

STATEMENT OF  
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BEFORE THE  
SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT,  
THE FEDERAL WORKFORCE, AND THE DISTRICT OF COLUMBIA  
COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS  
UNITED STATES SENATE

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Chairman Akaka, Ranking Member Johnson, and members of the Subcommittee, I appreciate the opportunity to appear before you again to discuss rebalancing the mix of work performed by Federal employees and contractors. When I last discussed this subject with you in May 2010, the Office of Federal Procurement Policy (OFPP) had just begun a formal process for reviewing and improving, with the public's input, the policies for determining when functions must be carried out by Federal employees and when they may be performed by either Federal employees or contractors. Earlier this month, OFPP completed this process with the finalization of Policy Letter 11-01, *Performance of Inherently Governmental and Critical Functions*, following careful deliberation of public comments and modest refinements to the contents and structure of the guidance. Issuance of the policy letter marks an important step forward in improving how we leverage the capabilities and capacity of government employees – the lifeblood of our Government – and the contractors who bring added expertise and innovation to support our employees in carrying out agency missions.

As stewards of taxpayer funds, we are entrusted with delivering the most effective and efficient government performance possible, and to do so we must understand the proper role for federal employees and for contractors. Unfortunately, many of the rules for drawing the line between work that may be contracted out and work that must be reserved for Federal employees were written nearly two decades ago and do not fully reflect the present-day challenges of managing the Government. As the President said in his March 2009 Memorandum on Government contracting, this line has become blurred. Both the President and Congress directed OMB to improve these rules. Policy Letter 11-01 answers this call by providing strengthened guidance to help agencies draw on each sector's skills in the most appropriate and effective manner possible in meeting the needs of our taxpayers.

Your letter of invitation expresses a particular interest in understanding how these policies may help the Intelligence Community in rebalancing the relationship between government employees and contractors. As the Administrator for Federal Procurement Policy, my initiatives generally focus on issues that address the needs of the Federal procurement community at large. For this reason, my office did not concentrate specifically on the Intelligence Community in developing the policy letter and my comments today will address the broader application of these policies. That said, the general principles in the final policy letter

should serve all agencies well, including those within the Intelligence Community, as they work to strike the right balance in their use of Federal employees and contractors. My understanding is that the Intelligence Community is taking full advantage of current guidance addressing the relationship between government employees and contractors, including that in OMB Memorandum M-09-26, which explains that rebalancing actions must be based on a reasoned analysis, taking into account each agency's mission and priorities, and associated human capital needs. I further understand that the Intelligence Community is carefully reviewing how to best employ new concepts in Policy Letter 11-01, such as that of a "critical function" (discussed in greater detail below), to support its ongoing efforts to achieve a healthy balance in its government employee to contractor mix.

Today, I would like to highlight for the Committee four significant features of Policy Letter 11-01 that we anticipate will help the Intelligence Community and the rest of the Executive Branch in its efforts to strike a balance that best protects the public's interest and serves the American people in a cost-effective manner.

1. Establishing a single definition for the term "inherently governmental function."

Over time, confusion has arisen over the definition of "inherently governmental function" because the authoritative sources for guidance on this issue – including the Federal Acquisition Regulation (FAR) and OMB Circular A-76 – contain overlapping but potentially inconsistent language for determining whether or not a function is inherently governmental. To help eliminate this confusion, the policy letter establishes a single definition for this term, essentially directing agencies to adhere to the single existing statutory definition as set out in the Federal Activities Inventory Reform (FAIR) Act. That definition states that a function is inherently governmental if it is "so intimately related to the public interest as to require performance by Federal Government employees," and the Act includes further clarifying language.

In addition, the policy letter lays out criteria for agencies to use in applying the definition and deciding if a function that is not called out in the definition is, nonetheless, inherently governmental. The policy letter also provides a list of examples of inherently governmental functions. Many of the examples are taken from current regulatory guidance – such as the hiring of Federal employees, the awarding of Federal contracts, and the direction and control of intelligence and counter-intelligence operations. Additionally, in response to public and agency comment, the final policy letter updates the list to clarify the inherently governmental status of several functions where there has been particular confusion over the role of contractors.

One such area of confusion regards the use of contractors to perform security operations connected with combat or potential combat. The policy letter makes clear that contractors may take action in self-defense or defense of others against the imminent threat of death or serious injury, but cannot take part in security operations: (i) performed in direct support of combat as part of a larger integrated armed force, (ii) where there is significant potential for the operation to evolve into combat, or (iii) where security entails augmenting or reinforcing others (whether private security contractors, civilians, or military units) that have become engaged in combat.

Another area of confusion involves certain Federal contracting activities. Here, the list makes clear that the determination of price reasonableness – which is a prerequisite to awarding

a contract – is an inherently governmental function. This includes approval of any evaluation relied upon to support a price reasonableness determination. That said, an agency is not precluded from using the services of a contractor to provide input for government cost estimates. It is important, however, that whatever the government relies on to determine price reasonableness is reviewed and approved by a government employee who is not simply “rubber stamping” the recommendation because he or she is completely dependent on the contractor’s superior knowledge and unable to independently evaluate the merits of the contractor’s work or to consider alternatives.

2. Clarifying when work should be considered “closely associated with inherently governmental functions.” It has long been recognized that the practice of identifying functions that are closely associated with inherently governmental functions serves an important management purpose in helping agencies guard against losing control of inherently governmental functions. The attention given to these functions across agencies, however, has not been consistent. The policy letter strengthens guidance in this area by: (i) identifying a list of examples of closely associated functions, such as support for policy development, budget preparation, or acquisition activities (again taken from existing guidance, but clarified based on public and agency comment); and (ii) reminding agencies of their statutory responsibility to give special consideration to Federal employee performance of these functions.

The policy letter also provides a comprehensive checklist of special management responsibilities that agencies must address when contractors perform work that is closely associated with inherently governmental functions in order to minimize the risk of “mission creep.” These responsibilities include: (i) assigning a sufficient number of qualified government employees, with expertise to administer or perform the work, to give appropriate management attention to the contractor’s activities, and (ii) taking appropriate steps to avoid or mitigate conflicts of interest, such as by conducting pre-award conflict of interest reviews that will help to ensure contract performance is in accordance with objective standards and contract specifications, and developing a conflict of interest mitigation plan, if needed, that identifies the conflict and specific actions that will be taken to lessen the potential for conflicts of interest or reduce the risk involved with a potential conflict of interest.

3. Ensuring that agencies have the internal capacity to perform their critical functions.

In the FY 2009 National Defense Authorization Act, Congress identified a new category of “critical functions,” which are functions that, while not inherently governmental, are needed for an agency to effectively perform its mission and maintain control of its operations. The introduction of this new category fills a void in current policy and provides an important concept to help agencies ensure they are not overly dependent on contractors in performing functions that are core to an agency’s mission.

Unlike inherently governmental functions, which can only be performed by Federal employees, critical functions often can be performed by both Federal employees and contractors. However, there always must be a sufficient number of Federal employees performing, or managing, the function so that the agency can maintain control of its mission and operations. This determination will vary from agency to agency. For this reason, the policy letter requires Federal officials to evaluate, on an agency-by-agency basis, whether they have sufficient internal

capability, taking into account factors such as the agency's mission, the complexity of the function, the need for specialized staff, the current size and capability of the agency's acquisition workforce, and the potential impact on mission performance if contractors were to default on their obligations. At the same time, the policy letter makes clear that, so long as agencies have the internal capacity needed to maintain control over their operations, they are permitted to contract out positions within critical functions.

4. Ensuring management accountability. Some of the confusion that has arisen in connection with deciding when work must be performed by Federal employees and when it may be performed by contractors has been caused by limited guidance addressing responsibilities for the implementation and oversight of policies governing this determination. Policy Letter 11-01 addresses these management weaknesses in several ways.

First, the policy letter reinforces the 2009 guidance in OMB Memorandum M-09-26, making clear that striking the right balance of work performed by Federal employees and contractors is a shared responsibility between human capital, acquisition, program, and financial management offices. For example, human capital and program offices must work together to ensure that a sufficient amount of work is dedicated to performance by Federal employees to build competencies, provide for continuity of operations, and retain institutional knowledge of operations. Acquisition offices must also be engaged to help ensure there are sufficient personnel with appropriate training, experience, and expertise to manage the contractor's performance and evaluate and approve or disapprove the contractor's work products and services, recruiting and retaining the necessary Federal talent where it is lacking.

Second, the policy letter spells out a number of management responsibilities that must be taken to ensure that appropriate attention is given to the nature of functions both before and after a contract is awarded. For example, as part of acquisition planning, the agency must confirm that the services to be procured do not include work that must be reserved for performance by Federal employees and document the contract file if the procurement of services is above the simplified acquisition threshold (currently \$150,000). After award, agencies must review, on an ongoing basis, the functions being performed by their contractors. In particular, agencies must pay attention to the way in which contractors are performing work and how agency personnel are managing the contractors performing work closely associated with inherently governmental or critical functions. Agencies will be expected to support this post-award responsibility through the annual development of service contractor inventories, as required by law. A contractor inventory can give an agency greater insight into how contract resources are distributed. This insight can then help an agency determine if its practices are creating an over-reliance that requires increased contract management or rebalancing to ensure the government is effectively managing risks and getting the best results for the taxpayer.

It should be noted that the Intelligence Community has been a role model for its use of service contract inventories as a management tool to assist its understanding of how services are being used to support mission and operations and whether its contractors' skills are being used in an appropriate manner. The Intelligence Community is using these inventories to help identify where there may be areas of over-reliance on contractors and, if so, how such overreliance is best addressed.

Third, Policy Letter 11-01 addresses management responsibilities in connection with small business contracting and insourcing. Concern has been expressed, including during the public comment process, that small businesses are bearing the brunt of agency insourcing actions. To help address these concerns, the policy letter reiterates OMB guidance, including that in M-09-26, making clear that insourcing is a management tool, not a goal, and should only be used in a targeted and reasoned way. Equally important, the policy letter instructs agencies to place a lower priority on reviewing work performed by small businesses where the work is not inherently governmental and where continued contractor performance does not put the agency at risk of losing control of its mission or operations, especially if the agency has not recently met, or currently is having difficulty meeting, its small business goals. Agencies are encouraged to involve their small business advocates if considering the insourcing of work currently being performed by small businesses. If an agency makes a management decision to insource work that is currently being performed by both small and large businesses, the policy letter calls on agencies to apply the “rule of two” to the work that will continue to be performed by contractors (the rule of two calls for a contract to be set aside for small businesses when at least two small businesses can do the work for a fair market price).

Fourth, Policy Letter 11-01 requires agencies to develop agency-level procedures, provide training, and designate senior officials to be responsible for implementation of these policies. With respect to training, in particular, OFPP will work with the Federal Acquisition Institute and the Defense Acquisition University on appropriate instructional materials for the acquisition workforce and other affected stakeholders. One of many important training points will be to remind agencies that functions often include multiple activities, or tasks, some of which may be inherently governmental, some of which may be closely associated with inherently governmental work, and some may be neither. For instance, within the acquisition function of source selection, the tasks of determining price reasonableness and awarding a contract are inherently governmental, the task of preparing a technical evaluation and price negotiation memorandum are closely associated, and the task of ensuring the documents are in the contract file is neither inherently governmental nor closely associated. By identifying work at the activity level, an agency can more easily differentiate tasks within a function that may be performed only by Federal employees from those tasks that can be performed by either Federal employees or contractors without blurring the line between the role of Federal employees and contractors.

As I said when I appeared before you in 2010, the policy letter should not lead to a widespread shift away from contractors. I continue to hold this belief today for a number of reasons. Most agencies have been informally following many of the overarching principles of the policy letter for more than a year and there has not been a significant shift to date. In addition, as explained earlier, agencies may, with proper management and oversight tools, rely on contractors to perform functions closely associated with inherently governmental functions. They may also permit contractors to perform critical functions that are core to the agency as long as the agency has the in-house capability to maintain control of its mission and operations. Moreover, in many cases, overreliance on contractors may be corrected by allocating additional resources to contract management. In other words, rebalancing does not require an agency to insource. That said, we expect every agency to give appropriate attention to identifying if and when rebalancing is needed and to take action, when necessary, to fix imbalances created either

by improper reliance on contractors, such as where the outsourced work is inherently governmental, or overreliance on contractors, such as where the agency is at risk of losing control of its mission and operations.

Over the coming weeks and months, OFPP will be working closely with the Federal Acquisition Regulatory Council to develop appropriate changes to the FAR to implement Policy Letter 11-01. We are optimistic that the final policy letter will lead to meaningful and lasting improvements in the way we use the talents of our Federal employees and contractors to serve the American people. I look forward to working with the Committee, other members of Congress, and our other stakeholders as we move forward together on this important effort.

This concludes my prepared remarks. I am happy to answer any questions you have.