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CONTRACT MANAGEMENT

Taking a Strategic Approach to Improving Service Acquisitions

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Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to participate in today's hearing on H.R. 3832, the Services Acquisition Reform Act of 2002 (SARA). The bill's proposals focus on strengthening the acquisition workforce, moving toward a performance-based contracting environment, and improving the management of service acquisitions. As we testified[1] before you last November, our work shows that all these areas need attention, particularly in light of the government's increasing dependence on services.

Today, I would like to discuss our recent findings on how leading companies tackled the same kinds of problems the bill is seeking to remedy. The practices that these companies followed clearly paid off in terms of dollar savings and service enhancements. We believe that the federal government has an opportunity to achieve similar outcomes with support and commitment from the Congress. I would also like to discuss our ongoing work related to specific proposals in the bill as well as concerns we have about other sections of the bill.

Best Practices for Service Acquisitions

A main goal of the bill is improving the management of service acquisitions. There is good reason for this. Over the past decade, federal agencies have substantially increased their purchases of services, particularly for information technology and professional, administrative, and management support. In fiscal year 2001 alone, the federal government acquired about $109 billion[2] in services. This money, however, is not always well-spent. Our work, as well as the work of other oversight agencies, continues to find that millions of service contract dollars are at risk at defense and civilian agencies because acquisitions are poorly planned, not adequately competed, or poorly managed.[3]

In view of these problems, we examined how leading companies changed their approach to acquiring services. The companies we studied found themselves in a situation several years ago similar to the one that federal agencies are in today. They were spending a substantial amount of money

[1]U.S. General Accounting Office, *Contract Management: Improving Service Acquisitions*, GAO-02-179T (Washington, D.C.: Nov. 1, 2001).

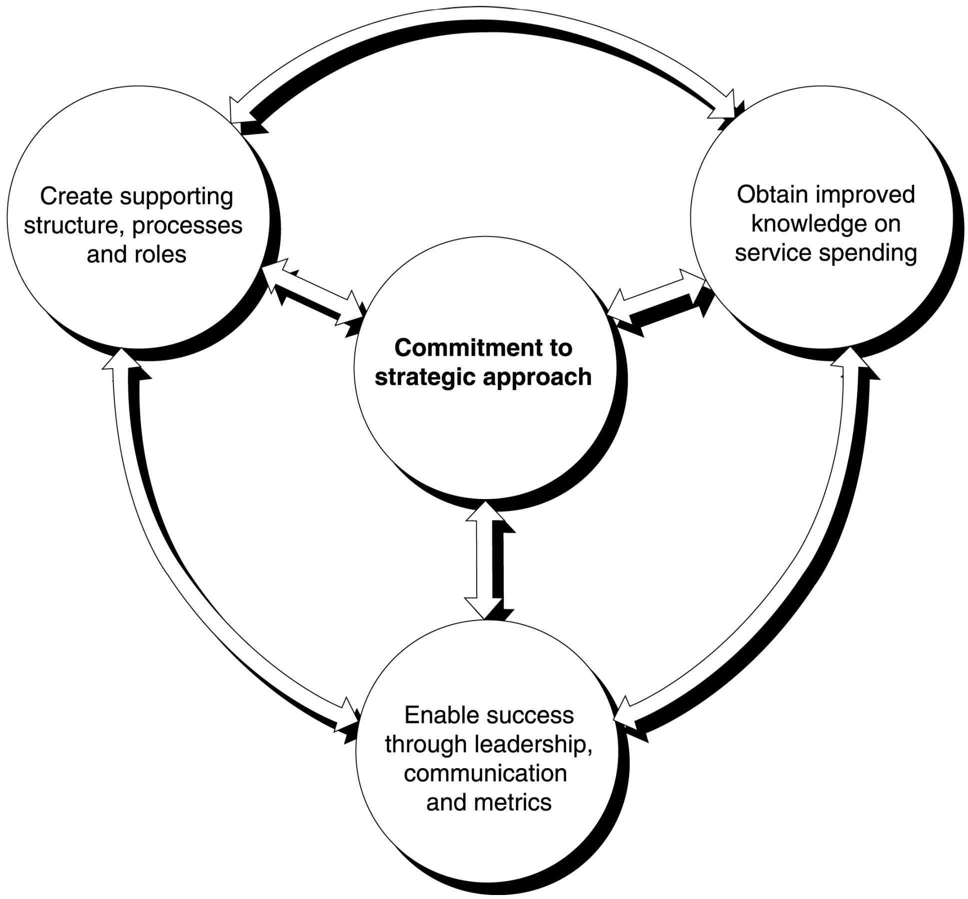
[2] Excludes Research and Development. Data developed for actions exceeding $25,000.

[3]U.S. General Accounting Office, *Contract Management: Trends and Challenges in Acquiring Services*, GAO-01-753T (Washington, D.C.: May 22, 2001).

on services—ranging from routine maintenance, to advertising, to information management—but did not have a good grasp of how much was being spent and where these dollars were going. Moreover, they were not effectively coordinating purchases, and they lacked tools to make sure that they were getting the best overall value.

The companies we studied were able to turn this situation around by adopting a more strategic perspective to service spending; that is, each company focused more on what was good for the company as a whole rather than just individual business units, and each began making decisions based on enhanced knowledge about service spending. The specific activities they undertook ranged from developing a better picture of what they were spending on services, to taking an enterprisewide approach to acquiring services, to developing new ways of doing business. Figure 1 highlights key elements of the strategic approach.

Figure 1: Key Elements of Strategic Approach Taken by Leading Companies



Source: GAO analysis.

Specifically, the companies we visited analyzed their spending on services to answer basic questions about how much was being spent and where the dollars were going. In doing so, they realized that they were buying similar services from numerous providers, often at greatly varying prices. The companies used this data to rationalize their supplier base, or in other words, to determine the right number of suppliers that met their needs. Hasbro's spend analysis, for example, revealed that it had 17 providers of temporary administrative, clerical, and light industrial personnel for 7 locations. The company also found that it had inconsistent policies and processes, multiple contact points, and limited performance measures. Information was not being shared across locations.

The companies we studied changed how they acquired services in significant ways. Each elevated or expanded the role of the company's procurement organization; designated "commodity" managers to oversee key services; and/or made extensive use of cross-functional teams to help identify their service needs, conduct market research, evaluate and select providers, and manage performance. These changes transformed the role of purchasing units from one focused on mission support to one that was strategically important to the company's bottom line. For example, Dun & Bradstreet officials told us that, with the support of senior corporate management, their procurement function now exercises far more control and responsibility over their services and that it acts more in an advisory capacity to business units rather than just being relied on for negotiating expertise.

Bringing about these new ways of doing business was challenging. For example, some companies spent months piecing together data from various financial management information systems and examining individual purchase orders just to get a rough idea of what they were spending on services. Other companies found that establishing new procurement processes met with resistance from individual business units reluctant to share decision-making responsibility and involved staff that traditionally did not communicate with each other.

To overcome these particular challenges, the companies found they needed to have sustained commitment from their senior leadership—first, to provide the initial impetus to change and second, to keep up the momentum. Since service acquisitions were largely viewed as a mission support activity and peripheral to the bottom line, such commitment needed to be intense and accompanied by clear communication on the rationale, goals, and expected results from the reengineering efforts.

Moreover, to help sustain management attention, the companies implemented performance measures to help them gauge whether reengineering efforts were really working. For example, ExxonMobil employed an extensive system to measure performance of its procurement function, which included metrics on the procurement organization's progress in meeting financial, customer satisfaction, and business operation objectives; compliance with best practices; and more detailed metrics to assess the performance of local purchasing units.

Why should these particular practices matter in looking how to reform service acquisition in the federal government? Taking a strategic approach clearly paid off. Companies were able to negotiate lower rates and better match their business managers' needs with potential providers of services. One official estimated that his company saved more than $210 million over the past 5 years pursuing more strategic avenues to purchasing information technology services, while another estimates his company typically achieved savings of 15 percent or more on efforts that were undertaken using the new processes.

Best Practices and the Services Acquisition Reform Act

The SARA bill touches on some aspects important to the approach followed by the leading companies. First, the proposed bill also encourages greater use of performance-based contracting. Performance-based service contracting is a process where the contracting agency specifies the outcome or result it desires and leaves it to the vendor to decide how best to achieve the desired outcome. Historically, the government has not widely used this strategy, but it is beginning to move in that direction in an effort to attract leading commercial companies to doing business with the government, gain greater access to technological innovations, and better ensure contractor performance.

Second, the bill would create a chief acquisition officer within each agency. We support the concept of a chief acquisition officer. Our discussions with a number of officials from private sector companies about how they buy services indicate that a procurement executive or a chief acquisition officer plays a critical role in changing an organization's culture and practices. The bill, however, differs from the approach taken by leading companies in terms of the scope and the decision-making authority of this position. Specifically, at the leading companies, these officials were corporate executives who had authority to influence decisions on acquisitions; implement needed structural, process, or role changes; and provide the necessary clout to obtain initial buy-in and acceptance of reengineering efforts. Under SARA, it is not clear that the chief acquisition officer would have comparable responsibility and authority.

Additional Ongoing Work Related to the Proposed Services Acquisition Reform Act

In addition to our work on best service acquisition practices, we are performing a number of evaluations related to specific proposals in the Services Acquisition Reform Act, including those on (1) acquisition workforce, (2) performance-based contracting, and (3) share-in-savings contracting. I would like to highlight what this work entails and how it can be of use to the subcommittee as it moves forward on the bill.

Acquisition Workforce

The proposed bill contains several provisions to address the challenges being faced in the acquisition workforce. Procurement reforms and technological changes have placed unprecedented demands on the acquisition workforce. Contracting personnel are now expected to have a much greater knowledge of market conditions, industry trends, and technical details of the commodities and services they procure.

We believe it is essential for agencies to define the future capabilities needed by the workforce and to contrast these needs with where the workforce is today. Doing so will provide a solid basis for evaluating whether different management tools are needed to meet the needs of the future workforce. Specifically, agencies could improve the capacity of the acquisition workforce by focusing on four key areas:

- **Requirements**—assessing the knowledge and skills needed to effectively perform operations to support agency mission and goals.
- **Inventory**—determining the knowledge and skills of current staff so that gaps in needed capabilities can be identified.
- **Workforce strategies and plans**—developing strategies and implementing plans for hiring, training, and professional development to fill the gap between requirements and current staffing.
- **Progress evaluation**—evaluating progress made in improving human capital capability and using the results of these evaluations to continuously improve the organization's human capital strategies.

In our current work for this and other committees, we are examining efforts to assess and address the needs of the future acquisition workforce. Specifically, we are looking at (1) the adequacy of agency training requirements for the acquisition workforce and agency practices for determining the level of funding needed for training, (2) selected federal agencies' strategic planning efforts to manage and improve the capacity of the acquisition workforce, and (3) strategies being used to ensure that the acquisition workforce is prepared to meet the new challenges for acquiring services.

Performance-Based Contracting

As noted earlier, the proposed bill is promoting greater use of performance-based contracting. The work we are conducting now for this subcommittee should be particularly useful in determining the extent to which performance-based contracting is taking hold and whether there are governmentwide mechanisms that can be used to encourage greater use of it.

Our work to date shows that for fiscal year 2001, about 23 percent of eligible service contracts were reported to be performance-based. This number is in line with a 20-percent goal set by the Office of Management and Budget. However, our work shows that there are inconsistencies in the interpretation of the definition of a performance-based contract. Moreover, demonstrating either monetary savings or efficiency gains will be challenging. We look forward to sharing the results of our review with the subcommittee by August of this year.

Share-in-Savings Contracting

The proposed bill focuses specifically on promoting greater use of one particular form of performance-based contract: share-in-savings. Basically, in share-in-savings contracting, a contractor funds a project up front in return for a percentage of the savings that are actually realized by an agency. Almost 6 years after the Clinger-Cohen Act called for the creation of pilot programs to test the share-in-savings concept in federal information technology contracts, the government has not identified many suitable candidates for use of this innovative technique. In large part, this is because use of this tool requires solid baseline data about the existing cost of an activity and a reliable method for measuring whether success has been achieved. Gathering reliable baseline data can be difficult.

The work we are conducting in this area will identify examples of best practices using the share-in-savings contracting method found in the commercial sector and assess how these practices can be effectively applied in the federal government. We are specifically asking commercial companies why they chose this tool as a means to help achieve their business goals and what their experiences have been. One particular form of share-in-savings that has emerged in our discussions is gain sharing. Under this approach, a contractor does not assume all of the risk, rather it will reduce its normal fees in return for a percentage of increased earnings or savings that result from the contractor's work. The idea is to develop a "win-win" arrangement, which jointly encourages the contractor and the client to achieve sustainable business results.

Specific Concerns About SARA Proposals

I would like to share initial concerns we have with some particular provisions of SARA based on our previous work and experiences.

First, section 221 of SARA would amend the Office of Federal Procurement Policy Act to increase the micropurchase threshold from $2,500 to $25,000. The governmentwide commercial purchase card is the preferred method for making micropurchases and is widely used. We have not comprehensively examined the use of purchase cards across the federal government. However, our reviews at selected agencies, including two Navy units, have found weak internal controls, which have left agencies vulnerable to a variety of improper purchases. We are concerned, therefore, that raising the micropurchase threshold may not be advisable until problems with controls and abuses are addressed and resolved.

Second, section 223 of SARA would strengthen the process under which agencies decide challenges to their procurement decisions by imposing a statutory stay of contract award or performance pending resolution of any bid protest. The bill would require an agency to issue a decision on a bid protest within 10 business days. We support prompt resolution of protests and believe the proposed bill may help accomplish this. We are concerned, however, that the 10-day time limit would be too brief in many cases to permit meaningful consideration of a protester's complaints, especially when the protest involves any degree of complexity.

Third, section 211 of the proposed bill would authorize service contractors to submit invoices for payment more frequently—biweekly instead of monthly. Although this change would have a positive effect on service contractors' cash flow, it could increase the cost of doing business for the government. Additionally, this change may increase the risk of erroneous payments—a significant problem across the government—as it could increase the volume of invoices and would provide agencies with less time to process and review them. As such, we believe further study is warranted on this provision.

Lastly, the bill also makes a number of significant changes to commercial items, including one, section 404, that would designate as a commercial item any product or service sold by a commercial entity. Although we have not fully assessed the possible impact of the proposed change, we are concerned that the provision would allow for products or services that had never been sold or offered for sale in the commercial marketplace to be considered a commercial item. In such cases, the government may not be able to rely on the assurances of the marketplace in terms of the quality and pricing of the product or service.

In conclusion, long-standing problems and the increasing significance of contracting for services point to a need for reforms in how services are procured, managed, and overseen. Strengthening leadership over service acquisitions and using performance-based contracting are good steps in this direction. However, agencies need to take additional measures in order to achieve the types of outcomes obtained by leading companies. These include developing a reliable and accurate picture of service spending; developing new structures, mechanisms, and metrics to foster a strategic approach; and providing strong leadership to carry out these changes. Such actions would help agencies to begin learning more about where their service dollars are going and to find ways to leverage those dollars.

Mr. Chairman, this concludes my statement. We look forward to sharing the results of our reviews and continuing to assist the subcommittee in its development of the Services Acquisition Reform Act. I will be happy to answer any questions you may have.

Contact and Acknowledgement

For further information, please contact William T. Woods at (202) 512-4841. Individuals making key contributions to this testimony include Cristina Chaplain, Ralph Dawn, Carolyn Kirby, Gordon Lusby, and Adam Vodraska.