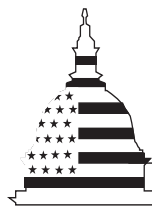


Report to the Chairman, Subcommittee
on Government Management,
Information, and Technology
House Committee on Government
Reform

September 2000

COMPETITIVE
CONTRACTING

Agencies Upheld Few
Challenges and
Appeals Under the
FAIR Act



G A O

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**United States General Accounting Office
Washington, D.C. 20548**

General Government Division

B-283779

September 29, 2000

The Honorable Stephen Horn, Chairman
Subcommittee on Government Management,
Information, and Technology
Committee on Government Reform
House of Representatives

Dear Mr. Chairman:

The Federal Activities Inventory Reform (FAIR) Act of 1998 directs agencies to develop annual inventories of the activities performed by their employees that are not inherently governmental.¹ Interested parties, as defined by the act, may challenge agencies' inventories based on "an omission of a particular activity from, or an inclusion of a particular activity on" an inventory, and appeal adverse agencies' decisions.² In essence, the FAIR Act codified a requirement already set forth in the Office of Management and Budget's (OMB) Circular A-76 for agencies to inventory their commercial activities. The FAIR Act provided for, beginning in 1999, public notice of these inventories' availability; challenges by interested parties over the inclusion or exclusion of activities on inventories; and agency heads' reviews of these inventories. Agencies' responses to the issues interested parties raised in their challenges and appeals, as well as the usefulness of FAIR Act inventory information, will affect the future implementation of this act and the extent to which the inventories might provide information to agencies that they could use to help improve how efficiently they perform their activities.

The first FAIR Act inventories were due to OMB in June 1999. Responding to your request for information on agencies' handling of appeals and

¹ Section 5 of the FAIR Act, Public Law No. 105-270, 31 U.S.C. § 501 note (1998), defines an inherently governmental function as "a function that is so intimately related to the public interest as to require performance by Federal Government employees."

² An interested party is (1) a private sector source that is a prospective or actual offeror for any contract who has a direct economic interest in performing the activity and would be adversely affected by a determination not to procure the performance of the activity from a private sector source; (2) a representative of any business or professional association whose membership includes private sector sources described in (1) above; (3) an officer or employee of an organization within the executive agency that is an actual or prospective offeror to perform the activity; or (4) the head of a labor organization, referred to in 5 U.S.C. 7103 (a) (4), that includes members who are officers or employees within an executive agency involved in performing the activity.

challenges within the broader context of the initial implementation of the FAIR Act, this report provides information on (1) the 24 Chief Financial Officer (CFO) Act agencies' inventories and the number of challenges and appeals that interested parties filed;³ (2) issues raised in challenges and appeals by interested parties (such as industry or employees) and agencies' responses to them; and (3) six agencies' plans for reviewing or using their inventories, and, while not required by the FAIR Act, how agencies could use information contained in the inventories to help ensure that activities are effectively aligned and efficiently performed.

Results in Brief

The 24 CFO Act agencies identified about 900,000 full-time equivalent (FTE) positions in their inventories as performing commercial activities, but over one half (about 513,000 FTEs) were exempted from consideration for competition at the time that the inventories were compiled.⁴ These agencies received and responded to a total of 332 challenges and 96 appeals to their 1999 FAIR Act inventories from interested parties. Of those submitted, 20 challenges (about 6 percent) and 3 appeals (about 3 percent) were successful. Private companies or industry representatives (hereafter referred to as industry) filed most of their 145 challenges and appeals at civilian agencies, while employees and labor unions (hereafter referred to as employees) filed most of their 283 challenges and appeals at the Department of Defense (DOD), as shown in table 1.

Table 1: Summary of Industry and Employee Challenges and Appeals to Agencies

Agency	Number of challenges and appeals filed by industry	Number of challenges and appeals filed by employees	Total
DOD	33	230	263
Civilian agencies	112	53	165
Total	145	283	428

Source: GAO analysis of agency information.

Many of the issues that industry raised in their challenges and appeals went beyond the provisions of the FAIR Act because they concerned issues other than the inclusion or omission of an activity from an agency's

³ CFO Act agencies include the Departments of Agriculture, Commerce, Defense, Education, Energy, Health and Human Services, Housing and Urban Development, Interior, Justice, Labor, State, Transportation, Treasury, Veterans Affairs; the Environmental Protection Agency; the National Aeronautical and Space Administration; the Agency for International Development; the Federal Emergency Management Agency; the General Services Administration; the National Science Foundation; the Nuclear Regulatory Commission; the Office of Personnel Management; the Small Business Administration; and the Social Security Administration.

⁴ FTEs are used to measure federal civilian employment. One FTE is equal to 1 work year of 2,080 hours.

inventory. For example, industry challenged agencies that indicated that they did not plan to consider many of the commercial activities on their inventories for competition. In contrast, almost all of the employees' challenges and appeals were within the provisions of the act, because they concerned the inclusion of activities that the employees contended should have been omitted because they were inherently governmental. Although the challenge and appeal process did not result in significant changes to agencies' inventories, the process served a broader purpose by identifying the need for greater clarity in agencies' inventories for use by both interested parties and agencies. OMB revised its guidance on the format and organization of agencies' inventories based on the first year's experience with the FAIR Act.

The six agencies' plans for reviewing or using their FAIR Act inventories varied considerably between the civilian and defense agencies. The civilian agencies have begun to review their inventories to identify ways to improve their inventories or to use the information on them to make more informed management decisions. In contrast, DOD has used its inventories of commercial activities to identify activities, currently performed by federal personnel, for possible competition. It will require a sustained leadership effort on the part of OMB to help ensure that agencies review their inventories and identify opportunities for better using agency resources by, for example, subjecting activities to competition. Even so, inventories only provide a portion of the information that agency management could use in making decisions about how all of its activities (inherently governmental, commercial, and contracted) are carried out and whether the activities are being performed in the most efficient and cost-effective manner. To enhance the usefulness of inventories in informing decisions about improving efficiencies, we recommend that OMB, as part of its ongoing effort to implement the FAIR Act, undertake a sustained effort to help improve the clarity of inventories and help ensure that agencies review them.

The three agencies that provided comments on a draft of this report generally agreed with its characterization of the issues involved in implementing the challenge and appeal provisions of the FAIR Act. In addition, four agencies did not provide official comments on the draft report.

Background

OMB Circular A-76 and its accompanying supplemental handbook provide guidance on what types of activities are commercial as well as guidelines for conducting cost-comparison studies to determine whether it is more cost effective to have commercial activities performed in-house by federal

employees, through inter-service support agreements (ISSA), or contracted to the private sector. Before Congress enacted the FAIR Act, there had been considerable debate about agencies' efforts under the circular to ensure that they relied on the private sector for commercial goods and services to the extent that it was cost effective. Our work evaluating competitive sourcing studies in DOD has found that savings can result regardless of whether the competitions are won by the government or private sector.⁵ The FAIR Act provides a process for executive agencies to identify activities that are not inherently governmental and that thus may be considered for competitive sourcing.

FAIR Act inventories are due to OMB no later than June 30 each year, and the first set of inventories was due in June 1999. Following OMB's review of the inventories and consultation with the agencies, OMB is to publish a notice of public availability in the Federal Register, and agencies are to make the inventories available to the public. Notices of availability for the first year's inventories were published in the fall and winter of 1999. In April 2000, we reported on the initial implementation of the FAIR Act and, based on our review of selected inventories, the need for inventories to be clear and understandable.⁶

Interested parties are to submit any challenges within 30 days after publication of the notice of public availability. An agency has 28 days to respond after receipt of a challenge. The act also allows an interested party to appeal an adverse decision on its challenge within 10 days after receiving notification of the agency's decision, and agencies have 10 days to respond after receiving an appeal. The act directs that agencies are to include, in their responses to both challenges and appeals, the rationale for their decisions. If an agency's inventory changes as a result of a challenge or appeal, the agency is to publish notice in the Federal Register.

OMB's Circular A-76 guidance contains function codes, initially developed by the Department of Defense, for agencies' use in classifying the various types of commercial activities their employees perform. An example of a function code is "Installation Services: Museum Operations." OMB's A-76 guidance also contains "reason codes" for agencies to categorize whether

⁵ Competitive sourcing refers to the reinvention of government through the conversion of recurring commercial activities to or from in-house, contract, or ISSA performance. It does not refer to simply contracting with the private sector for the provision of goods or services. Rather, it is the competition that is key to ensuring that the government obtains the same or higher quality of goods or services at lower prices, regardless of the source.

⁶ Competitive Contracting: The Understandability of FAIR Act Inventories Was Limited (GAO/GGD-00-68, Apr. 14, 2000).

the commercial activities they list in their inventories should or should not be subject to consideration for competition at the present time. Reason code A, for example, designates activities that are performed by federal employees that the agencies have exempted from OMB Circular A-76 cost comparison requirements. Reason code B indicates that the activity performed by federal employees is subject to the cost comparison or direct conversion requirements. Reason code C designates activities that are performed by federal employees that Congress, Executive Order, or OMB has exempted from Circular A-76 provisions. (Appendix I contains a listing of OMB's reason codes.)

The FAIR Act also requires that agencies review their inventories within a "reasonable period of time." Further, it requires agencies to use a competitive process when they consider contracting with the private sector.

Scope and Methodology

To provide information on the 24 CFO Act agencies' inventories, we reviewed the inventories and the number of challenges and appeals that interested parties filed. We identified the number of FTEs that the agencies categorized under OMB reason codes.

To address our second objective of determining the nature of issues raised in interested parties' challenges and appeals and agencies' responses to them, we analyzed the challenges and appeals submitted to the 24 CFO Act agencies. We also interviewed agencies' FAIR Act contacts to discuss the general nature of challenges and appeals they received. We met with industry representatives that filed the majority of industry's challenges and appeals to obtain their views on agencies' implementation of the FAIR Act. We also met with two of the six employee unions that submitted the bulk of the employee challenges and appeals to obtain their views.

To examine the issues raised in agencies' responses to interested parties, we collected and analyzed the agencies' responses to challenges and appeals of their 1999 FAIR Act inventories. We did not verify the substance of agencies' rationales that supported whether they sustained or denied challenges or upheld or reversed appeals. We also obtained documentation from six agencies (the Departments of Agriculture (USDA), Education, Housing and Urban Development (HUD), and Labor; DOD; and the National Aeronautics and Space Administration (NASA)) about the procedures they used to respond to the first round of FAIR Act challenges and appeals. We selected these 6 agencies, following our discussions with all 24 CFO Act agencies, because of the variety of their procedures for responding to challenges and appeals and because the agencies'

organizations and missions differed. We interviewed these agencies' FAIR Act contacts to provide the context for how the agencies were organized to respond to challenges and appeals.

To address our third objective of identifying six agencies' plans for reviewing or using their FAIR Act inventories, and how information on their inventories might assist them in ensuring that activities are carried out in the most cost-effective manner, we obtained agencies' plans for using their inventories. Agencies were to submit these plans to OMB in June 2000 for OMB's review. We also interviewed agency FAIR Act contacts and asked whether, and if so how, the agencies were using their inventories. We requested data on the extent to which these agencies already contracted for activities, or were studying activities under Circular A-76. In addition, we reviewed the 24 CFO Act agencies' inventories to determine the number of activities they identified as in the process of being cost compared or converted directly to contract or inter-service support agreements.

We conducted our work between December 1999 and July 2000 in accordance with generally accepted government auditing standards. We also relied on work conducted at the Department of Defense (DOD) beginning in June 1999 at the request of the House Armed Services Committee.⁷ We provided a draft of this report for review and comment to the Director of OMB and the Administrator of NASA, and to the Secretaries of USDA, DOD, Education, HUD, and Labor. Their comments are reflected in the agency comments section of the report.

Agencies Received Numerous Challenges and Appeals

The 24 CFO Act agencies' FAIR Act inventories identified a total of about 900,000 FTEs as performing commercial activities. These agencies identified about 513,000 of those FTEs as performing activities that were exempt from consideration for competition (i.e., that would not be studied under OMB Circular A-76). The agencies identified about one-third of their FTEs as performing activities that could be considered for competition. As the largest of the CFO Act agencies, DOD identified the largest number of FTEs performing commercial activities, as well as the largest number performing commercial activities that could be considered for competition. (See appendix II for summary information on the CFO Act agencies' 1999 FAIR Act inventories.) Compared with prior efforts under Circular A-76 to identify commercial activities performed by executive branch agencies, the initial implementation of the FAIR Act has increased

⁷ The results of this work are reported in *DOD Competitive Sourcing: More Consistency Needed in Identifying Commercial Activities* (GAO/NSIAD-00-198, Aug. 11, 2000).

the number of inventories developed by those agencies, and the number of FTEs identified as performing commercial activities.

Interested parties filed 332 challenges at the 24 CFO Act agencies concerning these inventories.⁸ Most (88 percent) of the 213 challenges filed at DOD were from employees, as shown in table 2. In contrast, most (67 percent) of the 119 challenges filed at civilian agencies were from industry.

Table 2: Number of Industry and Employee Challenges Filed at CFO Act Agencies

Agency	Number of industry challenges	Number of employee challenges	Total
Agriculture	7	2	9
Commerce	7	1	8
DOD ^a	25	188	213
Education	4	0	4
Energy	3	1	4
Environmental Protection Agency	7	1	8
Federal Emergency Management Agency	1	0	1
Health and Human Services	7	3	10
HUD	3	0	3
General Services Administration	5	1	6
Interior	11	2	13
Justice	1	5	6
Labor	1	1	2
NASA ^b	8	0	8
National Science Foundation	1	0	1
Nuclear Regulatory Commission ^b	2	0	2
Office of Personnel Management	0	1	1
Small Business Administration	0	0	0
Social Security Administration	3	1	4
State	1	0	1
Transportation	2	2	4
Treasury	1	5	6
U.S. Agency for International Development	2	0	2
Veterans Affairs	3	13	16
Total	105	227	332

^aExcludes one challenge that DOD's Defense Logistics Agency had not responded to as of September 20, 2000.

^bIncludes those filed at the agency's Office of Inspector General.

Source: GAO analysis of agency information.

⁸ This total excludes one challenge made to DOD's Defense Logistics Agency that had not been responded to as of September 20, 2000.

Agencies sustained 20 of the 332 challenges (about 6 percent), as shown in table 3; they denied the remainder. Of the 96 appeals, 3 (about 3 percent) were successful.

Table 3: Agency Decisions on Challenges and Appeals

Agency	Number of challenges ^a			Number of appeals ^a		
	Received	Denied	Sustained	Received	Unsuccessful	Successful
Agriculture	9	6	3	12 ^b	12	0
Commerce	8	8	0	2	1	1
DOD ^c	213	203	10	50	50	0
Education	4	4	0	1	1	0
Energy	4	4	0	1	0	1
Environmental Protection Agency	8	8	0	3	3	0
Federal Emergency Management Agency	1	1	0	1	1	0
Health and Human Services	10	9	1	2	2	0
HUD	3	3	0	1	1	0
General Services Administration	6	6	0	1	1	0
Interior	13	13	0	4	3	1
Justice	6	2	4	1	1	0
Labor	2	2	0	1	1	0
NASA	8	8	0	4	4	0
National Science Foundation	1	1	0	0	0	0
Nuclear Regulatory Commission	2	2	0	1	1	0
Office of Personnel Management	1	0	1	0	0	0
Small Business Administration	0	0	0	0	0	0
Social Security Administration	4	4	0	2	2	0
State	1	1	0	1	1	0
Transportation	4	4	0	2	2	0
Treasury	6	6	0	3	3	0
U.S. Agency for International Development	2	2	0	0	0	0
Veterans Affairs	16	15	1	3	3	0
Total	332	312	20	96	93	3

^aThe term “denied” indicates that an agency did not agree with any issue raised in an interested party’s challenge, while the term “sustained” indicates that an agency agreed with at least one issue raised and made revisions to its inventory as a result of the challenge. The term “unsuccessful” indicates that an agency did not agree with any issue raised in an interested party’s appeal, while the term “successful” indicates that an agency agreed with at least one issue raised and revised its inventory as a result of the appeal.

^bThe number of appeals exceeds the number of challenges because Agriculture forwarded challenges to its component agencies and directed them to respond, and interested parties appealed several component agencies’ denials.

^cExcludes one challenge and three appeals that DOD’s Defense Logistics Agency had not responded to as of September 20, 2000.

Source: GAO analysis of interested parties’ challenges and appeals, and agencies’ responses.

Interested Parties Raised Issues That Can Improve Future Inventories

Interested parties' challenges raised several issues that have the potential to improve the clarity of future inventories, even though they did not meet the FAIR Act provisions that allow for challenges of activities omitted from or included on agencies' inventories. OMB has revised its guidance for preparing the 2000 inventories—by, for example, suggesting a standard format for inventories and providing additional explanatory material concerning the reason codes—in an attempt to address some of these concerns. Although the six agencies we reviewed used a variety of procedures for responding to challenges and appeals, their responses to the interested parties were generally provided within the time frames specified in the act and addressed the issues that were raised. (See appendix III for a description of the six agencies' procedures.)

Most of Industry's Challenges and Appeals Reflected Broad FAIR Act Implementation Concerns

About one-third of industry's challenges cited the omission of activities from agencies' inventories, with many of the remainder citing issues that went beyond the provisions of the FAIR Act because they did not involve either the inclusion of an activity on or its omission from an inventory.

Industry submitted 105 challenges to agencies, and of those, 38 contended that the agency omitted activities from its inventory. The act, which provides for this type of challenge, further states that an interested party must identify the omission or inclusion of particular activities. Thus, while some challenged the exclusion of specific activities, other were quite broad in nature and did not identify particular activities. For example:

- In its challenge to NASA, an association stated that NASA appeared to have omitted entire categories of activities from its list. NASA, in its denial, stated that the association did not cite a particular commercial activity performed by civil servants at specific locations, and thus the association did not have a challenge within the meaning of the act. Because of this, NASA stated that the issues raised by the association would have to be handled outside of the challenge process.

In contrast, some challenged particular activities. For example:

- An association challenged the potential omission of forest service campground management activities from USDA's inventory. In its denial, USDA stated that even though it did not consider campground management as an inherently governmental function and that much of it was contracted out, decisions to do so were made on a case-by-case basis.

Some of industry's challenges demonstrated the difficulties industry had in identifying specific activities on inventories because inventories did not

include all activities performed by an agency. The FAIR Act only requires inventories to include non-inherently-governmental activities performed by federal employees. For example:

- One association challenged the Department of Education on the basis that it omitted information and data processing activities from its inventory. Education, in its denial, stated that while it employed 171 information technology professionals and included 152 information technology FTEs on its inventory, the remainder of its information technology work was performed under contract. It stated that it spent over \$400 million annually for information technology services under its contracts, and that over 2,000 contractor FTEs were employed.

Industry's challenges that inventories did not include particular activities also demonstrated the difficulty that industry had with understanding what activities were categorized under OMB's function codes, and the need for additional information. For example:

- An association obtained information from the Office of Personnel Management (OPM) on the number of employees classified under position classification codes associated with mapping, charting, or surveying at the Department of Interior. In its challenge to Interior, it stated that the number of employees under those position classification codes did not match the number of FTEs listed on Interior's inventory under comparable function codes. In its denial, Interior responded that the number of FTEs on its inventory did not coincide with OPM data because of the diverse nature of some employees' duties. As a result, Interior officials stated, some FTEs appeared on the inventory under other function codes, while some work performed by other FTEs was classified as inherently governmental (and thus would not be included on its inventory).

DOD also excluded activities from its inventory when uniformed military personnel were performing them, even though the activities could be considered commercial in nature. OMB agreed with DOD's omission of military personnel from its FAIR Act inventory. For example:

- An association's challenge stated that it appeared that many of the positions performed by military personnel were not included on DOD's inventory. In its denial, DOD responded that military members are not covered under the FAIR Act, and thus those FTEs were not included on its inventory.

The remaining issues raised by industry did not meet the challenge provisions of the FAIR Act. As shown in table 4, these issues included (1) the agency’s use of OMB’s reason codes for categorizing commercial activities, (2) the format of the agency’s inventory, (3) the agency’s use of OMB’s function codes, and (4) a general dissatisfaction with OMB guidance or the act, or agency compliance with either.

Table 4: Issues Raised by Industry That Were Not Within the Provisions of the FAIR Act

Issue raised	Number of challenges raising this issue
The agency’s use of OMB reason codes	84
Format of the agency’s inventory	72
The agency’s use of OMB function codes	36
Dissatisfaction with OMB guidance or the act	30

Source: GAO analysis of industry challenges.

The most frequently cited issue (raised by 84 of the 105 industry challenges) was the agencies’ use of OMB’s reason codes, particularly the fact that these reason codes indicated agencies did not plan to consider competing many of the commercial activities listed on their inventories.⁹ Industry representatives cited the fact that the FAIR Act does not direct the use of, and categories for, reason codes. OMB, they stated, developed these. Industry representatives said that they disliked the reason codes because the codes allow agencies to protect commercial functions and positions from competition. Industry challenges contended that agencies (1) categorized activities under reason codes that indicated that the activities were not subject to consideration for competition, (2) did not specify why particular reason codes were used, and (3) coded the same function codes under different reason codes. For example:

- An association that represents companies providing a wide array of services to government agencies challenged the General Services Administration’s (GSA) inventory on the basis that functions and activities were categorized in a confusing and often contradictory fashion. It asserted that similar functions appeared multiple times, often classified under different reason codes, and that it was impossible to identify functions that crosscut several agency locations or to determine why the same function was coded differently either at the same or different locations. GSA denied the challenge. In its response, GSA explained that the FAIR Act’s challenge and appeal provisions only provide for challenges of whether FTEs are classified as commercial or inherently governmental,

⁹ As discussed in appendix II, agencies exempted 57 percent of their commercial activities from consideration for competition under reason codes A and C.

as opposed to challenges of any further distinctions an agency chose to make within the commercial classification. GSA stated, however, that it would be available to discuss any concerns the association might have that were outside of the scope of the FAIR Act challenge and appeal process.

- One company that provides facility management services submitted challenges to the Navy and Air Force. The company questioned certain activities on the Navy's and Air Force's inventories (such as motor vehicle maintenance, building maintenance, and supply operation positions) because few of the activities were coded as reason code B (indicating they could be considered for competition). In its denial, the Air Force replied that because the activities performed by civilians were integrated with those activities performed by the military, which was tasked for wartime deployments or combat, it was not possible to sever the civilian workload to allow for contractor performance.

The next most frequently raised issue in the challenges from industry was the format of the agency's inventory. Almost all of these 72 challenges stated that the agency's inventory was vague, incomplete, or ambiguous. For example:

- An association representing independent laboratories challenged USDA's Forest Service on the basis of its inventory's format. In its challenge, it asserted that the inventory was ambiguous and did not identify functions in a reasonable manner for interpretation by outside parties. In its denial, the Forest Service stated that the format of the inventory was not an area covered under the challenge portion of the FAIR Act.
- An association challenged the Nuclear Regulatory Commission's (NRC) inventory on the basis that the inventory was ambiguous and did not identify activities or functions in a cogent manner that allowed for a reasonable interpretation by outside parties. It further asserted that the format made it impossible to "set forth the activity being challenged with as much specificity as possible," as OMB guidance suggested. In its denial, NRC stated that the inventory cited the appropriate information required by OMB.

Another 36 industry challenges cited the agency's use of OMB's function codes to classify activities. Industry representatives stated that the function codes were essentially flawed because they did not convey sufficient information to determine what the nature of work performed by agency personnel was. In its challenges, industry contended that OMB's function codes did not clearly identify activities and cited the lack of any

additional descriptions or examples of what activities the function codes entailed. In addition, some industry challenges stated that agencies did not properly use the function codes to categorize their FTEs. For example:

- An industry trade association stated in its challenge to the Environmental Protection Agency (EPA) that the function codes bore no discernable relationship to any particular activities that agencies perform. It also asserted that EPA did not properly use OMB's function codes. In its denial, EPA stated that its inventory complied with the FAIR Act and OMB's guidance and pointed out that its inventory had been subject to OMB's review and consultation. Because OMB voiced no objections to the structure or format of the inventory, and because OMB published a notice of the availability of the agency's inventory, EPA concluded that its inventory was structured and formatted in a satisfactory manner.

Industry representatives we spoke with said that the FAIR Act itself is quite brief in that it does not provide detailed instructions on the format or content of inventories. Because of this, they said, it required strong leadership on the part of OMB to implement the statute. They stated that OMB's use of its Circular A-76 to implement the act was one of the primary reasons why inventories were unclear. The function codes were flawed and did not make agencies' activities as transparent as industry said the FAIR Act intended. They also contended that some agencies did not comply with the act or OMB's guidance, and that OMB could have more closely reviewed agencies' inventories to ensure greater consistency. Their challenges, as a result, registered industry's general dissatisfaction with OMB guidance, the act, or agency compliance. For example:

- In its challenge to the Department of Transportation (DOT), an industry association challenged that DOT failed to submit a list that, by content, format, form, and substance, was in conformance with the requirements of the act because the association could not identify the nature of work performed under the function codes, and the inventory did not provide sufficient descriptive information to mount challenges. DOT, in its response, stated that it complied with the FAIR Act and OMB guidance.

Officials from the agencies we spoke with said that they seriously implemented the FAIR Act and followed OMB guidance. They said that agencies devoted time and resources to implement the FAIR Act. For example, USDA officials estimated that well over 100 people spent several thousand hours compiling its inventory. Similarly, Labor officials estimated that staff spent about 45 days reviewing guidance, and developing procedures and other guidance for its component agencies, in

Agencies Dismissed Most of Industry's Challenges and Appeals

addition to the time spent by its 16 component agencies to develop guidance and inventories.

Because most of industry's challenges and appeals did not involve either the inclusion, or omission of, an activity from an agency's inventory, agencies dismissed them. Of the 145 challenges and appeals made by industry to the CFO Act agencies, USDA sustained three challenges, and the Department of Commerce agreed to revise its inventory as a result of one successful appeal.

One of the three challenges USDA sustained was from a business federation that contended that USDA's inventory did not contain sufficient information to support the assignment of multiple reason codes to the same function codes. Even though the basis for this challenge was beyond the provisions of the FAIR Act, USDA's Farm Services Agency (FSA) agreed that it used multiple reason codes to classify computer support FTEs and activities. In reviewing its classification on the inventory, FSA removed these FTEs and activities because it determined that they were performing inherently governmental activities.

USDA also sustained two industry association challenges that contended that it excluded some information-technology-related activities from its inventory. As a result of these challenges,

- USDA concurred that it would include 6 positions involved in developing contract requirements, supervision, and oversight of information technology functions, and
- USDA's Grain Inspection, Packers and Stockyards Administration agreed to include 28 FTEs performing information technology functions on the inventory.

USDA subsequently published a notice of the revisions in the Federal Register, as required by the FAIR Act.

The Department of Commerce agreed to revise its inventory as a result of a successful appeal from an association representing firms engaged in mapping, charting, and related imaging services that challenged the omission of mapping and charting activities at several Commerce agencies, including the Bureau of the Census. Initially, Commerce denied the challenge on the basis that map compilation activities at the Bureau were limited and involved no original compilations because its geographic data base for producing maps to support field operations was updated through

state and local government input. In its appeal, the association stated that Commerce did not deny that the Census Bureau was involved in cartographic activities and that, in fact, Commerce specifically identified them in its response to its challenge. Commerce agreed to include 60 commercial cartographer and cartographic positions on its inventory. While an official said that Commerce did not publish a notice that it was revising its 1999 inventory as a result of this appeal, she said that Commerce revised its 2000 FAIR Act inventory to reflect the change.

Employees and Unions Challenged Inventories That May Have Included Inherently Governmental Activities

Almost all (219 of the 227) employee challenges contended that the agency erroneously included an inherently governmental function on its inventory, when it should have been omitted. For example:

- Employees at the Public Affairs Office at the U.S. Military Academy stated that the public affairs function should not be included on the Army's inventory because OMB's guidance on the types of activities considered commercial did not cite "public affairs." In support of their position, they argued that public affairs personnel make decisions on behalf of the federal government. DOD denied the challenge, stating that the purposes of the public affairs function were to provide official information to the public and to foster good relations—neither of which suggested an application of governmental authority or the making of value judgments on behalf of the government.
- An employees union challenged Treasury's inventory of the Bureau of Alcohol, Tobacco, and Firearms' (BATF) activities. The union said that certain financial and accounting technician positions should have been omitted because the positions involved inherently governmental work, such as directing and controlling federal employees, determining federal program priorities or budget requests, or determining agency policy. BATF denied the challenge. It responded that those positions were part of financial service support functions that it considered commercial, and that FTEs in these positions did not make budget decisions or set policy as a matter of practice.
- An employees union challenged the Department of Transportation's Maritime Administration's (MA) inventory on the basis that decisions on who should perform the work should not be based solely on the lowest bid. It stated that personnel working at MA's Beaumont Reserve Fleet had additional qualifications that should be taken into account. For example, some personnel were certified electricians, riggers, or mechanics, and some were emergency medical technicians. On this basis, the union argued, the positions and FTEs should be excluded from the inventory. In

its denial, MA stated that these issues called attention to important considerations for the A-76 process. However, the issues did not bring into question the nature of the work performed, which was the basis for inclusion on or exclusion from the inventory.

Union officials stated that they experienced the same frustrations as industry did in understanding agencies' inventories. According to an official with one employees union, function codes were not clear and some agencies miscategorized personnel into the wrong function codes. This official said that the function codes had little resemblance to the work that employees performed, and that it was difficult for an employee to determine whether his or her position was on an inventory. Officials from another employees union agreed. This union obtained additional information in order to identify what positions were included on agencies' inventories, and to support its challenges. National Treasury Employees Union (NTEU) officials, for example, said that they obtained position descriptions from the agencies to determine whether any of the FTEs on the inventories performed activities that could be considered inherently governmental. In instances where NTEU found language in the position descriptions that appeared to support inherently governmental work, NTEU then filed challenges.

Other issues, such as an agency's use of OMB's function or reason codes or the format of the inventory, were raised in a relatively small number of the employee challenges, as shown in table 5.

Table 5: Issues Raised by Employees That Were Not Within the Provisions of the FAIR Act

Issue raised	Number of challenges raising this issue
Format of the agency's inventory	47
The agency's use of OMB function codes	40
The agency's use of OMB reason codes	13
Dissatisfaction with OMB guidance or the act	7

Source: GAO analysis of employee challenges.

For example:

- An employees union stated in its challenge to the Department of Treasury's Financial Management Service (FMS) that the FMS inventory was both limited and ambiguous, thereby inhibiting the union's efforts to challenge in sufficient detail the positions designated as commercially competitive. Because of this, the union challenged every position that was coded under

reason code B as being commercial competitive. In its denial, FMS reiterated the FAIR Act's provision that an interested party may challenge the omission or inclusion of a particular activity on an inventory. It used as a basis for its denial of the union's challenge the fact that the union challenged the inclusion of positions and FTEs, as opposed to activities, on its inventory, and that positions and activities were not synonymous.

- An employees union challenge to the Department of Justice stated that it was unclear which locations were included on the inventory for several positions. It stated that if the number of positions for functions at any one location fell below OMB's threshold level of 10, the positions were exempt from the cost comparison requirement. It said that such positions should be classified as exempt or removed from the inventory. Justice, in its response, stated that it coded functions at locations having fewer than 10 FTEs as exempt under reason code A (exempted by the agency). It stated that in future inventories, it would use reason code C, as directed by OMB (exempted by Executive Order).
- An employees union challenge to DOT stated that it was not notified of any contracting studies or planned studies and that such failure to notify the union of these studies violated the union's agreement with the agency. It also stated that because it was not notified, it was prevented from being afforded the opportunity to properly prepare a challenge. In its denial, DOT stated that the listing required by the FAIR Act was not a study or a planned study to determine whether work performed by union members would be contracted. It also stated that if a study was planned or eventually undertaken, it would comply with the agreement. DOT also told the union that its challenge was filed in a timely manner following OMB's notice in the Federal Register that DOT's inventory was available to the public, and that it believed the union was afforded the opportunity to properly prepare the challenge.

Agencies Sustained Some Employee Challenges and Appeals

Agencies agreed to revise their inventories as a result of 7 percent of the employee challenges and appeals, compared with 3 percent of those from industry. Seven of the CFO Act agencies sustained 17 of the 227 employee challenges, while 2 of the 56 appeals were successful.¹⁰ For example:

- Justice sustained four challenges filed by two employees and two unions. For example, a union challenged that some positions involved access to extremely sensitive information that, if disclosed to unauthorized persons

¹⁰ These seven agencies were DOD; the Departments of Energy, Health and Human Services, Interior, and Justice; the Office of Personnel Management; and the Veterans Administration.

or misused, would significantly affect the life, liberty, or property of private persons. Justice agreed to remove certain Immigration and Naturalization Service activities performed by law enforcement communications assistants, electronics technicians, and administrative support staff from the inventory.

- DOD components sustained 10 employee challenges. The Army determined, for example, that functions involving about 3,800 FTEs were inherently governmental and should not have been on the FAIR Act inventory of commercial activities.

According to agency officials, the seven agencies that sustained challenges or had successful appeals revised their inventories.

Agencies' Procedures Varied, but Agencies Were Generally Timely and Responsive to Issues Raised

The six agencies we reviewed used a mixture of centralized and decentralized processes to handle challenges and appeals, but we found that agencies' responses were generally timely and addressed the issues raised regardless of the approaches used. (The procedures six agencies used are described in greater detail in appendix III.) However, we identified two instances where agencies were not timely in their responses.

Although the FAIR Act calls for agencies to respond to appeals 10 days after receiving them, USDA's responses to appeals submitted in December 1999 were not sent to interested parties until June 2000. Officials said that USDA's responses had undergone extensive internal review, in part because of the nature of issues raised by interested parties and USDA's desire to fully explore the basis for them.

DOD's Defense Logistics Agency (DLA), which received four challenges to its FAIR Act inventory, had not responded to one as of September 20, 2000. A DLA official explained that this challenge (submitted in January 2000) remained unresolved because of differences of opinion among the functional offices that are involved in issues related to the challenge. Further, DLA, which received appeals from each of the challengers that it responded to, had not yet responded to them as of September 20, 2000.

Agencies Identified the Need for Improved Clarity on Their Inventories

Not only did interested parties have difficulties with the clarity and understandability of the 1999 FAIR Act inventories, the agencies also noted limitations in their usefulness. After meeting with groups of interested parties and agency officials and identifying areas for improvement, OMB revised its guidance for the 2000 inventories.

Officials from the six agencies stated that they did not find their 1999 FAIR Act inventories as useful as they potentially could have been because the inventories provided only limited information about the nature of the activities that federal employees perform. According to the HUD official responsible for compiling and reviewing the 1999 inventory, similar organizations performing the same functions were commonly reported under different function codes due, in part, to the lack of definition associated with many of these codes. This official said that the different organizations applied the reason codes differently. In view of the limited amount of time that he had had to review the inventory, given the reporting deadline, he said that there was little that could have been done to improve consistency either within or across HUD's component organizations. This lack of consistency in how the organizations used OMB's function codes, according to this official, could preclude identification of good candidates for cost comparison studies and adversely affect the inventory's usefulness as a management tool. According to HUD, while its internal review did disclose some inconsistencies in reporting, which were addressed and changed prior to submitting its inventory to OMB, it believes that better defined function codes would reduce the number of inconsistencies.

According to a Department of Labor official, Labor aligned the federal government's occupational series designations with OMB function codes as an internal organizational approach to assist its managers in determining agency functions. This official stated that because, in 1999, OMB function codes were descriptive of such a broad range of activities, interested parties could not determine with any precision the true nature of commercial activities as delineated in the agency inventory. Because of this, she stated, occupational series designations were preferable in determining job functions, as opposed to OMB function codes. While Labor determined that this was a viable option for its agency, the extent to which an agency's personnel perform the duties specified by their occupational series may dictate how viable this option is for other agencies.

Education officials also said that the usefulness of the inventory was limited. Reasons for this included the fact that (1) many in-house employees perform multiple activities on OMB's list of function codes, (2) many in-house employees perform some commercial and some inherently governmental functions, (3) generic function codes without detailed definitions limited Education's ability to accurately classify some of its activities under OMB's codes, and (4) some activities performed by Education did not easily fit into the activity codes OMB provided. Because

of this, Education stated that it would like to see function codes further defined and clarified. Detailed definitions, it stated, would aid the public in determining the nature of activities performed by Education's FTEs. Detailed definitions would also assist Education staff responsible for preparing inventories in ensuring that activities were properly categorized. Without such definitions and clarifications, Education stated, it anticipated receiving challenges, to future inventories, alleging that its inventory was vague or that it did not identify functions in a reasonable manner.

NASA stated that the usefulness of its inventory was limited because it categorized the predominant activity performed by each of the branches at its centers under a single OMB function and reason code, as opposed to under the activity or activities performed by individuals at those branches.

OMB's revised Circular A-76 Handbook, which provides guidance for compiling inventories, states that OMB anticipates issuing additional guidance on the structure and format of future submissions, based upon the experience gained from the first annual review and consultation process. After its review, and following meetings with agency officials and interested parties, OMB issued revised guidance in April 2000 that OMB officials said will address several of the issues cited in challenges made in the first year's implementation of the FAIR Act. For example, to address the issue of the agency's use of OMB reason codes, OMB developed additional explanatory material concerning the codes. To address the issue of the format of the agency's inventory, OMB proposed a standard format and recommended that each agency's inventory be accompanied by a cover letter summarizing the inventory in terms of total agency and commercial FTE and contract support information. To address the agency's use of OMB function codes, OMB expanded its list of approved codes.

Inventories Provide a Tool for Reexamining How Goods or Services Are Obtained

The FAIR Act requires agencies to review the activities on their inventories. Whenever agencies consider contracting with the private sector to perform an activity on their inventories, they are required to use a competitive process unless otherwise authorized by law, executive order, or regulation. Based on our review of DOD's competition program and the five civilian agencies' plans for reviewing their inventories, we found that, beyond the FAIR Act requirements, the inventories have the potential to help inform management decisions about how to more efficiently perform activities and effectively align agencies' operations. The extent to which agencies will ultimately use their inventories to identify activities for competitive sourcing or for other purposes remains to be seen. To date, DOD has been the principal federal agency aggressively encouraging the

use of competitive sourcing. As we have noted in the past, savings are possible when agencies undertake a disciplined approach, such as public/private competitions called for under Circular A-76—regardless of whether the competitions are won by governmental organizations or by the private sector. Data on the full range of agencies' activities, whether performed by federal personnel or by contract, could inform managers and other decision makers about how they are performing their mission and mission support activities, and how they have currently allocated their resources.

DOD Used Its Inventory to Identify Competitive Sourcing Opportunities

Since 1995, DOD has been a leader among federal agencies in focusing on competitive sourcing as a means of achieving economies and efficiencies in operations and freeing up funds for other priority needs, such as weapons modernization. DOD has established aggressive competitive sourcing goals of studying over 200,000 positions between 1997 and 2005 under its OMB Circular A-76 program and thereby saving an estimated \$9.2 billion.¹¹

In January 1998, to help the military services and DOD agencies identify commercial activities that could be candidates for competition, the Deputy Secretary of Defense required DOD's military services and DOD agencies to (1) review all authorized military and civilian positions to determine whether the functions performed were inherently governmental, commercial but exempt from competition, or commercial and eligible for competition; (2) develop consistent guidelines for doing so; and (3) compile an inventory of all categorized positions.

In response to the FAIR Act, DOD adapted the civilian commercial portion of its 1998 reform initiative inventory to meet the reporting requirements of the act and OMB's guidance. DOD revised its internal coding to correspond to OMB's reason codes for classifying commercial functions and updated its inventory to reflect any significant changes. While DOD encountered problems with the function and reason codes that OMB directed agencies to use in compiling their FAIR Act inventories, DOD officials said that the process of compiling the reform initiative inventory should provide them more complete information to help identify areas for competition. DOD officials have taken some steps to improve the process, such as developing function code definitions. Officials said that DOD plans to update its reform initiative inventory on an annual basis to meet

¹¹ In our report entitled DOD Competitive Sourcing: Some Progress, but Continuing Challenges Remain in Meeting Program Goals (GAO/NSIAD-00-106, Aug. 8, 2000), we reported that the military departments have had difficulty finding activities to study for competition.

its competitive sourcing goal and comply with the requirements of the FAIR Act.

Whether DOD will meet its goals of studying over 200,000 positions by 2005 and saving \$9.2 billion is uncertain. In our August 2000 report on DOD's competitive sourcing program, we reported that DOD does not expect to compete all the commercial activities and associated positions that appear on its inventory.¹² DOD officials cited factors, such as the (1) geographic dispersion of its positions and (2) difficulty in separating commercial and inherently governmental work within the same activity, that limited the number of FTEs that could be studied. Nevertheless, DOD leadership has aggressively encouraged its components to pursue competitive sourcing as a means of reducing costs and improving the efficiency and effectiveness of its operations.

Other Agencies' Plans to Use FAIR Act Information

The five civilian agencies in our review were among those that submitted plans to OMB in June 2000 that described ways they use or could use information from their FAIR Act inventories.¹³ The Department of Labor's plan, for example, stated that its FAIR Act inventory is part of a "two-pronged" approach to identify opportunities for obtaining goods or services from the private sector. According to its plan for using its FAIR Act inventory, Labor cross-referenced commercial competitive activities on its FAIR Act inventory with requirements delineated in its acquisition plan for purchasing from the private sector, which it compiles annually, to identify common requirements. Where common requirements exist, Labor said that it plans to expedite the privatization process, consistent with federal acquisition regulations and guidance. Labor also stated that its inventory significantly assisted it in complying with, and more accurately administering, the Business Opportunities Development Reform Act of 1988 by providing it more timely and up-to-date commercial activities data.¹⁴

HUD said that it plans to use the inventory to help ensure that agency decisions to exempt FTEs from consideration for competition are justified. HUD said that it also plans to use its inventory to identify possible candidates for cost comparison studies. It pointed out that the data in the inventory can provide a new source of information by, for example,

¹² DOD Competitive Sourcing (GAO/NSIAD-00-198, Aug. 11, 2000).

¹³ OMB's revised Circular A-76 Handbook instructs agencies to report annually on the management of their commercial activities. In its April 2000 guidance, OMB instructed agencies to include in these reports a description of the agencies' review processes.

¹⁴ Public Law 100-656.

combining it with workload data to allow more informed judgments and decisions to be made regarding organizational performance and resource allocation.

USDA stated that its inventory is an integral part of its review process which is designed to ensure that USDA's component agencies follow OMB's A-76 guidance in determining whether activities should remain in-house or be performed by contract. Similarly, the Department of Education's plan states that managers and senior officials will review the commercial activities on its inventory to facilitate decisions on competing activities, to determine whether activities should be performed under contract or in-house. According to NASA, revisions to its 1999 inventory contributed to a better understanding of the scope of work performed at its centers, as well as an increased understanding of the commercial components of its civil service workforce.

The A-76 process has not been a high priority within OMB or civilian agencies since the late 1980s, and as we testified in 1998, it appeared that the A-76 process is still not a high priority.¹⁵ This may still be the case. Even though the five agencies have plans for using their inventories, none of the five has a competitive sourcing program as significant as DOD's. According to officials at the five civilian agencies, none of the five agencies is currently conducting A-76 studies. Further, the remainder of the civilian CFO Act agencies' 1999 FAIR Act inventories indicate that only about 580 FTEs are associated with activities undergoing study or direct conversion to contract or inter-service support agreements. This is an early indication that, unless OMB leads efforts to help ensure that civilian agencies seriously review their inventories, the initial progress the FAIR Act achieved in increasing the number of FTEs agencies identify as performing commercial activities may be of limited usefulness.

Agencies Agree That Comprehensive Data on All Their Activities Could Help Inform Management

While the FAIR Act does not direct that agencies use the information on their inventories for any specified purpose, we have reported in the past that information on all activities an agency performs—whether through contracts or in-house—is key to providing decisionmakers with a more complete picture of all of an agency's activities. Complete information on who is performing specific activities—whether by federal personnel or by contract—and how these activities are integrated to accomplish an agency's mission, can inform agency managers' assessments about whether an agency is aligning its activities and distributing resources in the most efficient manner.

¹⁵ OMB Circular A-76: Oversight and Implementation Issues (GAO/T-GGD-98-146, June 4, 1998).

In our discussions with agency officials, however, we found that not all agencies have a complete picture of their activities, how these activities are performed, and whether these activities are integrated efficiently to accomplish their agencies' missions. While some of the agencies we reviewed can provide information on contract dollars spent on specific contracts, agency officials told us that it is difficult to compare the extent and nature of activities performed under contract with those performed in-house. For example, Education stated that while Education has extensive information on, among other things, the amount of contract dollars spent, items bought, and activities performed under contract, because of the difficulties in comparing in-house and contract activities, it continues to work on a better assessment of activities performed by contract. NASA officials said that they have conducted extensive work to compile rough indicators of what types of activities are performed by contract and the cost of some of these contracts. In 1999, they estimated that approximately 87 percent of NASA's funding was dispersed through contracts. According to Labor officials, they have access to limited contractor information through the Federal Procurement Data System.

In addition, not all of the agencies compile or maintain data on inherently governmental work performed by federal employees or personnel. Officials from Labor and HUD agreed that, although not currently required under the FAIR Act, a comprehensive inventory of all of an agency's commercial and inherently governmental activities--whether by contract or in-house employees--may enhance the management of those resources and help ensure that the agency's resources are used in the most cost-effective and efficient manner.

In contrast, as noted previously, DOD does have an inventory of all positions performed that are inherently governmental, commercial but exempt from competition, or commercial and eligible for competition. DOD is also required to provide Congress information on contractor support for the agency.¹⁶ In its 1998 Commercial Activities Report, it estimated that contractors performed about 40 percent of DOD's work years. The accuracy of DOD's estimates of the number of contract personnel performing commercial activities, however, has been questioned. In the fiscal year 2000 Defense Authorization Act, Congress included a requirement for more detailed reporting.¹⁷ By no later than

¹⁶ 10 USC 2461(g) requires DOD to submit to Congress each fiscal year a report estimating the percentage of commercial activities or functions performed by contractors as compared with the percentage performed by DOD employees.

¹⁷ Fiscal Year 2000 Department of Defense Authorization Act (P.L. 105-65, section 343).

March 2001, DOD is also required to provide Congress a report summarizing the number of direct and indirect labor work year equivalents performed by contractors providing services in fiscal year 2000. The Department of the Army is testing the feasibility and benefits of requiring contractors to provide needed information electronically. According to an Army official directing the program, the Army requires contractors to enter labor hour information in conjunction with requests for payment and has had cooperation from contractors participating in the program.

Conclusions

Prior to the FAIR Act, there had been considerable debate that agencies, with some exceptions, were not making a serious effort under Circular A-76 to ensure that they relied on a competitive process to determine whether it would be more cost effective to keep a commercial activity in-house or contract with the private sector. Compared with prior efforts under the Circular to inventory commercial activities, the first year's implementation of the FAIR Act has increased the number of executive agency inventories and the number of FTEs identified as performing commercial activities. This is important, as our prior work has shown that savings are possible when agencies undertake a disciplined approach, such as that called for under Circular A-76, to review their operations and implement any necessary changes to become more efficient in the use of their resources.

The successful implementation of the FAIR Act depends on several things, however, such as clear and understandable inventories that provide useful information to agency management and interested parties. Our review of agencies' inventories and challenges and appeals suggests that there are ample opportunities to improve the clarity and understandability of some agencies' inventories. OMB revised its guidance for the 2000 inventories, but it will require a sustained and continuing commitment of OMB leadership and agency management to improve the clarity of agencies' FAIR Act inventories.

Although the FAIR Act does not direct agencies to use their inventories as a basis for competitive sourcing, DOD's program has shown that the inventories do have the potential to provide some useful information. Under its program, DOD has compiled inventories of commercial activities and developed a process for reviewing these to identify activities for competitive sourcing consideration, such as for study under OMB Circular A-76. As noted, our work has found that savings can result from competitive sourcing studies, regardless of whether the competitions are won by the government or the private sector. Whether civilian agencies will use their inventories in a similar manner is unknown. Based on the

number of activities currently being studied by civilian agencies for competition, early indications are that, unless OMB takes steps to help ensure that agencies undertake a sustained commitment to review inventories and then identify appropriate activities for competition, opportunities for savings may be missed.

The inventories also have the potential to help inform agency management about that portion of their workforce that performs non-inherently-governmental activities. This information could be useful for management decisions about whether agency resources are efficiently aligned to properly execute an agency's mission. It must be recognized, however, that FAIR Act inventories only provide agencies with a piece of the information that management needs to ensure that all activities are carried out in the most efficient and cost-effective manner. Information on inherently governmental and contracted activities is also needed to help managers ensure that their agencies' activities are integrated and are performed in the most efficient and cost-effective manner.

Recommendation for Executive Action

Consistent with OMB's ongoing efforts, but in light of the historical difficulty of maintaining a governmentwide commitment to consistently develop useful inventories of commercial activities, the Director of OMB should undertake a sustained effort to help improve the clarity of agencies' FAIR Act inventories and lead efforts to help ensure that agency heads review their commercial activities within a reasonable time, as required by the FAIR Act.

Agency Comments and Our Evaluation

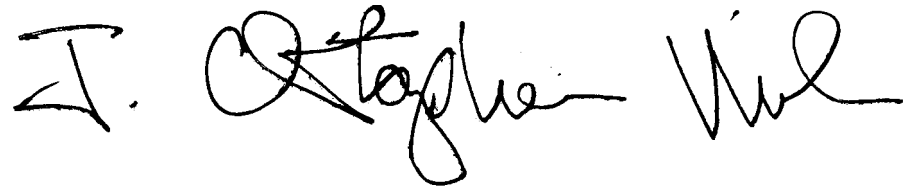
We requested comments on a draft of this report from the Secretaries of USDA, DOD, Education, HUD, Labor; the Administrator of NASA; and the Director of OMB. The Chief Financial Officer, Department of Education; the Deputy Chief Financial Officer, HUD; and the Associate Administrator for Human Resources and Education, NASA, provided written comments that are included in appendixes IV, V, and VI, respectively. In their written comments, the agencies generally agreed with the draft report's characterization of the issues involved with implementing the challenge and appeal provisions of the FAIR Act. Officials from four agencies (USDA, DOD, Labor, and OMB) said that these agencies had no comments, but they provided some technical revisions that we have incorporated as appropriate to clarify information pertaining to their agencies.

We are sending copies of this report to Senator John Breaux, Senator Bill Frist, Senator Phil Gramm, Senator Tom Harkin, Senator James Jeffords, Senator Edward Kennedy, Senator Carl Levin, Senator Richard Luger, Senator Paul Sarbanes, Senator John Warner, Representative Dan Burton,

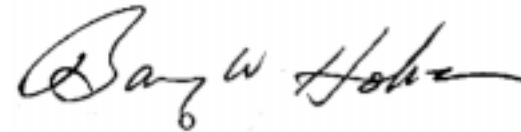
Representative William Clay, Representative Larry Combest, Representative Barney Frank, Representative William Goodling, Representative Ralph Hall, Representative Rick Lazio, Representative James Sensenbrenner, Jr., Representative Ike Skelton, Representative Floyd Spence, Representative Charles Stenholm, Representative Jim Turner, and Representative Henry Waxman in their capacities as Chair or Ranking Minority Members of Senate and House Committees and Subcommittees. We are also sending copies to the Honorable Jacob J. Lew, Director of OMB; the Honorable Dan Glickman, Secretary of USDA; the Honorable Richard Riley, Secretary of Education; the Honorable Andrew Cuomo, Secretary of HUD; the Honorable Alexis Herman, Secretary of Labor; the Honorable William Cohen, Secretary of DOD; and the Honorable Daniel Goldin, Administrator of NASA. We will also make copies available to others on request.

Major contributors to this report are listed in appendix VII. If you have any questions about this report or would like to discuss it further, please contact either Christopher Mihm on (202) 512-8676 or Barry Holman on (202) 512-5581.

Sincerely yours,



J. Christopher Mihm,
Associate Director
Federal Management and Workforce Issues



Barry Holman
Associate Director
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Background

It is the general policy of the federal government that it will rely on the private sector for goods and services that are not inherently governmental. Reasons an activity might be considered inherently governmental include the fact that it might

- bind the United States to take or not take some action by contract, policy, regulation, authorization, order, or otherwise;
- determine, protect, and advance economic, political, territorial, property, or other interests by military or diplomatic action, civil, or criminal justice proceedings, contract management, or otherwise;
- significantly affect the life, liberty, or property of private persons;
- commission, appoint, direct, or control officers or employees of the United States; or
- exert ultimate control over the acquisition, use, or disposition of the property (real or personal, tangible, or intangible) of the United States.

The policy that the federal government will rely on the private sector for those goods and services that are not inherently governmental has been in place for 45 years and is currently embodied in the Office of Management and Budget's (OMB) Circular A-76.

OMB implemented the FAIR Act by revising Circular A-76 and the handbook and incorporating FAIR Act requirements that

- agencies annually prepare and submit to OMB inventories of commercial activities;
- OMB review the inventories and publish notices of public availability;
- interested parties can lodge administrative challenges and appeals of an agency's decisions to include or exclude a particular activity from the agency's inventory; and
- agency heads review the activities on the inventories within a reasonable time after the publication of their notice of availability. Each time that an agency head considers contracting with a private sector source for the performance of an activity, the agency head will use a competitive process to select the source.

Not all of an agency's commercial activities are subject to OMB's A-76 cost comparison study requirements. For example, cost comparisons are not required to convert commercial activities to or from in-house or contract, or to an inter-service support agreement when these activities are for

- ensuring the national defense or national intelligence security,

**Appendix I
Background**

- maintaining the quality of patient care at government-owned hospitals or health facilities,
- ensuring the government has the necessary capabilities to fulfill its mission responsibilities or meet emergency requirements, or
- supporting research and development.

Cost comparisons are also not required under Circular A-76 for activities involving 10 or fewer FTEs, or when no satisfactory commercial source is available to perform them. OMB’s A-76 guidance contains “reason codes” for agencies to use to categorize their activities, as shown in table I.1.

Table I.1: Reason Codes Contained in OMB Circular A-76 Guidance

Reason code	Explanation
A	The activity is performed by federal employees and is specifically exempted by the agency from the cost comparison requirements of the Circular and the Supplemental Handbook.
B	The activity is performed by federal employees and is subject to the cost comparison or direct conversion requirements.
C	The activity is performed by federal employees but has been specifically made exempt from the provisions of the Circular and the Supplemental Handbook by Congress, Executive Order, or OMB.
D	The activity is currently performed by in-house federal employees and is in the process of being cost compared or converted directly to contract or inter-service support agreement performance.
E	The activity is retained in-house as a result of a cost comparison.
F	The activity is currently performed by federal employees, but a review is pending a force-restructuring decision (i.e., base closure, realignment, consolidation, etc.).
G	The activity is prohibited from conversion to contract because of legislation.
H	Waiver issued.
I	The activity is performed in-house as a result of a cost comparison resulting from a decision to convert from contract to in-house performance.

Source: OMB Circular A-76 Supplemental Handbook.

The FAIR Act, in addition to requiring that agencies annually compile inventories, also requires agencies to review them. In an effort designed to improve the understandability of agencies’ 2000 FAIR Act inventories, OMB (1) instructed agencies to use a standard format; (2) provided additional explanatory material on the use of reason codes; (3) developed additional function codes to facilitate the development of inventories; (4) required that agencies post their inventories on their internet sites; and (5) instructed that agencies provide, in their annual management of commercial activity reports to OMB, a description of the agency’s plans to review activities identified as commercial on their FAIR Act inventories.

Overview of Agencies' FAIR Act Inventories

The number of FTEs that the 24 Chief Financial Officer Act agencies identified as performing commercial activities ranged from 16 FTEs at the National Science Foundation to 504,417 at the Department of Defense (DOD) (as shown in table II.1). DOD identified the largest number of FTEs performing activities that could be competed, or about 48 percent of its commercial FTEs. Six agencies did not identify any FTEs performing activities that could be considered for competition.

Recognizing that agencies may have legitimate reasons for not studying certain commercial activities under OMB Circular A-76, the Office of Management and Budget (OMB) instructed agencies to classify activities under reason code A when they determined that the activities were specifically exempt from the cost comparison requirements of the Circular and the Supplemental Handbook. Agencies classified a total of 208,423 FTEs, or 23 percent, as performing commercial activities categorized under reason code A. Agencies were instructed to list activities under reason code B when they determined that the activity was subject to the cost comparison or direct conversion requirements of the Circular and Supplemental Handbook. Agencies categorized 294,802 FTEs, or 33 percent, as performing commercial activities under reason code B and thus as being competitive. OMB instructed agencies to categorize activities under reason code C when the activity had been specifically made exempt from the provisions of the Circular and Supplemental Handbook by Congress, Executive Order, or OMB. Agencies identified a total of 304,307 FTEs, or 34 percent, performing activities classified under reason code C.

Agencies identified few FTEs performing activities under other reason codes. These reasons include the agencies' determinations that the activities (1) are prohibited from conversion to contract because of legislation, (2) had been or are in the process of being subject to cost comparison studies, (3) are pending force restructuring decisions, or (4) are subject to a waiver. A total of 87,233 FTEs were categorized as performing activities under other codes.

Table II.1: Number of FTEs Associated With Commercial Activities on CFO Act Agencies' Inventories for 1999

Agency	Reason code A	Reason code B	Reason code C	Other	Total FTEs
Agriculture	6,612	16,132	25,648	116	48,508
Commerce ^a	N/A	N/A	N/A	N/A	N/A
DOD	121,970	241,420	74,174	66,853	504,417
Education	0	0	3,624	0	3,624
Energy	9,586	619	1,560	0	11,765
Environmental Protection Agency	775	30	24	0	829
Federal Emergency Management Agency	2,302	22	0	0	2,324

Appendix II
Overview of Agencies' FAIR Act Inventories

Agency	Reason code A	Reason code B	Reason code C	Other	Total FTEs
Health and Human Services	21,154	2,506	8,971	246	32,877
HUD	290	231	5,785	0	6,306
General Services Administration ^b	874	4,556	0	1,819	7,249
Interior	5,043	2,834	10,119	0	17,996
Justice	3,034	1,198	0	59	4,291
Labor	402	523	1,870	23	2,818
NASA	7,957	0	0	0	7,957
National Science Foundation	16	0	0	0	16
Nuclear Regulatory Commission ^c	783	0	0	0	783
Office of Personnel Management	1,760	0	363	0	2,123
Small Business Administration	287	49	1,126	0	1,462
Social Security Administration	9,094	721	990	0	10,805
State	908	489	0	0	1,397
Transportation	7,332	3,163	1,390	911	12,796
Treasury	7,426	932	1,351	17,197	26,906
U.S. Agency for International Development	430	0	0	9	439
Veterans Affairs	387	19,377	167,313	0	187,077
Total	208,423	294,802	304,307	87,233	894,765

^aFTE's were not clearly designated in Commerce's FAIR Act inventory.

^bThe General Services Administration's (GSA) categories of commercial exempt, competitive, and in-house corresponded to, according to GSA officials, reason codes A, B, and F, respectively. Reason code F indicates that a review of the activities performed by those FTEs is pending a force restructuring decision (such as base closure, realignment, consolidation, etc.).

^cExcludes the agency's Office of Inspector General.

Source: Agency information and GAO analysis.

Agencies' Procedures for Responding to Challenges and Appeals

Agencies' Procedures for Responding to Challenges and Appeals Varied

The Departments of Agriculture (USDA), Housing and Urban Development (HUD), and Defense (DOD) delegated much of the responsibility for responding to challenges and appeals to their component agencies. Education and Labor both retained responsibility at the department level, while the National Aeronautics and Space Administration (NASA) used a centralized but organizationally independent approach. Even though the procedures these six agencies developed differed, we found that agencies were generally responsive to issues raised in both the challenges and appeals.

- USDA and HUD delegated responsibility for responding to challenges to each of their operating agencies. According to USDA officials, responsibility was decentralized because of the diverse nature of USDA's missions and because the department believed that the operating agencies should be aware of the nature of challenges to USDA's inventory, given the components' responsibilities for compiling USDA's inventory. A HUD official said that responsibility was delegated within that department because of the belief that the operating agencies would be more knowledgeable about their positions and FTEs. Officials from both USDA and HUD said that responsibility for responding to appeals was centralized to retain independence. In addition, USDA officials said that, because OMB's guidance states that responsibility for responding to appeals be retained at the assistant secretary level, it was necessary to do so.
- DOD delegated responsibility for responding to challenges and appeals to the military services and DOD agencies, which used a variety of approaches to respond to challenges and appeals. The Army, for example, designated a central point of contact for all of Army's challenges and appeals. The Air Force, however, delegated responsibility for responding to challenges and appeals to its major commands.
- Education and Labor both retained responsibility at the department level. Within Education, the Chief Financial Officer was authorized to respond to challenges. This official reports to the Deputy Secretary, who was authorized to respond to appeals. Within Labor, the Procurement Executive was authorized to respond to challenges. This official reports to the Assistant Secretary for Administration and Management, who was authorized to respond to appeals.
- NASA used a centralized but organizationally independent approach to responding to challenges and appeals. According to NASA officials, authority for responding to challenges and appeals was retained at NASA headquarters, but was delegated to separate Associate Administrators to ensure that the process was as independent as possible within the agency.

Agencies Were Generally Timely and Responsive to Issues Raised

We found that the differences in procedures the six agencies used to respond to challenges and appeals did not appear to result in differences in how timely or responsive agencies were. According to FAIR Act officials at the six agencies, the agencies tried to respond to interested parties within the time frames set forth in the act and as defined by OMB's guidance. In its guidance, OMB defined the time frame for responding to challenges as 28 calendar days and that for responding to appeals as 10 working days.¹

We found that the six agencies generally met OMB's time frames, with few exceptions. Of the six agencies, USDA was more frequently late than the five other agencies in responding to challenges. It was also late in responding to appeals. According to USDA officials, its operating agencies did not always meet the time frames for responding to challenges because of the delays caused by forwarding the challenges to appropriate agency officials. The size and geographic dispersion of some agencies also resulted in delays in obtaining information necessary to be responsive to issues raised in the challenges.

USDA also did not meet time frames for responding to appeals because, according to USDA officials, many of the challenges raised issues that went beyond the provisions set forth in the FAIR Act. Because many of the appeals reiterated these same issues, USDA officials said that USDA wanted to ensure that it further explored the basis for the issues, and was fully responsive. Thus, responses underwent extensive review at the department level prior to being finalized. Responses to appeals, most of which were submitted by interested parties to USDA in December 1999, were not sent out to interested parties until June 2000. These officials acknowledged that the amount of time to respond was extensive, but they said that they notified interested parties that they would be late in responding and, further, because it was USDA's belief that an interested party would not be financially injured by the delay, its caution was believed to be justified.

DOD's Defense Logistics Agency (DLA) also was not timely in responding to its challenges and appeals. DLA received four challenges to its FAIR Act inventory, but as of September 20, 2000, it had responded to only three

¹ To assist agencies in responding to challenges to their 2000 inventories, OMB is proposing to change the 28-day time frame from calendar to working days, providing agencies with some additional time to prepare their responses.

Appendix III
Agencies' Procedures for Responding to Challenges and Appeals

of them. One challenge, dated January 28, 2000, remains unresolved. An agency official explained that the challenge remains unresolved because of differences in opinion among the functional offices that are involved in issues related to the challenge. Further, DLA received appeals to each of the three challenges to which it responded. All remain unresolved.

Comments from the Department of Education

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF THE CHIEF FINANCIAL OFFICER

September 15, 2000

J. Christopher Mihm
Associate Director
Federal Management and Workforce Issues
General Government Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Mihm:

Thank you for the opportunity to review the draft of the General Accounting Office (GAO) Report to the Chairman of the Government Management, Information, and Technology Subcommittee of the House Government Reform Committee, entitled Competitive Contracting: Agencies Upheld Few Challenges and Appeals Under the FAIR Act (Report). In general, the Report provides a good overview of the handling of challenges and appeals under the Federal Activities Inventory Reform (FAIR) Act.

We offer the following comments and clarifications on areas of the Report that deal specifically with challenges and appeals received by the Department of Education (ED).

Concerning the challenge we received which stated that ED omitted information and data processing activities from its inventory (page 10), GAO indicated that ED informed the challenger that we employed 171 information technology professionals and that the remainder of that work was performed under contract. We also informed the challenger that we *did include* 152 IT professionals on our inventory under function code W826 - Systems Design, Development and Programming Services.

Regarding the dollar amount ED spends annually for information technology services under its contracts (page 10), the figure we provided was \$400,000,000.00, not \$40 million.

The Report states that ED officials said that the usefulness of the inventory was limited (page 19). We would like to see the function codes further defined and clarified. Detailed definitions for the function codes would aid the public in determining/assessing the activities performed by ED full time equivalent employees (FTE). It would also assist ED staff responsible for preparing the inventory in classifying the activities of individual in-house employees. An inventory entry that simply states "C400 - Budget Support" does not offer much about the activities actually being performed. As a result of continuing to use these descriptions, ED anticipates that it may receive

See p. 10.

See pp. 19
and 20.

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Appendix IV
Comments from the Department of Education

See p. 24.

appeals/objections to its 2000 inventory such as "ED does not identify functions in a reasonable manner for interpretation by outside parties" or "the descriptions accompanying each function do not provide for fair inventory assessment" or "impossible to challenge with specificity" or "inventory is ambiguous, vague, unclear", etc., similar to those received in 1999.

On the topic of the type of information ED collects on its contracts (page 23), ED did indicate that some information is not specific to gauge the level of effort in terms of FTE for some contracts. We collect an extensive amount of useful information on our contracts but can differ depending on the type of goods or services as well as the type of contract agreement itself. We have data on dollars spent, items bought, labor categories and rates, activities performed, type of business, etc. However, we do not collect identical data for activities performed by in-house FTE and activities performed by contractor FTE. The Department, as well as the Government as a whole, continues to increase the acquisition of commercial items as well as defining its requirements in terms of performance-based outcomes and paying for those outcomes on a fixed price basis where we do not require, nor should we require, the collection of that type of data from industry. This means that the data generated by these types of contractual relationships do not necessarily include the number of employees to perform as would be generated by cost reimbursement and time and material type contracts. Therefore, it will continue to be difficult to make one to one comparisons in terms of FTE. However, we are currently working on a better assessment of the activities being performed by contractor FTE, to the extent that type of data is available.

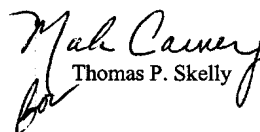
Recommendation

We agree that OMB must undertake a sustained effort to help improve the clarity of inventories and help ensure that agencies review them.

ED would like to stress its commitment to developing a useful inventory of commercial activities. As required by the FAIR Act, we will review the inventory within a reasonable time to examine our operations and implement any necessary changes to become more efficient in the use of our resources.

If you have any questions regarding our comments, please contact Gary Weaver at 202-401-0083.

Sincerely,


Thomas P. Skelly

GAO Comment

The following is GAO's comment on the Department of Education's letter dated September 15, 2000.

1. The Department of Education agreed that the usefulness of FAIR Act inventories was limited and that OMB must undertake a sustained effort to help improve the clarity of inventories and help ensure that agencies review them. We revised the section of the report entitled "Most of Industry's Challenges and Appeals Reflected Broad FAIR Act Implementation Concerns" to include additional information about Education's response to a challenge, and the section entitled "Agencies Identified the Need for Improved Clarity on Their Inventories" to reflect Education's desire to have function codes defined and Education's concerns over future challenges it may receive should such definitions not be developed. We revised the section entitled "Agencies Agree That Comprehensive Data on All Their Activities Could Help Inform Management" to further explain the extent of contract information Education obtains.

Comments from the Department of Housing and Urban Development

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



U. S. Department of Housing and Urban Development
Washington, D.C. 20410-0100

SEP 15 2000

OFFICE OF THE CHIEF FINANCIAL OFFICER

Mr. J. Christopher Mihm
Associate Director
Federal Management and Workforce Issues
U.S. General Accounting Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Mihm:

Thank you for the opportunity to review and comment on the draft report entitled Competitive Contracting: Agencies Upheld Few Challenges and Appeals Under the FAIR Act. For the most part, we found that the report accurately reflects issues surrounding the implementation of the Federal Activities Inventory Reform (FAIR) Act, and procedures established by HUD to respond to FAIR Act challenges and appeals. However, we offer the following comments for your consideration in preparing the final report:

1. Page 19, Agencies Identified the Need for Improved Clarity on Their Inventories, 1st paragraph: The draft report states that "HUD found, for example, that similar organizations performing the same functions were commonly reported under different function codes..." The statement, as written in the draft report, is misleading. The source of this information appears to be HUD's "Annual Report on Management of Commercial Activities", which was submitted to the Office of Management and Budget (OMB) in accordance with the FAIR Act requirements. Please note that in the Annual Report, HUD was describing its inventory review process. This process included analyses of the inventory submissions to identify instances where similar HUD organizations performing the same functions were reporting using different function codes. While the review did disclose inconsistencies, these issues were addressed and changes were made prior to submission of the inventory to OMB. We offer the following rewording for your consideration: "HUD's internal review process disclosed that similar organizations were ... While HUD does have a process in place to detect and correct reporting inconsistencies prior to submission of the inventory to OMB, HUD believes that better defined function codes would reduce the number of inconsistencies. HUD pointed out that the lack of"

See comment 1.

Appendix V
Comments from the Department of Housing and Urban Development

See comment 2.

2. Page 23, Agencies Agree that Comprehensive Data on All Their Activities Could Help Management, 2nd and 3rd paragraphs: The draft report states that "...HUD does not have inventories of what activities are already contracted". The report also implies that HUD does not have a complete and full picture of the nature of its commercial activities and how they are being carried out. HUD has a system that captures all contracts awarded. While HUD does not have the equivalent of a FAIR Act inventory of activities already contracted out, it certainly has a "picture of the nature" of the commercial functions that have been contracted out, as well as controls in place to know "how all of them are being contracted out". These out-sourced services are now an integral part of our program delivery and management control structure. We should also point out that there is no statute nor regulation that requires HUD to maintain an inventory of *functions* under contract. Therefore, we recommend that all references to HUD in this section be deleted.

We hope that you will consider our comments in revising the final GAO report. Should you or your staff have any questions on our comments, please contact James M. Martin, Deputy Assistant Chief Financial Officer for Financial Management, on (202) 708-0638, extension 3706 or Janice W. Blake-Green, Director, Risk Management Division, on extension 3214.

Sincerely,



Victoria L. Bateman
Deputy Chief Financial Officer

GAO Comments

The following are GAO's comments on the Department of Housing and Urban Development's (HUD) letter dated September 15, 2000.

1. HUD was concerned that the draft was misleading because it appeared we based a statement about the clarity of its inventory on its "Annual Report on Management of Commercial Activities." However, this was not the case. We obtained information about the clarity of HUD's inventory for 1999 from HUD's FAIR Act official who was responsible for ensuring that HUD compiled an inventory that met statutory and OMB reporting requirements. This official reviewed and compiled HUD component organizations' lists of commercial activities for submission to OMB. We revised the report to reflect that HUD's review identified and corrected inconsistencies but that HUD believes that better defined function codes would aid in this effort.
2. We agree that the FAIR Act does not require agencies to compile inventories of activities performed by contract that are comparable to its inventories of commercial activities performed in-house, and the report notes this in the section entitled "Agencies Agree That Comprehensive Data on All Their Activities Could Help Inform Management." We further clarified this distinction and deleted one reference to HUD from the report.

Comments from the National Aeronautics and Space Administration

National Aeronautics and
Space Administration
Headquarters
Washington, DC 20546-0001



Reply to Attn of: **FM**

SEP 14 2000

Mr. J. Christopher Mihm
Associate Director
Federal Management and Workforce Issues
United States General Accounting Office
Washington, DC 20548

Dear Mr. Mihm:

NASA appreciates the opportunity to comment on the General Accounting Office review of FAIR Act challenges and appeals (Code 410526).

We would like to thank the GAO for the professional manner in which this review was conducted. NASA has no issues with the report.

Sincerely,

Vicki A. Novak
Vicki A. Novak
Associate Administrator for
Human Resources and Education

GAO Contacts and Staff Acknowledgments

GAO Contacts

J. Christopher Mihm, (202) 512-8676

Barry W. Holman, (202) 512-5581

Acknowledgments

In addition to those named above, Marcia McWreath, Margaret Morgan, Steven Boyles, Robert Poetta, Susan Ragland, Jerry Sandau, Jim Turkett, and Marilyn Wasleski made key contributions to this report.

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