

New Guidance Expected on In-sourcing

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Early this year, the Defense Finance and Accounting Service did the math and decided to stop relying on Lockheed Martin Corp. to process pension checks for retired Defense Department employees.

The agency calculated it could save \$25 million over the next decade and provide DFAS with greater flexibility to handle increasing workloads by bringing that work in-house at DFAS' Cleveland office.

The agency plans to have feds performing the work by Feb. 1, the day the contract expires. DFAS has already hired several of the 469 Lockheed Martin employees doing the work to help ensure a smooth transition, DFAS spokesman Tom LaRock said.

The Pentagon has more in-sourcing in store. In 2010, the department plans to add 13,000 new federal employees who will perform work previously done by contractors — mostly in the areas of acquisition support, logistic support, program management, intelligence analysis, training, security, engineering, accounting, public affairs and other services. In all, the move will save \$900 million in 2010, a Defense official said.

Defense is on the leading edge of a new era in government-contractor relations: in-sourcing.

In July, the Office of Management and Budget ordered every agency in fiscal 2010 to conduct a study of at least one outsourced function to determine if outsourcing is appropriate, cost-effective and well managed. If not, the work should be brought in-house or agencies should hire more federal employees to oversee the contractor, according to a July OMB memo.

Last week, agencies submitted their proposals to OMB and agencies will report on the results of those reviews in April.

"There is no requirement to in-source," said Jeff Liebman, executive associate director of OMB. "There is a requirement to do proper human capital planning and analysis to make sure the government isn't losing control of its mission because of an overreliance on contractors."

OMB will issue new guidance in the coming weeks to clarify the definition of what is an "inherently governmental function," which will help agencies determine which work should be outsourced or in-sourced.

As currently defined, inherently governmental functions are jobs that obligate the government to take an action, such as signing a contract or negotiating with a foreign power. But opponents of outsourcing say outsourcing work that supports decision makers — such as technical advisers hired to design a database or contractors analyzing intelligence — is tantamount to outsourcing work that is inherently governmental.

"When the guidance comes out, we will have more to say about that, but in some cases, the issue agencies are facing is [that] they hired contractors to do functions that were not inherently governmental, but the roles expanded over the line," Liebman said.

Last year, Congress passed new in-sourcing rules directing agencies to in-source contractor-performed work when the contractor fails to perform, the work is deemed improperly outsourced, or when the work was outsourced without competition.

In short, agencies should do a full-blown cost analysis to ensure that appropriately outsourced work provides value to the government. If it doesn't, the work should be in-sourced, Liebman said.

If acquisition officials determine work should be brought in-house, they must work with the program management, human capital and financial management offices to ensure the agency has the managerial and financial capacity to do the work in-house, he said. The offices should also collaborate to develop a staff training and recruiting plan, he said.

That was just the approach taken by DFAS as it moved forward with its in-sourcing project, LaRock said. The agency set up a committee of senior executives, led by the agency's principal deputy director, to develop a project management plan. The panel holds biweekly meetings to ensure transition milestones are met, he said.

Liebman said he expects in-sourcing efforts such as the one at DFAS will be a key way that agencies cut contract spending by 7 percent over the next two fiscal years, as directed by OMB.

Some in industry worry agencies may be interpreting OMB's guidance as an in-sourcing mandate.

"Despite the memo's balance, there is a growing perception we're seeing and hearing from agencies ... that there is an in-sourcing mandate," said Stan Soloway, president of the Professional Services Council. The industry group recently polled its 350 members and found that 60 percent reported some kind of reduction in their contracts as agencies turned contractor-filled positions into federal employee positions, Soloway said.

Agencies may use in-sourcing as a way to cut contract spending, but it doesn't mean they're saving money, he said. Rather, it is a budgetary sleight of hand that moves the contract costs to other lines in the agency's budget, such as personnel and utility costs, he said.

"We don't want to incur unnecessary costs or hidden costs that will come back and bite us," Soloway said. Agencies considering in-sourcing should take into account all overhead costs, such as technology and energy use, which contractors factor in to the fees they charge government, he said.

Ideally, agencies should hold competitions to decide the best business case for who does what work, he said.

"Competition validates costs," by forcing both sides to find ways to perform the work in the most efficient way, he said. Static cost comparisons recommended by the July guidance may not achieve the same level of savings, Soloway said.

The American Federation of Government Employees disagrees. "If the work had been performed by federal employees or could have been performed by federal employees, but contractors acquired the work without the benefit of public-private competition, then obviously no public-private competitions are necessary," said John Threlkeld, a legislative affairs representative for AFGE.

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