

December 2005

COMPETITIVE SOURCING

Health Benefits Cost Comparison Had Minimal Impact, but DOD Needs Uniform Implementation Process



Highlights of [GAO-06-72](#), a report to congressional committees

COMPETITIVE SOURCING

Health Benefits Cost Comparison Had Minimal Impact, but DOD Needs Uniform Implementation Process

Why GAO Did This Study

Competitive sourcing is a management tool where federal agencies conduct competitions between federal employees and private companies to determine the best source to provide commercially available services.

Concerns have been raised in the Congress that differences in the costs of federal and private health insurance benefits could disadvantage the federal workforce in public-private competitions. A health benefit cost comparability provision in the 2005 Defense Appropriations Act prohibited any advantage for private offerors that provide no health benefits or contribute less for them than the Department of Defense (DOD) contributes for its civilian employees. Legislation is pending to extend the provision for another year. GAO, in response to a mandate, determined (1) how DOD implemented the provision, and (2) what impact the provision had on DOD's fiscal year 2005 competitive sourcing program.

What GAO Recommends

To avoid the potentially inconsistent treatment within DOD of private offerors' cost proposals, GAO recommends that DOD use a uniform and consistent process to implement the health benefit cost provision. DOD concurred with the recommendation.

www.gao.gov/cgi-bin/getrpt?GAO-06-72.

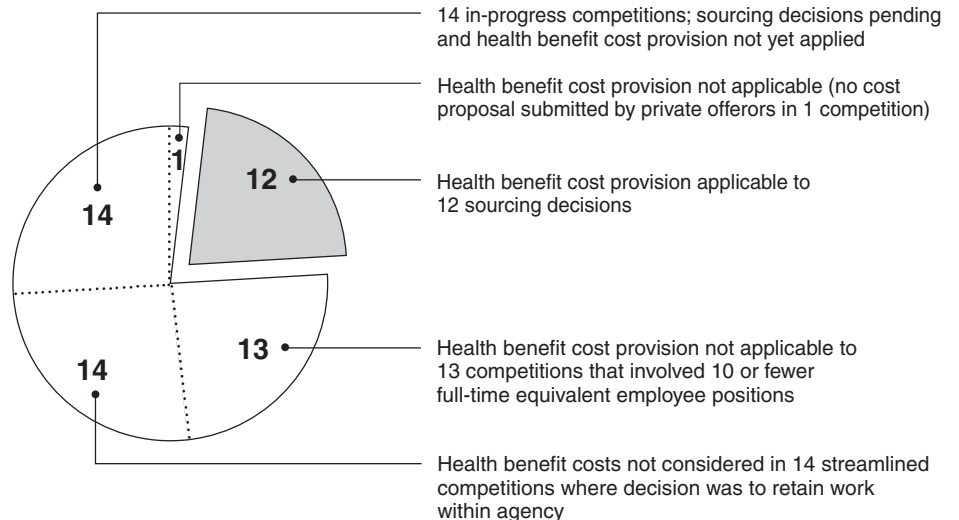
To view the full product, including the scope and methodology, click on the link above. For more information, contact William T. Woods, 202-512-4841, woodsw@gao.gov.

What GAO Found

Most DOD components implemented the health benefit cost provision using a process designed to ensure that private sector proposals include an amount for employee health benefits at least equal to the amount that Office of Management and Budget Circular A-76 requires to be added to agency cost estimates to account for employee health benefits. Under Circular A-76, this amount is 5.5 percent of direct labor costs. The Defense Logistics Agency (DLA), however, used a different process designed to determine whether a private sector offeror's monthly health benefit premium contributions are at least equal to DOD's. While DOD's and DLA's processes are both reasonable approaches, the use of different processes could result in different competitive sourcing outcomes in some cases.

The health benefit cost provision had minimal impact on DOD's fiscal year 2005 competitive sourcing program. Of the 54 public-private competitions we reviewed, the health benefit provision was applicable in only 12 sourcing decisions (see figure). In 7 of these 12 competitions, DOD collected health benefit cost data from private sector offerors and found that most of their health benefit costs exceeded 5.5 percent of direct labor costs. This is largely due to the requirements of the Service Contract Act—which mandates minimum wages and fringe benefits (which could include health insurance) for employees on government service contracts. Although the processes used by DOD and DLA resulted in increasing two private offerors' cost proposals, the adjustments did not alter the outcome of the competitions. Contracting officials and the private sector offerors told us that complying with the health benefit cost provision was not unduly burdensome.

Application of Health Benefits Cost Provision in DOD's Fiscal Year 2005 Competitive Sourcing Program (as of June 30, 2005)



Source: GAO analysis of DOD data.

Contents

Letter		1
	Results in Brief	2
	Background	4
	In General, DOD Implemented Health Benefit Cost Provision Based on Standard A-76 Cost Factor	8
	Health Benefit Cost Provision Had Minimal Impact	14
	Conclusions	19
	Recommendation For Executive Action	19
	Agency Comments and Our Evaluation	19
Appendix I	Health Benefits in the Private Sector and the Transitional Benefit Corporation Concept	22
Appendix II	Scope and Methodology	27
Appendix III	Legislative Provision for Health Benefit Cost Comparability	29
Appendix IV	Fiscal Year 2005 Competitions in Which Health Benefit Costs Were Not a Factor	31
Appendix V	Comments from the Department of Defense	35
Appendix VI	Comments from the Office of Management and Budget	38
Tables		
	Table 1: Components of Circular A-76 Civilian Position Fringe Benefits Cost Factor	5
	Table 2: Hypothetical Illustration of DOD's Preferred Health Benefit Cost Comparability Process	10

Table 3: Competitions Where DOD Component Determined That Health Benefit Cost Data Were Not Needed	16
Table 4: Competitions Where Private Offerors Submitted Health Benefit Cost Data	16
Table 5: Competitions In Progress as of June 30, 2005 Where Health Benefit Cost Comparability Had Yet to Be Considered, and Competitive Sourcing Decision Was Pending	32
Table 6: Streamlined Competitions Where DOD's Market Research Determined the Agency Was the Lowest-Cost Source and Health Benefit Cost Comparability Was Not a Factor	33
Table 7: Competitions Involving 10 or Fewer FTEs and Health Benefit Cost Comparability Was Not Applicable	34

Figures

Figure 1: Application of Health Benefits Cost Provision in DOD's Competitive Sourcing Program as of June 30, 2005	15
Figure 2: Percentage of Private-Sector Employers That Contributed Toward Health Insurance in 2003, by Number of Employees	23
Figure 3: Private Employers Percentage Share Contributed Toward Employee Health Insurance Premiums in 2003, by Number of Employees	24

Abbreviations

DLA	Defense Logistics Agency
DOD	Department of Defense
FEHBP	Federal Employees Health Benefits Program
FTE	full-time equivalent
SCA	McNamara-O'Hara Service Contract Act
MEO	most efficient organization
OMB	Office of Management and Budget

This is a work of the U.S. government and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.



United States Government Accountability Office
Washington, DC 20548

December 9, 2005

Congressional Committees

Competitive sourcing is a management tool used by federal agencies to determine whether commercial activities, such as maintenance of facilities or information technology support, should be performed by federal employees or by contractors. Agencies use competition between the public and private sectors to determine the best source. Competitive sourcing is intended to encourage innovation and improve efficiency and performance. Competition between the two sectors is conducted under procedures prescribed in Office of Management and Budget (OMB) Circular A-76,¹ which was revised in 2003 to reflect the recommendations of the congressionally chartered Commercial Activities Panel.²

Concerns have been raised in Congress about whether the differing costs of providing health insurance benefits to the federal workforce and to private sector employees may create a competitive advantage for contractors. The Department of Defense Appropriations Act of 2005³ included a health benefit cost comparability provision effective for fiscal year 2005 that prohibits an advantage in public-private competitions for a private sector source that does not offer employee health benefits or that pays less towards health benefits than the Department of Defense (DOD) pays for its civilian employees. On several occasions, DOD, the Small Business Administration, and OMB have sought repeal of this provision on the basis that it is difficult to administer and a disincentive to private

¹ OMB's Circular A-76 establishes federal policy and standard procedures for determining whether commercial activities should be performed by the agency, by another federal agency, or by the private sector. It contains procedures for calculating public and private sector costs to ensure that the comparison reflects the full cost of performance.

² Commercial Activities Panel, *Final Report: Improving the Sourcing Decisions of the Government* (Washington, D.C.: April 2002). The Congress mandated a study of the government's competitive sourcing process under A-76—a study conducted by the Commercial Activities Panel, chaired by the Comptroller General of the United States. The panel included representatives from OMB, DOD, the Office of Personnel Management, private industry, academia, a trade association, and federal employee unions.

³ Public Law 108-287, section 8014(a)(3), enacted August 5, 2004. Under a continuing resolution enacted November 19, 2005 (Public Law 109-105), this provision remains in effect through December 17, 2005.

sector participation—particularly by small businesses—in DOD’s competitive sourcing program. Legislation is pending in the Congress that, if enacted, would extend the provision for another year.⁴

The conferees for the fiscal year 2005 National Defense Authorization Act⁵ directed that we review the implementation of the appropriations health benefits cost provision. After providing a preliminary briefing on our work in April 2005, we agreed with the congressional defense committees to determine (1) how DOD has implemented the provision, and (2) what impact the provision had on DOD’s fiscal year 2005 competitive sourcing program. In addition, we agreed to summarize recently published research on the availability of employee health benefits and employer contributions in the private sector and provide information on a concept for assisting displaced federal employees known as the transitional benefit corporation. Information on these additional topics is included in appendix I.

To determine how DOD has implemented the health benefits cost provision and the impact the provision is having on its fiscal year 2005 competitive sourcing program, we reviewed the 54 DOD public-private competitions that were in progress or completed from October 1, 2004, through June 30, 2005. We also interviewed and obtained information from DOD, OMB, and private offeror officials. We conducted our review between February and October 2005 in accordance with generally accepted government auditing standards. More information on our scope and methodology is contained in appendix II.

Results in Brief

Most DOD components implemented the health benefits cost provision using a process designed to ensure that private sector proposals include an amount for employee health benefits at least equal to the amount that Circular A-76 requires to be added to agency cost estimates to account for employee health benefits. Under Circular A-76, this amount is 5.5 percent of direct labor costs. The Defense Logistics Agency (DLA), however, used a different and more complicated process designed to determine whether a private sector offeror’s monthly health benefit premium contributions are at least equal to DOD’s maximum monthly premium contributions for

⁴ H.R. 2863, Department of Defense Appropriations Bill, 2006, passed the House on June 20, 2005, and the Senate on October 7, 2005.

⁵ Section 327, Conference Report 108-767, to accompany H.R. 4200, Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005, October 8, 2004.

civilian employees' health benefits. While the processes used by DOD and DLA are both reasonable approaches to implementing the legislative health benefits cost provision, the use of different approaches within DOD could result in different competitive sourcing outcomes in some cases and is not in keeping with the sourcing principle of the Commercial Activities Panel that advocated the consistent application of clear and transparent competitive sourcing procedures.

The health benefits cost provision had minimal impact on DOD's fiscal year 2005 competitive sourcing program. Of the 54 public-private competitions we reviewed as of June 30, 2005, the health benefit provision was applicable in only 12. The provision was not applicable in 42 competitions for various reasons, such as when the use of streamlined competitions showed that the performance by government employees would be less expensive even without adjusting for any difference in the cost of employee health benefits. In 5 of the 12 competitions where the provision applied, obtaining data on health care costs was unnecessary because either the agency cost estimate was the lowest or DOD components determined that adding a 5.5 percent evaluation factor to the low private sector proposal would not have made a difference. In 7 remaining competitions, DOD collected health benefit cost information from private sector offerors and found that most of their health benefit costs exceeded 5.5 percent of direct labor costs. This is mostly due to the requirements of the Service Contract Act—which mandates minimum fringe benefits (which could include health insurance) for employees on government service contracts. Although DOD's and DLA's processes resulted in increasing two private offerors' cost proposals, the adjustments did not alter the outcome of the competitions. Contracting officials and the private sector offerors told us that complying with the health benefit cost provision was not unduly burdensome.

To avoid the potentially inconsistent treatment within DOD of private offerors' cost proposals in the future, this report includes a recommendation to DOD to use a uniform and consistent process to implement the health benefit cost provision in its competitive sourcing program.

In comments on a draft of this report, DOD concurred with the recommendation. Both DOD and OMB said they remain concerned that the health care cost provision may harm small business participation in DOD's competitive sourcing program. As such, both agencies said they will continue to seek elimination or amendment of the provision. Written

comments from DOD and OMB are reprinted in appendices V and VI, respectively.

Background

Competitive sourcing is a process under which federal agencies subject the performance of their commercial activities to competition among public and private sector sources. It is intended to contribute to cost savings, improved performance, and a better alignment of the agency's workforce to its mission. OMB's Circular A-76, *Performance of Commercial Activities*, establishes federal policy and prescribes the procedures to be used in determining whether commercial activities should be performed by a federal agency or by the private sector.

Circular A-76 Processes for Conducting Public-Private Competitions

Circular A-76 contains uniform procedures to be used by agencies for calculating costs so that cost comparisons between private sector proposals and government estimates are fair. The Circular mandates use of a standard and consistent process designed to ensure that evaluated costs reflect the full cost of performance by public and private sector sources. This is consistent with the Commercial Activities Panel's final report, which recommended that these competitions should be conducted on as nearly equal terms as possible, using clear, consistent, and transparent processes for all offerors. As part of this process, the Circular is intended to help ensure that the estimated cost of government performance fairly reflects all of the personnel and non-pay costs of an agency source performing the work.⁶

When preparing estimates of government performance, agencies are required to use standard cost factors that are in effect as of the solicitation closing date and make adjustments to reflect changes projected to occur during the performance period. To estimate personnel costs for example, agencies add to basic pay (for full-time and part-time permanent civilian positions) a standard overall costing factor of 32.85 percent to account for fringe benefits. This overall factor is comprised of several components, including a standard cost factor of 5.7 percent to account for life insurance and health benefits as shown in table 1. According to OMB officials, the 5.7

⁶ Circular A-76 requires agencies to use a software program called COMPARE to calculate, compare, and document the cost proposals in public-private competitions. COMPARE incorporates the standard costing procedures and factors contained in Circular A-76 to help ensure that agencies are calculating and documenting such costs uniformly.

percent factor consists of 0.2 percent for life insurance and 5.5 percent for health benefits.⁷

Table 1: Components of Circular A-76 Civilian Position Fringe Benefits Cost Factor

Standard cost factor	Percentage of basic pay ^a
Insurance and health benefits ^b	5.7
Standard civilian retirement benefits ^c	24.0
Medicare benefit	1.45
Miscellaneous fringe benefit	1.7
Total	32.85

Source: Circular A-76, Attachments C and D.

^aCircular A-76 defines basic pay as a civilian employee’s annual salary plus other applicable employee pay entitlements, such as premium pay for civilian law enforcement officers.

^bIn addition to FEHBP, employees may receive life insurance benefits through the Federal Employee’s Group Life Insurance program.

^cThe standard civilian retirement benefit cost factor includes the government share for pension benefits (Social Security, Thrift Savings Plan, Federal Employees or Civil Service Retirement Systems) and the accruing costs for postretirement health benefits.

To conduct public-private competitions under Circular A-76, agencies may use either a standard or a streamlined competition process, depending on the number of positions involved. Agencies must use a standard competition process for activities with more than 65 full-time equivalent (FTE)⁸ positions. As part of the standard process agencies issue solicitations with a performance work statement describing the work to be performed, appoint an agency tender official to prepare a response to the solicitation based on a “most efficient organization” (MEO),⁹ and evaluate that response along with the proposals submitted by private offerors.

⁷ OMB has not examined the extent to which the Circular A-76 standard insurance and health benefits cost factor of 5.7 percent—which has not been revised since 1999—has kept pace with increases in Federal Employees Health Benefits Program (FEHBP) costs over the last 6 years. Federal budget costs to provide health insurance under FEHBP climbed 65 percent between fiscal years 1999 and 2005. In view of this growth in FEHBP costs, we recommended that OMB’s Director review and update as necessary the health benefits cost factor. See GAO, *Review of OMB Circular A-76 Health Benefit Cost Factor Needed*, [GAO-06-87R](#) (Washington, D.C.: Nov. 17, 2005).

⁸ Full-time equivalent (FTE) is a measure of federal civilian staffing. Circular A-76 defines FTEs in terms of 1,776 annual productive work hours.

⁹ OMB defines a most efficient organization (MEO) as the staffing plan of the agency, developed to represent the agency’s most efficient and cost-effective organization.

Also, under the standard competition process, unless contractor performance would save the government \$10 million or 10 percent of agency personnel-related costs (whichever is less), the work will be retained within the agency. This ensures that an agency does not convert to contract performance in cases where only marginal savings are anticipated.¹⁰

For activities with 65 or fewer FTEs, agencies may use a streamlined competition process. Streamlined competitions are based only on a comparison of public and private sector costs. Private sector costs are obtained either from documented market research or soliciting cost proposals in accordance with the Federal Acquisition Regulation. Use of the streamlined process enables agencies to complete the comparison more quickly.

The Circular was revised in May 2003 based largely on the Commercial Activities Panel's sourcing principles and recommendations for improving the government's competitive sourcing processes. Among other things, the panel recommended that the government's sourcing decisions be based on a clear, transparent, and consistently applied competitive sourcing process. This principle is key to ensuring the integrity of the process, as well as to creating trust in the process on the part of those it most affects: federal managers, users of the services, federal employees, the private sector, and the taxpayers. The revised Circular A-76 states that agencies should centralize oversight responsibility to foster fairness in their public-private competitions, and effectively apply a consistent process based on lessons learned and best practices.

DOD's Competitive Sourcing Program

The Department of Defense has a long-established competitive sourcing program and is the leader among federal agencies in terms of the number of public-private competitions conducted and positions competed. In fiscal year 2004, DOD reported that it made sourcing decisions in 58 public-private competitions, with projected net savings of approximately \$740 million. DOD has a centralized management structure to oversee its competitive sourcing program and those of the DOD components. The Deputy Under Secretary of Defense (Installations and Environment) in the Office of the Secretary of Defense has responsibility for establishing and

¹⁰ The same conversion differential applies when there is contractor-performed work the government might wish to bring back within the agency for government performance.

overseeing DOD-wide policies, procedures, and guidance.¹¹ DOD components—such as the Army, Navy, Marine Corps, and Air Force—as well as the defense agencies and DOD field activities have their own centralized management structures to operate their competitive sourcing programs based on DOD’s policies, procedures, and guidance.

Under legislation applicable only to DOD for activities with more than 10 FTEs, unless contractor performance would save the government \$10 million or 10 percent of agency personnel-related costs (whichever is less), the work will not be converted to contractor performance.¹²

Health Benefits Available to Federal and Service Contract Act Employees

Federal employees and the employees of the government’s service contractors may receive health insurance benefits based on different statutory requirements. The Federal Employees Health Benefits Act of 1959 established the framework for government civilian employees’ health insurance benefits through the Federal Employees Health Benefits Program (FEHBP).¹³ Participation in FEHBP is voluntary for civilian employees and their dependents and retirees. This statute sets the government’s share of each participant’s health insurance premium cost at an amount equal to 72 percent of the weighted average of the premiums of all FEHBP plans, but caps the government’s share at 75 percent of any individual plan’s premium. This formula is applied to the self-alone and self-and-family plans separately. For example, in fiscal year 2005, the government’s annual share of FEHBP premiums for two major FEHBP plans ranged between \$2,600 to \$3,400 for self coverage and \$5,900 to \$7,800 for self-and-family coverage.¹⁴

¹¹ Within the Office of the Deputy Under Secretary of Defense (Installations and Environment), the Department of Defense Housing and Competitive Sourcing Office has overall responsibility for managing DOD’s competitive sourcing program.

¹² Unlike the Circular A-76 streamlined competition process established for the rest of the government for activities with 65 or fewer FTEs, annual DOD and consolidated appropriations laws have, in effect, required DOD to use aspects of the standard process anytime more than 10 FTEs are involved because (1) agency employees must be allowed to form MEOs to compete with the private sector, and (2) savings realized from outsourcing the work must exceed specific monetary targets.

¹³ The Federal Employees Health Benefits Act of 1959, Pub. L. No. 86-382 73 Stat. 708, established the program. The act, as amended, is codified at 5 U.S.C. §8901 et seq.

¹⁴ For these two major plans, the non-postal federal employee’s annual share of FEHBP premiums ranged between \$865 to \$2,322 for self-coverage and \$1,964 to \$4,716 for self-and-family coverage.

The McNamara-O'Hara Service Contract Act (SCA) of 1965¹⁵ requires minimum wages and fringe benefits for employees working on government service contracts that exceed \$2,500. The Department of Labor administers the SCA and determines the prevailing wages in geographic localities for various job categories. In June 2005, the department increased the standard SCA health and welfare minimum benefit rate to \$2.87 per hour from \$2.59 per hour. Government contractors have flexibility in the types of health and welfare benefits they provide, as long as they meet or exceed the \$2.87 minimum health and welfare requirement. For example, contractors can meet their SCA benefits obligations by providing health insurance benefits, by allowing their employees to place some or all of the SCA benefits in a retirement plan, or by providing cash payments.

In General, DOD Implemented Health Benefit Cost Provision Based on Standard A-76 Cost Factor

Most DOD components implemented the health benefit cost provision by ensuring that private sector proposals included an amount for health insurance benefits at least equal to the amount that Circular A-76 requires to be added to agency cost estimates to account for health benefit costs. Under Circular A-76, this amount is 5.5 percent of direct labor costs. The Defense Logistics Agency (DLA), however, used a process based on the monthly premium contributions DOD is required to make towards civilian employees' health insurance plans under the FEHBP. Either of the processes used by DOD or DLA provides a reasonable approach for ensuring that private offerors do not receive a competitive advantage for less costly health benefits. Use of two different processes, however, results in health benefit costs being treated inconsistently within DOD and could even result in different competitive sourcing outcomes.

¹⁵ 41 U.S.C. 351, et seq. The Service Contract Act applies to contracts that involve primarily the delivery of services in the United States and are valued at more than \$2,500. In a GAO report due to be released in January 2006, information is presented on how the Department of Labor establishes locally prevailing wages and fringe benefits and enforces SCA. See GAO, *Service Contract Act: Wage Determination Process Could Benefit From Greater Transparency, and Better Use of Violation Data Could Improve Enforcement*, [GAO-06-27](#) (Washington, D.C.: Dec. 7, 2005).

DOD Developed a Preferred Process for Implementing the Health Benefit Cost Provision, but Has Not Mandated Its Use

The health benefit cost requirement established for DOD's public-private competitions in section 8014(a)(3) of the Department of Defense Appropriations Act, 2005 requires that a private offeror not receive a competitive advantage by not offering health insurance for its employees, or by paying less for employee health benefits than the government contributes for civilian employee health benefits. (See app. III for the text of Section 8014.)

To implement this legislation, DOD's competitive sourcing officials told us they consulted with officials from OMB's Office of Federal Procurement Policy, DOD's Office of General Counsel, and DOD components' competitive sourcing offices to develop their interpretation of the legislation and a process for implementation. Officials from OMB advised DOD that the Circular A-76 standard insurance and health benefits cost factor of 5.7 percent consisted of 0.2 percent to account for the cost of federal employees' life insurance benefits and 5.5 percent to cover health benefit costs. DOD decided to use the Circular A-76 standard health benefits cost factor as the benchmark for ensuring that the costs of health benefits provided by private offerors are sufficient to comply with the legislation. In November 2004, DOD communicated this approach as the preferred process throughout the department, but gave discretion to the competitive sourcing program offices of the DOD components to use alternate processes, as long as they consulted with DOD's competitive sourcing office.

Under DOD's process, contracting officials are to follow a multistep approach to implement the health benefit cost comparability provision. First, for competitions conducted subsequent to the issuance of DOD's guidance, contracting officials should obtain data from the private offeror regarding the company's costs for contributions to employee health insurance (i.e., benefits) as well as its proposed direct labor costs for the performance of the competed commercial activity. Second, the contracting officials calculate the private offeror's costs of employee health benefits as a percentage of direct labor costs. Finally, contracting officials make any necessary adjustments to their calculation of the private offeror's proposed costs using the following criteria:

- If the health benefit cost percentage is lower than 5.5 percent, then the private offeror's proposed cost is adjusted upward by the amount necessary to make the contribution equal 5.5 percent.
- If the percentage contribution is equal to or greater than 5.5 percent, no adjustment is necessary.

Hypothetical examples of this process are shown in table 2.

Table 2: Hypothetical Illustration of DOD’s Preferred Health Benefit Cost Comparability Process

Proposal costs and adjustments	Proposal requiring adjustment	No adjustment required
Private offeror’s total proposed cost	\$1,000,000	\$1,000,000
Direct labor	\$500,000	\$500,000
Health benefit contribution	\$15,000 (3 percent of direct labor)	\$27,500 (5.5 percent of direct labor)
DOD’s adjustment to implement health benefit cost provision	\$12,500 (Add 2.5 percent to the proposed 3 percent of direct labor to equal 5.5 percent)	None needed (Health benefit cost is 5.5 percent)
Total evaluated cost after adjustment	\$1,012,500	\$1,000,000

Source: GAO analysis using hypothetical data and DOD’s preferred process.

According to DOD officials, any health benefit cost adjustment made to the private offeror’s proposed costs is for evaluation and cost comparison purposes only. For work currently performed within the agency, if contracting officials determine that the private offeror has a higher priced proposal than the agency’s cost estimate, either before or after any adjustments for health benefit contributions, DOD will retain the work within the agency. If a private offeror selected for award under the solicitation’s evaluation criteria has a lower cost proposal after any adjustment for health benefit contributions—and contractor performance would save DOD at least \$10 million or 10 percent of the agency team’s personnel-related costs—the offeror will be awarded a contract at its original proposed amount. Section 8014 does not compel DOD officials to reject a private offeror’s proposal based solely on the cost or extent of the company’s health benefit coverage. Nor does it require the private offeror to match the DOD’s health benefit costs, since according to DOD officials this would in effect have to be subsidized by DOD through higher awarded costs.

DOD officials told us that using the 5.5 percent Circular A-76 cost factor to implement the health benefit cost legislation accomplishes several objectives. First, the approach is consistent with the requirement of the statute that private sector offerors not receive a competitive advantage by offering to pay less for health benefits than what the government pays. Second, DOD officials believe the approach is fair because it ensures that proposals from both the public and private sectors have an equal health benefit cost component of at least 5.5 percent. Third, the approach is consistent with the standard adjustment agency sources already make to

account for health benefit costs when preparing agency cost estimates. Fourth, DOD officials said that the process reduces the chances of human error and miscalculations inherent in alternative approaches that might attempt to compare the quality of public and private health benefits. DOD officials commented that it would be difficult to do a true “apples-to-apples” comparison of federal and private sector health benefit plan costs because of the wide variation among federal civilian and private sector plan benefits and employee participation. Finally, according to DOD officials, this process avoids the problem of comparing aggregate employer contribution costs for health benefits, and better accounts for differences in proposed staffing across offers without penalizing a smaller company that may pay less for health benefits overall than the agency source.

Most DOD Components Adopted DOD’s Health Benefit Cost Comparability Process

Except for DLA, which implemented its own process, the DOD components we reviewed adopted DOD’s preferred process to implement the health benefit cost comparability provision. Competitive sourcing program officials in the Air Force, Navy, Marine Corps, and Army Corps of Engineers told us that they have taken actions to implement the DOD process in their fiscal year 2005 competitive sourcing programs. According to these officials, implementation actions ranged from offering instructions to contracting staff about incorporating the DOD preferred process in ongoing competitions to more formal actions such as incorporating the preferred process in competitive sourcing manuals. For example, the Marine Corps’ competitive sourcing program officials added a section with guidance for implementing the health benefit cost provision in its draft competitive sourcing program manual, which contracting officers will use to run Marine Corps public-private competitions.

Early in fiscal year 2005, some components took steps to implement the health benefit cost provision in advance of communication from DOD about its preferred process because these components had immediate needs to comply with the requirement in several pending public-private competitions. These early implementation efforts were generally consistent with the preferred process that DOD later communicated in November 2004. For example, Navy and Marine Corps contracting officials told us they issued amendments to ongoing solicitations in which they requested information from private offerors to implement the health benefit provision. This information included whether the offeror would provide an employer-sponsored health insurance plan, the total cost of the employer’s contribution to the plan on behalf of employees, and their direct labor costs to perform the commercial activity being competed.

Navy and Marine Corps contracting officials told us that they collected this information in order to compare this offeror information against the standard Circular A-76 insurance and health benefit cost factor.

Because of a pending competitive sourcing decision early in fiscal year 2005, DLA also moved ahead and implemented the health benefit cost comparability provision before DOD communicated its preferred process. DLA's process, which it continues to use, differs from DOD's and is based on using the monthly premium contributions DOD is required to make under the FEHBP towards civilian employees' health insurance¹⁶ as the benchmark for comparing private offerors' health benefit coverage and costs. DLA's process requires detailed data collection and the use of a complex benefit and cost comparison method. Specifically, for a private offeror to demonstrate that it meets DLA's health benefit cost comparability benchmark, the company first must provide data showing that

- its health insurance plan allows employees to enroll either self-alone or self-and-family, and
- the amount the company contributes towards the plan's premium cost is at least the lower of the following two benchmarks: (1) the monthly maximum amount of DOD's premium contribution for self-alone and self-and-family coverage under FEHBP—\$298.23 and \$646.17, respectively, or (2) 75 percent of the cost of the company plan's monthly premium, which is the same cap set for any government contributions under the FEHBP.¹⁷

Next, DLA's process requires that the contracting officer calculate the offeror's health benefit costs for self-alone and self-and-family coverage, and compare those costs with the agency's health benefit cost benchmarks under FEHBP, and make any cost adjustments based on the following criteria:

¹⁶ 5 U.S.C. 8906(b) establishes the percentage formula of monthly premium contributions DOD is required to make under FEHBP towards civilian employees' health insurance.

¹⁷ Under 5 U.S.C. 8906(b)(1), the Office of Personnel Management (OPM) annually sets the FEHBP governmentwide weighted average of premiums, for self-only and self-and-family participation. To implement the health benefit cost comparability requirement, DLA used as its benchmark the maximum monthly premium contribution set by OPM for the government-paid portion for fiscal year 2005 for self-alone coverage (\$298.23 per month) and self-and-family coverage (\$646.17 per month). In addition, OPM has capped the monthly premium contributions under the FEHBP at 75 percent.

-
- If the private offeror's health benefit plan cost equals or exceeds the lesser of DLA's two premium contribution benchmarks,¹⁸ no upward adjustment is made to its cost proposal.
 - If the private offeror's health plan cost does not meet one of DLA's two premium contribution benchmarks, a "health benefit cost factor" is added to the private offeror's proposal cost to make up the shortfall.

As with DOD's process, such adjustments, if necessary, are made by DLA only for the purpose of determining compliance with the health benefit cost provision. If the private offeror still has the lower costs after such adjustment and completion of the cost comparison—and meets the minimum \$10 million or 10 percent savings margin required for contractor conversion—the private offeror may be awarded a contract at its original proposal amount.

In explaining the rationale for this process, DLA officials told us that their interpretation of section 8014 focused on determining that private offerors not receive a competitive advantage when they contribute less towards the premium share than the amount that is paid by DOD for civilian employees' health benefits under FEHBP. DLA consulted in advance with DOD's competitive sourcing office, which concurred with DLA's proposed process for implementation. DOD's competitive sourcing officials told us that they consider DLA's process to be more complicated to administer than the preferred process of using the 5.5 percent health benefit cost benchmark. Nevertheless, they told us that DLA's process is consistent with DOD's current guidance which allows the use of an alternative process to implement the requirement for a health benefit cost comparison, as long as components consult in advance with DOD.

Either of the processes used by DOD or DLA provides a reasonable approach for ensuring that private offerors do not receive a competitive advantage for less costly health benefits. Use of two different processes, however, results in health benefit costs being treated inconsistently within DOD and could even result in different competitive sourcing outcomes.

For example, in one of the competitions we reviewed, the company's contribution for health benefits totaled about 15 percent of its total direct

¹⁸ DLA's two premium benchmarks are (1) \$298.23 and \$646.17 per month for self-alone and self-and-family participation, respectively or (2) 75 percent of the premium for the company's health benefit plan.

labor costs. Under DOD's preferred process for determining health benefit cost comparability, the company's cost proposal would have required no adjustment since the offeror contributes substantially more than the 5.5 percent benchmark. Under DLA's process, however, the contracting officer found that the private offeror's share of the health insurance premium fell short of DLA's benchmark for self-and-family coverage. As a result, the contracting officer added about \$280,000 to the private offeror's cost proposal to make up for the shortfall. Ultimately, because the agency cost estimate was lower, regardless of the health care addition, this adjustment did not change the competitive sourcing decision. Had the cost competition between the public and private sources been closer, however, the use of a different cost comparison approach could have resulted in a different outcome.

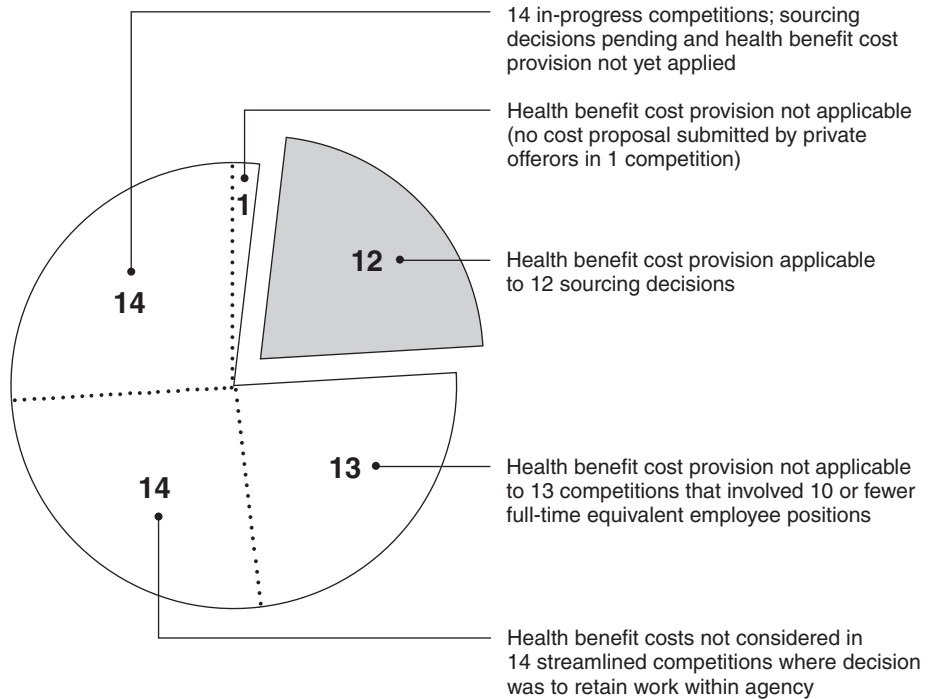
Health Benefit Cost Provision Had Minimal Impact

The health benefit cost comparability provision has had minimal impact on DOD's fiscal year 2005 competitive sourcing program and the offerors that participated. Of the 54 public-private competitions we reviewed, the health benefit provision was applicable in only 12 sourcing decisions. In 7 of these 12 competitions, DOD collected health benefit cost information from private sector offerors and found that most of their health benefit costs exceeded 5.5 percent of direct labor costs. This is mostly due to the requirements of the Service Contract Act—which mandates minimum wages and fringe benefits (which could include health insurance) for employees on government service contracts. DOD contracting officials and the private sector offerors told us that complying with the health care cost provision was not unduly burdensome. Implementation of the health care provision did not alter the outcome of any of the competitions.

Few Competitions Involved Consideration of Health Benefit Costs and No Sourcing Decision Changed as a Result

We reviewed the 54 public-private competitions that were either in progress or completed between October 1, 2004, and June 30, 2005. As shown in figure 1, only 12 public-private competitions that reached a sourcing decision involved some consideration of the requirements of the health benefit cost provision. Also as shown in figure 1, in the remaining 42 of the 54 competitions, the health benefit cost provision was not a factor for various reasons. For example, DOD contracting officers did not need to implement the health benefit cost comparability provision in 13 competitions that involved 10 or fewer FTEs since the requirement applies only to competitions involving more than 10 FTEs. (See app. IV for more information on the remaining 42 competitions where the health benefit cost provision was not yet applied or not a factor in sourcing decisions.)

Figure 1: Application of Health Benefits Cost Provision in DOD's Competitive Sourcing Program as of June 30, 2005



Source: GAO analysis of DOD data.

The DOD component conducting the public-private competition determined that there was no need to collect data on health benefit costs in 5 of the 12 competitions for which the legislative provision was applicable. As shown in table 3, in one of those competitions, the work was retained for agency performance. In that case, the cost estimate for agency performance was about 45 percent lower than the private offer. In the remaining four cases, a private offeror submitted a lower cost proposal than the agency's cost estimate,¹⁹ and the difference was so great (ranging between 8.1 and 14.8 percent less) that even adding the full health cost factor of 5.5 percent would not have made a difference.

¹⁹ The private offerors' cost proposals were lowest cost even after DOD's cost comparison adjusted for the minimum savings margin of \$10 million or 10 percent (whichever is less) needed before the work can be converted to contractor performance.

Table 3: Competitions Where DOD Component Determined That Health Benefit Cost Data Were Not Needed

Public-private competition	DOD component	FTEs competed	Sourcing decision	Cost proposal difference
1	Air Force	191	Private	14.3 percent lower
2	Marine Corps	265	Private	9.9 percent lower
3	Marine Corps	16	Public	45.6 percent lower
4	Navy	11	Private	14.8 percent lower
5	Navy	290	Private	8.1 percent lower

Source: GAO analysis of DOD data.

In the remaining 7 of the 12 competitions, DOD components collected and assessed health benefit data from private offerors. As shown in table 4, most private offerors' proposed costs for health benefits far exceeded DOD's 5.5 percent benchmark.

Table 4: Competitions Where Private Offerors Submitted Health Benefit Cost Data

Public-private competition	DOD component	FTEs competed	Sourcing decision	Private offeror a small business?	Private offeror contributes towards health benefits?	Health benefit cost as percentage of direct labor	Cost proposal adjustment needed for health benefit comparability
6	Navy	809	Public	No	Yes	21.0	No
7	Marine Corps	38	Public	Yes	Yes	17.0	No
8	Navy	103	Private	No	Yes	10.0	No
9	Marine Corps	27	Public	Yes	Yes	2.1	No ^a
10	Marine Corps	52	Private	Yes	No	0.0	Yes ^b
11	DLA	124	Public	No	Yes	15.4 ^c	Yes ^c
12	DLA	341	Public	No	Yes	Not available ^d	No

Source: GAO analysis of DOD and private offeror data.

^aContracting office did not need to adjust the private offeror's cost proposal since agency's cost estimate was lower.

^bProposal cost adjustment was not documented in the source selection file.

^cGAO calculation using DOD process and private offeror data. Contracting officer used DLA's process for comparison and private offeror's health benefit cost fell short of DLA's health benefit cost benchmarks.

^dPrivate offeror's health benefit cost as percentage of direct labor was not available and GAO was unable to calculate health benefit cost as percentage of direct labor. Contracting officer used DLA's process for comparison, and private offeror's cost proposal met DLA's health benefit cost benchmarks.

Collection of Health Benefit Data Was Not Unduly Burdensome

According to DOD component contracting officers and our review of competitive sourcing documents, the administrative steps taken to collect health benefit data were not unduly burdensome and generally did not significantly delay competition schedules. For the seven competitions in which cost data were obtained from the offerors, the components usually obtained the data through solicitation amendments. This step was necessary because the solicitations had been issued prior to the health benefit cost provision becoming effective. Component contracting officers generally told us that collecting the health benefit data imposed neither unusual burden nor unacceptable delays.²⁰ In one case, instead of a solicitation amendment, the contracting officer simply contacted the offeror and asked the company to submit the health care cost data. Contracting officers told us that they plan to include the health benefit cost provision in the future solicitations.

Our discussions with the offerors in the public-private competitions also indicated the process created little difficulty for them, and required minimal efforts. The health benefit data needed were readily available and generally maintained in the company accounting systems. This was the case for both small and larger companies. According to the offerors we interviewed (including one firm that submitted to DLA detailed data about health benefits), submitting the health benefit data was not considered unusually burdensome. The private offeror involved in DLA's process we contacted raised no concern with us about any burden. Our review of DLA's competition documents, however, indicated that much more documentation about health benefits and costs is expected to be submitted by a private offeror participating in a DLA public-private competition than what is expected of private offerors participating in other competitions following DOD's preferred process.

²⁰ In one case however, DLA officials told us that they did experience a delay for a competition that was nearing source selection just after the new fiscal year would start. It was at that time that DLA officials realized that the health benefit cost comparability provision was about to take effect before they could complete their source selection process for this competition. As a result, DLA extended the source selection by about a month to establish a new process for implementing the requirement and to amend the solicitation in order to collect and compare needed health benefit data from both agency and private offerors.

Service Contract Act Results in Most Private Offerors Paying for Health Benefit Costs

In all seven competitions we reviewed where DOD obtained health benefits data, private offerors were subject to the Service Contract Act (SCA). At the time DOD reviewed their health benefit costs, the SCA required that these offerors pay at least \$2.59 per hour for employees' fringe benefits.²¹

We contacted 6 of the 7 private offerors who submitted health benefit data for these competitions. Four of these offerors allowed their employees to use all of the SCA minimum benefit rate towards the cost of the health insurance, and they easily met the 5.5 percent health benefit cost benchmark. The fifth offeror allowed its employees to use a portion of the SCA benefits towards health insurance cost and receive the remainder as an increased hourly wage. As a result, this company's offer fell short of the 5.5 percent benchmark for health benefit costs. No adjustment was made, however, because the agency cost estimate was lower.

The sixth private offeror's proposal included the cost of the required SCA fringe benefits, but the company notified DOD and also told us that it does not offer to pay for employee health insurance. Company officials told us that because most of their employees are former military or civilian employees with military or federal retiree health benefits, the company's business decision under the SCA fringe benefit requirement is not to contribute towards employee health benefits. Instead, company officials told us they contribute towards a retirement benefit. Even after adjusting the offeror's cost proposal by adding the 5.5 percent health benefit cost factor, the offeror had the lowest cost proposal and won the contract.

DOD competitive sourcing and legal officials told us that they did not consider the availability or cost of SCA minimum requirements for health and other fringe benefits when they developed their approach for implementing the health benefit provision. DOD competitive sourcing officials acknowledged most private offerors will be able to match or exceed the 5.5 percent health benefit cost benchmark simply by meeting existing SCA fringe benefit requirements. Our analysis of established SCA rates for wages and benefits indicates that the ratio of benefit costs to labor costs is usually much greater than the 5.5 percent health benefit cost comparability benchmark under DOD's process. For example, a general maintenance worker paid \$17.28 an hour and receiving the current SCA benefit of \$2.87 an hour for employer-paid health insurance would result in

²¹ In June 2005, the health and welfare benefit rate was increased to \$2.87 per hour.

that employer paying roughly 16.6 percent of its direct labor costs for health benefits.²²

Conclusions

The Department of Defense is currently using two different processes to implement the legislative health benefit cost provision. Although both are reasonable approaches for ensuring that private offerors do not gain a competitive advantage from lower health benefit costs, and neither one has yet affected the outcome of any public-private competition, the use of two different processes is problematic. The lack of a consistent DOD-wide process may—in future competitions where agency and private offerors’ proposal costs are close—result in different competitive sourcing outcomes depending on which approach is used. Such a result would be inconsistent with the purpose of Circular A-76, which is to provide for greater consistency in the competitive sourcing process and with the sourcing principles adopted by the Commercial Activities Panel. DOD currently lacks a uniform process for implementing the health benefit cost comparability provision that is in keeping with the sourcing principle that public-private competitions be guided by clear, transparent, and consistently applied processes. With legislation pending to extend this health benefit cost comparability provision through fiscal year 2006, DOD should not continue to permit this inconsistency to persist.

Recommendation For Executive Action

To align DOD’s competitive sourcing program more fully with governmentwide policy contained in Circular A-76 and the sourcing principles of the Commercial Activities Panel, we recommend that if the health benefit cost provision is extended, the Secretary of Defense should direct the Deputy Under Secretary of Defense for Installations and Environment to require use of a uniform and consistent process for the DOD components in evaluating the health benefits costs of private sector offerors in public-private competitions.

Agency Comments and Our Evaluation

In comments on a draft of this report, DOD concurred with the recommendation. Both DOD and OMB said they remain concerned that the health care cost provision may harm small business participation in DOD’s competitive sourcing program. As such, both agencies said they

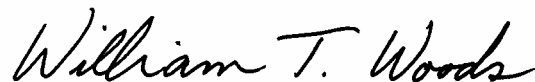
²² General maintenance worker hourly rate obtained from the Department of Labor’s May 23, 2005, Wage Determinations for the District of Columbia and surrounding areas.

will continue to seek elimination or amendment of the provision. Written comments from DOD and OMB are reprinted in appendices V and VI, respectively.

DOD and OMB also commented that the report is based on very limited data involving only 12 competitions and that our finding of minimal impact cannot be used to predict the impact on future competitions. However, we did not focus on assessing what impacts the provision could potentially have on DOD's competitive sourcing program in the future. Rather, we assessed the impacts the health benefits provision was having on DOD's fiscal year 2005 competitive sourcing program. Our finding that the provision had minimal impact is based not only on the 12 competitions in which the provision was applicable, but also on analysis of 42 other public-private competitions where the provision did not come into play for various reasons. In addition, we reviewed other information and obtained the views of DOD officials involved with the competitions and representatives for private offerors who submitted health benefit cost data for DOD's consideration.

We are sending copies of this report to interested congressional committees, the Secretary of Defense, and the Director of OMB. We will also provide copies to others on request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staffs have any questions about this report, please contact me at (202) 512-8214; or WoodsW@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report were Carolyn Kirby, Assistant Director; John Dicken, Rosa Johnson, Charles Perdue, Russ Reiter, Sylvia Schatz, Natalie Schneider, Bob Swierczek, Ann Marie Watt, and Anthony Wysocki.



William T. Woods, Director
Acquisition and Sourcing Management

List of Congressional Committees

The Honorable John Warner
Chairman
The Honorable Carl Levin
Ranking Minority Member
Committee on Armed Services
United States Senate

The Honorable Duncan L. Hunter
Chairman
The Honorable Ike Skelton
Ranking Minority Member
Committee on Armed Services
House of Representatives

The Honorable Ted Stevens
Chairman
The Honorable Daniel K. Inouye
Ranking Minority Member
Subcommittee on Defense
Committee on Appropriations
United States Senate

The Honorable C.W. Bill Young
Chairman
The Honorable John P. Murtha
Ranking Minority Member
Subcommittee on Defense
Committee on Appropriations
House of Representatives

Appendix I: Health Benefits in the Private Sector and the Transitional Benefit Corporation Concept

This appendix provides information on the availability of and employer contributions for health benefits in the private sector based on our review of recently published research. Information is also presented on the transitional benefit corporation concept that has received attention as a mechanism for minimizing the loss of health insurance and other benefits for civilian federal employees affected by conversion of commercial activities performed by government employees to private sector performance.

Availability of and Employer Contributions for Health Benefits in the Private Sector

Recent government and private sector studies indicate that a variety of changes have taken place with employer-sponsored health insurance plans in the last 5 years, including a decrease in the percentage of small firms offering health benefits and an increase in the cost of the health benefit premiums for all employers. According to recent Current Population Survey data,¹ 81 percent of all individuals aged 18 to 64 years with health insurance in 2004 received coverage through employment-based insurance.

From 2000 through 2005, the percentage of all firms offering health benefits fell from 69 percent to 60 percent according to the Kaiser Family Foundation's annual survey in 2005 of employer benefits.² This decline is largely due to the decline in the percentage of small firms³ that offer health insurance because small firms represent the majority of all employers. However, nearly all larger firms (with 200 or more employees) offer employer-paid health benefits—98 percent in 2005 according to Kaiser's survey. This is consistent with government data from the 2003 Medical Expenditure Panel Survey⁴ (MEPS), which indicates that as establishment

¹ Carmen DeNavas Walt, Bernadette D. Proctor, and Cheryl Hill Lee, *Income, Poverty, and Health Insurance Coverage in the United States: 2004*, U.S. Census Bureau (Washington, D.C.: August 2005).

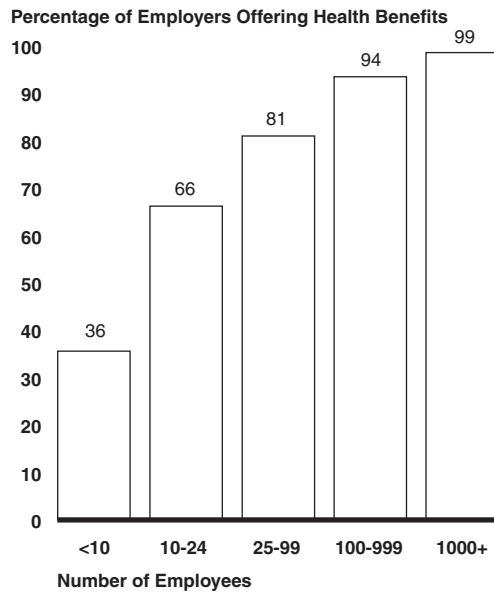
² The Kaiser Family Foundation and Health Research and Educational Trust, *Employer Health Benefits 2005 Summary of Findings* (Menlo Park, Calif.: 2005)

³ In Kaiser's survey, small firms had between 3 and 199 employees.

⁴ Agency for Healthcare Research and Quality (AHRQ), Department of Health and Human Services, conducts the Medical Expenditure Panel Survey (MEPS). According to AHRQ, the survey collects data on the specific health services that Americans use, how frequently they use them, the cost of these services, and how they are paid for, as well as data on the cost, scope, and breadth of private health insurance held by and available to the U.S. population.

size increases in terms of the number of employees, the percentage of employers offering health insurance increases. (See fig. 2.)

Figure 2: Percentage of Private-Sector Employers That Contributed Toward Health Insurance in 2003, by Number of Employees

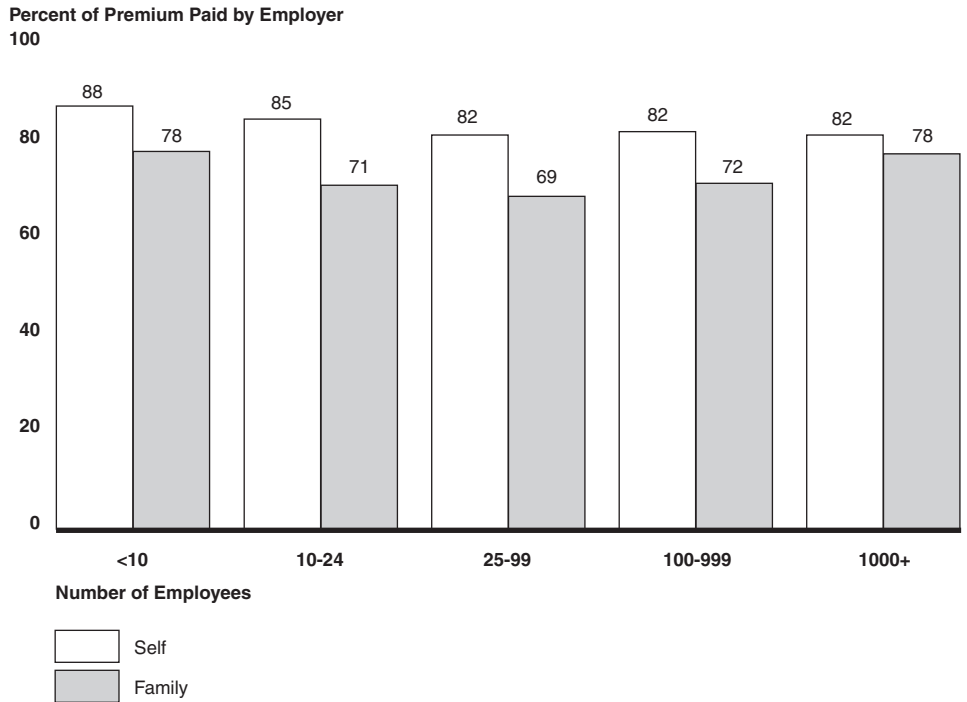


Source: GAO analysis of MEPS data for 2003.

According to Kaiser’s annual survey in 2005, the cost of health insurance premiums has increased dramatically from 1999 to 2005, rising by over 97 percent. Average annual premiums for employer-sponsored health insurance rose to \$4,024 for self-only and \$10,880 for self-and-family.⁵ Analysis of 2003 MEPS data indicates that private industry generally contributes at least as much towards employees’ health insurance plan premiums as the 72 percent average that the government contributes towards civilian employees’ health insurance premiums under FEHBP. According to MEPS, all size categories of private sector employers on average paid greater than 80 percent of the health benefit premiums for self -alone coverage and between 69 percent and 78 percent for self-and-family coverage. (See fig. 3.)

⁵ Employees on average contributed \$610 of the \$4,024 annual cost of self-only coverage and \$2,713 of the \$10,880 annual cost of the self-and-family coverage.

Figure 3: Private Employers Percentage Share Contributed Toward Employee Health Insurance Premiums in 2003, by Number of Employees



Source: GAO analysis of MEPS data from 2003.

Transitional Benefit Corporation Concept

Under the transitional benefit corporation concept, if an agency determines that one of its commercial activities could be performed by nongovernmental employees, the employees currently performing that activity would be given the opportunity to incorporate as a new, more efficient business organization outside of the federal agency to continue performing the same type of activity. This new employee-formed corporation could obtain business by contracting with the private sector or partnering with other governmental, private sector, educational, or not-for-profit entities.

The transitional benefit corporation concept includes a mechanism intended to minimize the immediate loss of federal health insurance and retirement benefits for those former government employees affected by the agency's decision to convert work to private sector performance. Specifically, under the concept, the former government employees could temporarily keep their participation in federal health insurance and

retirement benefit programs while transitioning from federal government to private sector employment status. Under this concept, during this transition, an agreement may be established allowing the government agency to continue to pay for the employee's federal retirement and health insurance benefits, with the new private corporation eventually paying for those benefits.

The concept has been suggested as an alternative to the government's conducting Circular A-76 competitions for commercial activities. According to one analysis of this topic,⁶ the benefits of a transitional benefit corporation include

- **Economic development and savings:** The government would realize savings more quickly than through the A-76 competition process. For example, the estimated time period to develop a transitional benefit corporation is 6 months, with savings realized shortly thereafter. The current A-76 process may be much longer and therefore would not provide savings as quickly. Also, savings to the government would also result from no longer needing to maintain underutilized assets and personnel.
- **Surge capability/readiness:** The government could contract with the transitional benefit corporation in order to expand its workforce rapidly and draw on the former employees during times of increased government workload. Because the transitional benefit corporation is a private organization, it would be able to hire staff outside the constraints of traditional government hiring, which can slow the hiring process.
- **"Soft landing" for former government employees:** Government employees who would become part of the transitional benefit corporation would be guaranteed their job and allowed to retain their government benefits, such as pension and health insurance, for a certain time period.

According to one analyst, for the transitional benefit corporation concept to be a viable alternative to A-76 and for the government to realize its potential benefits, three conditions must exist. First, displaced federal employees must have the appropriate skills to compete in private sector. Second, private sector competitors must be present within the same business area. Third, the agency proposing the creation of a transitional

⁶ Stephen M. Sorett, Brad P. Bender, and Lorraine T. Mullings, Public Contract Law Journal, *The Crossroads of the A-76 Costs Debate: Cost Comparisons and Some Attractive Alternatives*, (Washington, D.C: Fall 2001).

benefit corporation must have adequate knowledge about the current market conditions and whether or not workload would be sufficient for the new organization to be viable and maintain revenue.

DOD competitive sourcing officials told us that they do not consider the concept as a viable alternative to competing commercial activities under the A-76 competitive sourcing process. DOD officials commented that the A-76 process is more appropriate because it emphasizes a competitive process to select a service provider, while the transitional benefit corporation concept would use a sole-source approach that preserves specific jobs and benefits for affected employees. DOD officials also questioned the feasibility of allowing former employees to retain and accrue federal benefits when they are no longer employed by the government. An OMB competitive sourcing official told us that while OMB officials are aware of the concept, they have no current plans to conduct an analysis for governmentwide implementation.

Appendix II: Scope and Methodology

To determine how DOD has implemented the health benefit cost comparability provision and the impact the provision is having on its fiscal year 2005 competitive sourcing program, we interviewed competitive sourcing officials with overall responsibility in the Office of the Deputy Undersecretary of Defense (Installations and Environment). We also interviewed DOD component competitive sourcing program and contracting officials in the Army, Air Force, Navy, Marine Corps, Army Corps of Engineers, Defense Logistics Agency, Defense Contract Management Agency, and the Department of Defense Education Activity involved with fiscal year 2005 public-private competitions involving the health benefit comparability provision.

To determine the impact of the provision, we reviewed the 54 DOD public-private competitions that were in progress or completed (i.e., tentative or final sourcing decision announced) between October 1, 2004, and June 30, 2005. We identified and obtained data on these 54 competitions from DOD's automated system used to manage the program across the department—the Commercial Activities Management Information System (CAMIS). CAMIS contains certain data elements for individual A-76 cost comparisons, including numbers and length of individual competitions; numbers of positions to be affected; comparisons of agency and contractor estimated costs; and solicitation, sourcing decision, and contract award dates. We have previously reported some concerns about the accuracy and completeness of data contained in CAMIS.¹ A recent DOD Office of Inspector General report concluded that DOD has not effectively implemented its CAMIS system to track and assess the cost of the performance of functions under the competitive sourcing program.² To check the quality of the CAMIS data on the 54 competitions we identified that were in progress or completed between October 1, 2004, and June 30, 2005, we asked cognizant DOD and competitive sourcing officials in the components to verify the accuracy and completeness of the CAMIS data we used for each of the 54 competitions. Based on the results of our verification of the data with these cognizant officials, we believe that the data are sufficiently reliable for purposes of this report.

¹ GAO, *DOD Competitive Sourcing: Savings Are Occurring, but Actions Are Needed to Improve Accuracy of Savings Estimates*, [GAO/NSIAD-00-107](#) (Washington, D.C.: Aug. 8, 2000).

² DOD, Office of Inspector General, *Defense Infrastructure: DOD Reporting System for the Competitive Sourcing Program*, D-2006-028, Nov. 22, 2005.

We reviewed Circular A-76 policies and procedures regarding agency cost estimates for personnel and benefits in public-private cost comparisons. We also discussed DOD's implementation of the health benefit comparability provision with OMB officials responsible for governmentwide competitive sourcing policy and procedures under Circular A-76. We reviewed DOD's policies, procedures, and guidance and analyzed public-private competitive sourcing and other documents pertaining to the implementation of the health benefit comparability provision in DOD's fiscal year 2005 competitive sourcing program. We reviewed this material to document actions taken by DOD to implement the health benefit comparability provision in fiscal year 2005 public-private competitions and the impact the provision had in terms of administrative difficulty, competitive sourcing decision outcomes between agency or contractor performance, and any disincentives for private sector participation in DOD's competitive sourcing program.

We also obtained views and information about the implementation and impact of the health benefit comparability provision by interviewing representatives for six private offerors that submitted health benefits cost data for a public-private competition where DOD reached a sourcing decision between October 1, 2004, and June 30, 2005. We reviewed DOD competitive sourcing documents and interviewed contracting officials for another competition, but did not contact the offeror for an interview due to a pending appeal of the agency's tentative sourcing decision. For background purposes to gather information on the health benefit comparability provision, we also interviewed representatives of a federal labor union, government contractor associations, and researchers on government competitive sourcing.

To provide information on the availability of health benefits and employer contributions in the private sector, we reviewed recently published research from selected government and nongovernmental health benefits research organizations. To provide information on the transitional benefit corporation concept, we reviewed relevant literature. We interviewed one legal analyst who has published an article about governmentwide adoption of the transitional benefit corporation concept as an alternative to Circular A-76 public-private competitions. We also interviewed DOD and OMB competitive sourcing policy officials to obtain their views on the concept and prospects for implementation as an alternative to conducting A-76 public-private competitions for commercial activities.

We conducted our review from February 2005 through October 2005 in accordance with generally accepted government auditing standards.

Appendix III: Legislative Provision for Health Benefit Cost Comparability

The health benefit cost comparability provision is a requirement for DOD under Section 8014 of the Department of Defense Appropriations Act, 2005 (Public Law 108-287, enacted August 5, 2004). See italicized text below for the Section 8014 (a)(3) provision.

SEC. 8014. (a) LIMITATION ON CONVERSION TO CONTRACTOR PERFORMANCE.—None of the funds appropriated by this Act shall be available to convert to contractor performance an activity or function of the Department of Defense that, on or after the date of the enactment of this Act, is performed by more than 10 Department of Defense civilian employees unless—

(1) the conversion is based on the result of a public-private competition that includes a most efficient and cost effective organization plan developed by such activity or function;

(2) the Competitive Sourcing Official determines that, over all performance periods stated in the solicitation of offers for performance of the activity or function, the cost of performance of the activity or function by a contractor would be less costly to the Department of Defense by an amount that equals or exceeds the lesser of—

(A) 10 percent of the most efficient organization’s personnel- related costs for performance of that activity or function by Federal employees; or

(B) \$10,000,000; and

(3) the contractor does not receive an advantage for a proposal that would reduce costs for the Department of Defense by—

(A) not making an employer-sponsored health insurance plan available to the workers who are to be employed in the performance of that activity or function under the contract; or

(B) offering to such workers an employer-sponsored health benefits plan that requires the employer to contribute less towards the premium or subscription share than the amount that is paid by the Department of Defense for health benefits for civilian employees under chapter 89 of title 5, United States Code.

(b) EXCEPTIONS.— (1) The Department of Defense, without regard to subsection (a) of this section or subsections (a), (b), or (c) of section 2461 of title 10, United States Code, and notwithstanding any administrative

regulation, requirement, or policy to the contrary shall have full authority to enter into a contract for the performance of any commercial or industrial type function of the Department of Defense that—

(A) is included on the procurement list established pursuant to section 2 of the Javits-Wagner-O'Day Act (41 U.S.C. 47);

(B) is planned to be converted to performance by a qualified nonprofit agency for the blind or by a qualified nonprofit agency for other severely handicapped individuals in accordance with that Act; or

(C) is planned to be converted to performance by a qualified firm under at least 51 percent ownership by an Indian tribe, as defined in section 4(e) of the Indian Self-Determination and Education Assistance Act (25 U.S.C. 450b(e)), or a Native Hawaiian Organization, as defined in section 8(a)(15) of the Small Business Act (15 U.S.C. 637(a)(15)).

(2) This section shall not apply to depot contracts or contracts for depot maintenance as provided in sections 2469 and 2474 of title 10, United States Code.

(c) TREATMENT OF CONVERSION.—The conversion of any activity or function of the Department of Defense under the authority provided by this section shall be credited toward any competitive or outsourcing goal, target, or measurement that may be established by statute, regulation, or policy and is deemed to be awarded under the authority of, and in compliance with, subsection (h) of section 2304 of title 10, United States Code, for the competition or outsourcing of commercial activities.

Appendix IV: Fiscal Year 2005 Competitions in Which Health Benefit Costs Were Not a Factor

This appendix presents information on the 42 competitions in which the health benefit cost comparability provision was not a factor in sourcing decisions between October 1, 2004 and June 30, 2005, for various reasons. In one competition decided in October 2004, the health benefit comparability provision was not a factor (and is not included in the tables below). In this case, the Navy decided to retain the Naval Education and Training Command support services (involving 276 FTEs) within the agency because no cost proposals were submitted by private offerors in response to the Navy's solicitation.

Table 5 presents information on the 14 competitions that were in progress as of June 30, 2005. In these competitions, DOD had yet to make a sourcing decision, and thus DOD contracting officers had not yet needed to implement the health benefit cost comparability provision. Table 6 presents information on 14 streamlined competitions that—as a result of market research completed through June 30, 2005—contracting officers determined that the agency cost estimate was the lowest. Thus, in these decisions, DOD contracting officers did not need to request health benefit data because no private offerors were being considered for the work. Finally, table 7 presents information on 13 competitions involving 10 or fewer FTEs. In these cases, contracting officers did not need to implement the health benefit cost comparability provision, since the requirement applies only to competitions involving more than 10 FTEs.

**Appendix IV: Fiscal Year 2005 Competitions
in Which Health Benefit Costs Were Not a
Factor**

Table 5: Competitions In Progress as of June 30, 2005 Where Health Benefit Cost Comparability Had Yet to Be Considered, and Competitive Sourcing Decision Was Pending

Competition and location	FTEs competed
Air Force competitions	
Multi-Support Functions, Keesler Air Force Base, Miss.	291
Multi-Support Functions, Keesler Air Force Base, Miss.	19
Army and Corps of Engineers competitions	
Information Management, Army Corps of Engineers, all locations agencywide	1,460
Base Support Services, Walter Reed Army Medical Center, Washington D.C.	161
Base Support Services, Walter Reed Army Medical Center, Washington D.C.	534
Public Works, Army Corps of Engineers, Vicksburg, Miss. and Hanover, N.H.	55
Finance Center, Army Corps of Engineers, Millington, Tenn.	80
Navy competition	
Satellite Operations, Norfolk, Va.	54
Defense Logistics Agency competitions	
Distribution Operations, Defense Distribution Depot, Oklahoma City, Okla.	576
Installation Services, Defense Depot, Tracy, Calif.	67
Installation Services, Defense Depot, New Cumberland, Pa.	136
Distribution Operations, Defense Supply Center, Richmond, Va.	115
Department of Defense Education Activity competitions	
Logistics, Fort Knox, Ky.	48
Logistics, Fort Benning, GA and Robins Air Force Base, Ga.	43

Source: GAO analysis of DOD data.

**Appendix IV: Fiscal Year 2005 Competitions
in Which Health Benefit Costs Were Not a
Factor**

Table 6: Streamlined Competitions Where DOD’s Market Research Determined the Agency Was the Lowest-Cost Source and Health Benefit Cost Comparability Was Not a Factor

Competition and location	FTEs competed
Defense Contract Management Agency streamlined competitions	
Information Technology Support Services, Boston, Mass.	17
Information Technology Field Support Services, Philadelphia, Pa.	19
Information Technology Field Support Services, Warren, Mich.	16
Information Technology Field Support Services, Denver, Colo.	14
Information Technology Field Support Services, Boston, Mass.	19
Information Technology Field Support Services, Hazelwood, Mo.	14
Information Technology Field Support Services, Picatinny, N.J.	13
Information Technology Field Support Services, Carson, Calif.	23
Information Technology Field Support Services, Orlando, Fla.	21
Information Technology Field Support Services, Dallas, Tex.	20
Department of Defense Education Activity streamlined competitions	
Minor Construction, Maintenance and Repair of Buildings and Structures other than Family Housing, Quantico, Va.	17
Custodial Services, Minor Construction, Maintenance and Repair of Buildings and Structures Other Than Family Housing, Fort Stewart, Ga.	26
Custodial Services, Maintenance, Repair and Minor Construction of Other Real Property, Fort Rucker, Ala., and Maxwell Air Force Base, Ala.	12
Building Management, Retail Supply Operations, Pacific Region	13

Source: GAO analysis of DOD data.

**Appendix IV: Fiscal Year 2005 Competitions
in Which Health Benefit Costs Were Not a
Factor**

Table 7: Competitions Involving 10 or Fewer FTEs and Health Benefit Cost Comparability Was Not Applicable

Competition and location	FTEs involved
Defense Contract Management Agency competitions	
Computing Services and/or Data Base Management, Columbus, Ohio	6
Information Technology Support Services, Carson, Calif.	10
Department of Defense Education Activity competitions	
Grounds Maintenance, Fort Benning, Ga.	5
Custodial Services, West Point, N.Y.	7
Grounds Maintenance, Fort Knox, Ky.	5
Grounds Maintenance, Quantico, Va.	5
Air Force competition	
Information Systems, Randolph Air Force Base, Tex.	3
Army competitions	
Specialized Skill Training, Fort Monroe, Va.	0 ^a
Combat Development Evaluations and Experimentation, Army Training and Doctrine Command, Fort Monroe, Va.	0 ^a
Military Training, Fort Monroe, Va.	0 ^a
Military Training, Fort Monroe, Va.	0 ^a
Military Training, Fort Monroe, Va.	0 ^a
Marine Corps competition	
Manpower Administration, Camp Lejeune, N.C.	8 ^b

Source: GAO analysis of DOD data.

^aAt the time of Army's A-76 competition processes for this commercial activity, the work was being performed by contract employees and no federal employees' positions were being competed.

^bThe Marine Corps contracting officer did collect health benefit cost data from a private offeror involved in this competition. However, we included this competition in this category in which health benefit costs do not need to be considered (because Section 8014's health benefit cost comparability provision is not applicable to competitions involving 10 or fewer FTEs).

Appendix V: Comments from the Department of Defense



ACQUISITION,
TECHNOLOGY
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE
3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

December 2, 2005

Mr. William T. Woods
Director, Acquisition and Sourcing Management
Government Accountability Office
Washington, DC 20548

Dear Mr. Woods:

This letter is the Department of Defense (DoD) response to the GAO draft report, "COMPETITIVE SOURCING: Health Benefit Cost Comparison Had Minimal Impact, But DOD Needs Uniform Implementation Process," dated November 10, 2005, (GAO Code 120399/GAO-06-72). The report evaluates the health benefit cost comparability provision in section 8014 of the Department of Defense Appropriations Act, 2005. Section 8014 prohibits the Department from giving an advantage in public-private competitions to a private sector source that either does not offer employee health benefits or pays less towards health benefits than the government pays for Federal civilian employees. Our concurrence with the report's recommendation is enclosed and general comments follow.

While the draft report finds that DoD's initial implementation of section 8014 has not been unduly burdensome, we believe it is premature to conclude that it will not present future problems. The report's findings are based on a very limited data set of twelve cost comparisons that were performed under the provisions of the previous OMB Circular A-76, not the current Circular. DoD's limited experience with this new legislative requirement, as well as the new public-private competition process of the revised Circular, make it difficult to predict the full impact of the legislation at this time.

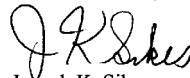
We also remain concerned that section 8014 may harm small business participation in the Department's Competitive Sourcing Program. Although the report evaluated competitions involving small businesses that were in-progress when section 8014 became effective, there is no reliable way of determining how many small businesses may have been discouraged from participating in these competitions as a result of this new statutory requirement.

Moreover, the report offers no evidence that section 8014 promotes healthcare for a contractor's employees. We will continue to support either elimination of section 8014 or, at a minimum, amendment of the provision to acknowledge the variety of tools the private sector uses to provide health care to their employees.



**Appendix V: Comments from the Department
of Defense**

The DoD primary action officer for this report is Mrs. Annie L. Andrews, 703-602-2608
or email annie.andrews@osd.mil.



Joseph K. Sikes
Director, Housing and Competitive Sourcing

Enclosure:
As stated

GAO DRAFT REPORT - DATED NOVEMBER 10, 2005
GAO CODE 120399/GAO-06-72

**“COMPETITIVE SOURCING: HEALTH BENEFIT COST COMPARISON HAD
MINIMAL IMPACT, BUT DOD NEEDS UNIFORM IMPLEMENTATION PROCESS”**

**DEPARTMENT OF DEFENSE COMMENTS
TO THE RECOMMENDATIONS**

RECOMMENDATION 1: The GAO recommended that if the health benefit cost provision is extended, the Secretary of Defense direct the Deputy Under Secretary of Defense (Installations and Environment) to require use of a uniform and consistent process for the DoD Components in evaluating the health benefit costs of private sector offerors in public-private competitions. (p. 19/GAO Draft Report)

DOD RESPONSE: Concur.

Appendix VI: Comments from the Office of Management and Budget



DEPUTY DIRECTOR
FOR MANAGEMENT

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

December 1, 2005

Mr. William T. Woods
Director
Acquisition and Sourcing Management
Government Accountability Office
Washington, DC 20548

Dear Mr. Woods:

This responds to your November 10, 2005 request for comment from the Office of Management and Budget (OMB) on your draft report "COMPETITIVE SOURCING: Health Benefit Cost Comparison Had Minimal Impact, But DOD Needs Uniform Implementation Process." The report evaluates the health benefit cost comparability provision in section 8014 of the FY 2005 Department of Defense (DOD) Appropriations Act.

Section 8014 prohibits DOD from giving an advantage in public-private competitions to a private sector source that either does not offer employee health benefits or pays less towards health benefits than DOD pays for its civilian employees. Your report states that most DOD components are taking steps to ensure that private sector proposals include an amount for employee health benefits at least equal to the amount that Circular A-76 adds to public sector proposals to account for employee health benefits (i.e., 5.5 percent of direct labor costs).

Members of Congress and the Administration, as well as industry and small business representatives, have raised strong concerns regarding section 8014. These concerns include the potential harm to small businesses' ability to compete for government contracts and increased costs to taxpayers through the elimination of incentives for contractors to provide cost-effective health benefits. (See, for example, the Administration's Statement of Administration Policy, dated September 30, 2005, on the Department of Defense Appropriations Bill, FY 2006, H.R. 2863, available at www.whitehouse.gov/omb/legislative/sap). The GAO draft report finds that DOD's initial implementation of section 8014 has had minimal effect on the Department's competitions and has not been unduly burdensome. These findings notwithstanding, OMB believes there remains cause for concern about the long-term effects of section 8014.

In particular, the report's findings are based on very limited data. DOD's limited experience with this new requirement makes it difficult to accurately predict the full impact this provision will have on private sector participation in the Department's future competitions. We remain especially troubled that section 8014, in its current form, will harm small businesses, the innovative engine of our economy. Although the report looked at several competitions involving small businesses that were in-progress when section 8014 became effective, we do not know how many small businesses may be discouraged from participating in

2

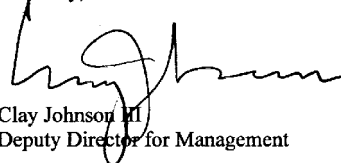
future competitions as a result of this new requirement. As acknowledged in Appendix I of the report, the number of small firms offering health benefits has decreased. This trend suggests that small businesses may have difficulty competing for federal contracts, especially if the A-76 health care factor that DOD uses to benchmark what contractors must pay in health care costs is adjusted upward in the future. At a minimum, as stated in our November 14, 2005 letter to the Defense conferees on the FY 2006 Department of Defense Appropriations bills, section 8014 should be modified to allow consideration of more efficient health care tools, such as health savings and medical savings accounts, that small businesses are more likely to be able to offer to their employees.

Moreover, based on our review, the report appears to offer no evidence that section 8014 is beneficial. Imposing a requirement for the ostensible purpose of ensuring health care for workers that then fails to recognize the various ways contractors can effectively provide this benefit to their employees moves us further from, not closer to, a more effective and efficient government.

For these reasons, OMB will continue to urge Congress either to eliminate section 8014 or, at a minimum, to amend the provision to acknowledge the variety of tools contractors use to make health care accessible to their employees. We will also work to ensure that a provision identical to the current section 8014 is not extended to civilian agencies. In the meantime, we hope your report will emphasize that its findings are based on very limited data.

I appreciate the opportunity to comment on the draft report.

Sincerely,



Clay Johnson
Deputy Director for Management

GAO's Mission

The Government Accountability Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to www.gao.gov and select "Subscribe to Updates."

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are \$2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office
441 G Street NW, Room LM
Washington, D.C. 20548

To order by Phone: Voice: (202) 512-6000
TDD: (202) 512-2537
Fax: (202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm

E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Gloria Jarmon, Managing Director, JarmonG@gao.gov (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, D.C. 20548

Public Affairs

Paul Anderson, Managing Director, AndersonP1@gao.gov (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, D.C. 20548