Contracting Fairness

Subcommittee on Government Operations
Committee on Oversight and Government Reform
U.S. House of Representatives

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Statement of

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Mr. Chairman and members of Subcommittee: It is a great privilege to appear before you today to testify on how to improve fairness in federal government contracting, especially for goods and services that are available on commercial markets. The government owes its citizens—and taxpayers—the highest possible value for the money they send to Washington, and there is no doubt that effective contracting for commercially available services can save money.

In pursuing this strategy, it is essential that the government keep in mind an important lesson. All large private companies rely heavily on buying goods and services, just as the federal government does. The federal government can benefit from the lessons taught by the best-run private companies. These companies know that good contracting can save them money. They also know that ensuring these savings requires strong and effective contract management, by acting as a ***smart buyer***:

- Specifying clearly what they want to buy
- Making good choices of suppliers who can provide the highest quality of products
- Keeping a watchful eye on the quality of products to make sure they get what they pay for

As the government seeks to increase its purchase of commercially available products, it needs to follow these steps carefully. To do otherwise risks increasing fraud, waste, abuse, and mismanagement.

1. Contracts for Commercial Products Are Becoming a More Important Part of the Federal Government's Strategy

The federal government has a long-standing policy, wherever possible, of purchasing commercially available goods and services. The practice has great potential for saving taxpayer dollars. In fact, the U.S. Government Accountability Office has found that leading private companies have been able to save between 4 and 15 percent in strategic sourcing of the services that they buy.[1] Contracting out represents a large share of the federal government's discretionary spending—nearly 2/5 of the all discretionary spending. Purchase of commercial items accounts for almost 1 of every 10 federal discretionary dollars.

In the last five years, total federal spending for contracts has declined, as a result of two intersecting forces: the tough sequestration targets in the federal budgetary process; and uncertainty about the amount of money available for contracts. The former has made less money available; the latter has made it harder to make longer-term contractual commitments in spending it. From Fiscal Year 2011 to 2015, total government spending on contracts has declined 18.6 percent, to $439 billion in FY2015 (37.6 percent of federal discretionary spending). Federal spending for commercially available products, however, fell much less: a decline of 3.6 percent, to $111 billion (9.5 percent of federal discretionary spending). Over this period, contracts for commercially available products increased as a share of federal contract spending, to 25.2 percent.

Federal Contract Spending on Commercial Items

Fiscal year	Contracts for commercial items	Total contract spending	Commercial items as percentage of all contracting	Total contracting as percentage of discretionary outlays	Commercial items as percentage of discretionary outlays
2011	$114.7	$539.5	21.3%	40.0%	8.5%
2012	$119.0	$519.2	22.9%	40.4%	9.3%
2013	$107.3	$462.9	23.2%	38.5%	8.9%
2014	$110.2	$445.2	24.8%	37.8%	9.3%
2015	$110.5	$439.1	25.2%	37.6%	9.5%

Dollar amounts in billions
Source: Federal Procurement Data System; Congressional Budget Office

[1] U.S. Government Accountability Office, *Strategic Sourcing: Leading Commercial Practices Can Help Federal Agencies Increase Savings When Acquiring Services,* GAO-13-417 (April 2013), at http://www.gao.gov/assets/660/653770.pdf

In brief:

- Contracts represent a substantial share of federal discretionary spending
- Contracts for commercial products represent a big share of federal contracts
- Contract spending, both in total and for commercial products, have been declining in recent years. This is a direct product of caps on federal discretionary spending and uncertainty in the budget process.
- Despite these budget pressures, contracts for commercial products are increasing substantially as a share of total contract spending and discretionary spending.

Contracts for commercial products are a large and important part of the federal government's strategy. More stability in the federal budget process will likely lead to increases in such spending.

2. Inadequate Management of Contracts and Contractors Can Bring Big Risks

We can—should—and must rely on contacts and contractors to support the federal government's work. Indeed, since the days of George Washington, the federal government has relied on contractors. In the 21st century, agile organizations in both the public and private sectors rely on the strategic and carefully managed use of partnerships with contractors to best achieve their mission at the lowest possible costs.

Reliance on contractors, however, is no panacea. Contracting out brings its own collection of potential problems, for private companies as well as government. Nearly 30 auto manufacturers have recalled their vehicles because of problems in airbags they purchased from Takata, one of their suppliers.

Waste, fraud, abuse, and mismanagement are not the province just of government. They are the product of organizations that fail to manage themselves—and their supply chain—well.

Failures to manage contracts well have plagued federal programs as well. Consider the following:

- The Office of Personnel Management has relied on private companies, including U.S. Investigative Services, to conduct employee background checks. Part of the company's payments were calculated by the number of security clearances it approved, and that created strong incentives to rush the investigation process. Subsequent investigations found that some of the company's employees had falsified records, and that the company had engaged in a long-standing process of "flushing"—certifying investigations as complete when, in fact, they were not. The company had investigated

and cleared both Aaron Alexis, the shooter who killed 12 people at the Washington Navy Yard, and Edward Snowden, the former National Security Agency employee who leaked classified documents.

- Fraud and improper payments plague contractors' supply of goods and services to Medicare, to the tune of about $60 billion a year—one of every ten dollars spent on the program.

- Supreme Group B.V., a Dutch company with offices in the United States, paid a $146 million in 2105 for false claims filed by its subsidiaries for supplies—food, water, cargo, and food—for troops stationed in Afghanistan.

Inadequate management of contracts can bring big risks.

3. Strong Contract Management Can Reap Big Success

For 25 years, GAO has identified the 32 areas of the federal government most prone to fraud, waste, abuse, and mismanagement—it's "high-risk list."[2] The list is a wide-ranging collection of the federal government's most-difficult problems.

My analysis of this list produces an important finding: *half of the areas on the high-risk list suffer from problems of ineffective contract management.*

On the other hand, over the high-risk list's 25-year history, 24 areas have been taken off the list. *Stronger contract management was essential for half of these cases.*[3]

Consider several federal programs:

- The IRS revolutionized its information systems, shifting from outdated batch-processing of returns to a modern database, by relying on expert contractors carefully managed by the agency's top information technology officials.

- NASA has developed stronger contract management systems to ensure that more of its missions are launched on time and within budget.

- In improving the sharing and management of terrorism-related information, the Department of Homeland Security has worked to align its mission to improve

[2] U.S. Government Accountability Office, *High-Risk List* (2015), at http://www.gao.gov/highrisk/overview

[3] Donald F. Kettl, *Managing Risk, Improving Results: Lessons for Improving Government Management from GAO's High-Risk List* (Washington: IBM Center for the Business of

interoperability* of the nation's system, through close partnerships with contractors supplying cutting-edge equipment.

Fraud, waste, and abuse are not government-only problems. The problems flow from the failure to follow the basic rules of buying smart: know what you want to buy, find a supplier who can provide high-quality goods and services, and check what you bought to ensure you got what you paid for. The federal government has demonstrated that good contract management can be effective in resolving some of the toughest problems it faces. Here's an excellent example of where running the government more like the private sector—paying attention to contract management—is precisely the right step to follow.

4. An Effective Cost Comparison System Is Essential to the Contracting Process

Most observers agree on two things. First, the government ought to contract out for goods and services, especially products that are commercially available, when they're cheaper than the government's cost of producing them. Second, there is no consensus on the methodology for making such comparisons.

The federal government ought to use the option that's cheapest. We don't have agreement on a methodology to determine a program's cost. As a result, cost comparisons are often inconsistent and, sometimes, are driven more by ideology than economic assessment.

OMB Circular A-76 creates the basic structure for addressing this problem, but at this point, there is no consistent methodology by which to make effective cost comparisons between public and private provision of government's work. Among the key issues are:

- *Employee costs*. In 2012, GAO produced a study that looked at existing analyses of pay across sectors. In its report, GAO concluded, "The findings of the selected studies comparing federal and private sector pay and total compensation varied because they used different approaches, methods, and data."[4] The Project on Government Oversight conducted its own survey and found that government employees were less expensive on 33 of the 35 occupational classifications it surveyed. Contracting out, therefore, might be more expensive in some cases. But contracting out unquestionably saves

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Government, 2016), at http://www.businessofgovernment.org/sites/default/files/Managing%20Risk%20Improving%20Results.pdf

[4] U.S. Government Accountability Office, *Federal Workers: Results of Studies on Federal Pay Varied Due to Differing Methodologies,* Report GAO-12-564 (June 2012), p. 31, at http://www.gao.gov/assets/600/591817.pdf

money in other cases.[5] Because methodologies of studies have varied so greatly, it is impossible to make good comparisons of whether public or private employees are cheaper.

- *Benefits.* Important to the cost comparison is the value of fringe benefits. Public employee groups often complain that they are disadvantaged in cost comparisons because of the value of benefits that the federal government pays its permanent employees.

- *Overhead rates.* A critical point of cost comparison is the calculation of the overhead rate. Relying on project-based overhead rates, of course, runs the risk of making arbitrary (or skewed) assumptions; relying on a standard rate risks making comparisons that don't fit the actual performance of a mission. This is an area that needs more work.

- *Life-cycle costs.* Cost comparisons sometimes look only at the initial launch and short- to medium costs. Cost comparisons need to include the full cost, over the life cycle of a program.

- *Non-cost considerations.* In addition to the cost comparisons, other factors are important, including:

    - *Capacity.* The government's ongoing capacity to achieve its mission. If the government becomes too heavily reliant on external contractors for long-term missions, its capacity to support those missions could erode.
    - *Transparency.* The more the government relies on third parties to perform its work, the harder it can be to be clear on who is responsible for doing what.
    - *Flexibility.* Reliance on contractors can increase government's flexibility in adapting to new problems, gaining additional expertise, and building needed short-term capacity.

The central argument for increased use of contractors to provide government's goods and services rests on making cost comparisons. There is a strong need for a federal advisory committee to create a more-effective methodology for making these cost comparisons.

For off-the-shelf products, the job is easier. Both the products and their prices are more transparent. In these cases, the key is in maximizing the government's buying power.

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[5] Project on Government Accountability, "Feds vs. Contractors: Federal Employees Often Save Money, But an Advisory Panel is Needed to Create a Cost Comparison Model" (April 15, 2013), at http://www.pogo.org/our-work/letters/2013/20130415-feds-vs-contractors-cost-comparison.html

5. New and Enhanced Strategies Can Improve the Effectiveness of Contracts

To work through these important issues, several challenges are especially important.

- *Human capital.* For government to realize the advantages of contracting, it needs to be a smart buyer—and being a smart buyer requires smart employees. However, OMB has identified the need for the acquisitions workers as one of the government's most critical skill gaps.[6] Increasing government's use of contractors demands closing this skill gap--first.

- *Category management.* The Office of Federal Procurement Policy has been working aggressively to increase the government's use of category management, in which the government is breaking down its purchase of goods and services into discrete categories (for example, computers or travel) across the entire enterprise; managing the purchase of these products to get the best price; and developing the relationship with suppliers to enhance the quality of the result. For commercially available products, category management, which focuses on common spending that can largely be met with commercial solutions, represents one of the most important opportunities that the federal government has to increase government efficiency while reducing costs. By buying as one and reducing the level of duplicative actions across thousands of buying offices, category managers can help drive agencies to best-in-class contract vehicles or other solutions that take greater advantage of customary commercial terms and conditions and standard commercial configurations in lieu of more costly customized solutions.

The federal government has always relied on contracts with private suppliers. It will undoubtedly continue to do so. It could benefit from expanding its partnerships with private suppliers.

The key is strengthening its ability to be a smart buyer in the broader marketplace, to get the best deals for taxpayers and the best results for the country.

Thank you very much for the opportunity to appear before you today. I'd be happy to answer questions from the members of the subcommittee.

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[6] U.S. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2017: Analytical Perspectives* (Washington: GPO, 2016), p. 92, at https://www.whitehouse.gov/sites/default/files/omb/budget/fy2017/assets/ap_8_strengthening.pdf

Committee on Oversight and Government Reform
Witness Disclosure Requirement – "Truth in Testimony"
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Name: DONALD F. KETTL

1. Please list any federal grants or contracts (including subgrants or subcontracts) you have received since October 1, 2012. Include the source and amount of each grant or contract.

NONE

2. Please list any entity you are testifying on behalf of and briefly describe your relationship with these entities.

NONE. TESTIFYING PERSONALLY.

3. Please list any federal grants or contracts (including subgrants or subcontracts) received since October 1, 2012, by the entity(ies) you listed above. Include the source and amount of each grant or contract.

NONE

I certify that the above information is true and correct.

Signature: Donald F. Kettl

Date: 6 JULY 2016