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Comptroller General
of the United States

United States General Accounting Office
Washington, DC 20548

January 16, 2003

The Honorable Mitchell E. Daniels, Jr.
Director, Office of Management
and Budget

Subject: *Proposed Revisions to OMB Circular A-76*

Dear Mr. Daniels:

I want to recognize the considerable effort expended by you and your team on the proposed revision to Office of Management and Budget (OMB) Circular A-76, which prescribes policies and procedures agencies must use when considering the transfer of commercial activities between the public and private sectors. The proposed revision was issued for public comment on November 19, 2002, and I understand that OMB has received hundreds of comments on the proposal. As you consider these comments, I want to provide GAO's assessment of the proposed changes, as well as our recommendations for how the proposal could be improved.

The proposed revision in many ways is consistent with the sourcing principles and recommendations adopted by the Commercial Activities Panel, which I chaired, in its April 30, 2002, report.¹ In particular, the proposal stresses the use of competition in making sourcing decisions and, through reliance on procedures contained in the Federal Acquisition Regulation (FAR), should result in a more transparent, expeditious, fair, and consistently applied competitive process. The proposal should promote sourcing decisions that reflect the best overall value to the agencies, rather than just the lowest cost. Importantly, the proposed revision also should result in greater accountability for performance, regardless of the service provider selected.

There are several areas, however, where the proposed revisions to the Circular are not consistent with the principles or recommendations of the Commercial Activities Panel. Specifically, these include the absence of a link between sourcing policy and agency missions, unnecessarily complicated source selection procedures, certain unrealistic time frames, and insufficient guidance on calculating savings. Each of these areas is discussed in detail below, together with recommendations intended to align the proposal more fully with the views expressed by the Panel.

¹ Commercial Activities Panel, *Improving the Sourcing Decisions of the Government* (Washington, D.C.: April 30, 2002).

Emphasize Sourcing As a Strategic Issue

The first of the 10 sourcing principles unanimously adopted by the Panel is that federal sourcing policy should support agency missions, goals, and objectives. In other words, sourcing policy is not just about choosing among potential service providers. Rather, an agency's sourcing policy should be viewed as part of an overall strategy for how best to accomplish the mission of the agency, including how it conducts human capital planning. The current A-76 Revised Supplemental Handbook reflects this idea by pointing out that in focusing on core mission competencies and service requirements, agencies should consider a wide range of options, including restructuring, privatization, devolution of activities to state and local governments, or the termination of obsolete functions. To this list of options, the Panel recommended adding high-performing organizations and public-private partnerships. The proposed revision, however, does not list these or other options,² nor does it otherwise stress the importance of considering alternative approaches to accomplishing agency missions. Given that many of these options can result in improved efficiency and enhanced performance, we recommend that the Circular continue to encourage agencies to consider these and other alternatives to A-76.

Source Selection Issues

The Panel recommended that public-private competitions be conducted using the framework of the FAR, with appropriate changes to accommodate public-sector proposals. For the most part, the proposed revised Circular would implement this recommendation in a manner consistent with the Panel's principles. We have concerns, however, regarding the source selection evaluation approaches contained in the proposal.

The proposed revised Circular provides for two different types of evaluation approaches—"integrated" and "phased"—to address cases where an agency may wish to make trade-offs between cost and higher performance levels in selecting a service provider. The trade-off concept is fully consistent with the Panel's call for a process that considers both quality and cost factors and is used routinely throughout the government in FAR-based acquisitions. In the proposed integrated approach, however, the revised Circular would require that decisions to select other than the lowest cost provider be supported by a "quantifiable rationale." While it is certainly reasonable to expect procurement officials to articulate the rationale for their decisions—and the FAR requires that they do so—there is no requirement in the FAR that the rationale be "quantifiable." It is not clear what is intended by the use of the term "quantifiable," or what the agencies would need to do beyond what the FAR currently requires to ensure that trade-off decisions are justified and adequately explained. We recommend that the revised Circular include additional guidance concerning any requirement that an agency's trade-off decision be "quantifiable."

In the phased evaluation approach, an agency would evaluate the technical merit of tenders and offers in the first phase, adjust its required performance standards as needed, and then select the lowest-cost provider in the second phase. This approach

² In fact, the proposed Circular discourages public-private partnerships by prohibiting agencies from entering into new contracts when creating "most efficient organizations."

raises two issues. First, in the technical evaluation phase, the agency essentially would conduct a cost-benefit analysis for each instance in which a proposed performance standard differed from a solicitation requirement. This process, which does not appear to be based on the FAR, likely would be quite burdensome both for the offerors, who must assign specific dollar values to each differing level of performance, and for the agencies in evaluating the costs and benefits of differing performance levels for perhaps scores of discrete performance standards. Second, should it decide that an offered performance standard is desirable, an agency would be required to advise all competitors of its revised requirements and allow the submission of revised proposals or tenders. Particularly for some of the more complex requirements, this process could serve as a disincentive to innovation should offerors become reluctant to propose improved ways to enhance contract performance out of fear that their proposed approaches will be shared with their competitors. We recommend that the phased evaluation approach be revised to simplify the process and ensure the protection of certain proprietary and highly competition-sensitive information.

Unrealistic Time Frames

In the course of its review, the Commercial Activities Panel repeatedly heard complaints from all sides about the length of time required to conduct A-76 cost comparisons, and there is an obvious effort in the proposed revision to expedite the process. The proposal would establish a 12-month limit for completing the standard competition process and, within that time frame, a 4-month limit for source selection. In our view, however, the proposed required time frames are unrealistic. Over the last 5 years, the average time to complete a cost comparison process in the Department of Defense was 25 months (excluding appeals and protests). Source selection alone averaged 7 months. While these averages demonstrate the need to expedite the process, we question whether simply imposing aggressive, fixed deadlines is the answer. Rather, additional training, technical resources, or other support for agency officials in preparing for and participating in public-private competitions may be needed. We recommend that the time frames be revised to be more realistic (perhaps 15 to 18 months overall) and that OMB ensure that agencies provide sufficient resources to comply with the new A-76 requirements.

Business Case Direct Conversions

The Commercial Activities Panel strongly supported continued emphasis on competition in determining whether the public or the private sectors should perform commercial services. In fact, the Panel said that direct conversions from one sector to another without the benefit of competition generally should occur only where the number of affected positions is *de minimis* (10 or fewer full-time equivalent [FTE] positions). For the most part, the proposed revision of A-76 would maintain current policy and permit direct conversions only in limited circumstances, such as for direct research and development, for national defense or intelligence security with the prior approval of OMB, or for “small activities” (i.e., 10 or fewer civilian employees). The proposed revision would expand the list of permissible direct conversions, however, to include activities performed by up to 50 employees based on a “business case analysis.” This analysis, which is essentially the same as the streamlined cost comparisons currently permitted for activities involving up to 65 positions, would

compare the estimated cost of agency performance with the lowest-priced existing contract for a similar workload to determine whether to directly convert the function.

We have two concerns about the proposed business case direct conversions. First, changing the characterization of the process from a streamlined cost comparison to a business case direct conversion sends an unfortunate signal that the administration is attempting to increase the number of direct conversions. As you know, this is a particularly sensitive matter for federal employees, whose trust in the objectivity and fairness of the system will be critical to the success of the administration's competitive sourcing initiative. Second, the cost comparison would continue to be based upon an agency's current organization, with no opportunity for developing a "most efficient organization" (MEO). We recommend that the proposed revision require that any streamlined cost comparison be based on a reliable estimate of the efficiencies likely to be realized through the creation of an in-house MEO. Should the cost comparison indicate that continued agency performance of the function would be more advantageous to the government than other alternatives, the agency should be required to develop and implement the MEO.

Lack of Guidance on Calculating Savings

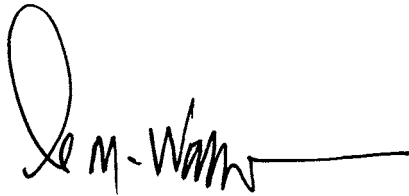
The Circular requires that agencies report the savings that accrue from A-76 competitions. The Circular does not provide any guidance, however, on how savings are to be calculated. Our work examining the use of Circular A-76 in the Department of Defense has shown a lack of consistency among and even within the military services in how they calculate savings. While our analyses indicate that significant savings are likely from many of these competitions, we have not been able to quantify the precise level of savings because of the lack of good baseline data and other limitations. Calculation of savings is an area that requires additional OMB guidance.

Implementation Is Key

Finally, the critical issue for all affected parties is how the government's sourcing policies are implemented. In this regard, one of the Panel's sourcing principles was that the government should avoid arbitrary numerical or FTE goals. This principle is based on the concept that the success of government programs should be measured by the results achieved in terms of providing value to the taxpayer, not the size of the in-house or contractor workforce. Although the proposed revised Circular contains no numerical targets or goals for competitive sourcing, this has been a controversial area in the past. In our view, the administration needs to avoid arbitrary targets or quotas, or any goal that is not based on considered research and analysis.

With the changes specified above, the revised Circular A-76 would be more consistent with the recommendations of the Commercial Activities Panel and with the sourcing principles the Panel adopted. Please contact me at (202) 512-5500 or Bill Woods, Director, Acquisition and Sourcing Management, if you would like further discussion of these issues. Bill can be reached at (202) 512-8214 or at Woodsw@gao.gov.

Sincerely yours,

A handwritten signature in black ink, appearing to read "D. M. Walker", with a long horizontal line extending to the right.

David M. Walker
Comptroller General
of the United States

cc: Mark Everson
Deputy Director for Management

Angela Styles
Administrator, Office of
Federal Procurement Policy

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