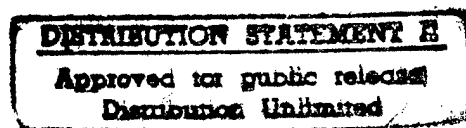

Logistics Management Institute

Quality of Commercial Activities Inventory Report

IR614R1

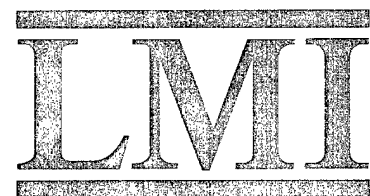
August 1997

Isidore M. Greenberg
Norman T. O'Meara



DTIC QUALITY INSPECTED 3

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Quality of Commercial Activities Inventory Report

IR614R1

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Isidore M. Greenberg
Norman T. O'Meara

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LOGISTICS MANAGEMENT INSTITUTE
2000 CORPORATE RIDGE
MCLEAN, VIRGINIA 22102-7805

Quality of Commercial Activities Inventory Report

IR614R1/AUGUST 1997

Executive Summary

The annual Commercial Activities Inventory (CAI) report was designed nearly 20 years ago to help the Department of Defense comply with Office of Management and Budget (OMB) policy that requires federal agencies to rely on the private sector for products and services when they can be produced more economically in the commercial sector. The report provides a detailed functional inventory of in-house civilian and military organizations performing those so-called commercial activities. Personnel positions performing "inherently governmental functions," as defined by OMB, are excluded from the CAI report.

In August 1995, the Deputy Secretary of Defense directed the military services to make the outsourcing of support activities a priority. The Logistics Management Institute (LMI) published a study in support of this effort; it concluded that the FY94 CAI report grossly underestimated the number of commercial activity positions. For example, only 42 percent of DoD civilians employed in the United States were classified as performing commercial functions. The LMI report concluded that a more reasonable estimate for civilians performing commercial functions would fall in the range of 60 to 80 percent.

The purpose of this current study is to determine whether the renewed interest in outsourcing has improved the CAI reports submitted by DoD components. We compare the September 1994 report with the June 1996 report.

We find that the Office of the Secretary of Defense outsourcing initiative has not changed the propensity of the DoD components to use the inherently governmental shield to protect the in-house work force from exposure to outsourcing consideration. In fact, the proportion of the U.S. civilian work force classified as commercial dropped from 42 percent in September 1994 to 38 percent in June 1996, and the military work force classified as commercial dropped from 22 percent to 14 percent.

We also examine three Defense agencies that report either no commercial activities or a low percentage of such activities, namely the Defense Contract Audit Agency, the Defense Logistics Agency, and the Defense Investigative Service. We conclude that most of the work force of these agencies is commercial rather than

inherently governmental. We do not recommend whether or not functions in these agencies should be outsourced to the private sector. This determination can only be made on the basis of cost comparisons and the availability of private-sector vendors to perform the needed activities. However, determining the functions that are truly commercial activities is a critical first step. Classifying a function as inherently governmental bars consideration of outsourcing. We recommend the following:

1. The CAI report should be retained because it can be a useful tool for managing outsourcing and because it fulfills an OMB requirement.
2. Improved instructions should be issued on how to differentiate between inherently governmental and commercial activities.

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Chapter 1

Introduction

The annual Commercial Activities Inventory report was designed in 1978 to help the Department of Defense manage compliance with long-standing Office of Management and Budget (OMB) policy that requires federal agencies to rely on the private sector for products and services when they can be procured more economically in the commercial sector.¹ In addition to prescribing detailed cost-comparison procedures, OMB also requires federal agencies to maintain a detailed functional inventory of in-house manpower performing commercial activities. Personnel positions performing “inherently governmental functions” are excluded from the inventory. In addition, the Commercial Activities Inventory (CAI) uses specified reason codes to justify why a commercial activity in the inventory is being performed in house rather than by the private sector. The report summarizes submissions from field activities. The CAI can be disaggregated by function and field unit. The report covers military and civilian personnel in the United States including its territories and possessions.

Starting in the late 1980s, congressional opposition to outsourcing implemented by an array of restrictive legislation dampened interest in conducting cost-comparison studies for outsourcing. Legislative obstacles reinforced the negative views of field commanders and employees to outsourcing. In this climate, there was little use of the CAI and little interest in monitoring its accuracy.

In August 1995, the Deputy Secretary of Defense directed the military services and defense agencies to make the outsourcing of support activities a priority and established working groups to examine outsourcing opportunities in various support areas. DoD is seeking expected savings from outsourcing to help cope with budgetary limitations.

The Logistics Management Institute (LMI) provided research support to the functional working groups and also worked on cross-cutting issues that affected all working groups. An LMI study was conducted to provide the working groups with estimates of the number of military and civilian positions that could be reviewed for outsourcing. The LMI report concluded that the FY94 CAI report grossly underestimated the number of commercial activity positions.² For example, only 42 percent of the DoD civilians employed in the United States were classified as commercial, implying that 58 percent were performing inherently governmental

¹ The Office of the Assistant Secretary of Defense (Economic Security), *Report on the Performance of Department of Defense Commercial Activities*.

² Logistics Management Institute, *DoD Manpower Potentially Available for Outsourcing Consideration*, Report EC508RD1, Isidore M. Greenberg and Norman T. O'Meara, May 1996.

functions. We estimated that a more reasonable estimate for commercial activities would fall in the range of 60 to 80 percent.

The screening process for determining which activities can be classified as commercial to become available for outsourcing is conducted in two major steps:

- ◆ Step 1 eliminates from outsourcing consideration those activities deemed to be inherently governmental. As stated in *OMB Circular No. A-76 Revised Supplemental Handbook*, “As a matter of policy, an inherently governmental activity is one that is so intimately related to the public interest as to mandate performance by Federal employees.”³ The detailed guidance for identifying inherently governmental functions is expressed in Office of Federal Procurement Policy (OFPP) Policy Letter 92-1, *Inherently Governmental Functions*, dated 23 September 1992. This guidance has been incorporated in *OMB Circular No. A-76*. Inherently governmental positions do not appear in the CAI. Furthermore, the CAI provides no justification or accounting for the inherently governmental positions that have been screened from the CAI. This Step 1 screening shelters more than half of the civilian work force from outsourcing consideration.
- ◆ Step 2 shelters commercial activities reported in the CAI from outsourcing consideration for so called “compelling reasons.” The major compelling reasons in FY94 were
 - national defense,
 - needed for rotation or career training,
 - lower cost in house,
 - pending base closure,
 - congressional authority,
 - cost study exceeded time limit, and
 - other reasons—unspecified.

In the FY94 CAI report, the Step 2 screening eliminated 85 percent of the civilians and 91 percent of military personnel reported as commercial.

The net effect of the Step 1 and Step 2 screening shielded 93 percent of the civilians and 98 percent of the military personnel from outsourcing.

³ *OMB Circular No. A-76 Revised Supplemental Handbook, Performance of Commercial Activities*, Office of Management and Budget, March 1996.

In order to make progress in promoting increasing outsourcing, the working groups established by the Deputy Secretary of Defense and the service staffs have largely ignored the screening data from the CAI report and developed their own databases. However, a sound CAI report would facilitate analysis of outsourcing potential. The detailed taxonomy of support functions can be displayed at several levels of aggregation, and data are available at different levels of command including field unit or location. The report data are easy to access on a PC.

The cost-comparison procedures described in *OMB Circular No. A-76* for in-house versus contractor performance are complex and time-consuming. These procedures have probably motivated DoD components to either classify activities as inherently governmental or to screen out commercial activities using one of the compelling reasons available in Step 2 of the screening process. However, *OMB Circular No. A-76* has provisions that permit outsourcing solely by competitive awards to private-sector vendors instead of in-house versus private-sector competitions. For example, new requirements and severable expansions can be outsourced without in-house versus private-sector cost comparisons. Maintenance support to a new weapon system or direct delivery of supplies from the manufacturer to field activities would be considered new requirements. In addition, *OMB Circular No. A-76* also permits cost-comparison waivers under certain conditions.

The current follow-up study, supported by LMI independent research and development funds, was initiated to answer the following questions:

- ◆ Have the outsourcing/privatization initiatives announced in August 1995 by the Deputy Secretary of Defense motivated the DoD components to improve the CAI report?⁴
- ◆ Are field activities that prepare the CAI report given adequate instructions on how to identify inherently governmental activities?
- ◆ Do the DoD component staffs responsible for managing the CAI report actively monitor it?

This study compares the September 1994 report with two subsequent reports:

- ◆ The September 1995 report issued in January 1996.
- ◆ The June 1996 report issued in October 1996.

⁴ Deputy Secretary of Defense Memorandum, "Privatization, Base Closures and Reuse," 14 August 1995.

Chapter 2

Trends in Reported Commercial Activities Inventory

The May 1996 LMI report *DoD Manpower Potentially Available for Outsourcing Consideration* was based on the FY94 CAI report. In August 1995, the Office of the Secretary of Defense launched a major effort to encourage outsourcing DoD activities. The Deputy Secretary of Defense established a Privatization Integrated Policy Team staffed by representatives of OSD and DoD components to determine opportunities, identify obstacles, and develop solutions and strategies for outsourcing. Senior officials of DoD components issued statements supporting the effort.

In this Chapter, we examine whether OSD's program promoting privatization has motivated the DoD components to increase the proportion of the in-house work force identified as commercial rather than as inherently governmental. Increasing the commercial activities category would broaden the potential for outsourcing.

Table 2-1 summarizes the *Commercial Activities Inventory report* for the base period September 1994 and two subsequent time periods. OSD's privatization initiative was announced in August 1995. The September 1995 report was submitted by DoD components in January 1996. The June 1996 report was submitted in October 1996. Both submissions were made after OSD had announced the privatization initiative.

*Table 2-1. Commercial Activities Inventory Compared to Total Work Force,
U.S. Only
(in thousands)*

	Civilian work years			Military work years		
	Sep. 94	Sep. 95	June 96	Sep. 94	Sep. 95	June 96
Total in-house work years ^a	808	768	741	1,361	1,302	1,248
Commercial activities work years ^b	337	248	282	303	141	176
Percentage commercial	42%	32%	38%	22%	11%	14%

^a Work years computed by averaging the beginning and ending strength for each time period.

^b From *Report on the Performance of Department of Defense Commercial Activities*.

We find that OSD's initiative to expand outsourcing had an inverse effect on DoD components. Instead of expanding the proportion of the workforce that could be considered for outsourcing, the DoD components sheltered an even higher proportion of the workforce.

The September 1995 CAI (submitted January 1996) reduced the commercial percentage for civilians from 42 to 32 percent and the military proportion from 22 to 11 percent. The downward adjustments were made at the headquarters of the military services by revising field activity submissions. The September 1995 report was so embarrassing that OSD asked the DoD components to advance by 3 months the following annual submission. The June 1996 report was submitted to OSD in October 1996. This report did increase the commercial activities proportions compared to the September 1995 report, but the proportion was still lower than reported in September 1994.

Table 2-2 compares the CAI by DoD component for two time periods, September 1994 and June 1996. We omit the implausible September 1995 report.

*Table 2-2. Commercial Activities Inventory by DoD Component Compared to Total In-House Work Force, U.S. Only
(in thousands)*

DoD component	Civilian					
	September 1994			June 1996		
	In-house work years	Comm. work years	% Comm.	In-house work years	Comm. work years	% Comm.
Army	233	87	37	218	70	32
Navy	241	97	40	213	94	44
Marine Corps	16	8	50	15	10	67
Air Force	184	87	47	171	55	32
Other defense	134	58	43	124	54	44
Total	808	337	42%	741	282	38%
Military						
Army	418	31	7	395	25	6
Navy	426	64	15	366	76	21
Marine Corps	145	10	7	146	10	7
Air Force	359	194	54	332	63	19
Other defense	13	3	23	9	2	22
Total	1,361	303	22%	1,248	176	14%

Note: Comm. = commercial. Numbers may not add due to rounding.

Based on our analysis of the recent *CAI Reports*, we conclude that the OSD privatization initiative has *not* changed the propensity of the DoD components to use the “inherently governmental” shield to protect the in-house workforce from exposure to outsourcing consideration.

In fact, the total CAI has been reduced since the privatization program was announced. Most of the reduction was attributable to the Air Force’s desire to lower

their inventory closer to Army and Navy levels. As indicated in the LMI report *DoD Manpower Potentially Available for Outsourcing Consideration*, we believe that about 60 to 80 percent of the in-house U.S. civilian workforce should be categorized as "commercial." In the September 1994 *Commercial Activities Inventory Report*, only 42 percent were classified as commercial. In the June 1996 report, only 38 percent were classified as commercial.

We examined the instructions issued by DoD components for determining whether a function is a commercial activity or inherently governmental. Most components repeat the sparse instructions issued in DoD Instruction 4100.33, *Commercial Activities Program Procedures*. DoD components also had access to the more detailed guidance in OFPP Policy Letter 92-1, but most DoD components were not using it. Furthermore, it is often difficult to determine how the OFPP guidance affects specific DoD functions. In the previous LMI report, *DoD Manpower Potentially Available for Outsourcing Consideration*, we recommended that

OSD in coordination with the Heads of the DoD Components should issue supplementing guidance on the identification of inherently governmental functions and activities. That guidance should be relevant to specific DoD support units and, if necessary, parts of units.¹

We reiterate this recommendation after examining the instructions and guidance available to field activities and managers of the *CAI Report*.

¹ LMI Report EC508RD1, May 1996.

Chapter 3

Case Studies on Identifying Commercial Activities

In Chapter 2, we concluded that the OSD outsourcing program sponsored by OSD has not changed the propensity of the DoD components to use the inherently governmental shield to protect the in-house workforce from exposure to outsourcing consideration. In this chapter, we examine three defense agencies that report either no commercial activities or a small percentage of such activities. These three agencies have functions that traditionally have been considered to be inherently governmental.

The case studies were conducted for the following defense agencies:

- ◆ Defense Contract Audit Agency (DCAA)
- ◆ Defense Logistics Agency (DLA)
- ◆ Defense Investigative Service (DIS)

In this chapter, we examine whether a particular function in these agencies should be reported in the CAI. We do not recommend whether or not the function should be outsourced to the private sector. This determination can only be made on the basis of cost comparisons and the availability of qualified private-sector vendors. However, determining that a function is a commercial activity is a critical first step. Classifying a function as inherently governmental bars any considerations of outsourcing.

DEFENSE CONTRACT AUDIT AGENCY

The DCAA performs all necessary contract audits for DoD and provides accounting and financial advisory services regarding contracts and subcontracts to all DoD components responsible for procurement and contract administration. DCAA performs similar services for other federal government agencies on a cost-reimbursable basis. DCAA employs about 5,000 civilians and reports none in the Commercial Activities Inventory report.

In a meeting with DCAA representatives and in a letter to LMI dated 31 July 1996, the agency provided the following information in support of its position that the work of DCAA should remain classified as inherently governmental:

1. OFPP's Policy Letter 92-1, *Inherently Governmental Functions*, 23 September 1992, states that "whether or not a function in question is an

inherently governmental function, for purposes of this policy letter is a matter for agency determination. However, agency decisions that a function is or is not an inherently governmental function may be reviewed, and if necessary, modified by appropriate OMB officials.” OMB has not modified the DoD determination. In the absence of OMB modification of DoD’s determination, there is no noncompliance with OFPP’s Policy Letter.

2. DoD Directive (DoDD) 7600.2, *Audit Policies*, dated 2 February 1991, paragraph 14, states that DoD components shall not contract for audit services, unless expertise required to perform the audit is not available within the DoD audit organization or temporary audit assistance is required to meet audit reporting requirements. Prior approval of the DoD Inspector General is required in order to contract for audits.
3. Among its functions, DCAA determines, on behalf of the government, final overhead rates to settle contracts for hundreds of contractors and authorizes payment of government funds to thousands of contractors. These actions are governmental decisions, not “recommendations.”
4. Over 90 percent of the incurred costs questioned by DCAA auditors are not expressly unallowable costs as outlined in the Federal Acquisition Regulation, but instead are areas where interpretation of the regulation and their application to specific fact situations are determinative.
5. The governmental functions described in paragraphs 3 and 4 above, while not the entire mission performed by DCAA, are inextricably intertwined with DCAA’s other functions to the extent that segregating them would not be efficient or cost-effective.

However, substantial arguments support the view that the DCAA functions should be classified as a commercial activity. They are as follows:

1. The introduction to OFPP Policy Letter 92-1 states that governmental decisions on contract costs may be based on recommendations made by contract auditors and, moreover, that the use of contract auditors has been authorized by Congress.¹ The OFPP letter states:

“The decision on what costs are reasonable, allocable and allowable is ultimately a Government decision, but that decision may be based on recommendations made by contract auditors. Certified public accountants, for example, only render “opinions” and contracts sometimes

¹ The term “contract auditors” used in the OFPP letter refers to outside auditors employed by a contract with a private-sector accounting firm.

provide that audit reports are advisory only. Moreover, the use of contract auditors has been authorized by Congress as noted above.”²

2. DoDD 7600.2 does not absolutely bar the use of contract auditors. It gives the DoD Inspector General the authority to approve or disapprove the use of non-federal auditors. It further states that contracts for audit services shall be awarded and administered in accordance with procurement regulations.
3. Independent public accountants (IPAs) generally perform the audits of state and local governments, colleges and universities, and other nonprofit institutions who are recipients of federal financial assistance. These institutions may either use state and local government auditors or hire public accountants. Federal agencies oversee the audits and have the authority either to conduct or contract for additional audits. The point is that the law and OMB circulars recognize a role for IPAs,³ in audits of contracts let by nonprofit organizations and state and local governments.
4. The DoD Inspector General is considering conducting a test of outsourcing contract audits. This test would be a response to the OSD pressures to expand outsourcing. Such a test could not be conducted if the auditing of federal contracts is believed to be an inherently governmental activity.

On the basis of the evidence we have presented, we conclude that most of the functions performed by DCAA are not inherently governmental and *should* be reported in the annual CAI. DCAA auditors *do* perform some inherently governmental functions—setting of overhead rates and approving payments to contractors. These functions would have to remain in house.

This conclusion does not necessarily mean that it will prove to be desirable or feasible to outsource all or even a major portion of the work performed by DCAA. The possible disadvantages of outsourcing are as follows:

1. *Conflicts of Interest.* Many accounting firms may be reluctant to take on contract audit work to avoid conflicts of interest that would limit their current or future private-sector business opportunities. Also, defense contractors may resist disclosing information to a private-sector auditor who also performs audits for a competitor.
2. *Quality of Audits.* Most public accountants do not have an in-depth knowledge of government procurement regulations and accounting rules. Furthermore, the use of numerous accounting firms would make it difficult to assure consistency in the application of these rules and regulations. A survey of nine non-DoD government agencies serviced by DCAA rated the

² Section 6(a)(9) of the Inspector General Act codified at 5 U.S.C., App. 3.

³ Single Audit Act, P.L. 98-502, and *OMB Circulars A-128* and *A-133*.

quality of contract audits performed by DCAA, their own Inspector General office, and independent public auditors. In this survey, DCAA received the highest rating and the independent public auditors received the lowest rating.⁴

DEFENSE LOGISTICS AGENCY

DLA provides materiel, supplies, contract administration services, and other logistics services to all branches of the military. Table 3-1 shows the number of DLA personnel assigned to organizational elements of DLA and the proportions of the staff reported in the FY95 Commercial Activities Inventory (CAI) report. Those not reported in the CAI report are considered by DLA as performing “inherently governmental” functions.

Table 3-1. Proportion of Total DLA Manpower Reported Performing Commercial Activities, FY96

Organization	Military and civilian work years ^a		Percent comm.
	Total	Comm.	
Headquarters DLA	357	99	28
Supply Management	11,500	860	7
Distribution	16,500	11,375	69
Defense Contract Management Command	15,252	101	1
Defense Reutilization and Marketing	3,703	1,468	40
Logistics Services Center	23	14	61
National Stockpile Center	262	0	0
Systems Design Center	1,292	789	61
Total	48,889	14,706	30

Source: DLA staff. Excludes Defense Acquisition University, Defense Technical Information Center, and defense support activities.

Note: Comm. = commercial.

^a Military work years represent only 3 percent of the work years.

DLA reports that only 30 percent of the workforce are classified as performing commercial activities; they consider 70 percent are performing inherently governmental functions. We did not conduct a field examination of the duties performed in each type of organization. We examined DLA-published descriptions of the work performed in each DLA component and considered LMI staff members' knowledge of these organizations.

⁴ *Subcommittee Report on Audit Scope and Quality as Members of the Task Forces on Contract Auditing*, 2 March 1992.

We believe that the DLA CAI can be increased in the following organizational elements. We will discuss each of these activities:

- ◆ Supply Management
- ◆ Distribution
- ◆ Contract management
- ◆ Reutilization and Marketing
- ◆ National Stockpile Center
- ◆ Systems Design Center

Supply Management

This category consists of six supply management centers.⁵ These centers consolidate the services' requirements and procure the supplies in sufficient quantities to meet the services' projected needs. These organizations often are called inventory control points. DLA reports that 7 percent of these organizations perform commercial activities.

Appendix A of OFFP Policy Letter 92-1 provides examples of inherently governmental functions. One of these examples is pertinent to supply management centers:

Determining what supplies or services are to be acquired by the Government (although an agency may give contractors authority to acquire supplies at prices within specified ranges and subject to other reasonable conditions deemed appropriate by the agency).

The Department of Defense has been implementing innovative outsourcing contracts with the private sector that are consistent with OFFP Policy Letter 92-1. These reduce in-house staffing in both the supply management and distribution organizations of DLA. The two new systems are as follows:

- ◆ *Direct vendor delivery.* The customer orders the product from the manufacturer and the product is shipped to the customer directly from the manufacturer.

⁵ Defense Supply Center, Columbus, OH; Defense Electronics Supply Center, Dayton, OH; Defense Fuel Supply Center, Fort Belvoir, VA; Defense Supply Center, Richmond, VA; Defense Industrial Supply Center, Philadelphia, PA; and Defense Personnel Support Center, Philadelphia, PA.

-
- ◆ *Prime vendor.* The customer orders the product from a local distributor who stocks products produced by many manufacturers. The local distributor ships the product directly to the customer.

The trend is to gradually outsource supply management functions by using direct vendor delivery and prime vendor contracts. Eventually, only about 10 to 20 percent of the current supply management manpower will be needed in house to perform the inherently governmental functions of negotiating and managing contracts with private vendors. Therefore, 80 to 90 percent of the current in-house staff should be reported in the CAI.

Distribution

DLA manages 25 distribution depots in the United States. Sixty-nine percent of the in-house manpower is reported as commercial. We believe that an increase to 90 percent is reasonable, given the overwhelmingly commercial nature of this function.

Reutilization and Marketing

The Defense Reutilization and Marketing Service redistributes and disposes DoD equipment and supplies no longer needed by the original user. Assets are transferred within DoD, to federal and state agencies, or sold to the public. Eighty-three percent of the workforce was reported as commercial in a previous CAI report. Now, DLA states that only 40 percent are commercial. We believe that the previously reported 83 percent is reasonable.

National Stockpile Center

The Defense National Stockpile Center procures and disposes strategic and critical materials to reduce dependence upon foreign sources of supply in times of national emergency. Currently, this function is not reported in the Commercial Activities Inventory. The bulk of this organization's work meets the criteria of a commercial activity and 85 percent should be reported in the Commercial Activities Inventory.

Systems Design Center

This center designs, develops, and maintains the automated information systems used for DLA procurement, supply management, contract management, and logistics support operations. Currently, 60 percent of the in-house workforce is reported as commercial. The functions of determining requirements for information systems and negotiating and managing contracts with vendors are inherently governmental functions. The functional managers in DLA—the center's customers—establish the requirements for the information systems. The production of soft-

ware is a commercial function. We conclude that about 80 percent of the current in-house workforce should be reported in the CAI.

Contract Management

DLA's Defense Contract Management Command (DCMC) manages contracts awarded by the defense components, the National Aeronautics and Space Administration, other government agencies, and international organizations. The staff of this command is located at 100 subordinate offices and at plant representative offices in contractor plants. In FY96, less than one percent of the 15,252 work years of the DCMC were reported in the Commercial Activities Inventory.

OFFP Policy Letter 92-1 states that the following functions related to the DCMC mission are inherently governmental:⁶

- ◆ Participating as a voting member on source-selection boards
- ◆ Approval of contractual documents
- ◆ Awarding contracts
- ◆ Administering contracts (including ordering changes in contract performance of contract quantities; taking action based on evaluations of contractor performance; and accepting or rejecting contracts, products, or services)
- ◆ Terminating contracts
- ◆ Determining whether contract costs are reasonable, allocable, and allowable
- ◆ Determining what property is to be disposed of and on what terms (although an agency may give contractors authority to dispose of property at prices within specified ranges and subject to other conditions).

We attempted to determine how many of the employees in the DCMC perform the duties defined as inherently governmental in OFFP Policy Letter 92.1. Table 3-2 presents the occupational distribution of the civilian workforce.

These performing inherently governmental functions are most likely in these three job series:

- ◆ Series 01910, Quality Assurance Specialists: 4,449 employees
- ◆ Series 01102, Contracting Specialists: 2,506 employees

⁶ Appendix A of OFFP Policy Letter 92-1, paragraphs 11(b), (c), (d), (e), (f), and (g).

- ◆ Series 01103, Industrial Property Management Specialists: 394 employees.

Not all personnel in these three job series are necessarily performing inherently governmental functions.

Table 3-2. Civilian Personnel Inventory—Defense Contract Management Command, 31 December 1996

Job series	Title	Inventory	Percent of inventory	Cumulative percentage
01910	Quality Assurance Specialist	4,449	30.7	30.7
01102	Contracting Specialists	2,506	17.3	48.0
00800	Engineers ^a	1,055	7.3	55.3
01106	Procurement Clerical and Assistance	989	6.8	62.1
01101	General Business and Inventory	879	6.1	68.2
01150	Industrial Specialist	858	5.9	74.1
00318	Secretary	744	5.1	79.2
00343	Management Analysis	427	2.9	82.1
01103	Industrial Property Management Specialists	394	2.7	84.8
00334	Computer Specialist	340	2.3	87.1
00303	Miscellaneous Clerk and Assistant	266	1.8	88.9
00326	Office Automation Clerical and Assistance	255	1.8	90.7
00344	Management Clerical and Assistance	203	1.4	92.1
02130	Traffic Management	96	0.7	92.8
—	All other	1,040	7.2	100.0
Total		14,501	100.0	—

Source: Defense Manpower Data Center "civilian personnel master file."

^a Computes the following engineer types: electronics, general, industrial, aerospace, mechanical, computer, materials, and safety.

We found that 32 percent of the Contracting Specialists held "warrants" that permit them to perform some inherently governmental functions delegated to them by the procuring contracting officers (PCOs). The PCOs are assigned to various contracting activities outside the DCMC.

DCMC is responsible for ensuring contractor compliance with contractual quality assurance requirements. We have been unable to determine how many of the 4,449 Quality Assurance Specialists have the delegated authority to accept or reject products in evaluating contractor performance. Also, we have been unable to

determine how many of the 394 Industrial Property Management Specialists have the authority to dispose of industrial property. Absent this information, we calculated a range of estimates based on two alternative assumptions:

- ◆ Thirty-two percent of the personnel in all of the three skills are performing inherently governmental functions. This alternative assumes that the ratio calculated for Contracting Specialists is applicable to the other two skills.
- ◆ Thirty-two percent of the Contracting Specialists and 100 percent of the Quality Assurance and the Industrial Property Specialists are performing inherently governmental functions.

In both alternatives, we assumed that the military personnel assigned to DCMC have a governmental-commercial distribution comparable to that of the civilian workforce. (Military personnel represent only about 1.5 percent of the DCMC workforce.)

Based on the above assumptions, we conclude that the proportion of the DCMC performing inherently governmental functions ranges from 16 to 39 percent. Further research would be required to narrow this range.

Although a high proportion of the DCMC in-house workforce is commercial, the outsourcing potential is not known at this time. This determination would require an analysis of the following questions:

- ◆ What functions are severable and can be described in a work statement with performance criteria? (Personal service contracts that provide personnel who are supervised directly by government employees are illegal.)
- ◆ How many junior personnel need to be retained in house to provide a career path for the more senior personnel who perform inherently governmental functions?
- ◆ What has been the experience of other federal agencies that have outsourced contract management functions?

The Deputy Secretary of Defense recently approved a "concept of operations" for the Defense Contract Management Command that requires the implementation of unit cost management systems and consideration of alternate financing options such as a Defense Working Capital Fund or direct reimbursable funding.⁷

The concept of operations makes no mention of using outsourcing as a cost-reduction tool. We assume that a decision has been made to seek cost reductions while maintaining the Command as an in-house operation. This decision does not

⁷ DepSecDef, Memorandum, Subject: *Defense Contract Management Command Concept of Operations for Implementing Resource and Costing Efficiencies*, 19 April 1997.

exempt DCMC from adhering to the procedures for identifying inherently governmental functions and reporting the remaining in-house staff in the CAI. Furthermore, the OSD study team that has been established to monitor the implementation of the concept of operations may decide to consider outsourcing at a future date.

DLA Summary

We conclude that the commercial activities portion of the DLA work force can be raised from 30 percent to 78 to 86 percent.

DEFENSE INVESTIGATIVE SERVICE

The Defense Investigative Service (DIS) is staffed with approximately 2,600 civilians. About two-thirds of the staff members work on personnel security investigations and one-third on industrial security investigations. DIS does not report any work years in the Commercial Activities Inventory report. DIS has traditionally considered its organization to be inherently governmental.

Personnel Security Investigations

DIS conducts personnel security investigations for all DoD components in order to provide information necessary for adjudicators to evaluate a person's trustworthiness, reliability, and integrity required for access to classified information and employment in sensitive positions. These investigations are conducted for active duty and reserve military personnel, DoD civilians, and contractor personnel. The scope and frequency of the investigation depends on the level of security clearance (e.g., Sensitive Compartmented Information, Top Secret, and Secret/Confidential). Completed investigations are forwarded to eight DoD central adjudication facilities to grant, deny, or revoke a security clearance. The central adjudication facilities are not operated by DIS. DIS also conducts more than 250,000 entrance National Agency checks each year to determine suitability of recruits for military service. The military services adjudicate these investigations.

The first issue is whether personnel security investigations are an inherently governmental function or a commercial activity. We conclude that the personnel security investigation function is a commercial activity for the following reasons:

- ◆ The General Accounting Office (GAO) in testifying before Congress on the issue of privatizing the Office of Personnel Management's (OPM's) investigations function. "Based on OMB guidance and our analyses, it appears that investigative functions confined to the gathering and reporting of information to federal agencies could be legitimately privatized. However, decisions regarding an individual's suitability for employment or

eligibility for clearance should be made by federal officials.”⁸ The DIS gathers and reports information. It does not make decisions on individuals’ suitability for employment or eligibility for clearance.

- ◆ A decision has been made to contract the work performed by OPM’s Investigative Service to U.S. Investigative Services, Inc. (USIS). USIS is a private company that will be owned by former OPM employees under an employee stock ownership plan. OPM will retain a core of in-house employees to manage the contract with USIS. The functions contracted by OPM are comparable to those now performed by DIS. The OPM Investigative Service’s products included those required for adjudicating clearances at all levels of security. The privatization decision was supported by OMB, the agency responsible for making final decisions on interpreting the distinctions between inherently governmental and commercial activities.
- ◆ Prior to contracting with USIS, OPM conducted about 30 percent of the background investigations conducted by the federal government. The remaining investigations were conducted by 13 federal agencies (including DoD) that had the authority to either conduct investigation in house or to contract out for the investigations.⁹ It is estimated that federal agencies contracted with private firms for approximately \$20 million worth of investigations annually. In addition, the Department of State reported conducting many of its background investigations through personal services contracts with independent contractors. The Department of Defense contracts out for approximately 5 percent of its background investigations.

Although it is clear that the DIS personnel security investigations function is a commercial activity, the decision on whether or not to outsource the function will rest on the results of the cost-comparison process required by *OMB Circular A-76* and an evaluation of the capability of the contractors.

The OPM contract with employee-owned USIS bypassed the competitive bidding process. A cost analysis was conducted that estimated the long-term savings that would be experienced by the federal government. Contractors who would have bid in open competition assert that the sole-source contract with USIS limited the potential savings that could have been achieved. OPM decided to award the contract to USIS to ensure the quality of the investigations and to ensure employment of the former federal employees.

⁸ Statement of Timothy Bowling, GAO, testifying before the Subcommittee on Civil Service, House Committee on Government Reform and Oversight, 15 June 1995.

⁹ Prepared remarks of Hon. John L. Mica before the House Government Reform and Oversight Committee on Civil Service, Hearings on Privatization of OPM’s Office of Federal Investigation, 15 June 1995.

It is not clear whether or not the in-house staff of DIS would lose to the private sector in an open competition. DIS costs are lower than previous in-house costs of the OPM's Investigation Service for comparable types of investigations. For example, DIS estimated that a full background investigation cost \$1,750, where OPM estimated its costs at \$3,300.¹⁰

The quality of private-sector investigations also will be an issue in deciding whether to outsource. The private-sector companies ready to bid on such contracts claim to employ mostly retired or highly experienced former federal investigators who adhere to federal procedures. However, a previous outsourcing episode in 1985 by OPM led to contract cancellations because of poor quality performance. The private contractor community claims they now have the experience to meet high-quality standards.

Industrial Security Program

The second issue is whether the Industrial Security Program is an inherently governmental function or a commercial activity. The main products of this program are described in the next subsections.

FACILITY SECURITY CLEARANCES

On-site inspections are conducted for the issuance and periodic validation of facility security clearances.¹¹ The contractor is notified in writing of the results of the inspections. This notification identifies significant deficiencies noted during the inspection. The facility is given a date by which all deficiencies noted shall be corrected. Depending on the severity of the deficiencies and the reliability and attitude of the facility, the cognizant security office may either conduct a special inspection or accept management's written statement that corrective action was accomplished, subject to verification at the next inspection. Periodic inspections are conducted every 6 or 9 months depending on the level of security material held by the contractor. Based on the recommendations of the cognizant security office, the director of DIS, after consultation with the concerned contracting organization, may authorize the revocation of facility clearances.

PERSONNEL SECURITY CLEARANCES FOR CONTRACTOR PERSONNEL

The Defense Industrial Security Office, an organizational element of DIS, is responsible for

- ◆ initiating investigations performed by other elements of DIS;
- ◆ issuing clearances;

¹⁰ Ibid.

¹¹ DoD Regulation 5220.22-R, *Industrial Security Regulations*, December 1985.

- ◆ maintaining clearance records; and
- ◆ preparing recommendations to the Office of the General Counsel, OSD, for suspension, revocation, or denial of clearances.

PHYSICAL SECURITY OF SENSITIVE CONVENTIONAL ARMS, AMMUNITION, AND EXPLOSIVES

DIS is responsible for

- ◆ assessing contract compliance by conducting security surveys and inspections of contractors within the United States and
- ◆ providing results of such surveys and inspections to DoD components and the appropriate contract and procurement offices.¹²

INDUSTRIAL SECURITY EDUCATION

DIS is responsible for educating contractor and DoD personnel on the principles, requirements, and techniques of the DoD Industrial Security Program. The educational effort includes

- ◆ preparing and distributing educational material (e.g., manuals, leaflets, bulletins, and audio-visuals) and
- ◆ operating the Defense Security Institute for presenting courses attended by contractor and DoD personnel.

We find that significant portions of the Defense Industrial Security Program are commercial activities. Table 3-3 suggests a functional classification for each of the major elements of the Industrial Security Program.

Reporting portions of the Industrial Security Program as commercial activities does not necessarily mean that these functions should be outsourced. The decision to outsource or retrain in house will depend on the availability of qualified contractors and cost comparisons.

¹² DoD Manual 5100.76-M, September 1992.

Table 3-3. Defense Investigative Service Industrial Security Program

Function	Inherently governmental	Commercial activity
Facility security clearances:		
Inspections/investigations		✓
Issuance or denial of clearance	✓	
Personnel security clearances for contractor personnel:		
Issuing clearances	✓	
Maintaining clearance records		✓
Preparing recommendations for suspension, revocation, or denial of clearances	✓	
Physical security of sensitive arms, ammunition, and explosives:		
Surveys and inspection		✓
Transmitting survey and inspection results to appropriate DoD offices		✓
Industrial security education		✓

Chapter 4

Trends in Reporting the Availability of Commercial Activities for Outsourcing

In Chapter 2, we discussed the application of the first screen—eliminating inherently governmental activities from outsourcing consideration. The portion of the workforce that survives the first screen is reported in the CAI report and is subsequently subjected to the second screen, which eliminates most of the commercial activities (CA) from outsourcing consideration for “compelling reasons.” The codes used in this screening of CA and their explanations are shown in Table 4-1 below.

Table 4-2 shows the application of the compelling reason codes for DoD as a whole, in the June 1996 CAI report. In that report, an effort was made by DoD components to correct some of the major inaccuracies and inconsistencies in the application of the codes that were apparent in previous reports. In addition, DoD directed its components to add a new code, Code B—Subject to Cost Comparison. This new code was introduced to show in-house commercial activities personnel who are available for outsourcing consideration but who have not been subjected to cost-comparison studies. The absence of this code in the past led to the contamination of other categories.

The title for Code B (Subject to Cost Comparison) implies that all activities using this code will be subjected to in-house versus private-sector cost comparison. Some of these activities may be outsourced by competitive awards to the private sector without cost comparison with the in-house activity. *OMB Circular No. A-76* prescribes conditions for outsourcing without cost comparisons.

Table 4-1. Codes for Denoting Compelling Reasons for Performing Work In-House

Reason Code	Explanation
A	Indicates that the DoD CA has been retained in house for national defense reasons. ^a
B	Subject to Cost Comparison.
C	Indicates that the DoD CA is retained in house because the CA is essential for training or experience in required military skills, the CA is needed to provide appropriate work assignments for a rotation base for overseas or sea-to-shore assignments, or the CA is necessary to provide career progression to a needed military skill level.
D	Indicates procurement of a product or service from a commercial source would cause an unacceptable delay or disruption of an essential DoD program.
E	Indicates that there is no satisfactory commercial source capable of providing the product or service needed.
F	Indicates that a cost comparison has been conducted and that the government is providing the product or service at a lower total cost as a result of a cost comparison.
G	Indicates that the CA is being performed by DoD personnel now, but the decision to continue in house or convert to contract is pending results of a scheduled cost comparison.
H	Indicates that the CA is being performed by DoD employees now, but it will be converted to contract because of cost-comparison results.
J	Indicates that the CA is being performed by DoD hospitals and, in the best interest of direct patient care, is being retained in house.
K	Indicates that the CA is being performed by DoD employees now, but a decision has been made to convert to contract for reasons other than cost.
N	Indicates that the CA is performed by DoD employees now, but a review is in progress pending a decision (i.e., base closure, realignment, or consolidation).
X	Indicates that the installation commander is not scheduling this CA for cost study under the provisions of congressional authority.
Y	Indicates that the CA is retained in house because the cost study exceeded the time limit prescribed by law.
Z	Indicates that the CA is retained in house for reasons not included above (i.e., a law, Executive order, treaty, or international agreement).

Source: DoDI 4100.33, *Commercial Activities Program Procedures*, 9 September 1985.

^a The purpose of reason Code A (National Defense) is to comply with legislation that prevents outsourcing of more than 40 percent of depot maintenance activities.

Trends in Reporting the Availability of Commercial Activities for Outsourcing

Table 4-2. Application of Reason Codes to Commercial Activities Manpower, June 1996

Reason Code	Military		Civilian		Total	
	(000)	Percent	(000)	Percent	(000)	Percent
A—National Defense	31.5	17.9	51.5	18.3	83.0	18.1
B—Subject to Cost Comparison	34.8	19.8	85.3	30.3	120.1	26.2
C—Military Training/Rotation	60.5	34.4	8.5	3.0	69.0	15.1
D—Unacceptable Delay/Disruption	0.4	0.2	2.9	1.0	3.3	0.7
E—No Commercial Source	*	*	0.2	0.1	0.2	*
F—Lower Cost In House	0.7	0.4	5.0	1.8	5.7	1.2
G—Pending Results of Cost Comparison	3.4	1.9	22.8	8.1	26.2	5.7
H—Scheduled for Conversion—Cost	0.1	*	0.1	*	0.2	*
J—Best for Patients	0.0	0.0	0.0	0.0	0.0	0.0
K—Scheduled for Conversion—Non-Cost	0.2	0.1	0.1	*	0.3	0.1
N—Review Pending BRAC ^a	26.5	15.1	46.6	16.5	73.1	16.0
X—Congressional Authority	0.8	0.5	4.5	1.6	5.3	1.2
Y—Cost Exceeded Time	0.9	0.5	9.7	3.4	10.6	2.3
Z—Other Reasons and Unreported	16.1	9.2	44.6	15.8	60.7	13.3
Total	175.8	100.0	281.9	100.0	457.7	100.0

Note: * = less than 0.05. BRAC = Base Realignment and Closures Act. Numbers may not add due to rounding.

^a The purpose of Reason Code A (National Defense) is to comply with legislation that prevents outsourcing of more than 40 percent of depot maintenance activities.

The June 1996 CAI report does improve the accuracy and consistency of the application of the reason codes compared to previous commercial inventory reports; however, further improvements are necessary. We examined the application of the reason codes for each DoD component and found the following examples of invalid reporting:

- ◆ The Army did not use the new Code B—Subject to Cost Comparison. Up through 1994, the Army simply inflated Code G—Pending Results of Cost Comparison. In the June 1996 report, the Army purified the entry for Code G but reported the amounts that should have been placed in Code B into Code N—Review Pending BRAC.
- ◆ There is a wide disparity among the military services in the use of Code C—Military Training/Rotation as shown in Table 4-3.

*Table 4-3. Reported in Code C—Military Training/
Rotation, June 1996*

Service	Military	Civilian	Total
Army	496	139	635
Navy	44,761	4,391	49,152
Marine Corps	2,661	2,716	5,377
Air Force	12,593	2,875	15,468

The Navy may require a larger CONUS rotation base than the other services, but the wide disparity should be justified. Furthermore, the use of Code C for the civilian workforce should be justified for all services.

- ◆ DLA uses Code Z—Other Reasons and Unreported to protect 60 percent of its CA inventory from outsourcing. Code Z indicates that a commercial activity is retained in house for reasons not covered in other codes. Examples include a law, Executive order, treaty, or international agreement. DLA appears to use Code Z simply to forestall outsourcing, or, at least, the cost-comparison review process.

We also examined the trends in the amounts reported in the various reason codes to determine whether the OSD program to increase outsourcing has resulted in more cost comparisons and scheduled conversions. Three of the reason codes can be used to judge the pending and scheduled level of outsourcing activity:

- ◆ Code G—Pending Results of Cost Comparison
- ◆ Code H—Scheduled for Conversion—Cost
- ◆ Code K—Scheduled for Conversion—Non-Cost.

These three codes are, in effect, the outsourcing pipeline. Table 4-4 compares the portion of the commercial activities workforce reported in these codes in the September 1994 Commercial Activities Inventory report compared to the June 1996 CAI report.

Trends in Reporting the Availability of Commercial Activities for Outsourcing

Table 4-4. Conversion Pipeline—Military and Civilian Combined

Component	Code G		Code H		Code K	
	Sep 94	June 96	Sep 94	June 96	Sep 94	June 96
Army	50,903	826	389	149	8	93
Navy	0	0	7	0	0	0
Marine Corps	324	32	54	18	562	0
Air Force	2,146	3,648	0	0	174	227
Agencies	25,090	21,694 ^a	0	0	0	0
DoD total	78,463	26,200	450	167	744	320

Source: *Commercial Activities Inventory Report*.

^a Primarily the Defense Finance and Accounting Service.

The large drop in Code G, Pending Results of Cost-Comparison, from 78,463 to 26,200 occurred because the Army eliminated erroneous reporting in this code. The Air Force does report an increase in cost-comparison activity from 2,146 in 1994 to 3,648 in 1996.

The numbers reported for Codes H and K—codes that indicate scheduled conversions from in house to contract—were small in 1994 and even lower in 1996. The June 1996 CAI report indicates that only 480 jobs are pending conversion.

The June 1996 CAI report, issued in October 1996, does not reflect the large outsourcing plans announced by the services. From 1 October 1996 to 15 January 1997, the services announced plans to begin outsourcing studies involving 34,000 positions, most of which were associated with base support activities.¹ The next CAI report may reflect these announcements.

¹ Government Accounting Office (GAO)/NSIAD 97-86, *Base Operations Challenges Confronting DoD as It Renews Emphasis on Outsourcing*, March 1997.

Chapter 5

Conclusions and Recommendations

CONCLUSIONS

The conclusions are presented in the form of answers to the questions found in Chapter 1.

1. Have the outsourcing/privatization initiatives sponsored by the Deputy Secretary of Defense motivated the DoD components to improve the *CAI Report*?

No. As shown in Chapter 2, the proportion of the workforce categorized as “commercial” actually fell from 42 percent to 38 percent for civilian and from 22 percent to 14 percent for military personnel. In effect, this change shields a *larger* proportion of the workforce from outsourcing consideration. In addition, there are still major errors in the section of the *CAI Report*, which shows the application of reasons why in-house commercial activities cannot be outsourced (see Chapter 4).

2. Are field activities that prepare the *CAI Report* given adequate instructions for identifying “inherently governmental” activities?

No. DoD Instruction 4100.33 and the DoD component implementing instructions are inadequate for this purpose.

3. Do the DoD component staffs responsible for managing the *CAI Report* actively monitor it?

Based on our interviews, we found that some components do *not* monitor the reports; some have initiated Inspector General audits of the reports. Some have made changes to the field reports to reduce the commercial activities inventory.

Prior to the August 1995 OSD initiative to increase outsourcing, most DoD components did not monitor the CAI reports submitted by field activities. They simply consolidated the reports and forwarded them to OSD—where they also received little attention. After the August 1995 initiative was announced and working groups were established, monitoring of the CAI increased; but, in some cases, field reports were revised to lower the vulnerability of the DoD component to outsourcing. During our interviews with the DoD component report monitors, we

found that they were aware of the errors and inconsistencies in their *CAI Reports*; some were in the process of taking steps to improve particular *CAI Reports*.

RECOMMENDATIONS

We recommend that the CAI Report be retained for the following reasons:

1. Though the CAI report is not useful in its present condition, it could be a very useful tool for managing outsourcing.
2. There is both an OMB and a congressional requirement for the report:
 - a. OMB requires all federal agencies to maintain a commercial activities inventory using a standard functional taxonomy and a standard set of “compelling reasons” for continued in-house performance of commercial activities. The reason given by OMB is that they may wish to inspect the report to ensure compliance with OMB’s outsourcing policies. In actual practice, OMB has not shown an interest in the DoD CAI reports. However, eliminating the report would require OMB approval.
 - b. A highly summarized version of the report is also submitted annually to Congress. There is no indication that Congress pays any attention to the report received from DoD, but it may be difficult to eliminate the requirement or to comply without the data foundation provided by the current report.

Assuming the CAI Report is retained, we recommend the following improvements:

1. Develop improved instructions on *how to differentiate* between inherently governmental and commercial activities (see Chapter 2) and closer monitoring of decisions on classifying activities as inherently governmental. To assist DoD and OSD monitors of the report, it is recommended that field activities report the manpower associated with inherently governmental activities using functional codes designed by each component.
2. Ensure that the report is consistent with announcements on planned cost-comparison studies and pending outsourcing actions.
3. Redefine current Code B—Subject to Cost Comparison, to include commercial activities that may be outsourced by competitive awards without requiring in-house versus private-sector cost comparisons.

Glossary

BRAC	Base Realignment and Closures Act
CA	commercial activities
CAI	Commercial Activities Inventory Report
DCAA	Defense Contract Audit Agency
DCMC	Defense Contract Management Command
DIS	Defense Investigative Service
DLA	Defense Logistics Agency
DoD	Department of Defense
DoDD	Department of Defense Directive
GAO	General Accounting Office
IPA	independent public accountants
LMI	Logistics Management Institute
OFPP	Office of Federal Procurement Policy
OMB	Office of Management and Budget
OPM	Office of Personnel Management
OSD	Office of the Secretary of Defense
PCO	procuring contracting officers
USIS	United States Investigative Services, Inc.

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