



# The Engagement of Independent Professionals in the U.S. Federal Government: *An Opportunity in Wait*

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# The Engagement of Independent Professionals in the U.S. Federal Government: An Opportunity in Wait?

## Introduction

The U.S. Federal Government workforce is currently comprised of about 2.1 million civil servants<sup>1</sup>, 1.5 million regular members of the Armed Forces (and about the same number of reserves)<sup>2</sup> and 670,000 postal workers<sup>3</sup>. Augmenting this workforce of about 4.2 million are perhaps 6 million full time equivalent contractors, depending on the method of estimation.<sup>4</sup> Highly accurate estimates of contractor headcount across government are not available.

In fiscal 2000, the government spent \$208 billion on contractors; by fiscal 2009, that figure was up more than 150 percent, to \$540 billion.<sup>5</sup> Even adjusted for inflation (which was minimal in the period) growth in the contract workforce was enormous. At the Pentagon, for example, contractors grew from 21 percent of the workforce in 2001 to 39 percent in 2009.<sup>6</sup>

Simply stated, the nation relies on contractors to perform much of the work associated with federal government. It has been this way for some time; as Professor Paul Light of New York University (NYU) states:

In 2008, the federal government spent \$188 billion on noncompetitive contracts, a figure that increased by 229 percent since 2002 (\$84 billion). Additionally, cost-reimbursement contracts, which are highly inefficient, grew from \$71 billion in 2000 to \$135 billion in 2008. A major part of the inefficiency problems likely come from the state of federal procurement professionals themselves. The Acquisitions Advisory Panel found that “*Since 1999 the size of the acquisition workforce has remained relatively stable, while the volume and complexity of federal contracting has mushroomed.*”

- Paul Light, NYU

“The federal government may have administered the Marshall Plan, but private contractors did most of the work. The federal government may have imagined the interstate highway system, but private contractors and grantees did most of the construction. And the federal government may have implemented the Clean Water Act,

<sup>1</sup> Office of Personnel Management (OPM), Historic Federal Workforce Tables. See: <http://www.opm.gov/feddata/HistoricalTables/ExecutiveBranchSince1940.asp> (note that military uniformed personnel -- about 1.6 million -- are not counted)

<sup>2</sup> Department of Defense, Armed Forces Strength Figures for June 30, 2011 (see: [siadapp.dmdc.osd.mil/personnel/military/ms0.pdf](http://siadapp.dmdc.osd.mil/personnel/military/ms0.pdf))

<sup>3</sup> Congressional Research Office, U.S. Postal Service Workforce Size and Employment Categories, 1990-2010, April 4, 2011

<sup>4</sup> Joe Davidson, “Before shrinking size of government, start with correct question”, Washington Post, May 26, 2010

<sup>5</sup> Politifact Virginia, “Rep. Gerry Connely says federal workforce hasn’t grown since 1990”, Dec 21, 2010

<sup>6</sup> Raj Sharma, “The Move to Insourcing ... Proceed with Caution” p.2, FAIR Institute, June 2009 (see: [http://www.thefairinstitute.org/downloads/The%20Move%20to%20Insourcing\\_June%202009.pdf](http://www.thefairinstitute.org/downloads/The%20Move%20to%20Insourcing_June%202009.pdf))

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but state and local government employees did much of the monitoring and enforcement, while grantees built the water treatment plans.”<sup>7</sup>

The work performed by contractors is often highly skilled knowledge work that is both core and critical to the operations of government and to the safety, health and security of the American populace.<sup>8</sup>

It is not a novel idea to state that today’s government faces increasingly complex and unique challenges. Yet, it is becoming clearer that in order to face such challenges, the focus must be aimed at advancing innovation and leadership within the government. Top performing organizations invest heavily in leadership development programs for good reason: successful leaders drive employee engagement, which in turn, drives performance.

So what would the optimal framework for a federal government leadership development initiative look like? Dedicated to its mission of improving the effectiveness of the federal government, CHCI recently hosted a Leadership Roundtable where representatives from both the public and private sectors engaged in a dynamic discussion about senior leader development in the government. This white paper, based on the presentations from the Leadership Roundtable, offers bold ideas for a new leadership development program as well as valuable lessons for leaders regarding coaching, assessments, and enterprise social networking.

## Reducing Contractors

Notwithstanding the long history of outsourcing in government, many argue that the pendulum has swung too far and that today, even work that should be done by civilian or military personnel (“inherently governmental”) is often being performed by contractors. In 1992, the government declared inherently governmental work to be types of work requiring “governmental decision making because they are so intimately related to the

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<sup>7</sup> Paul Light, “The New True Size of Government”, Aug. 2006. \* In 2006, Paul Light of New York University estimated the true size of federal government at almost 15 million full-time equivalents: “Fueled by nearly \$400 billion in contracts in 2005 and another \$100 billion in grants, the true size of the federal government now stands at 14.6 million employees, which includes civil servants, postal workers, military personnel, contractors, and grantees. The total is up from 12.1 million in 2002, and just 11 million in 1999.” See: [http://wagner.nyu.edu/performance/files/True\\_Size.pdf](http://wagner.nyu.edu/performance/files/True_Size.pdf)

<sup>8</sup> ibid

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public interest that no question of ulterior motivation can be allowed to arise concerning those choices and those activities.”<sup>9</sup>

***“Agencies are clearly expected to ... reduce the budget for contractors but if this results in fewer contractors and less output, the solution may prove to be as impractical as in-sourcing — after all, virtually no one believes that the demands on the federal government are decreasing or will decrease in the foreseeable future.”***

On March 4, 2009, as part of a broader effort to curtail the growth of outsourcing and hire more civil servants to perform inherently governmental and mission critical work,

*“The sheer number of DHS contractors currently on board again raises the question of whether DHS itself is in charge of its programs and policies, or whether it inappropriately has ceded core decisions to contractors.”* Senators Lieberman and Collins, 2010

President Obama released a memo directing the Office of Management and Budget (OMB) to advise on the “appropriateness of outsourcing” and to determine what is “inherently governmental” work.<sup>10</sup> Several months later, the OMB Director at the time, Peter Orszag, ordered agencies to cut contract spending in part by in-sourcing and “restoring the right balance between federal and contract employees at programs that rely heavily on contractors”.<sup>11</sup>

While a few agencies, most notably USAID and Homeland Security (DHS) have reduced contractors in favor of civil servants, in-sourcing implementation has been spotty at best and generally short-lived. For example, at the Department of Defense (DoD), the government’s largest user of contractors, former Defense Secretary Robert Gates recently altered plans to cut 33,000 contractors by 2015. On Aug. 9, 2010, he declared that the Pentagon, while “reducing contractors, [isn’t] seeing the savings we had hoped from in-sourcing.”<sup>12</sup>

DoD has reduced spending on contractors, however. In August, 2010, Secretary Gates reported that the department was on track to see a 30 percent reduction in funds for support contractors through 2013.<sup>13</sup> However, the fact that the reductions will not be realized through the conversion of contracts to full time civil servants is important

<sup>9</sup> Policy Letter 92-1, Subject: Inherently Governmental Functions, issued September 23, 1992 by the OMB’s Office of Federal Procurement Policy (OFPP).

<sup>10</sup> Raj Sharma, “The Move to Insourcing ... Proceed with Caution” p.2, FAIR Institute, June 2009

<sup>11</sup> Stephen Losey, “Homeland Security expands push toward insourcing”, Federal Times, February 7, 2011

<sup>12</sup> The Washington Examiner, “Fairfax County Board asks federal government to stop insourcing”, Nov 21, 2010

<sup>13</sup> Matthew Weigelt, “Unions fire back at Gates for insourcing about-face”, Federal Computer Week, Aug 13, 2010

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because it necessitates more practical solutions to cost cutting where contractors are concerned. Indeed, other solutions will be critical following a July 2011 memo from the White House requiring agencies to reduce spending on service contracts by 15 percent by the end of 2012<sup>14</sup> and to do so without hiring federal employees through in-sourcing.<sup>15</sup>

Agencies are clearly expected to follow DoD's lead and reduce the budget for contractors but if this results in fewer contractors and less output, the solution may prove to be as impractical as in-sourcing—after all, virtually no one believes that the demands on the federal government are decreasing or will decrease in the foreseeable future. A more practical and sustainable solution will require savings through better processes, practices and methods in contracting with service providers, including independent professionals.<sup>16</sup>

## The Contingent Workforce

Most would agree that where work is “inherently governmental” government employees should be doing the work. And few would argue that mission critical work should be outsourced to the degree that the government loses its understanding and capacity to manage it. Inherently governmental and mission critical work in government is very similar to the concept of “core competencies” in the private sector. While companies and corporations have fully embraced the use of contingent workers and independent professionals, they rarely outsource those parts of their operations that they consider to be core competencies; most believe that doing so might erode their competitive advantage.

Just as consultants, contractors and independent professionals have become indispensable in the private sector, they are critical to government. They supply expertise and skills that cannot be readily obtained among the civil service workforce. They provide needed labor and talent for projects of short-term duration or of a non-recurring nature, and/or to transfer new expertise in rapidly changing fields. Most agree that it makes little sense to go through an expensive sourcing and hiring process to create a new civil servant with full benefits and future liabilities when his or her work will be needed for months rather than years or even where demand for the skills is unpredictable or uncertain (unless the work is deemed to be “inherently governmental”).

<sup>14</sup> Joe Davidson, “White House plans cuts to support service contracts.”, Washington Post, July 7, 2011

<sup>15</sup> Joe Davidson, “Outsource cuts won't mean insourcing jobs”, Washington Post, July 8, 2011

<sup>16</sup> The terms “independent contractor”, “independent professional,” “independent consultant” and “designated contractor” are used throughout this paper. The terms are essentially interchangeable, though “independent professional” is preferred because it best reflects the typical high-skill level of the independents that work in government.

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The US economy as a whole is witnessing rapid growth in the non-traditional workforce (i.e. independent professionals, contractors, consultants, “temps”, etc.) such that some have predicted that contingent workers will comprise more than 50 percent of all hiring as the economy comes out of recession.<sup>17</sup> Already, the Department of Labor defines 30 percent of the US workforce as contingent<sup>18</sup> and the Bureau of Labor Statistics (BLS) states that contingent work has been growing at a pace much greater than traditional employment for years.<sup>19</sup>

The explosive growth in the contingent workforce is for good reason, flexibility being high on the list along with cost and the changing nature of work itself. Evolving worker preferences are also a factor. The growth of independents and micro-business is fueled in part by highly skilled individuals who choose independence over a traditional career. Therefore, access to key skills, knowledge and networks is another key driver of contingent workforce growth, in this case, driven by employer demand and a segment of the workforce itself. Moreover, where many high demand skills are concerned, the government’s current pay grades are often inadequate to compete with private sector compensation, which sometimes makes the use of contractors the only available option.

Fundamentally, government uses contractors for the same reasons as the private sector. More and more government work is project-based and requires cutting-edge skills, thus fast response and flexibility are often critical. In today’s political environment, cost savings are a third and possibly primary driver. Yet the current federal government contracting and selection rules, as articulated in the Federal Acquisition Regulations (FAR) are often misunderstood or ignored by contracting officials when seeking more innovative, less expensive contracting solutions.

For independent consultants—a group that is today comprised largely of skilled professionals—engagements are almost always executed using the most convenient, traditional methods only. In some cases, current contracting practices not only cost a great deal more than necessary, they also violate the intent and spirit of the FAR, which encourages government acquisition professionals to seek innovative, cost-conscious options, even where risk-taking is required.

<sup>17</sup> “The Emerging New Workforce”, The Littler Report, April 2009 p.1 (see: <http://www.littler.com/PressPublications/Documents/Littler%20Report/Littler%20Report%20The%20Emerging%20New%20Workforce.pdf>)

<sup>18</sup> “Report of the working group on the benefit implications of the growth of a contingent workforce”, P.1, Department of Labor, November 10, 1999 (see: <http://www.dol.gov/ebsa/publications/contrpt.htm>)

<sup>19</sup> Patricia Schroeder, “Does the growth in the contingent workforce demand a change in federal policy?”, Washington & Lee University School of Law, 1995

## Management of Independent Professional Costs

The question of whether agencies and departments are getting the best deal when contracting has been debated for decades. In 1994, for example, the Government Accountability Office (GAO) issued a report which stated that “many agencies do not routinely perform independent cost analyses of the market reasonableness of contractor bids before the renewal, extension, or re-competition of existing contracts.”<sup>20</sup>

***“Significant savings are possible across the spectrum of government contracting but the most overlooked may be in the engagement of independent professionals.”***

In 2010, Chief of Procurement at DoD, Ashton Carter asked suppliers for their ideas on ways to cut back on “non-value-added costs,” in the procurement of contract services. In a notice issued on February 17, 2011 the department stated: “The Department of Defense understands that some of its mandates, reporting requirements, and other acquisition practices encourage industry to adopt processes and make investments that increase costs, especially overhead costs, but do not contribute to value added in systems and services delivered to the Department.” The DoD memo went on to say “DoD is requesting information from the industrial base to identify the sources of these costs, backed by specific, credible, convincing data. DoD’s goal is to develop a fact-based program to reform cost-inflating practices.”<sup>21</sup>

Among other things, Carter was likely referring to the Department’s need to be more specific in the requirements for its contracts so that fixed price contracts could be negotiated rather than time and materials or cost-reimbursement contracts (which are usually more risky and expensive). Carter was probably not thinking about unnecessary costs in the engagement of independent professionals. Yet significant savings are achievable in this area of contracting as well.

<sup>20</sup> “Measuring Costs of Service Contractors Versus Federal Employees”, p.9. GAO, March 1994 (see: <http://archive.gao.gov/t2pbat4/150977.pdf>)

<sup>21</sup> “Efficiency Initiative Effort To Reduce Non-Value-Added Costs Imposed on Industry by Department of Defense Acquisition Practices.”, Federal Register, Feb 17, 2011

## The Size of the Federal Government Independent Professional Workforce

Of the six million or so contract FTEs in federal government, the majority are likely workers associated with larger contracts—they are contractors only as they relate to the government, otherwise, they are regular employees (W-2) of the firms that perform work for the government. In other words, if a laborer from a construction company works on a highway project awarded to his firm by the federal government, he is counted among the six million contractor FTEs even though he is a W-2 employee of his firm.

Independent professionals are not naturally associated with larger firms. They are persons who may have retired from government and are asked to return on a contract basis, for example, or any other individual who has been identified by an agency directly, as opposed to being “supplied” as part of a larger contract (even if a larger contract is ultimately used as a vehicle to engage them). The FAR defines independent consultants as those under “non-personal services contracts” in that they are independent and no employer-employee relationship exists between the agency and the consultant (as opposed to Personal Services Contracts - PSCs). By many counts, this group represents more than a million current professionals, by all measures; it is an extremely significant part of the broader federal workforce and one where billions of dollars in savings are possible.

## The Hidden Cost of Independent Professionals in Government

In many cases, the government overpays for independent professionals. The reasons are clear. Very often, government managers know who they want to engage as an independent professional (IP) – for example, a recent retiree who has unique knowledge and skills necessary for a project, or a high security-cleared IP known to the department because they have been engaged previously or are perhaps referred by an employee.<sup>22</sup>

According to Professor Paul Light in his June, 2011 paper “Creating High-Performance Government”, the Postal Service has awarded more than 2,700 contracts to former

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<sup>22</sup> While discouraged in general, sole-sourcing is permitted and agencies may, under the right circumstances, engage independent contractors without competition as they would engage firms using sole-source justifications. See FAR part 6.3

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employees since 1991 and some are earning twice their original federal salaries. Light argues that “It makes sense to ask how contracting and procurement controls are breaking down in cases like these.”<sup>23</sup> The answer is clear. High costs are often driven by the procurement methods used to engage IPs in government.

Today, despite the fact that a hiring manager sources and selects an IP, he or she almost always engages them indirectly, through an existing and approved contracting vehicle (a third party) with associated markups. Only in rare cases are IPs contracted with directly. This is in part because Personal Services Contracts (PSCs) are permissible only with Congressional approval which is rarely given. Alternatively, an IP could register as a business and go through the long, costly and complex process of becoming a government supplier (i.e., getting on a GSA Schedule or sub-contracting for a prime integrator) but few are willing and their prospective client usually cannot wait.

This means that managers must find an approved third party vendor who they can pass the contractor’s compensation through on a new or existing contract. Often, an agency will ask a prime integrator to become the IP’s W-2 employer. This is done by adding the IP(s) onto one of the prime integrator’s existing contracts. In these cases, because the contract markup rates have already been negotiated (where the “prime” sources, supplies and manages the talent) rates are typically 100-200 percent of the IP’s hourly pay, despite the employer (the prime) having little or nothing to do with the contractor aside from issuing checks.

Alternatively, agencies seeking lower markups sometimes go through “exempt” firms such as ‘8As’ (set asides for various small businesses) where an extra IP or two can be slipped into a contract or a new contract struck, for what is typically a 30 to 50 percent ‘pass-through’ rate, including overhead.

It isn’t possible to precisely calculate what avoidable overhead for IP engagements costs the federal government each year. According to the Federal Bureau of Economic Analysis, the average federal government employee earned \$81,258 plus about 30 percent in benefits (not including costs to government of about 30 percent in overhead) in 2009.<sup>24</sup> Thus, if just ten percent of contractor engagements in the federal government involve IPs (as above, some peg the actual number much higher) and use existing contracting vehicles (with a conservative average markup of 50 percent) and assuming the average

<sup>23</sup> Paul Light, “Creating High-Performance Government: A Once-In-A-Generation Opportunity”, Robert F. Wagner School of Public Service, New York University, June 21, 2011

<sup>24</sup> See: <http://www.bea.gov/national/nipaweb/SelectTable.asp?Selected=N>

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contractor earns the equivalent total compensation of the average federal civil servant (a very conservative estimate) then the government spends almost \$32 billion in largely avoidable overhead fees for its IPs each year (600,000 x \$52,817).

Simply stated, in at least 10 percent of contractor procurements, the government only wants and needs the independent professional they have identified. Yet, in almost every case, they choose to purchase and pay for the unnecessary “extras” such as finder fees, overhead, benefits, etc. that come with using a third party with a convenient contracting vehicle. The equivalent might be fulfilling a need for staples by purchasing full staplers.

The reality today is that government agencies, like their private sector counterparts, frequently need “independent designated contractors. Agencies frequently engage uniquely skilled individuals or “designated contractors” who are required because of the specific combination of skills, knowledge and experience (even security clearances) they bring. Although sourcing efforts are made, it often becomes clear that only one person is both available and possesses the necessary skills to meet what are often urgent requirements. This reality is acknowledged and provided for by Personal Services Contracts (PSC) available to agencies. However, hiring through PSCs requires Congressional approval and is, as stated above, rarely granted.

As described below, there are other reasons that render PSCs an imperfect vehicle to hire independent professionals (the most obvious being that the PSC eliminates their “independence”). However, as the skills and knowledge sought in IPs grow, the persons needed for those roles are increasingly specific, and true, open competition for their engagement is often impractical. Fortunately, there is nothing to prevent federal agencies from selecting the IPs they want and need through efficient, competitive practices as envisioned by the FAR—practices that through competition, are also likely to reduce the costs of IPs in addition to the overhead.

Significant costs and a broken process for engaging IPs represent both a problem and an opportunity. Already at least two federal government organizations (made anonymous at their request) have discovered and implemented programs to solve these problems. Both have also seized a rare opportunity to lower costs.

## Federal Agency #1 (FA-1): Case Study

FA-1 is a self-funded agency that in 2009 began looking for a means to control the costs and compliance issues of engaging contractors. Per the Guiding Principles of the FAR<sup>25</sup>, It welcomed innovative but sound ideas from outside the mainstream.

Prior to 2010, the agency engaged its independent professionals directly, but a 2009 IRS audit revealed contractor misclassifications and cited the agency for bringing back retirees directly as contractors. Part 37.103 of the FAR requires that contracting officers distinguish between personal and non-personal services contracts. Mistakes are commonly made where independent contractors are classified under non-personal services contracts but in reality, resemble personal services contracts in many ways (i.e., they are directly supervised, don't manage their own schedules, they use government equipment, etc.) such that a de facto employee-employer relationship is created.

The IRS has strict definitions for what constitutes an independent contractor (see "Misclassification" sidebar opposite). They do not have tax withheld at source and are eligible for expense-related tax deductions that regular employees don't enjoy. Naturally, the IRS would prefer that tax be withheld at source for as many workers as possible (to reduce collection, investigation and audit expenses) and to restrict tax deductions only to those that should be receiving them. On a macro level, the problem is not insignificant. The Government Accountability Office (GAO) has discovered that tens of thousands of contractor companies owe the government over \$5 billion in unpaid taxes.<sup>26</sup>

### Misclassification

*"The relationship of employer and employee exists when the person or persons for whom the services are performed have the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the detail and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but as to how it shall be done. In this connection it is not necessary that the employer actually direct or control the manner in which their services are performed; it is sufficient if the employer **has the right to do so.**" IRS Revenue Ruling 87-41 (1987-1 Cum. Bil. At 298)*

<sup>25</sup> See Federal Acquisition Regulations, 1.102. "The System should also, however, encourage innovation, and local adaptation where uniformity is not essential. (2) To achieve efficient operations, the System must shift its focus from "risk avoidance" to one of "risk management." The cost to the taxpayer of attempting to eliminate all risk is prohibitive. The Executive Branch will accept and manage the risk associated with empowering local procurement officials to take independent action based on their professional judgment."

<sup>26</sup> White House Memorandum for the Heads of Executive Departments and Agencies, Jan 20, 2010 (see: <http://www.whitehouse.gov/the-press-office/memorandum-heads-executive-departments-and-agencies-1>)

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The most common problem stems from employers classifying persons as independent (and compensating them as such) who share all or many of the same characteristics as employees. Employee misclassifications are common throughout industry, indeed, fewer than 20 percent of organizations are confident that all of their IPs are properly classified.<sup>27</sup> Federal and State governments have increased their investigations of employee misclassifications since 2009. Infractions have resulted in substantial penalties and fines for many organizations.<sup>28</sup>

One possible solution for the agency would have been to work through a large consulting firm (a “prime”) with procurement vehicles already in place for doing work with that agency. If the agency was outsourcing an entire project, that approach might have been preferable in that the IPs would be part of a larger contractor team and could benefit from the firm’s resources, management and team dynamics. In this case, however, the agency had many different projects and in some specialized cases, knew the IPs (Designated Contractors) it wanted to hire. Consequently for a portion of the work there was neither a need for sourcing talent nor a need for a firm to manage that talent once it was in place. Moreover, the costs associated with running the IPs through an existing prime integrator contract were thought to be exorbitant. The agency could have chosen to pay the markups associated with a prime contractor or other approved vendor if it desired. However, because minimal sourcing services were required and the IPs did not require the benefits normally provided to them by a vendor, the agency’s procurement team felt the markups were not justified.

After research was conducted, a more innovative and cost effective solution was found in working through an Independent Contractor Engagement Specialist (ICES)<sup>29</sup> with overhead fees of about 4-5 percent.

***“Though there are no rules in the FAR that prevent the use of these cost saving options, thus far, no cabinet-level agencies are known to be using them.”***

The use of contractors at FA-1 had continued to grow since the audit in 2009 and the agency realized the importance of having them categorized and engaged correctly in order

<sup>27</sup> Liz Greene, “Classification Confusion Abounds, Study Finds”, March 3, 2010, Contingent Workforce Management Blog (see: <http://contracttalentmanagement.blogspot.com/>)

<sup>28</sup> IRS Headline Volume 280 (Nov. 9, 2009)

<sup>29</sup> “The Independent Contractor Engagement Specialist (or ICES) has emerged as an aggregator of ICs and small consulting firms. An ICES serves as a form of Managed Services Provider for ICs, often working alongside those engaged to manage staffing agencies and their workers.” See: <http://www.mbopartners.com/blog/way-work-gets-done-emerging-project-economy>

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to avoid future misclassification issues and penalties. The ICES services would not only perform the initial assessment for appropriate classification but would guarantee that if the IRS disagreed with their assessment, they (the ICES) would pay any fines. This service and the low fees associated with it were the factors that initially tipped the balance in deciding to move ahead with an ICES.

Moving from an environment where the agency contracted with approved IPs directly to a third-party assessment for appropriate classification with a guarantee, has become FA-1's solution to address the IRS audit findings. The relationship has quickly grown to include IP engagement services,<sup>30</sup> in which the agency is placing more of their independent professionals through their ICES (which, for IRS purposes, becomes the W-2 employer of the IP).

Today, the ICES works with FA1 to verify the proper classification of its IPs and to act as the W-2 employer for many of its independents, which, like an approved vendor, includes paying all employer taxes due the IRS. For each IP, the agency pays just 4-5 percent of the annual contract fee to the ICES each year. In some cases, the IPs themselves pay the fee, reducing costs to nothing. The alternative, as above, might have generated unnecessary costs of tens of thousands of dollars per IP.

The agency's ICES has helped it achieve the primary goal of not contracting directly with former employees, while adding the benefit of solving the problem at a comparatively low cost while also gaining a better understanding of its IP workforce and issues.

## Federal Agency #2 (FA-2): Case Study

FA2 is a US foreign aid agency with projects throughout the developing world but with voluntary caps on the numbers of government employees (FTEs) it can employ. About 40 percent of its workforce is comprised of contractors, including international development consultants, economists and educators.

The agency has the authority to employ contractors on Personal Services Contracts (PSCs). The process for filling a contract for an individual consultant or personal service

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<sup>30</sup> By focusing on both the contractor's and the employer's needs, PEORs appeal to the fastest-growing segment of the U.S. workforce. It is important to remember that most independent contractors want to be independent and autonomous. The Portable Employer of Record offers the same services as a staffing firm for employers but also allows a contractor to have one employer of record for all of their contracts. For this "freedom," and for a range of other benefits PEORs offer contractors, they are normally willing to pay a PEOR fee of between 4 percent and 8 percent of billings. This, in effect, relieves an employer of paying any fees at all.

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contract is competitive and includes an announcement on the agency's web site. FA2's consultants and personal service contract (PSC) candidates are typically experts in the international development arena and have come to know the agency's website and the opportunities presented, making this approach an efficient and competitive talent sourcing and pooling method.

There are roughly 160 individual consultants and PSCs supporting the roughly 290 FTE employees at the agency. Additionally, firms hired to support the mission of the agency are hired using a myriad of contracting methods pursuant to the FAR.

Except for those hard to fill, specialized international development sector positions, FA2 can recruit government employees for the same positions it fills with contractors until it reaches its cap of 300 FTEs. Where FTEs are concerned, it can take a few months for a fair and open competition to run its course and for a person to be hired, however the target is not to exceed an 80 day turnaround time from the announcement.

The agency uses all available methods of attaining the right mix of talent to support its mission. Where it makes sense to hire an FTE employee it does so and where it is most effective to engage an independent professional, it pursues that option. At its inception, FA2 was granted the right to award Personal Services Contracts (PSCs) in order to employ individuals who could be hired as contractors but could serve in critical roles where inherently governmental functions were to be accomplished—the agency makes regular use of this option as well.

The agency relies on the small arena that international development represents and is keen on ensuring that FTEs and IPs have good past performance and requisite experience in the sectors the agency is involved in. Despite having the authority to enter into PSCs, the agency has investigated various other options for engaging IPs, seeking the most cost effective approaches with the greatest flexibility possible. As with FA1, it followed the guiding principles of the FAR in seeking innovative solutions likely to save money and deliver the best results. This process led to the discovery that an ICES provider was, in some cases, the preferred option for engaging IP talent.

PSC's while easy to use, involve extra expense for benefits (15-30 percent) and some risk of misclassification. Moreover, true independent professionals are unlikely to accept PSC offers or remain in them long because they strip the IP of his or her independent status. PA2 still makes regular use of PSCs but now augments those hires with IPs engaged

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through its ICES. The agency has found that the ICES option offers the lowest cost solution and also helps the agency avoid the misuse of contractors. For example, the ICES helps FA2 in ensuring that IP's do not perform inherently governmental functions, functions for which PSCs are better suited.

Since 2010, FA2 has hired over 100 IPs through a Blanket Purchase Agreement (BPA) with its ICES. The BPA was awarded through a competitive GSA contract vehicle and has become the agency's main vehicle for IPs. Through the use of this vehicle, it has experienced as fast and efficient a hiring process as that of hiring individuals under PSC contracts, taking, on average, about 30 days compared to roughly the 80 day norm when an FTE hire is made.

Given the high level of consultants needed for the agency's projects, the average annual fully-burdened cost associated with consultants provided by large firms and primes is high, while the fully burdened cost of individuals hired under PSCs or IP contracts are considerably less due to lower overheads.

FA2 still hires FTEs and uses large firms, prime integrators and approved vendors when it makes sense for particular requirements. It believes that this mix of tools allows it to deploy a balanced workforce, where each contributor has been employed or engaged in the manner that delivers the greatest benefit for the agency.

The experiences of the two agencies profiled above, demonstrate that a sound alternative to the often expensive engagement of IPs through prime integrators and other approved vendors exists. Indeed, in spite of having hiring authorities that most government agencies are denied, both agencies in the case studies above elected to use an ICES—an option readily available (indeed, encouraged in the FAR) to any agency or department.

As yet, however, few federal government agencies or bodies appear to be using ICES services. Low awareness of the ICES option is likely the main reason but misinterpretation of the FAR and a failure to explore innovative alternatives to conventional contracting practices may be others.

## Barriers to More Effective and Efficient Independent Professional Contracting

As above, the first challenge with broader adoption of ICES is lack of awareness. Very few government procurement professionals know of ICES despite widespread use of these service providers in the private sector for almost a decade. This promising best practice has the potential to reduce government costs significantly but rapid change and adoption of new processes are not a hallmark of government. Innovations in procurement and contracting are extremely rare, despite the encouragement against risk avoidance in the FAR itself<sup>31</sup>.

## How To Engage Independent Professionals Through an ICES

As above, there are no rules in the FAR that prevent the use of these cost saving options. Federal agencies can engage IPs through an ICES in the following manner:

1. Develop an RFP/RFQ or similar instrument
2. Post it competitively either on a full and open competitive basis or through the use of GSA Schedules with sufficient competition among similarly situated vendors
3. Evaluate the responses and choose an ICES (the process to this stage normally takes about three months) which offers the best value to the government
4. Award a blanket purchase agreement (BPA) or IDIQ contract<sup>32</sup>
5. Post individual IP opportunities for competition on the agency website, and/or on the job board service provided by the ICES
6. Form a panel to evaluate the responses received from interested IPs, negotiate with the IPs and process the best value, best skill-match candidate through the ICES platform
7. Engage IPs through the ICES, including funding, travel, payments, etc.

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<sup>31</sup> See FAR part 1-102-1: "To achieve efficient operations, the System must shift its focus from "risk avoidance" to one of "risk management."

<sup>32</sup> See FAR part 13.303

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8. Extend and dismiss IPs at will, based on performance and need.
9. Re-compete individual IP requirements as required and repeat.

Both agencies profiled above selected their ICES through a competitive process. They contract with their ICES through a BPA awarded under the contractor's GSA schedule contract. The agencies have been using ICES for between one and five years, realizing significant hard dollar savings. In the case of FA2, a recently re-competed contract resulted in lower fees/rates, continued greater flexibilities and time savings. Both agencies continue to make appropriate use of ICES in a balanced approach to fulfill requirements to meeting their mission using the most cost effective, flexible, and time saving methods.

Where the IP's themselves are concerned, the agencies above typically encounter resistance at the beginning of their use of ICES. According to both organizations, however, IPs adapt quickly and often become advocates of the new solution. In the private sector, more than half of all IPs associated with ICES providers initiate the relationship directly and pay their own annual fees—evidence of the value they place in the services and tools their ICES/PEOR provides them as IPs.

## Conclusions

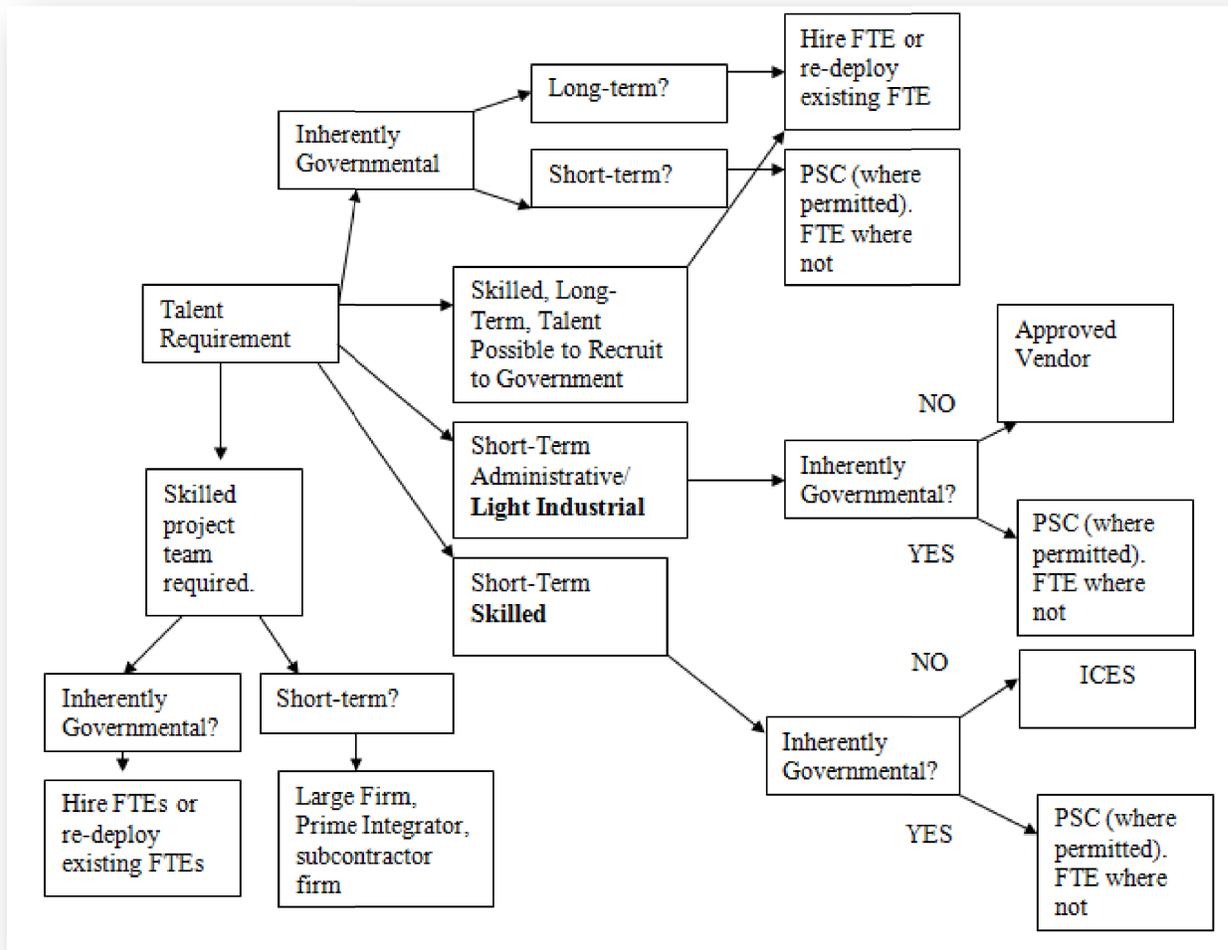
The federal government invests more than half a trillion dollars in its contract workforce each year. With budget restrictions and closer scrutiny on all spending, contract competitiveness and the costs associated with it are coming under increased pressure.

The use of Independent Contractor Engagement Specialists has become widespread in private industry as the size and skill level of the contingent workforce has grown. Organizations have found that ICES providers solve misclassification and co-employment issues that can result in costly settlements with the IRS. More importantly, by reducing overhead fees and by working more directly to source their own IPs and engage them through an ICES, significant, recurring savings are possible.

Government compounds the costs of IPs by often engaging them through prime integrators, approved vendors and other contract vehicle holders. As such, federal government agencies may have even more to gain than their private sector counterparts by adopting the best practice of working with ICES providers.

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## Appendix A: Talent Resourcing Decision Flow Chart



## Appendix B: About the Authors

### Allan Schweyer

Allan Schweyer is a Partner and Principal at the Center for Human Capital Innovation. At CHCI, Mr. Schweyer directs CHCI's research and education efforts and leads the design of new human capital transformation systems and strategies tailored specifically for federal, state, and local government.

Prior to joining CHCI, Mr. Schweyer was a Founder, President and Executive Director of the Human Capital Institute. Educated as a labor market economist and operations analyst, Mr. Schweyer has contributed to the field for over two decades. He is the author of two books, "Talent Management Systems" (Wiley&Sons, 2004) and Talent Management Technologies (HCI Press 2009). He is an author contributor to the best-selling books, The Talent Management Handbook and The Compensation Handbook (McGraw Hill) and has published hundreds of articles and white papers in dozens of popular media and industry specific publications worldwide. He is an internationally respected analyst and speaker on the topic of resource management, transformational human capital management for individuals, organizations, regions and nations. Allan is widely considered to be one of the world's leading thought leaders in human capital management. In 2009 he was recognized as among the "100 Most Influential People in HR and Talent Management".

Mr. Schweyer's contributions include studies in operational research and the development of award-winning systems for government, international organizations and the private sector. In 2000 and 2001, he worked as a management consultant to Reed Business Information in Boston while attending graduate school at Harvard University. Prior to joining CHCI, Mr. Schweyer was also a senior researcher, analyst and consultant with HR.com servicing large private and public sector clients worldwide.

### Allen Zeman, PhD

Allen R. Zeman is the President of the Center for Human Capital Innovation (CHCI). He formed CHCI after a 20-year, SES-level government career where he served in various Pentagon assignments and in multiple deployed assignments. The CHCI team works with government agencies to bring innovative solutions in resource allocation, financial modeling, operations research, training and development, and HR analytics. While with

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CHCI, Dr. Zeman has provided direct support to 14 cabinet agencies.

Dr. Zeman served as the Director of Naval Training and Education (N7) for the Chief of Naval Operations, responsible for the plans, policies, budgets and directives for all military and civilian development, leading the world's largest professional development organization. Prior to that, he worked for the Secretary of the Navy as the director of manpower and training, where he laid the foundation for the Navy's Revolution in Training, a systematic innovation in training design and delivery that led the Navy to new e-learning approaches, greater accountability and significant improvements in effectiveness and efficiency. While working for CNO and the Secretary of the Navy, he wrote and submitted Navy Program Objective Memoranda and trained all incoming action officers on the PPBE system for 11 years.

In his role as Director, Dr. Zeman pioneered executive mentoring programs and built career maps for all civilian and military employees in the Navy. Prior to these assignments, he deployed for three years to various Navy commands in the Pacific Fleet and for four months with the Marine Expeditionary Unit in support of operations in the former Yugoslavian Republic. Dr. Zeman's last government assignment was as the Chief Economist for the Iraqi reconstruction effort in Baghdad. From 2004-2005 he led the Embassy's Office of Strategic Analyses (OSA), responsible for Cabinet and congressional communication about the reconstruction and development of Iraq. OSA reported directly to the U.S. Ambassador to Iraq and aligned resources for the Iraqi Relief and Reconstruction Fund, a \$24 billion fund established for the post-invasion reconstruction efforts in the country.

Dr. Zeman also served as the Senior Advisor to the Deputy Prime Minister (Vice President equivalent) of Iraq. After his assignment there, he left government service, but continued to work in the international development field as the Vice President of an international development firm in support of USAID projects in 25 countries. Dr. Zeman is also an associate at the Spectrum Group in Alexandria, Virginia, working with numerous clients in the resource management, training, and operations research fields. He is a graduate of the George Mason Executive Coaching program, has worked as Lean Six Sigma deployment expert and remains an advocate of analytically based decision-making and strategic resource analyses.

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## About Center for Human Capital Innovation



The Center for Human Capital Innovation (CHCI) is a for-purpose firm dedicated to improving human capital management across the federal government. We do this by taking a systems approach to human capital, one that helps government agencies adopt and optimize best and next practices that will result in a highly productive and engaged workforce. We provide government leaders with valuable tools, deployment advice, and innovative insights aimed at advancing the science of human capital management across the federal government.

While the core principles of human capital management are the same in the public and private sector, distinct differences exist for successful implementation. These include nuances such as hiring reform legislation, labor management and merit-based principles, and results measured by mission achievement rather than profit. CHCI has assembled a dedicated team of professionals with both federal government leadership and Fortune 100 experience to bring the right mix of perspective and expertise to the optimization of talent across the federal government.

## About MBO Partners



MBO Partners brings a unique and timely solution to the Talent Management Innovation in Government Group. About seventy-five percent of government work is produced by contractors, making cost, and performance management of this part of the workforce vital. The MBO Partners model provides GSA-approved outsourced contractor consolidation, payment, and payrolling services that let your agency increase its reliance on talented contract professionals—without the costly overhead they typically incur. MBO Partner's services and tools provide greater efficiency and remarkable cost savings in the contractor administration processes.

Moreover, MBO Partners is proven to be the best engagement method for re-capturing retiring talent. Already, a variety of government agencies and departments are using MBO Partners to cost-effectively hire and manage contractors and to re-engage their best retirees as independent consultants.