office of Management and Budget would be useful in revising proposed guidelines to help Federal agencies obtain more of their automatic data processing from commercial sources. This guidance could simultaneously improve the industry's long-term capability for meeting more of the Government's automatic data processing requirements.



FGMSD-78-22
APRIL 11, 1978



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

DIVISION OF FINANCIAL AND
GENERAL MANAGEMENT STUDIES

B-115369

The Honorable James T. McIntyre
Director, Office of Management
and Budget

Dear Mr. McIntyre:

This report discusses our observations based on (1) a survey of the automatic data processing services industry and (2) a review of the Office of Federal Procurement Policy draft supplement to Office of Management and Budget Circular A-76 proposing additional guidance for the automatic data processing area. We made this review to assess the reasonableness of the Federal agencies relying on commercial sources for significant quantities of data processing services. We discussed the results of our review with officials of the Office of Federal Procurement Policy and have incorporated their comments in the report. The scope of this work was limited to the proposed supplement relating to automatic data processing. Another report on the overall effectiveness of executive agencies' policies and programs for acquiring commercial or industrial products and services for Government use is forthcoming.

Our study was made pursuant to the authority assigned to the Comptroller General in the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We are sending a copy of this report to each of the organizations that replied to our questionnaire.

Sincerely yours,

A handwritten signature in cursive script that reads "D. L. Scantlebury".

D. L. Scantlebury
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE DIRECTOR
OFFICE OF MANAGEMENT AND
BUDGET

SHIFTING THE GOVERNMENT'S
AUTOMATIC DATA PROCESSING
REQUIREMENTS TO THE PRIVATE
SECTOR: FURTHER STUDY AND
BETTER GUIDANCE NEEDED

D I G E S T

Basic policy guidance to Federal agencies concerning general reliance on the private sector for goods and services is set forth in Office of Management and Budget Circular A-76.

The Office of Federal Procurement Policy has been trying for some time to issue supplemental guidance to Circular A-76 that would cause more of the Government's automatic data processing needs to be met by private industry instead of in-house. The General Accounting Office has studied the capabilities of the automatic data processing services industry to determine whether obtaining such services from this source is feasible and in the best interest of both the Government and the industry.

Several factors point to the need for thorough consideration of the industry before issuing such guidance. For example, from a nationwide questionnaire survey of data processing services companies in which 348 firms responded, GAO learned that lack of qualified personnel and investment capital difficulties limited many firms' ability to expand enough within 12 months to fulfill Federal agencies' large-scale data processing requirements. On the other hand, the responses showed that--given adequate leadtime and a reduction in the administrative burden of responding to Government proposals--many firms could develop the capacity to accommodate more of the Federal Government's data processing needs.

GAO interviewed management officials of 21 firms to learn the extent commercial organizations rely on outside sources for their data processing needs. According to these officials, the net benefit of in-house operations generally

outweighs the net benefit of relying on commercial service firms. GAO believes this factor should be considered in developing guidance consistent with the objectives and policies of relevant Government programs.

While GAO was conducting this review, the Office of Federal Procurement Policy undertook a comprehensive study of Circular A-76 and on November 21, 1977, announced proposed changes to the circular in the Federal Register. This study has delayed issuance of the proposed supplemental guidance for the automatic data processing area. The delay provides an opportunity to assess the impact of changes in the basic circular on methods for meeting agency automatic data processing requirements and determining what additional guidance might be needed for implementing Circular A-76 in this area.

GAO suggests that, once the basic Circular A-76 is revised, the Office of Federal Procurement Policy study the situation in the automatic data processing area, taking GAO's findings into account, and consider the industry's capabilities to meet Federal automatic data processing needs. Then, the Office of Federal Procurement Policy should develop and issue policy guidance for Federal agencies to follow in decisions to acquire data processing services from commercial sources or by in-house performance.

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ABBREVIATIONS

ADP	automatic data processing
GAO	General Accounting Office
OFPP	Office of Federal Procurement Policy
OMB	Office of Management and Budget

CHAPTER 1

INTRODUCTION

POLICY STATEMENT

Office of Management and Budget (OMB) Circular A-76 states that, as national policy, the Government should rely on private enterprise to provide commercial or industrial products and services, with specific exceptions. The circular states that Federal agencies will not operate an activity to provide a product or service that is obtainable from a commercial source unless operating that activity has been justified as being in the national interest. Justification will be based on such criteria as necessity for military readiness, lack of a suitable commercial source, more costly commercial performance, availability from another Federal agency, or material disruption or delay of an agency program by service from commercial sources.

OMB's Office of Federal Procurement Policy (OFPP) is concerned over the limited extent to which agencies have implemented the policy as it relates to their automatic data processing (ADP) requirements. OFPP has been developing additional guidance for Federal agencies to improve the implementation of OMB Circular A-76 by moving the Government toward greater use of commercial firms to meet its ADP requirements.

While we were making our review, OFPP undertook a comprehensive study of Circular A-76, and a number of proposed changes are under consideration. These proposed changes were announced in the Federal Register on November 21, 1977, and comments were requested by January 20, 1978. ADP was identified in the proposed changes as a management function for which separate guidelines could be developed. The most recently proposed supplemental guidance specifically addressing the ADP area was issued for comment on August 10, 1976, and is presented as appendix I. However, this draft guidance has been temporarily set aside pending completion of the actions on the proposed changes to the basic circular.

AUTOMATIC DATA PROCESSING IN GOVERNMENT AND INDUSTRY

In the 1950s and early 1960s, no sizable industry was available to fulfill the Government's needs for ADP functions, such as systems analysis, systems design, programing, and computer operations. Accordingly, agencies had to develop

their own capabilities in these areas. While they acquired ADP equipment from private industry, agencies generally used Government personnel to operate and manage these facilities, and Government personnel did most systems analysis, systems design, and programing.

Through the years, an ADP industry has been developing; today there are many firms that provide services which the Government could, and to some extent already does, utilize. Services offered by the firms include computer time, time-sharing services, management consulting, programing, systems analysis, systems design, facilities management, and training. Companies vary in size, number of employees, areas of specialization, and types of services offered, and, therefore, in their near-term capability to meet Government needs.

Today, although it makes some use of these firms, the Government maintains an inventory of over 11,000 computers and employs thousands to perform ADP-related functions. Estimates of the Government's annual ADP costs run as high as \$15 billion.

SCOPE OF REVIEW

We made this review to assess the reasonableness of the Government's Circular A-76 policy as it relates to relying on private industry for ADP services. Specifically, we:

- Evaluated OFPP's proposed guidance to agencies for complying with national policy in meeting ADP requirements.
- Interviewed management officials in 31 private sector organizations to learn (1) the extent that they relied on the ADP services industry and (2) their plans to satisfy future ADP needs.
- Sent 500 questionnaires to ADP firms located in 43 States and the District of Columbia. (See app. II for a copy of the questionnaire with selected responses summarized.)
- Held discussions with officials of 10 Federal agencies about the use of commercial sources for their data processing requirements.

The nationwide questionnaire provided us data from a large segment of the industry. It covered a wide range of subjects, including (1) willingness to provide services to the Government, (2) kind and extent of services available, and (3) factors limiting the firms' ability to provide more services to the Government.

CHAPTER 2

NEED FOR FURTHER GUIDANCE ON APPLICATION OF CIRCULAR A-76 POLICY TO ADP ACTIVITIES

The Office of Federal Procurement Policy plan for applying Circular A-76 to the Government's ADP needs is to shift attention from in-house operations and services toward increased reliance on private industry. Although the ADP services industry is large, the information returned on our questionnaire led us to conclude that the industry comprises only a few large firms and many small ones. The smaller companies constitute a major segment of the industry, and their responses to our questionnaire show several factors which inhibit their readily offering services to the Government. Additionally, comments from the industry addressed the complexity of the ADP services issue and suggested that it be given further study and evaluation prior to formulating supplemental guidance to Circular A-76. In our opinion, OFPP's approach needs to recognize the short-term limitations of industrial capability, or the advantages OFPP envisions for both Government and industry will not be realized.

ACTION TO PLACE GREATER RELIANCE ON PRIVATE INDUSTRY FOR ADP REQUIREMENTS

OFPP's objective is to increase agencies' reliance upon commercial ADP sources, whenever possible. To accomplish this, OFPP has drafted planning and management guidelines calling for each agency to initiate a positive action program to ensure that the policy and requirements of Circular A-76 are fully implemented. The guidelines would include such matters as (1) review and revision of agency directives to incorporate A-76 requirements and (2) preparation of multiyear plans to include a schedule of actions with milestones to achieve greater reliance on the private sector for ADP services. (See app. I for a copy of the most recent draft of the guidance made available by OFPP.)

Circular A-76's basic policy is to rely on the private enterprise system to supply the Government's needs except when it is in the national interest for such needs to be provided in-house. One of the circumstances cited in the circular for the Government's providing such services in-house is when procurements from commercial sources would result in higher costs to the Government. Thus, economy is a key factor in choosing between in-house or commercial resources.

In our opinion, OFPP should consider cost and industry capability in finalizing and issuing supplemental guidance to Circular A-76 for two reasons. First, our discussions with officials of many of the companies we visited clearly showed that they find it more beneficial to have most of their ADP services done in-house by their own staffs. In this respect, commercial practice is similar to that of many Federal agencies. Second, the responses to our questionnaire showed that only a limited number of ADP service firms currently have the capability to assume the role envisioned for them by OFPP. Thus, an attempt to move additional major segments of the Government's ADP requirements to commercial firms in a short time may be counter-productive. These points are discussed in the following sections.

Commercial organizations' ADP practices are similar to Government practices

To learn why and to what extent commercial organizations rely on contracted ADP services, we interviewed management officials in 31 private sector organizations which use, or at one time seriously considered or evaluated using, commercial ADP services. These organizations, located in six eastern and midwestern metropolitan areas, had annual operating budgets ranging from \$6 million to well over \$1 billion. Most of the organizations operate internal ADP facilities providing 75 percent or more of their total ADP requirements. Officials from these organizations expressed the opinion that the benefits of in-house operations generally outweigh those of relying on commercial ADP service firms.

Of the 31 firms interviewed, only 2 firms' officials stated they meet all of their requirements from outside sources and only 2 indicated they provided 100 percent of their ADP services in-house.

We obtained information about the number of personnel employed in ADP activities by these 31 firms. Of the two companies meeting all their requirements from outside sources, only one had no ADP personnel on its rolls. The sizes of the ADP staffs for the remaining 30 firms were as follows:

<u>Number of ADP personnel employed</u>	<u>Number of firms</u>
Under 250	20
251 - 300	1
351 - 600	3
601 - 900	3
901 - 1,000	0
1,001 - 1,200	0
Over 1,200	<u>3</u>
	<u>30</u>

In selecting organizations for interviews, we intentionally sought firms that employed large numbers, as well as those that employed small numbers, of ADP personnel to obtain a wide spectrum in terms of size and magnitude of ADP activity.

Many of these firms had established policies relating to the use of commercial ADP services, and these policies considered factors, such as those shown below.

<u>Circumstances under which commercial ADP sources are used</u>	<u>Number of firms (note a)</u>
When in-house staff lacked required expertise	14
When in-house resources are fully utilized	10
To acquire developed systems, applications, or programs (e.g., payroll, accounts receivable, accounts payable, and inventory control)	12
Other	10

a/Some of the firms had multiple reasons for using commercial ADP sources.

Of the 29 firms that did use outside sources, we asked if cost analyses had been made to determine whether services should be provided in-house or obtained from external sources. Twelve firms indicated they did make cost analyses; ten had found it more cost advantageous to stay in-house generally; one concluded it was sometimes

advantageous to use outside sources; and one found no appreciable difference. Even though it was determined to be generally cost advantageous to perform work in-house, a decision to do the work outside could be made for one of the reasons cited in the table above. Officials of several organizations interviewed told us they plan to meet even more of their ADP needs through internal resources in the future.

Disadvantages in using commercial services cited by the officials included:

- Management tends to lose control over part or all of its operation.
- Contracting requires more administrative effort and resources.
- Services are not always provided on a timely basis.

Overall, however, the officials were satisfied with those ADP services they did obtain from external sources.

Few firms could currently assume
major segments of the Government's ADP needs

OFPP officials believe that the ADP industry, although relatively new, now has the capability of providing much of the ADP needs of Government and has the flexibility to expand as needed. Our analysis of the 348 questionnaire responses also points out that, given sufficient time, adequate capital, and qualified personnel, the firms could meet much of the Government's needs. However, within a single year, only a limited number of firms could readily provide large quantities of service.

Several factors limit the firms' ability to provide more ADP services to the Government in the near future.

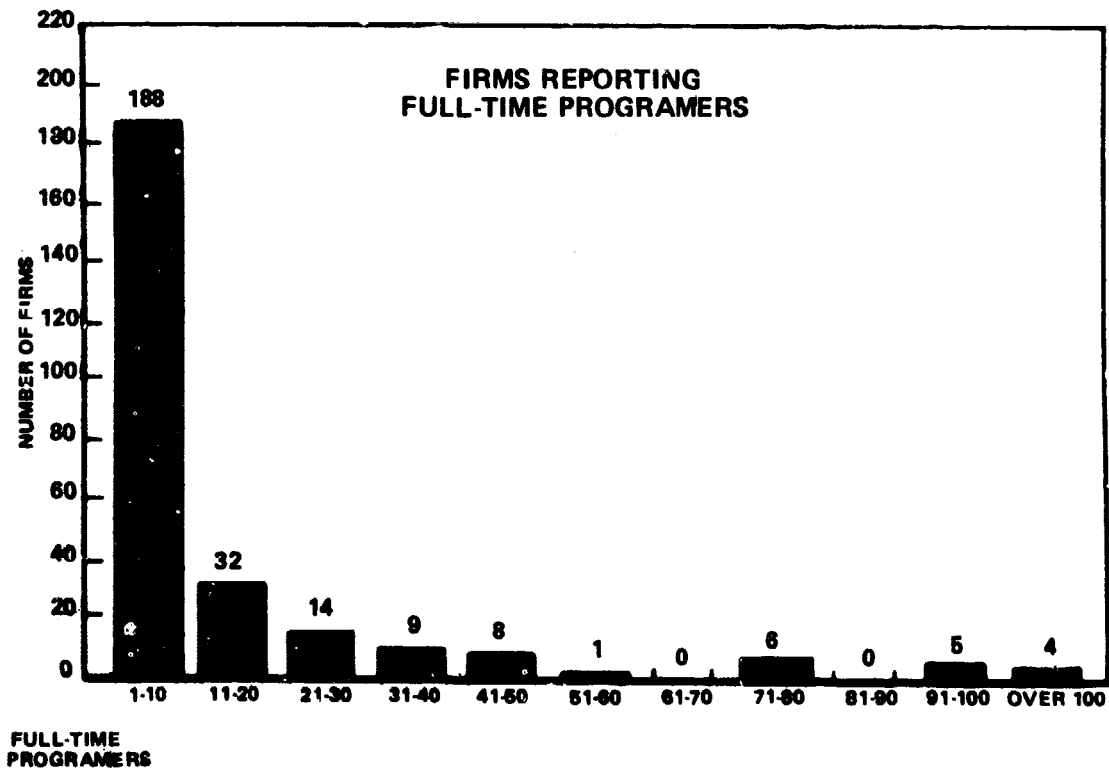
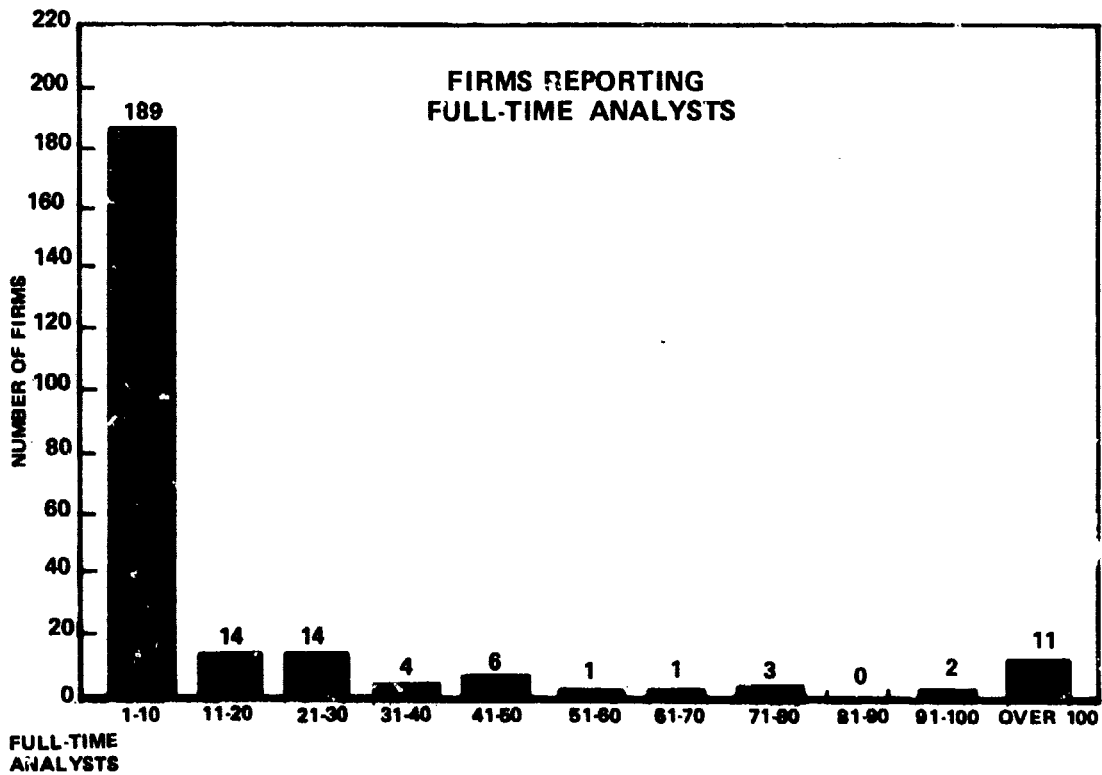
- Limited capacity.
- Lack of capital for expansion.
- Lack of qualified contracting personnel.

Limited capacity

Of the 348 firms responding to our questionnaire, 218 (63 percent) had 50 or fewer full-time ADP employees. In our opinion, many Federal agency ADP requirements would need to be segmented or specially structured into small tasks for this size of firm to be capable of responding to agency procurement efforts. The number of people employed by firms responding to the questionnaire is shown below:

<u>Number of employees</u>	<u>Number of firms</u>
1 - 20	116
21 - 50	102
51 - 100	49
Over 100	70
Not disclosed in response	<u>11</u>
Total	<u>348</u>

Two skill areas needed to meet Federal agencies' ADP services requirements are analysts and programmers. The questionnaire data revealed that many of the firms have only limited numbers of full-time employees in these two skill areas, as indicated in the following graphs.



Thus, of the 245 firms reporting the employment of analysts, 189, or over 77 percent, employed 10 or fewer full-time analysts. Of the 277 firms reporting the employment of programmers, 188, or nearly 68 percent, had 10 or fewer full-time programmers. This data seems to correlate with the statement by many of the firms that only a limited quantity of staff-years could be made available for programming and systems analysis within the next 12 months.

We asked the firms to estimate the quantity of services they could provide the Government during the next 12 months. The following table summarizes their stated capability for programming and systems analysis services.

<u>Staff-years available for Government work in the next 12 months</u>	<u>Number of firms by type of service (note a)</u>	
	<u>Programming</u>	<u>Systems analysis/design</u>
0	96	96
1 - 5	89	102
6 - 20	47	42
21 - 50	17	9
51 - 100	3	2
Over 100	9	7

a/Some firms provide both programming and system analysis/design services.

As shown above, many firms could provide small amounts of services, but their capability would be insufficient to fill the needs of many Government agencies. Significantly, 96 respondents said that they could not provide any programming or systems analysis during the next year.

Lack of capital for expansion

A number of the respondents were small- or medium-size firms with ADP revenues of less than \$5 million annually, and many stated they would have difficulty expanding. Ninety-nine firms said the lack of capital affected their ability to provide more services. Eighty-five of the firms had revenues of less than \$5 million. Typical of their comments were:

--The capital markets have all but disappeared, especially for small firms.

--Capital for small- to medium-size ADP service firms is a constant problem.

--Capital for expansion in the ADP service business will be difficult to obtain for small firms.

Lack of qualified contracting personnel

Many of the ADP service firms indicated that they had few, if any, employees knowledgeable about complex Government contract procedures. Over 25 percent of the firms responding said they had never provided services to the Government for this reason.

An official of a management consulting firm specializing in computer service industry activities advised us that Government agencies wishing to buy ADP services from a small- or medium-size firm need to change their procurement processes to make the entrepreneur:

"* * * feel that (1) he is welcome and (2) he has a chance. The Government must recognize that these companies have neither the time nor the resources to comply with the myriad difficulties normally encountered with submitting * * * proposals and cost justifications required by government * * *."

Difficulties in this area had been encountered by some of the firms queried. Forty-nine firms said they no longer provide services to the Government because:

--Bidding procedures required too much effort.

--They experienced too many problems with Government contracts (poor specifications, leadtimes, payment schedules, etc.).

--The profit margins were too low.

Other concerns voiced by the respondents were:

"Excessive work is involved in making a Government bid. It often seems a waste of time to respond to solicitations."

"Most small ADP companies do not have the time to spend on learning all that is needed to bid on

Government work. The time can better be spent on developing commercial accounts."

"Because of our size, we have difficulty obtaining large Government contracts when competing against industry giants."

"Smaller firms (less than \$25 million) cannot spend the time and dollars to submit proposals."

Several of the larger firms in the ADP industry also expressed concern about the Government's placing increased reliance on the commercial sector. Excerpts of their comments follow and point out both that the issue is complex and that the most cost-effective solution would require careful weighing of the alternatives available.

One very large respondent indicated the issue:

"* * * is not very different from the 'make or buy' decision normally made by private enterprise. The essential point is that EDP [electronic data processing] suppliers offer a wide variety of different methods of achieving the same data processing result. For example, many solutions may be implemented solely by software, by a software and hardware combination, by a redesign of the hardware configuration through the application of systems analysis/design services, by the use of time-sharing services, by the sharing of time on another Federal agency's computer system, and the list goes on and on.

"The Federal Government has long been a leader and innovator in the use of EDP techniques and has relied extensively on the private sector for EDP equipment and services. A great deal of time and effort has been expended to develop a higher [sic] competent group of computer professionals. The investment in people and resources has greatly assisted the Government in managing its problems and constitutes an important asset to the Federal establishment.

"We fully subscribe to Government policy of reliance on the private sector for its goods and services and feel in the EDP area there has been substantial compliance with the policy. There are areas, however, where greater emphasis could be placed on contracting for certain types of EDP services. The most important

factor we believe is the maintenance of a balance between those activities which can be contracted out and EDP activities which should continue to be performed in-house, either because of the nature of the EDP service itself or the need for the Government to retain direct control of mission-essential support functions.

"A trained and qualified staff capable of understanding the system in sufficient detail to write and evaluate competitive functional specifications will be required in order for the agency to compete effectively against outside services. The staff should maintain technical proficiency in order to keep abreast of the rapid technological changes which characterize the EDP industry so the agency can recommend and approve changes in system hardware and software.

"A presumption that either outside contracting or in-house performance is the least expensive method to provide an EDP service runs counter to sound management practice. Without cost studies of the various alternatives available for satisfying an EDP requirement, an agency could incur unnecessarily high risks and obligations."

Another commented that:

"Implementation [of the policy] will take strong direction from OMB. Budget redirection to [contractual services] with [a] resultant reduction of agency manpower on a programmed basis [would be necessary]. Short of that, agencies will maintain and increase in-house personnel."

CHAPTER 3

PROPOSED GUIDANCE COULD HAVE ADVERSE IMPACT

Several items in the proposed OFPP guidelines could adversely affect Government ADP operations, as well as private industry. The supplemental guidance would greatly reduce the requirement for comparative cost studies. On the other hand, the low cost thresholds for triggering cost studies, as now set forth in A-76, could cause both agencies and industry considerable problems when making minor changes to existing ADP operations. Finally, the supplemental directive includes no criteria or guidance for evaluating proposals responding to functional or service-type specifications; and there is no requirement to analyze what impact a shift to private industry would have on Government employees, equipment, and software.

LIMITED REQUIREMENTS FOR COST COMPARISONS

Circular A-76 states that it is the Government's policy to rely generally on the private sector for goods and services, and a cost comparison analysis is not required if an agency decides to use contractors. This position is reiterated in the proposed OFPP guidelines for agencies in meeting their ADP requirements.

In a January 7, 1976, letter to the Administrator of OFPP, we stated that obtaining goods and services at the lowest possible cost is a sound public policy; we indicated our agreement with the need to keep the expense and delay involved in making cost studies to a minimum, but we also pointed out that without making cost comparisons, the risk of selecting an uneconomical alternative will be greatly increased. This point was specifically made by a number of the firms responding to our questionnaire. (See p. 12 for one such view.)

LOW COST THRESHOLDS

While cost comparisons are key elements in determining whether work should be contracted out or performed in-house, such studies can be costly. The proposed guidelines repeat the cost thresholds established by Circular A-76 for a cost comparison study if an agency wants to provide an ADP service in-house. As discussed below some Government officials believe existing thresholds may be too low for the ADP area.

For an agency starting any new activity, the thresholds at present are

--\$25,000 or more for capital investment or

--\$50,000 or more for annual operating costs.

If an agency wants to expand or modernize an existing activity, the thresholds are

--\$50,000 or more for additional capital investment or

--\$100,000 or more for additional annual operating costs.

Various Government officials told us they foresee problems with these thresholds as applied to ADP. For example, one official stated:

"* * * the net effect of all of this is to require that all organizations rejustify doing their total data processing in-house * * * every time they want to add a couple of tape drives, a printer, or any other peripherals that amount to \$50,000."

Another official had similar observations and added that:

"* * * to preclude * * * minor workload changes from triggering too frequent * * * studies, the thresholds in these cases should be * * * increased."

One agency official observed that increasing the number of cost comparison studies would also affect private industry since firms will be requested to provide cost data to agencies. He stated that this could prove to be time consuming and costly for the private sector. As stated earlier, some ADP service firms could not or would not handle this increased workload or cost.

USE OF FUNCTIONAL SPECIFICATIONS WILL REQUIRE EVALUATION GUIDANCE

To foster greater reliance on the private sector for ADP, OFPP plans to require agencies to state their specific functional needs in terms of ADP "services to be performed rather than the equipment and software to be used in performing these services." OFPP believes the agencies should be primarily concerned with obtaining satisfactory services and not how the services are provided.

In our opinion, functional specifications can increase competition, but agencies will need criteria and guidance on how to evaluate vendor proposals and how to rank alternative solutions to a functional expression of an agency's needs. This problem should be addressed by OFPP.

NEED FOR PROCEDURES TO PROTECT THE
GOVERNMENT'S INVESTMENT IN HARDWARE,
SOFTWARE, AND PERSONNEL RESOURCES

Although the draft guidance contains statements that "reasonable consideration" be given to the impact on Government employees and that care be taken to avoid "disruption of the agency mission" in the termination or reduction of ADP activities, in our opinion the proposed guidance falls far short of being helpful and fails to address adequately the need to protect the sizable Government investment in software, hardware, and personnel resources.

Many of the data processing applications in use by the agencies directly affect, control, or are used to manage programs and processes vital to the agency and, frequently, vital to the general public as well. We believe specific procedures should be outlined in the guidance to ensure, whenever transition to commercial services is appropriate, (1) economical phaseout of Government-owned ADP hardware, (2) protection of the Government's investment in application software, (3) continued effective maintenance of existing software vital to critical agency programs, and (4) uniform and equitable treatment for employees affected by the termination or curtailment of Government in-house ADP activities.

The need to give due consideration to the pronounced dependency on ADP for the delivery of agency programs and effective services cannot, in our judgment, be overlooked.

CHAPTER 4

CONCLUSIONS, SUGGESTIONS, AND AGENCY COMMENTS

CONCLUSIONS

Given the size and capability for long-range expansion of the ADP services industry, the objective of placing greater reliance on that industry, when appropriate, is reasonable if pursued with adequate planning and guidance. However, OFPP should ensure that the guidelines accommodate the industry profile, its capabilities, and its limitations. This approach would take into account the ADP industry's near-term capabilities while concurrently enhancing the industry's future capacity to meet Government needs. A carefully phased approach would seem to be more workable than a massive shift of major segments of the Federal agencies' ADP requirements to the private sector.

It would be beneficial for OFPP to:

- Find out how organizations in the private sector determine whether external commercial ADP sources should be used and why.
- Seek guidance from ADP and procurement experts in the public and private sectors on proposed implementation procedures.
- Study the ADP industry to identify the kinds of support available and the extent of the support.
- Identify ways to strengthen the ADP services industry's participation in Federal work.
- Encourage the ADP services industry to expand its capabilities to meet the Federal agencies' requirements.

These efforts would enhance the guidelines for implementation and properly protect the Government's interests while improving effectiveness of operations.

SUGGESTIONS

We suggest that the Administrator, OFPP, revise the proposed guidelines based on a comprehensive analysis of the areas mentioned.

In addition, we suggest that, when preparing the new guidelines, the Administrator:

- Emphasize the need for cost comparison analysis rather than deemphasize it.
- Develop adequate guidance for making valid cost comparisons.
- Determine whether increasing the cost thresholds would be advantageous to Government and industry.
- Determine the feasibility of issuing procedures to facilitate smaller ADP firms providing services to the Government without incurring excessive costs.
- Develop procedures to assure appropriate protection of the Government's investment in ADP resources and assure that the impact on the agency's systems, related programs, and employees is addressed adequately.

AGENCY COMMENTS

We provided copies of our draft report to and discussed it with OFPP representatives. They indicated that our examination of the ADP services market and the issues associated with using commercial sources for meeting more of the Government's ADP needs was beneficial and provided information which would be useful in formulating the specialized guidance for the ADP area.

With respect to our discussion of commercial organizations' use of contracted ADP services (see pp. 5 to 7), the OFPP representatives pointed out that while commercial practice in satisfying ADP requirements in-house or by contract is of interest, the different roles of Government and private firms in our society must be recognized. Various Government policies, including reliance on the private sector, have evolved over the years to achieve objectives important to the national interest, but these policies do not necessarily apply to individual business firms.

Additional OFPP comments dealt with the absence of a suitable commercial source as proper justification for in-house performance. The representatives stated that proposed changes to Circular A-76 would require publication of Government requirements to determine if there is a commercial capability, and these changes would (1) provide a

basis for assessment on a case-by-case approach and (2) let the private sector know what the Government's needs are, thereby stimulating the development of commercial capacity.

The OFPP representatives told us that the proposed changes to Circular A-76 would increase the cost thresholds discussed on page 14 and would address the need to protect the Government's investment. (See p. 16.) The OFPP representatives said that:

"The emphasis on adequate work statements, careful selection of contractors, and proper contract performance should assure satisfactory performance. Recognition of current market value of hardware and software in cost comparisons should provide more realistic economic considerations. Several actions would increase consideration for Federal employees - a cost factor favoring the status quo for in-house activities, right of first refusal for jobs with the contractor, and an appeals process."

OFPP's comments indicate the proposed actions in revising Circular A-76 and the supplements should be responsive to the points raised by our views. We plan to monitor further developments in this area as part of our ongoing audit work.



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT POLICY

August 10, 1976

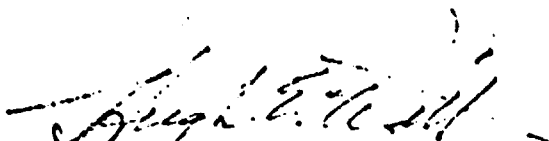
TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Guidelines for Application of OMB Circular A-76
to Government ADP Requirements

In our efforts to improve the implementation of OMB Circular A-76, "Policies for Acquiring Commercial or Industrial Products and Services for Government Use," data processing has been identified as an area in which there is extensive Government involvement in providing a service that is commercially available. It is also one of several functional areas in which application of the policy and requirements of the Circular is difficult, and supplemental guidance is needed to facilitate agency implementation efforts.

Consequently, the attached draft of a Transmittal Memorandum to Circular A-76 has been prepared, with the assistance of a small interagency task group, to provide guidelines for application of this policy to Government ADP requirements. The purpose of this issuance is to move Government practice toward greater use of commercial ADP services, in lieu of Government ownership and operation of ADP facilities.

Please review this draft Transmittal Memorandum and give us your comments and recommendations by September 15, 1976.


Hugh E. Witt
Administrator

Attachment



D R A F T
EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

CIRCULAR NO. A-76
Transmittal Memorandum No.

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Government Reliance on Commercial Services to Meet Automatic Data Processing Requirements

1. Purpose. This memorandum provides guidance for executive agencies in meeting their requirements for general purpose data processing services in accordance with the Government's general policy of reliance on the private sector for its needs, as set forth in Office of Management and Budget (OMB) Circular No. A-76, Policies for Acquiring Commercial or Industrial Products and Services for Government Use.
2. Authority and Scope. This Transmittal Memorandum is issued under the authority granted to the Office of Federal Procurement Policy by Public Law 93-400 to monitor and revise "policies, regulations, procedures, and forms relating to reliance by the Federal Government on the private sector to provide needed property and services" (41 U.S.C. 405). It is applicable to all general purpose data processing activities operated and managed by executive agencies that provide services that are obtainable from a private source, as defined in Circular No. A-76.
3. Background. It is the longstanding policy of the Federal Government to rely on the private enterprise system to satisfy its needs for products and services, except in those specific cases where it is clearly demonstrated to be in the National interest for an agency to provide a product or service for its own use. In the area of data processing, agencies have generally purchased or leased equipment and facilities to provide their automatic data processing (ADP) services. In this approach, the nature and degree of reliance on the private sector is distinctly different from acquisition of the needed service directly from a private source.

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An agency that procures facilities instead of services generally maintains a staff with the expertise necessary to perform system design, software development, operation, maintenance, and logistic support. The service approach, which shifts the agency role from performance to management of the ADP function, does not eliminate the need for in-house expertise, but establishes it at the level necessary to prepare service performance specifications and to monitor the performance of commercial services. Under the policy of Circular No. A-76, direct procurement of services, with all the associated functions being performed in the private sector, is the preferred alternative for meeting data processing requirements.

4. Policy. Consistent with the Government's general policy of reliance on the private sector, agencies will obtain ADP services from competitive commercial sources in preference to direct operation of in-house activities, except as provided in paragraph 5 of Circular No. A-76. All Government ADP activities that meet the Circular No. A-76 definition of a commercial or industrial activity are subject to the requirements of the Circular, including a "new start" review for initiation, expansion, upgrade, replacement, or modernization. Current agency ADP operations that cannot be justified under the criteria specified in Circular No. A-76 and this Transmittal Memorandum shall be terminated in a planned and appropriate manner.

5. Planning and Management Guidelines. Each agency will initiate a positive action program to ensure that the policy and requirements of this Transmittal Memorandum are fully and effectively implemented. This program will include the following elements:

a. Review (and revision as necessary) of all agency instructions and directives related to the acquisition of ADP support to identify and incorporate Circular No. A-76 requirements with emphasis on the application of this policy early in the ADP system planning process.

b. Maximum emphasis on "new starts" to avoid capital investment and financial commitments for new, expanded, or modernized facilities for ADP activities that have not been reviewed and justified under Circular No. A-76.

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c. Preparation of a multiyear plan, to be included in the Spring ADP Plan submitted annually to OMB, beginning with the 1977 submission. This plan should project new and continuing ADP requirements, and include a schedule of actions that will achieve greater reliance on the private sector for ADP services. Where appropriate, agencies should set goals and make use of Management by Objective (MBO) methodology to increase reliance on the private sector.

d. Development of a program outline for achieving greater reliance on commercial services, with milestones and specific targets where appropriate, for submission to OMB within ninety days from the date of issuance of this Transmittal Memorandum.

6. Acquisition Guidelines. Agency policies and procedures for acquiring ADP hardware, software, and services must reflect the policy of Circular No. A-76 and provide for the efficient procurement of commercial ADP services. As a minimum, the following guidelines will be implemented immediately:

a. Government ADP requirements normally will be expressed in terms of the services to be performed, rather than the equipment and software to be used in performing these services. The statement of requirements should allow the contractor maximum flexibility in the type of equipment and personnel used, as long as satisfactory services are provided.

b. Agency requests to the General Services Administration (GSA) for delegation of procurement authority for acquisition of ADP equipment to be operated by the agency will include a specific statement indicating that the proposed acquisition has been reviewed and approved under the provisions of Circular No. A-76, or an explanation of why the Circular does not apply.

c. Studies to determine whether a commercial or industrial ADP activity can be justified on the basis of cost should be limited to situations where there is reason to assume that in-house costs will be significantly less than competitive commercial prices. When cost studies are made they will include all the cost elements specified in Circular No. A-76. The cost differential favoring reliance on commercial sources will reflect the possibility of early obsolescence and the uncertainty of requirements which are

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characteristic of ADP operations. This differential (which Circular No. A-76 specifies should normally be at least 10% for any new start) should be established for each cost study at a level that is appropriate for the degree of risk and uncertainty involved in Government operation of that particular activity. In the case of ADP activities, this differential can be substantially more than 10%.

d. In the preparation of a cost comparison, particular attention must be given to the following areas to ensure an equitable and accurate result.

(1) Determination of a valid commercial cost figure presents a serious problem -- generally this requires solicitation of competitive bids for the required services. Commercial firms have indicated a willingness to provide cost or price proposals if they are assured that an objective cost study will be made.

(2) The Government and commercial cost estimates must be based on equivalent services.

(3) Fair market value of equipment and facilities used in existing Government ADP activities, which would become excess if the service were obtained commercially, must be determined and included in the study as a cost of Government performance.

(4) Determination of the proper residual or salvage value of equipment that the agency proposes to acquire, in order to ensure the correct depreciation cost in the cost comparison.

e. More comprehensive guidelines are being developed to assist agencies in calculating both the Government and commercial costs of providing ADP services. In the interim, guidance available in Circular No. A-76 and this Memorandum will be used.

7. Termination Guidelines. All agency ADP activities should be reviewed by September 30, 1977 to determine whether Government performance is justified under the exception criteria of Circular No. A-76. When a Government commercial or industrial activity is to be terminated or reduced, the action must be carefully planned to ensure transition without the disruption of vital services. Agency planning should include:

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a. All reasonable consideration for Government employees displaced by termination or curtailment of Government ADP activities, including a phased reduction of operations to facilitate reassignment and reduction by attrition.

b. Careful coordination of contract services, including a period of overlap, when necessary, to avoid disruption of the agency mission.

8. Inquiries. Inquiries concerning this Transmittal Memorandum may be submitted to the Office of Management and Budget, Office of Federal Procurement Policy, 726 Jackson Place, N.W., Washington, D.C. 20503, telephone 395-3327 (IDS Code 103).

James T. Lynn
Director

D R A F T

U. S. GENERAL ACCOUNTING OFFICE
SURVEY OF THE
AUTOMATIC DATA PROCESSING SERVICE INDUSTRY

INSTRUCTIONS

You will be requested to answer only certain sets of questions. Therefore, please follow the "skip to" directions carefully.

We ask that you answer the applicable questions as frankly and completely as possible.

In responding to the questions please mark your response in this manner: [X] or [✓]

TO ENABLE US TO SEND YOU A COPY OF THE REPORT AND FOR FOLLOWUP PURPOSES, WE NEED THE NAME OF YOUR FIRM ON THE QUESTIONNAIRE. PLEASE BE ASSURED THAT THE IDENTITY OF YOUR FIRM WILL NOT BE INCLUDED IN THE REPORT.

1. Please complete the following:

Name of your company: (See note a.)

Company address:

Name of person completing questionnaire:

Position/Title:

Telephone No. () AREA CODE NUMBER

2. How long has your firm been providing ADP services? (Please mark one.) (See note a.)

1/10 Less than 2 years

2/31 2 to 4 years

3/120 5 to 7 years

4/69 8 to 10 years

5/107 More than 10 years

NOTES PERTAINING TO QUESTIONNAIRE RESPONSES:

a/ For some segments of the questionnaire it was not practical to summarize the responses; therefore, data has not been entered for some questions or subparts. Where we were able to consolidate responses, the summarized data has been entered in the appropriate box.

b/ Data relating to question 7 is shown on p. 9.

c/ Data relating to question 20 is shown on p. 10.

3. What is your company profile in terms of (1) scope of operations, (2) area of concentration/specialization, and (3) customer mix?

(1) SCOPE OF OPERATIONS (Please mark the one best description.)

1/70 International

2/100 National

3/125 Regional

4/47 Local

5/ Other (please specify)

(2) AREA(S) OF CONCENTRATION/SPECIALIZATION (Please mark all that apply.)

1/98 Scientific applications

2/318 Commercial or business applications

3/ Other (please specify)

(3) CUSTOMER MIX:

1. Industrial/Commercial: (Please mark all that apply.)

1/55 Agriculture, forestry, or fishing

2/162 Construction

3/362 Finance, insurance, or real estate

4/258 Manufacturing

5/30 Mining

6/220 Retail trade

7/270 Services

8/179 Transportation or communications

9/192 Wholesale trade

10/149 Utilities

11/ Other (please specify)

APPENDIX II

APPENDIX II

2. Governmental: (Please mark all that apply.)

- 1/100 Federal
- 2/100 State
- 3/100 Local
- 4/39 Foreign

4. What was your approximate total revenue for 1975? (Please mark one.)

- 1/100 Less than \$1 million
- 2/100 \$1 million to less than \$25 million
- 3/30 \$25 million to less than \$100 million
- 4/11 \$100 million to less than \$500 million
- 5/1 \$500 million to less than \$1 billion
- 6/2 \$1 billion to less than \$5 billion
- 7/5 \$5 billion to less than \$10 billion
- 8/1 \$10 billion or more

5. During 1975 what types of ADP services were provided to your customers and approximately what percent of your total ADP services revenue did they represent? ADP services revenue should not include equipment sales or leasing revenues. (Please fill in the approximate percent for each applicable service listed below.)

Approximate percent of total ADP services revenue	Types of ADP services available
1. (See note a.)	Computer output microfilm (COM)
2. _____	Computer time
3. _____	Data entry
4. _____	Facility management
5. _____	Maintenance
6. _____	Management consulting
7. _____	Programming
8. _____	Systems analysis/design
9. _____	Training (customer personnel)
10. _____	Other (please specify)
_____	_____
_____	_____
100% Total	_____

6. In 1975 what was your approximate total ADP services revenue for the services identified in question 5? (Please mark one.)

- 1/170 Less than \$1 million
- 2/102 \$1 million to less than \$5 million
- 3/40 \$5 million to less than \$25 million
- 4/12 \$25 million to less than \$50 million
- 5/4 \$50 million to less than \$100 million
- 6/4 \$100 million to less than \$500 million
- 7/5 \$500 million to less than \$1 billion
- 8/5 \$1 billion or more

7. Indicate, for each personnel class listed below, the approximate number of full-time ADP employees currently on your payroll. (Please fill in the appropriate blanks.) (See note b.)

Personnel Class	Approximate Number of full-time ADP employees
1 Analysts	_____
2 Computer operators	_____
3 Consultants	_____
4 Data entry personnel	_____
5 Educators/trainers	_____
6 Maintenance personnel	_____
7 Managers	_____
8 Programmers	_____
9 Systems engineers	_____
10 Other (please specify)	_____
_____	_____
_____	_____

8. Are you currently providing ADP services to Federal agencies? (Please mark one.)

- 1/115 Yes (If yes, skip to question 14)
- 2/330 No (If no, continue to question 9)

9. Have you ever provided ADP services to Federal agencies? (Please mark one.)

- 1/40 Yes (If yes, skip to question 13)
- 2/180 No (If no, continue to question 10)

10. What are the principal reason(s) why your firm has never provided services to federal agencies? (Please mark all that apply.)

- 1 26 Do not sell what the Federal agencies are buying
- 2 30 Do not know how to get business with Federal agencies
- 3 13 Always been underbid
- 4 44 Too busy servicing commercial customer needs to seek Government contract work
- 5 24 Government contract work too difficult to obtain and/or maintain
- 6 Other (please specify) _____

11. Should the opportunity arise, would you be willing to provide ADP services to Federal agencies? (Please mark one.)

- 1 100 Yes (If yes, skip to question 20)
- 2 16 No (If no, continue to question 12)

12. Why are you unwilling to provide ADP services to Federal agencies? (Please mark all that apply.)

- 1 4 Too competitive -- potential of contract awards not high enough
- 2 8 Too much effort required to bid
- 3 7 Not willing to expand to accommodate Government needs
- 4 9 Too many potential contract problems (poor specifications, contract modifications, lead times, payment schedules, etc.)
- 5 7 Profit margins are too low
- 6 Other (please specify) _____

PLEASE SKIP TO QUESTION 22

13. If you formerly provided ADP services to Federal agencies but no longer do so, why did you stop? (Please mark all that apply.)

- 1 12 Other markets grew more appealing
- 2 17 Government stopped buying the services we offered
- 3 5 Government market became too competitive
- 4 22 Bidding procedure required too much effort
- 5 10 Experienced too many problems with Government contracts (poor specifications, contract modifications, lead times, payment schedules, etc.)
- 6 4 Profit margins too low
- 7 Other (Please specify) _____

PLEASE SKIP TO QUESTION 16

14. What was your approximate total ADP services revenue from Federal agencies in 1975? (Please mark one.)

- 1 31 Less than \$100 thousand
- 2 24 \$100 thousand to less than \$500 thousand
- 3 17 \$500 thousand to less than \$1 million
- 4 26 \$1 million to less than \$25 million
- 5 2 \$25 million to less than \$50 million
- 6 - \$50 million to less than \$100 million
- 7 2 \$100 million or more

APPENDIX II

APPENDIX II

15. In 1975 what types of services were provided to Federal agencies and approximately what percent of the total ADP services revenue gained from Federal agencies (reported in question 14) did each represent? (Please fill in the approximate percent for each applicable area listed below.)

17. Briefly describe the details of the problem(s) identified in question 16. (Areas rated as either "Poor" or "Unsatisfactory".) (If you need more space, please attach an additional sheet.)
(See note a.)

Approximate percent	(See note a.) Types of ADP services provided
1. _____	Computer output microfilm (COM)
2. _____	Computer time
3. _____	Data entry
4. _____	Facility management
5. _____	Maintenance
6. _____	Management consulting
7. _____	Programming
8. _____	Systems analysis/design
9. _____	Training (customer personnel)
10. _____	Other (please specify) _____
_____	_____
_____	_____
100%	Total (all ADP services)

16. Please rate, from excellent to unsatisfactory, the Government's performance in each of the areas listed below. (Please mark one box for each row.)

18. If the need arose, would your firm be willing to provide more ADP services to Federal agencies? (Please mark one.)
 158 Yes (If yes, skip to question 20)
 2 No (If no, continue to question 19)

	(1) Excellent	(2) Good	(3) Fair (O.K.)	(4) Poor	(5) Unsatisfactory
1. Clarity of specifications	20	74	44	7	2
2. Flexibility of specifications	7	51		23	4
3. Reasonableness of proposal requirements	10	48	53	23	4
4. Adequacy of lead times	6	59	58	20	2
5. Appropriateness of contract type, (e.g., fixed price, cost plus fixed fee, etc.)	13	65	52	12	5
6. Reasonableness of payment schedules	19	60	42	14	22
7. Overall fairness of contract administration	18	67	46	9	9

19. For which of the following reasons is your firm not willing to provide more ADP services to Federal agencies? (Please mark all that apply.) (See note a.)

- 1 Satisfied with current workload -- not seeking additional work from any source
- 2 No excess capacity available
- 3 Could not expand operations to meet additional Government needs
- 4 Do not wish to change current ratio of Government/Commercial business
- 5 Too much effort required to gain and maintain additional Government contracts
- 6 Other (please specify) _____

PLEASE SKIP TO QUESTION 22

20. Please estimate how much more ADP services your firm could provide to Federal agencies, during the next year. (Please fill in the appropriate blanks.) (See note c.)

ADP service	Estimated Increase By	
	Increase	Unit of measure
Computer output microfilm (COM)	1. _____	(_____)
Computer time:	2.	
Large scale system	1. _____	(hours)
Medium scale system	2. _____	(hours)
Small scale system	3. _____	(hours)
Data entry	3. _____	(_____)
Facility management	4. _____	(_____)
Maintenance	5. _____	(_____)
Management consulting	6. _____	(man years)
Programming	7. _____	(man years)
Systems Analysis/design	8. _____	(man years)
Training (customer personnel)	9. _____	(_____)
Other (please specify)	10. _____	(_____)
_____	_____	(_____)
_____	_____	(_____)

22. Which of the following factors, if any, are likely to limit the ADP service industry's (not just your firm's) ability to provide more ADP services to Federal agencies during the next year? (Please mark the more serious potential limiting factor(s).)

- 1 Capital for expansion
- 2 Computer time
- 3 Availability of properly skilled personnel
- 4 Number of qualified Government contracting personnel
- 5 None of the above
- 6 Other (please specify) _____

23. Please elaborate on the limiting factor(s) identified in question 22. (If you need more space, please attach an additional sheet.) (See note a.)

21. How would your firm provide more ADP services to Federal agencies? (Please mark all that apply.)

- 1 Use excess capacity
 - 2 Subcontract
 - 3 Expand the amount of existing services
 - 4 Offer new types of ADP services
 - 5 Other (please specify) _____
- _____
- _____

24. We would appreciate your views on the following matter. If the Federal agencies placed greater reliance on the ADP services industry, what do you think would be the short and long run: (If you need more space, please attach an additional sheet.)
 (See note a.)

25. Concerning the Government's policy of relying on private industry for ADP services, please briefly describe how you think this policy could best be implemented.
 (See note a.)

1. advantages to the ADP services industry?

2. disadvantages to the ADP services industry?

3. advantages to the Federal agencies?

26. May we send you a copy of the completed report on this project? (See note a.)

Yes

No

Please return the questionnaire in the envelope provided.

THANK YOU FOR PARTICIPATING IN THIS STUDY.

4. disadvantages to the Federal agencies?

(91314)