United States Government Accountability Office

GAO

Report to Congressional Committees

March 2006

OFFSHORING IN SIX HUMAN SERVICES PROGRAMS

Offshoring Occurs in Most States, Primarily in Customer Service and Software Development

This report was revised on May 25, 2006, to correct errors in data reported to us on the occurrence of offshoring in two state programs and make resulting corrections to certain summary information on the occurrence of offshoring. See page iii for a list of data changes.

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Highlights

Highlights of GAO-06-342, a report to congressional committees

Why GAO Did This Study

As states and the federal government have sought to streamline and improve administrative processes and take advantage of technological advances, both have outsourced certain functions to private firms. In some cases, these firms have used offshore resources to perform these functions. As a result, questions have been raised about the prevalence of offshoring in federal human services programs.

In response to widespread congressional interest, we conducted work under the Comptroller General's authority to determine (1) the occurrence and nature of offshoring, (2) the benefits state agencies have achieved through offshoring and problems they have encountered, and (3) the actions, if any, states and the federal government have taken to limit offshoring and why. We examined four federally-funded state-administered programs—Child Support Enforcement, Food Stamp, Temporary Assistance for Needy Families (TANF), and Unemployment Insurance—and two federally-administered programs that provide student financial aid—Pell Grant and Federal Family Education Loan (FFEL).

The Departments of Agriculture, Education, Health and Human Services, and Labor did not have comments on this report.

www.gao.gov/cgi-bin/getrpt?GAO-06-342.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Sigurd Nilsen at (202) 512-7215 or nilsens@gao.gov.

March 2006

OFFSHORING IN SIX HUMAN SERVICES PROGRAMS

Offshoring Occurs in Most States, Primarily in Customer Service and Software Development

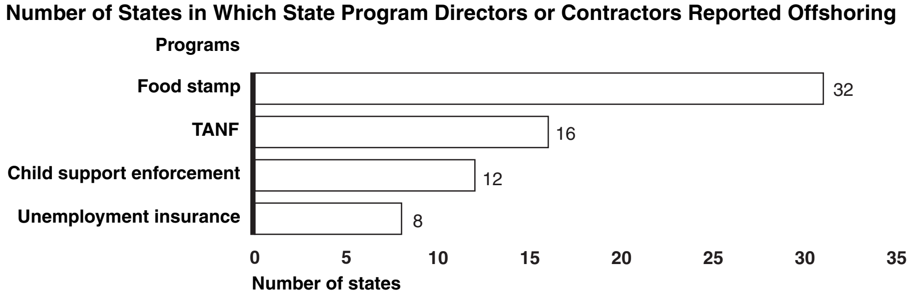
What GAO Found

Some work is performed offshore in the majority of states for the four state-administered programs we reviewed, but no work is performed offshore for the two federally-administered student aid programs. Offshoring occurred in one or more programs in 43 of 50 states and the District of Columbia, most frequently in the Food Stamp and TANF programs. However, expenditures for services performed offshore in the four state-administered programs appear to be relatively small. The services states most frequently reported as being performed offshore in the Food Stamp and TANF programs were functions related to customer service, such as call centers, and in the Unemployment Insurance and Child Support Enforcement programs functions were related to software development. India was the most prevalent offshore location, followed by Mexico. We did not find any occurrences of offshoring in the Pell Grant and FFEL programs and the Department of Education's U.S. residency requirement for contractors performing high-risk work has the effect of limiting offshoring.

State officials reported that lower costs are a benefit of having services performed offshore and few officials identified problems with offshore service providers in their contracts. Fifteen state program directors reported having performed cost comparisons for their current contracts, based on differences in the location of services, and all reported that they would achieve cost savings if some of the work were performed offshore. On average, these comparisons showed that with some services performed offshore, contract costs would be between 0.3 and 24 percent less than if all the services in the contracts were to be performed in the United States. The few state officials that reported any problems with the quality of services provided by offshore contractors said that they involved difficulties in understanding the English of software programmers or customer service representatives.

While numerous actions have been proposed at the state and federal levels to limit offshoring by government agencies, few restrictions exist with respect to the six programs we reviewed. Two states—New Jersey and Arizona—have prohibited offshoring in state contracts. Some states have also taken other actions, such as requiring state agencies to disclose when state-contracted work is performed offshore or to report on the implications of offshoring. The federal government does not have regulations specifically related to the offshoring of services in the six programs we reviewed.

Number of States in Which State Program Directors or Contractors Reported Offshoring



Source: GAO survey.

Contents

Abbreviations

EBT	electronic benefits transfer
FFEL	Federal Family Education Loan
PRWORA	Personal Responsibility and Work Opportunity Reconciliation Act
TANF	Temporary Assistance for Needy Families
TPP	Third Party Processor

This report was revised to correct data on the occurrence of offshoring in two state programs due to an error made by a contractor in its survey response to GAO. There was no reported offshoring in the Illinois Unemployment Insurance and New York Child Support Enforcement programs. As a result of these corrections, the report is also being revised to correct certain summary information on the occurrence of offshoring.

In the figure on the Highlights page, "9" for the Unemployment Insurance program should read "8" and "13" for the Child Support Enforcement program should read "12."

On page 3, in lines 9 and 12 of the last paragraph, the expenditures for contracts with some offshored services should read "$335" million.

On page 4, in line 7 of the first paragraph, the "9" should read "8."
On page 4, in line 8 of the first paragraph, the "13" should read "12."
On page 10, in line 6 of the last paragraph, the "13" should read "12."
On page 10, in line 7 of the last paragraph, the "9 should read "8."

On page 12, in line 14 of Figure 1, the triangle should be deleted for the Illinois Unemployment Insurance program.

On page 13, in line 4 of Figure 1, the triangle should be deleted for the New York Child Support Enforcement program.

On page 13, in the total line of Figure 1, the "9" should read "8" under Unemployment Insurance <u>and</u> the "13" should read "12" under Child Support Enforcement.

On page 14, in line 7, "85" should read "83."
On page 14, in line 8, "$339" should read "$335."
On page 14, in line 14, "$339" should read "$335."

On page 15, in Figure 2, "$339" should read "$335" <u>and</u> "85" should read "83."

On page 16, in Figure 3, for the graphic representing Child Support Enforcement, the "$159" should read "$158."

On page 22, in figure 5, "56" should read "55" for India and "28" should read "27" for Mexico.

United States Government Accountability Office
Washington, DC 20548

March 28, 2006

Congressional Committees

Advances in information technology and communications, coupled with a large pool of educated workers in some countries, have allowed private companies to move services work outside of the United States in such areas as call centers, back-office functions, and software programming. While some maintain that the services offshoring phenomenon is widespread, others say that the extent is limited. Media reports in 2004 that call centers providing customer service to Food Stamp recipients were based in India inspired proposals at the federal and state levels to restrict "offshoring" in public programs or the practice of performing contracted work outside of the United States. Offshoring generally refers to the import from abroad of goods or services that were previously produced domestically. As states and the federal government have sought to streamline and improve administrative processes and take advantage of technological advances, both have outsourced certain functions to private firms. In some cases, these firms have used offshore resources to perform these functions. Questions have been raised about the prevalence of offshoring and the potential consequences when federally-funded human services programs procure services from companies that offshore. However, as we reported in 2004, no comprehensive data or studies show the extent of services offshoring by state governments and data for the federal government are limited.[1]

In response to widespread congressional interest in this area, we conducted work under the Comptroller General's authority to determine the occurrence and nature of offshoring in six federally-funded human services programs. Specifically, we examined (1) the occurrence and nature of offshoring in each of these six programs, (2) the benefits government agencies have achieved through offshoring in these programs and the problems they encountered in offshoring work, and (3) the actions, if any, states and the federal government have taken to limit offshoring in these programs and why. The six federally-funded programs we examined include four state-administered human services programs—

[1]GAO, *International Trade: Current Government Data Provide Limited Insight into Offshoring of Services*, GAO-04-932 (Washington, D.C.: Sept. 22, 2004).

Child Support Enforcement, Food Stamp, Temporary Assistance for Needy Families (TANF), and Unemployment Insurance—and two federally-administered programs that provide student financial aid—Pell Grant and Federal Family Education Loan (FFEL). We selected these programs because they receive a substantial amount of federal funding for program administration, contract out some administrative functions, and are not administered solely at the local level. [2]

To determine the occurrence and nature of offshoring in the four state-administered programs, we administered two separate Web-based surveys:

- First, we surveyed directors of the Child Support Enforcement, Food Stamp, TANF, and Unemployment Insurance programs in all 50 states and the District of Columbia—a total of 204 directors. We asked each program director to provide information on up to three contracts held by the program: the contracts with known offshoring or, if there were fewer than three contracts with offshoring or no offshoring, the largest contracts (in dollars). We also requested information from each program director on the total number of contracts and total spending on contracted-out services. In addition, we reviewed contracts from state officials that reported no offshoring. We obtained a 93 percent response rate to our survey of state program directors.

- To supplement the survey of state officials, we surveyed the contractors whose names were provided by state officials to obtain additional information on the types of services provided to state programs and where these services are performed. We obtained a 54 percent response rate to our survey of contractors.

It is likely that our two surveys did not identify all instances of offshoring in the four state-administered programs. Therefore, the figures we cite for the four programs on the number of contracts in which some services were offshored and the total expenditures for these contracts should be viewed as minimum levels. To further understand the nature of contracting in these programs, we conducted site visits to Florida, Utah, and New York. We selected these states based on the presence of offshoring in multiple programs or in multiple contracts within a program.

[2] In some states, TANF is administered at the local level. Because we did not examine local TANF contracting, this report does not provide information about the occurrence of offshoring by local TANF administrators.

At these site visits, we interviewed state program officials and reviewed contract-related documents.

To determine whether any services are performed outside of the United States in the two federal student aid programs, we interviewed officials from the U.S. Department of Education's Office of Federal Student Aid (Student Aid) and reviewed departmental directives and contracting documents. While the Department of Education is responsible for overall administration of the Federal Family Education Loan program, loans are financed by commercial lenders such as banks and credit unions and non-profit lenders such as postsecondary institutions. State and national non-profit guaranty agencies administer the federal insurance that protects these lenders against losses and perform a variety of administrative functions. We did not include commercial and non-profit lenders or the guaranty agencies in this review. Rather, we focused on cases in which the Department of Education entered into direct contracts for services related to program administration.

To determine what actions states and the federal government have taken to limit offshore work in these programs, we reviewed laws, policies, and executive actions, including those identified through our state survey. Appendix I provides further details about our scope and methodology. Our work was conducted between January 2005 and February 2006 in accordance with generally accepted government auditing standards.

Results in Brief

Some work is performed offshore in the majority of states for the four federally-funded state-administered programs we reviewed, but no work is performed offshore for the two federally-administered student aid programs. Offshoring occurred in one or more programs in 43 of 50 states and the District of Columbia, most frequently in the Food Stamp and TANF programs. However, expenditures for services performed offshore in the four state-administered programs appear to be relatively small. Expenditures for contracts with some offshored services totaled at least $335 million—or about 18 percent—of the $1.8 billion in expenditures for all the state contracts in the four programs. Moreover, the magnitude of actual spending on the offshored services we identified is likely considerably lower than $335 million because for many of the contracts with some offshoring, the bulk of services are performed in the United States. For example, the U.S. company that holds the majority of state contracts with some offshoring in the Food Stamp and TANF programs estimated that services performed offshore constituted less than 3 percent of the total services provided through these contracts. We could not determine the specific amounts of spending on offshored services for several reasons, including that contractors generally do not provide states with the itemized cost of each service that is bundled in their contracts. The services states most frequently reported as being performed offshore in 31 states in the Food Stamp program and 16 states in the TANF program were functions related to customer service, such as call centers. In contrast, offshored services reported in 8 states in the Unemployment Insurance program and 12 states in the Child Support Enforcement program did not involve direct contact with program recipients but were functions related to software development. Offshoring in the four programs rarely involved state government agencies contracting directly with foreign companies; rather, it involved U.S. contractors using subcontractors that performed work offshore. India was by far the most prevalent offshore location, followed by Mexico, but some offshore work was also performed in Canada, Ireland, and Poland. We did not find any occurrences of offshoring in the contracts for administration of the Pell Grant and FFEL programs. Prior to initiating a security screening, Education requires that contractor employees who will work on high-risk department contracts, including those for the Pell and FFEL programs, be U.S. citizens or lawful permanent residents who have resided in the United States for at least 3 years. While this requirement is intended to facilitate the required background investigations and ensure that contractor employees are legally permitted to work in the United States, it limits the extent to which Education can enter into contracts with companies that perform services offshore. In contrast, federal agencies have not established such a requirement for state contractors in any of the four state-administered programs we reviewed.

State officials reported that lower costs are a benefit of having services performed offshore and few officials identified any problems with offshore service providers in their contracts. All 15 state program directors that reported having performed cost comparisons for their contracts based on differences in the location of services, reported that there are cost savings associated with having some of the work performed offshore. These comparisons showed that their contracts, with some services performed offshore, would cost from 0.3 percent to 24 percent less than if all the services in these contracts were to be performed in the United States. The few state officials that reported any problems with the quality of services provided by offshore contractors said that they involved difficulties in understanding the English of software programmers or customer service representatives. However, it is unclear how much these reports reflect the actual extent of performance problems with offshore providers in these programs. While some state officials may be knowledgeable of the performance of their offshore subcontractors, other officials rely on their primary contractors to monitor the subcontractors.

While numerous actions have been proposed at the state and federal levels to limit offshoring by government agencies, few restrictions exist with respect to the six programs we reviewed. Two states—New Jersey and Arizona—have prohibited offshoring in state contracts. Reasons cited for these prohibitions include concern over a potential increase in local unemployment rates and a potential risk to the protection of private information. At least five states have also taken other actions, such as requiring state agencies to disclose when state-contracted work is performed offshore or to report on the implications of offshoring. As a result of actions taken by some states and concerns by state governments, eight states have relocated previously offshored Food Stamp or TANF call center services to the United States and one state—North Carolina—has converted a previously offshored service into a state-run operation. The federal government does not have regulations specifically related to the offshoring of services in the programs we reviewed.

We do not make recommendations in this report. The Departments of Agriculture, Education, Health and Human Services, and Labor did not have comments on this report. The Departments of Education and Labor provided technical comments that have been incorporated as appropriate.

Background

No commonly accepted definition of offshoring currently exists, and the term includes a wide range of business activities. Generally, services offshoring is used to describe the replacement of domestically supplied service functions with imported services produced offshore. This definition focuses on a business's decision to contract out: should it produce the services internally, contract with a company located in the United States (outsourcing), or contract out with companies based offshore? Offshoring has also been used to describe the movement of domestic production (and the related jobs) offshore. In this case, the definition focuses not on imports of services from abroad, but on U.S. companies investing offshore. Business and professional services such as accounting, bookkeeping, and software programming and design do not have to be performed on site, and, therefore, can be outsourced offshore to any location. For example, a U.S.-based company can stop producing certain services in-house and instead purchase them from a company with foreign-based staff or a state government could contract out its software programming to a company with foreign-based staff.[3]

While limited, U.S. government data provide some insight into trends in offshoring of services.[4] Trade data from the Department of Commerce show that, generally, imports of services associated with offshoring are growing. Federal procurement data show that the total dollar value of the federal government's services contracts with offshoring increased between 1997 and 2002. However, when compared to all federal contracts with services, the proportion showed little change during that time.

State and Federal Programs We Examined

The federal government provides benefits (for example, food, child care, or income subsidies) through human services programs. Table 1 provides information on the state and federal human services programs we examined. The four state-administered programs spent about $15.7 billion dollars in state and federal funds on program administration in fiscal year 2004 (the most recent year for which expenditure data were available for all four of the programs).

[3]For a detailed discussion of the various types of business activities associated with offshoring, see GAO-04-932.

[4]These data do not encompass all of the various business activities associated with offshoring. See GAO-04-932 for further discussion of what government data indicate about services offshoring.

Table 1: State and Federal Programs Included in GAO's Review of Offshoring

Dollars in billions

Program	Program purpose	Federal agency	Expenditures for Program Administration: Federal administrative expenditures for FY 2005	Federal administrative expenditures for FY 2004	State administrative expenditures for FY 2004	Total administrative expenditures for FY 2004
Programs administered by state governments						
Child Support Enforcement	To help locate non-custodial parents, establish paternity when necessary, establish orders for support, and collect and distribute child support payments.	Department of Health and Human Services, Administration for Children and Families	$3.6	$3.5	$1.8	$5.3
Unemployment Insurance	To provide unemployment benefits to eligible workers who are unemployed, through no fault of their own, and meet other requirements of state law.	Department of Labor, Employment and Training Administration	2.7	2.7	0.3	3.0
Food Stamp	To provide basic nutrition to low-income individuals and families.	Department of Agriculture, Food and Nutrition Service	2.4	2.5	2.6	5.1
TANF	To provide time limited assistance and work opportunities to needy families.	Department of Health and Human Services, Administration for Children and Families	Not currently available	1.5[a]	0.8	2.3

Dollars in billions

Program	Program purpose	Federal agency	Expenditures for Program Administration: Federal administrative expenditures for FY 2005	Federal administrative expenditures for FY 2004	State administrative expenditures for FY 2004	Total administrative expenditures for FY 2004
Programs administered by the federal government						
FFEL	To provide below-market, variable-interest-rate, long-term loans to defray tuition costs for students enrolled in participating postsecondary schools.	U.S. Department of Education, Office of Federal Student Aid	0.2[b]	0.2	Not applicable	0.2
Pell Grant	To provide grants (not required to be repaid) for undergraduate students.	U.S. Department of Education, Office of Federal Student Aid	0.3[c]	0.3[c]	Not applicable	0.3

Source: Departments of Health and Human Services, Agriculture, Labor, and Education; and Office of Management and Budget.

Note: Total expenditures may not equal sum of federal and state expenditures due to rounding.

[a]Federal law allows states to spend up to 15 percent of their TANF block grants on administrative functions, which do not include spending on systems. The amount presented here represents the total spending for administrative functions and spending on systems. The most recent available data are from 2004.

[b]In addition to this amount, the Office of Federal Student Aid paid $549 million in administrative funds to guaranty agencies for the FFEL program in 2005 and $613 million in 2004.

[c]This figure represents administrative payments to institutions. In 2004, the Office for Federal Student Aid spent a total of $117 million for the administration of all student aid programs and a total of $719 million in 2005 for the administration of all student aid programs.

Federal Mandates May Influence Outsourcing

The federal government and some states have outsourced in response to federal mandates to automate or centralize certain functions of human services programs. For example, the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) of 1996 required states to establish a central unit for receipt and disbursement of child support payments from non-custodial parents and employers. According to data reported by the federal program office in March 2005, 27 state programs for child support enforcement have contracted with private companies to handle all or some of these functions. The federal government provides a 66 percent match to state spending for most of the administration of child support enforcement.

PRWORA also required states to implement electronic benefits transfer (EBT) systems for the reimbursement of food stamp benefits. EBT allows food stamp recipients to use a plastic card, much like a debit card, to pay for their food from authorized retailers and have the benefit deducted from the household's allocation. EBT contracts generally include a range of programs and support functions, including customer service. It is this complete group of services, often referred to as "bundled," that are included under the term "EBT" and for which states contract out. All 50 states and the District of Columbia provide Food Stamp benefits through EBT. Forty-eight states and the District of Columbia have contracts with private companies to provide all or some of these EBT services. The federal government provides a 50 percent match for most EBT and other administrative functions for states. Some states combine the distribution of benefits for Food Stamps with cash assistance under TANF. As such, some states spend TANF funds for the administration of their EBT systems. Thirty-six states distribute TANF benefits via EBT in combination with Food Stamps and other programs. While not mandated to do so, some Unemployment Insurance programs are redesigning their benefits systems to provide efficient and cost-effective services to unemployment insurance customers through electronic submission of applications and wage and tax data. Through federal unemployment taxes, the federal government provides all of the funding for the administration of Unemployment Insurance programs at the state level.

The 1998 reauthorization of the Higher Education Act of 1965 mandated the Office of Federal Student Aid (Student Aid) to integrate its separate computer systems, improve service to its customers and employees, and reduce its operational costs. Through the use of contractors, Student Aid is replacing these separate computer systems that aid the office in performing business operations such as determining eligibility, processing aid applications, and disbursing grants and loans with integrated computer systems. Through integrated computer systems, Student Aid will be able to streamline data sharing among schools, lenders, and its offices and eliminate system redundancies. The Higher Education Act also requires Student Aid to establish appropriate administrative, technical, and physical safeguards to ensure the security and confidentiality of privacy-protected information used in these systems. In 2004 and 2005, Student Aid spent about $500 million annually on information technology related to its programs.

Most States Perform Some Functions Offshore in Four State-Administered Programs, but No Offshoring Is Occurring in Two Federally-Administered Student Aid Programs

In the four state-administered programs we reviewed, 43 of 50 states and the District of Columbia have offshoring in one or more programs, but we did not find occurrences of offshoring in the two federally-administered programs. Offshoring occurs most often in the Food Stamp and TANF programs. We also found offshoring in Unemployment Insurance and Child Support Enforcement programs, but in fewer states. While the magnitude of expenditures on offshored services appears to be relatively small, we could not determine the specific amount of these expenditures for several reasons. Services most frequently reported as being performed offshore include customer service for the Food Stamp and TANF programs, and software development for the Unemployment Insurance and Child Support Enforcement programs. In all four programs, state officials rarely contracted directly with foreign companies to perform these services. Rather, state officials used U.S. contractors that either used subcontractors that performed the work offshore or used their own workers located offshore. In the federal student aid programs we examined—the Pell Grant and FFEL—we found no occurrence of offshoring. Education's efforts to safeguard high-risk work in these programs, through security screenings for contractor employees, has the effect of limiting the extent to which services can be performed offshore.

Most Offshoring Occurs in the Food Stamp and TANF Programs

Forty-three of 50 states and the District of Columbia have offshoring in one or more of the four state-administered programs. Offshoring was most often cited by state program directors and contractors in the Food Stamp (31 of 51) and TANF programs (16 of 51). Occurrences of offshoring were less frequently reported by state program directors and contractors in the Child Support Enforcement (12 of 51) and Unemployment Insurance programs (8 of 51). Of the state program directors we surveyed, most reported that they knew where services are performed and reported no offshoring in their contracts, but several state officials said they were uncertain about offshoring in their contracts. State officials most frequently reported that there was no offshoring in their contracts because they closely monitor contracts and know where the services are performed. However, our survey of contractors uncovered additional occurrences of offshoring in all four programs in some contracts for which state officials had reported either that no offshoring was occurring or that they were uncertain whether offshoring was occurring. In 16 states, we found offshoring in certain contracts where state officials had reported that the contractor performed all services within the United States.[5] Figure 1 shows the states and programs in which state officials and contractors reported offshoring in one or more contracts (including the 16 states) and also provides information on the total number of reported occurrences of offshoring in each of the four programs.

[5] We also found offshoring in one of these states in which a state official was uncertain about the location where contracted work was performed.

Figure 1: Offshoring in Four State-Administered Programs in 2005, as Reported by State Program Directors and Contractors

	Child Support Enforcement	Food Stamp	Unemployment Insurance	TANF
Alabama		▲		
Alaska		▲		
Arizona		—		▲
Arkansas			—	
California		▲		▲
Colorado		▲		
Connecticut	▲		—	▲
Delaware		▲		
District of Columbia		▲		
Florida	▲	▲		▲
Georgia		▲		▲
Hawaii		▲		—
Idaho		▲		▲
Illinois	▲			—
Indiana		▲	—	▲
Iowa				
Kansas	▲	▲		
Kentucky		▲	—	
Louisiana	▲	▲		
Maine				
Maryland		▲	▲	▲
Massachusetts	▲	▲	▲	
Michigan		▲		
Minnesota			▲	
Mississippi				
Missouri				
Montana			▲	
Nebraska		▲		
Nevada				

	Child Support Enforcement	Food Stamp	Unemployment Insurance	TANF
New Hampshire	▲	▲		▲
New Jersey	▲			
New Mexico		▲	▲	—
New York		▲	—	▲
North Carolina				
North Dakota		▲		
Ohio	▲	—		—
Oklahoma	▲			
Oregon				
Pennsylvania		▲		▲
Rhode Island		▲		▲
South Carolina			▲	
South Dakota		▲		
Tennessee		▲		▲
Texas	▲			
Utah		▲		▲
Vermont		▲		▲
Virginia		▲		
Washington		—	▲	—
West Virginia	—	▲		
Wisconsin	▲	▲	▲	
Wyoming				▲
Total[a]	**12**	**31**	**8**	**16**

▲ Programs with at least one contract with offshoring

— Programs that did not provide a survey response

Source: GAO survey.

[a]The sum of the totals for the four state-administered programs exceeds 51 (50 states plus D.C.) because offshoring was reported in more than one program in some states.

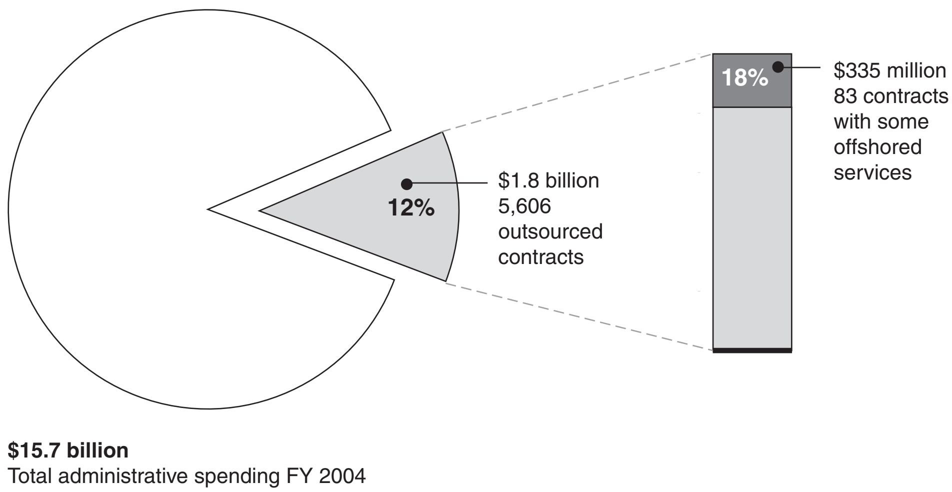
Magnitude of Spending on Offshored Services Appears to Be Relatively Small, but Is Difficult to Determine

The magnitude of spending on offshored services in the four state-administered programs appears to be relatively small with respect to total spending on outsourced services, but is difficult to quantify. In total, administrative spending across the four programs was about $15.7 billion in fiscal year 2004. At the time of our review, the four programs had about 5,606 contracts valued at approximately $1.8 billion (or 12 percent of total administrative spending).[6] The total value of the 83 contracts where some offshoring occurred was at least $335 million. For nine of these contracts, state officials did not report total contract costs. The contracts with reported offshoring comprised 2 percent of the total number of contracts and about 18 percent of the total spending for all contracted-out services across the four programs. However, the magnitude of actual spending on the offshored services we identified is likely considerably lower than $335 million because for many of the contracts with some offshoring, the bulk of services are performed in the United States. For example, the U.S. company that holds the majority of state contracts with some offshoring in the Food Stamp and TANF programs estimated that services performed offshore constituted less than 3 percent of the total services provided through these contracts. Similarly, a contractor providing services to several child support enforcement programs stated that offshored computer software programming comprised less than 1 percent of the total package of services provided to states. Figure 2 shows the estimated spending on contracts with some offshoring out of the total spending on administration across the four state-administered programs.

[6]There were an additional 201 contracts (for a total of 5,807) for which we did not receive values.

Figure 2: Estimated Spending in 2005 on Contracts with Some Offshored Services in the Four State-Administered Programs, Relative to Spending on Outsourced State Contracts and Total Administrative Spending

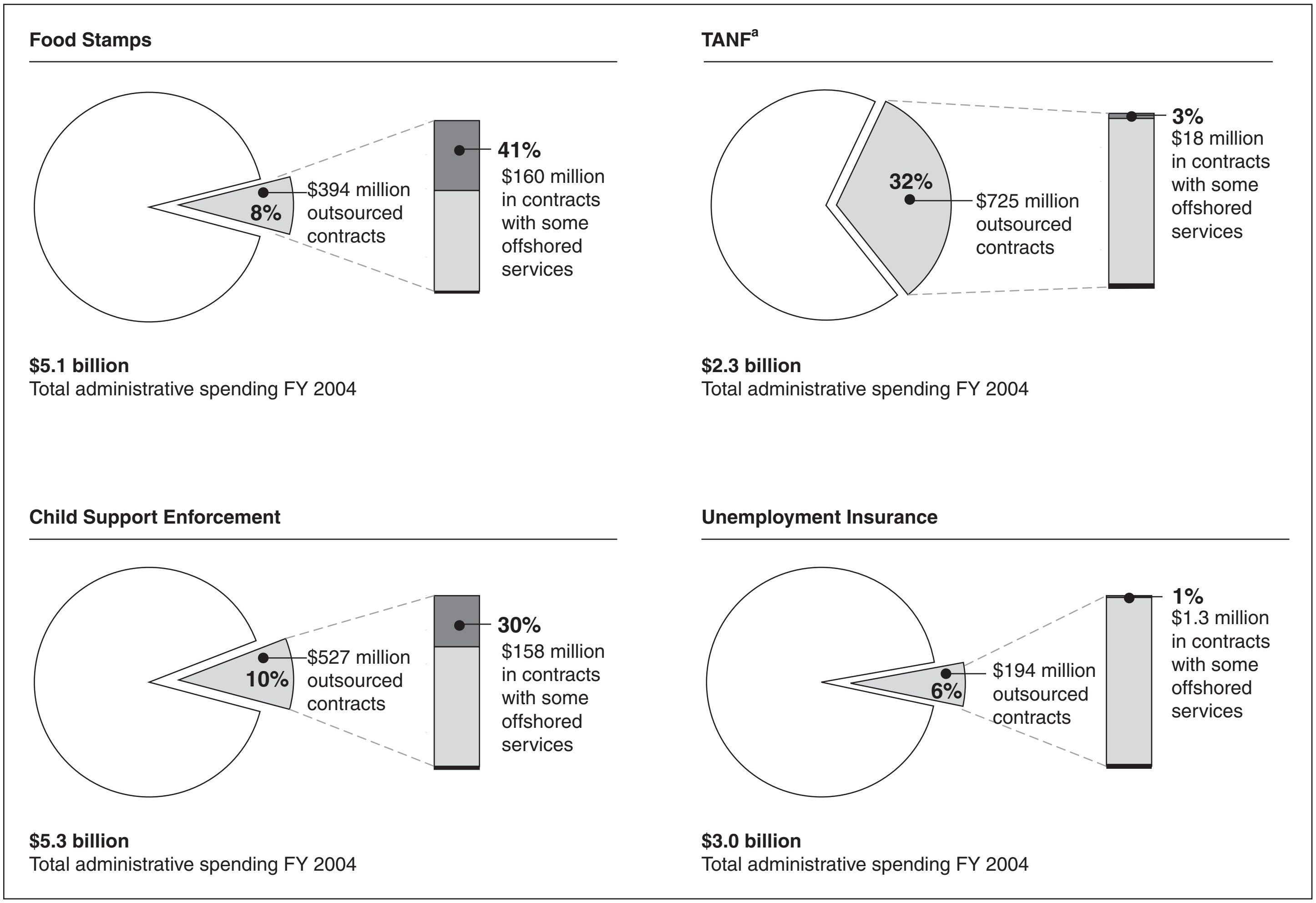
Estimated spending on contracts with offshoring



Source: Departments of Health and Human Services, Agriculture, and Labor; Office of Management and Budget ; and GAO survey.

The level of spending on contracts with some offshored services varies considerably among the four state-administered programs. As shown in figure 3, spending on contracts with some offshored services constituted 30 percent or more of total spending on outsourced contracts in the Food Stamp and Child Support Enforcement programs. The comparable percentages for the TANF and Unemployment Insurance programs are considerably lower.

Figure 3: Estimated Spending in 2005 on Contracts with Some Offshored Services in Each State-Administered Program, Relative to Spending on Outsourced State Contracts and Total Administrative Spending



Source: Departments of Health and Human Services, Agriculture, and Labor; Office of Management and Budget; and GAO survey.

[a]Because of data limitations, the TANF figures for outsourced contracts and contracts with some offshored services are understated to some extent. In some cases, EBT contracts were jointly funded with Food Stamp and TANF dollars, but we were unable to disaggregate the amount of funds provided by each program. In such cases, we allocated the entire annual contract amount to the Food Stamp program.

State officials in seven states provided estimates for their Food Stamp or TANF contracts of the percent of contract spending represented by offshore services and these estimates ranged from 3 to 39 percent of the total expenditures for each contract. However, it is unclear whether this range of estimates reflects levels of offshore spending in the other contracts with offshoring. The state officials who provided these spending estimates did not report expenditure data for each service in their contracts. For example, officials in New York told us that they do not receive itemized lists of costs for each service from their contractors who, in some cases, consider the information proprietary. The contractors providing services to states also reported that prices were not itemized, that companies sometimes use the same resources for many states or for private clients, and that the costs for specific services cannot be calculated for any one contract.

Services Most Frequently Reported as Being Performed Offshore Include Customer Service and Software Development

In the Food Stamp and TANF programs, state officials reported that contractors most frequently offshored certain customer service functions related to EBT systems. EBT systems encompass a wide a range of services and state officials reported that call centers with human operators and staff help desks were the services EBT contractors most frequently performed offshore. EBT call centers were offshored in 24 states. Typically, the offshoring scenario for call centers is when a food stamp recipient calls into the automated system to report a lost or stolen EBT card, inquire about balances, or obtain other assistance for example. The recipient can choose an option to be connected to a customer service representative. The telephone call is then routed to an offshore location, such as India if they are an English speaker or Mexico if they wish to speak to someone in Spanish, where a person in a call center handles the call. Staff help desks work much like call centers with human operators, but are typically available to help state program staff solve administrative problems such as accessing data from the EBT system. Staff help desks were offshored in 10 states. Figure 4 provides more details on the extent to which various types of EBT system services are performed offshore.

Figure 4: Typical Services Included in EBT Systems Contracts and Extent to Which the Services Are Performed Offshore in the Food Stamp and TANF Programs

Services most frequently offshored

- Live customer service representatives available 24 hours a day, 7 days a week for clients and merchants
- Help Desk for state and local staff

Services sometimes offshored

- Card issuance and personal identification number (PIN) selection
- Electronic benefits transfer (EBT) system software development
- Back-up training for EBT-only retailers

Services rarely or never offshored

- Project and contract management
- Project and system documentation
- EBT system hardware
- Online state/local office access to the EBT system
- Training materials for state, client, and EBT only retailers
- EBT account set-up and maintenance
- EBT transaction processing
- Daily settlement and reconciliation
- Daily and monthly reporting
- Installation of EBT machines and training for merchants
- Providing access to the EBT network for Third Party Processors (TPP) such as banks
- Maintaining systems that allow benefit recipients to use EBT cards across states

Source: GAO surveys of and interviews with state officials and contractors.

EBT contracts include a range of programs and support functions. EBT contractors told us that customer service is considered a support function. Contractors also said that certain other services may be performed offshore, including claims investigations when an EBT cardholder suspects a problem, supplemental software programming, and data entry. Contractors that provide some EBT services offshore said that even when the majority of a service is performed in the United States, backup services can operate offshore. For example, an offshore call center can assume the overflow workload of a U.S.-based call center in responding to benefit recipients.

In the Unemployment Insurance and Child Support Enforcement programs, the services most frequently performed offshore are software development and related services.[7] The services contractors performed offshore for Unemployment Insurance fell into three general areas: development of software for a computer system (e.g., a case management system), development of Web-interfaces (the actual systems the public would use), and computer system maintenance.[8] In four of the five states in which program directors reported offshoring in the Unemployment Insurance program, the offshoring occurred in contracts to convert all or some of a mainframe computer system to a Web-based system. In child support enforcement programs, the service contractors most often performed offshore was software development.[9] State program directors provided examples of services performed offshore in their contracts in the areas of software programming, Web development, and computer maintenance. The following examples illustrate the services that particular states have offshored in these programs:

- **Software Programming**: In South Carolina, the contractor hired to update the state's system for managing employer taxes is using software programmers in India to develop the new system. In Wisconsin, while the actual software programming was conducted in the United States, the contractors used an offshore help desk to obtain technical assistance in conducting software programming services. In several child support enforcement programs, the software designed for payment machines used in handling the receipt and disbursement of child support payments was created offshore. While the payment machines are housed and operated

[7]Across the four programs, state officials less frequently cited services such as document management, Web site development, and interpretation and translation as being performed offshore.

[8]Indiana has created an electronic payment card that Unemployment Insurance recipients can use for making purchases and withdrawing cash and will outsource this service to a private company. This new service suggests that Unemployment Insurance programs may be moving toward contracting out for services beyond software programming.

[9]We obtained this information from our survey of contractors. State officials that responded to our survey did not report software programming as being performed offshore. One child support enforcement official reported offshoring in genetic testing. While all states conduct genetic testing as part of child support enforcement, only one state official indicated that genetic testing was performed offshore. This official explained that genetic testing could be performed anywhere within the United States or outside of the United States, depending on where the non-custodial parent resides. As such, the company with which the state contracts could subcontract with foreign private physicians or companies to perform these tests if the non-custodial parent resided outside the United States.

within the United States, the company that produces the software that runs a part of the machine's operating system creates the software in India.

- **Web Development**: In New Mexico the contractor performed Web development services in India as part of the development of the front-end system to allow the public to file on-line claims.

- **Maintenance**: Contractors for Washington and Montana offshored the periodic maintenance work required when the state needs assistance with a particular machine or for periodic testing on a system. Contractors for Washington conducted the offshored maintenance work from a variety of locations depending on the time of day the request was initiated. Contractors for Montana conducted the maintenance work in Poland for any upgrades to the system.

Contractors Most Often Perform Offshore Services through Subcontractors that Operate in India and Mexico

Offshoring in the four state-administered programs almost always occurred when U.S. companies subcontracted with companies that performed work offshore. Generally, states did not directly contract with foreign companies.[10] As such, contractors, not state officials, made the decision to offshore in delivering the services the state requires. In addition, some contractors that use offshore subcontractors provide services to a large number of states. For example, one company holds the EBT contracts with offshoring in 28 of the 31 states where we identified offshoring in the Food Stamp and TANF programs. In 11 of the 31 states, the Food Stamp and TANF programs were covered under the same EBT contract that state officials or contractors identified as having some services performed offshore.

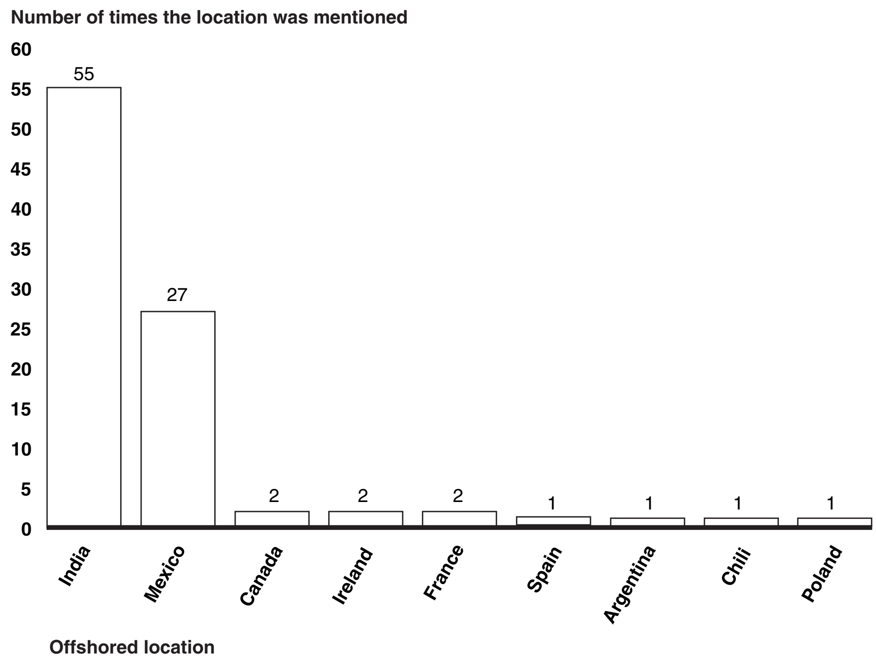
In the states where we identified offshoring, offshored services were most often performed by subcontractors. Offshore subcontractors provided services for states on both a continual and intermittent basis. In some cases such as EBT call centers, the subcontractor performed a variety of services on a consistent basis over the life of the contract, including the operation of the call center. In other cases, subcontractors work on an as-needed basis. For example, a contractor building a new computer system may use software or hardware from various companies. The subcontractors would be the companies that produced these various

[10]For three of the contracts with offshoring, states had contracted with foreign companies that had offices and employees in the United States as well as offshore operations.

software and hardware parts and would be called upon as needed to provide maintenance or assist in resolving problems with their products. In certain cases, services are performed offshore within short time frames or in response to unexpected deadlines. For example, an EBT contractor told us that during a peak period in the company's workload, it may use an overseas source to expedite the development of Internet-based information portals used by state officials.

India and Mexico were the most frequently cited locations where contractors and subcontractors performed offshored services in the four state-administered programs, as shown in figure 5. Other locations where services were offshored include Canada, France, Ireland, and Poland. In the Food Stamp and TANF programs, EBT call centers operated in India for English-speaking callers and Mexico for Spanish-speaking callers. In the Unemployment Insurance and Child Support Enforcement programs, most contractors performed services related to software programming in India. We also found examples of software programming work in France and Poland. State officials in Washington, while unable to identify the countries where services were performed, said contractors offshored so that customers can reach a customer service representative or technician 24 hours a day, 7 days a week.

Figure 5: Offshore Locations Most Frequently Reported by State Officials and Contractors in the Four State-Administered Programs



Source: GAO survey.

Mandatory Security Screenings of Contractors Limit Offshoring in the FFEL and Pell Grant Programs

Education officials did not report—and we did not find—any occurrences of offshoring in the two contracts for Information Technology (IT) development and 21 contracts for debt collection services for the FFEL and Pell Grant programs.[11] Education officials in the Office of Federal Student Aid (Student Aid), the office within Education that administers the FFEL and Pell Grant programs, reported that the locations where contractors and subcontractors performed work were all within the United States and that some contractors worked on-site at Education facilities. Student Aid officials told us that they are certain about the location where contracted services are performed because in some cases contractors provide the information and in other cases they require all

[11] Federal Family Education Loan loans are financed by commercial lenders such as banks and credit unions and non-profit lenders such as postsecondary institutions. State and national non-profit guaranty agencies administer the federal insurance that protects these lenders against losses and perform a variety of administrative functions. We did not include commercial or non-profit lenders or guaranty agencies in our review. Education officials told us that these private lenders most likely offshore some services.

contractors to disclose the locations where they will perform all contracted services. However, with the exception of debt collection contracts, Student Aid does not have specific requirements to monitor whether contractors are performing work within the United States or offshore after the contract is signed. Student Aid officials stated that contracting officials monitor the location where contractors perform services for the programs through the office's general contract monitoring efforts. These efforts include reviewing financial and performance audits, inspecting agreed-upon products, reviewing invoices, and conducting site visits. For debt collection contracts, Student Aid requires contractors and their subcontractors to provide bi-annual updates of the locations where they perform services.

Student Aid officials told us that a departmental requirement for contractor employees to be U.S. citizens or lawful permanent residents has the effect of preventing contractors from performing some services offshore in the FFEL and Pell Grant programs. Education has varying levels of security screenings for contractors based on the risk level associated with the work being performed. Before proceeding with appropriate security screenings for contractor employees working in high risk positions, Education requires employees to be either U.S. citizens or lawful permanent residents who have resided continuously in the United States for a minimum of 3 years.[12] The residency requirement is associated with the security screening and it was not established to limit offshoring; however, it has the effect of ensuring that departmental contractors are in fact performing their services in the United States. The residency requirement applies to all high-risk contractor employees, including those working on the FFEL and Pell Grant contracts. We did not find anything in the department's policy that restricted U.S. citizens from performing contracted work offshore.

Similar to Education, the federal agencies that administer the TANF, Child Support Enforcement, Food Stamp, and Unemployment Insurance programs also have processes for ensuring that federal contractors undergo the appropriate OPM background investigations. Like the

[12]High-risk positions include those with access to Education's IT systems that allow for the bypass of security controls or access. Such high-risk positions include firewall administrators, data entry team leaders, Web server administrators, and security administrators. The Department of Education's policy states that "every effort must be made to minimize and where possible eliminate, the number of non-U.S. citizens employed in High Risk level positions; this applies to all contractors and sub-contractors."

Department of Education, they have department-level requirements that contractor employees be U.S. citizens or legally permitted to work in the United States in order to perform high-risk work. However, these agencies have not established any requirements that would mandate either U.S. citizenship or a minimum period of residence in the United States (for lawful permanent residents) for state governments that are employing contractors for state administration of the TANF, Child Support Enforcement, Food Stamp, and Unemployment Insurance programs.

While the federal agencies have established requirements for the four state-administered programs to protect private information and information systems, states determine how to implement the protections and can establish their own policies and requirements. In some cases, such as in New Jersey and Arizona, state requirements are stricter than those passed down from the federal offices.[13] For example, the federal office that administers the Food Stamp program requires that states ensure the privacy of household data and provide benefit and data security in state EBT systems. The federal office does not prescribe the specific measures states should take in protecting private information and states can take a range of measures including encryption, password protection, physical security measures, and requiring contractors to sign confidentiality statements.

The federal Office of Child Support Enforcement requires states to apply a range of minimum physical and system security measures concerning their child support enforcement systems. New York, for example, also requires subcontractors working on child support enforcement contracts to sign confidentiality statements. In addition, New York also requires contractors and subcontractors to complete a background questionnaire that asks questions related to criminal or civil investigations, adherence to labor laws and other regulations, and the number of employees based outside of the United States.

[13] New Jersey and Arizona have banned offshoring in state contracts for services. We discuss these bans in more detail in our section of the report on what actions states and the federal government have taken to limit offshoring.

State Officials Cited Cost Savings as a Benefit of Contracting with Companies That Offshore Services and Few Officials Reported Any Problems with Offshored Services

State officials reported that contracts with some services performed offshore cost less than contracts with all services performed within the United States and the magnitude of cost savings varied across states. The cost savings associated with their contracts with offshoring tend to be higher when the alternative is performing all the contracted services within their own state, versus somewhere within the United States. While state program directors recognized lower costs as a benefit of contracts with some offshoring, most program officials we interviewed did not report any problems with the quality of services performed by offshore providers.

Magnitude of Cost Savings for Contracts in Which Some Services Are Performed Offshore Varies by State

All 15 state program directors that reported having performed cost comparisons for their contracts, based on differences in the location of services, reported that cost savings are associated with having some of the work performed offshore.[14] The cost savings associated with their contracts that have some offshored services tend to be higher when the alternative is performing all the contracted services within their own state, versus somewhere within the United States. For example, these comparisons showed that their contracts, with some services performed offshore, would cost from about 15 to 32 percent less than if all the services in these contracts were to be performed in-state. Their contracts, with some services performed offshore, would cost from about 0.3 to 24 percent less than if all the services in these contracts were to be performed somewhere within the United States. State program directors obtained these comparative cost data from contractors through bids or through the process of relocating or considering the relocation of an offshored service to the United States. The contract prices across the states varied, in part, because of differences in the contracts themselves or the different companies that provided services. [15] These cost savings

[14] India was the offshore location in all but one of these cost comparisons.

[15] For EBT contracts in the Food Stamp and TANF programs, caseloads could also impact the total contract price because EBT pricing is based on the number of cases in the contractors' systems. EBT contracts are priced by a unit known as the cost per case month. Companies charge states a cost for each case in the EBT system. This price fluctuates as the total caseload increases or decreases. Typically, the larger the caseload, the lower the cost per case month price will be. Therefore, for some TANF cases the prices are higher than for Food Stamps, because the TANF caseloads are relatively small.

figures likely understate the cost savings associated with performing a specific service offshore versus in the United States because the figures represent savings in the cost of a total contract, and we know that in many cases only a few services are offshored in these contracts. Table 2 provides more detailed information by state and program for the cost comparisons.[16]

Table 2: Percent Cost Savings Represented by States' Contracts with Some Offshored Services

	Food Stamp	TANF	Unemployment insurance	Type of contract for which the comparison was made	Approximate annual contract value[a]
Percent Cost Savings for Contracts with Offshoring When Compared to Performing All Contracted Services In-State					
Missouri	15	28	[b]	EBT	[b]
Mississippi	[b]	[b]	32	Software programming	$1,200,000
Percent Cost Savings for Contracts with Offshoring When Compared to Performing All Contracted Services Somewhere in the U.S.					
Alabama	8	10	[b]	EBT	3,721,332
Alaska	18	[b]	[b]	EBT	554,000
Arizona	[b]	16	[b]	EBT	6,287,000
Arkansas	3	3	[b]	EBT	2,913,905
Idaho	18	[b]	[b]	EBT	1,159,343
Kansas	5	5	[b]	EBT	852,251
Nebraska	13	[b]	[b]	EBT	2,027,256
New York	0.3	0.3	[b]	EBT	24,000,000
Oregon	12	12	[b]	EBT	2,760,000
Pennsylvania	3.6	3.6	[b]	EBT	–
Utah	5	5	[b]	EBT	1,720,000
West Virginia	9	[b]	[b]	EBT	4,200,000
Wisconsin	24	[b]	[b]	EBT	3,000,000

Source: GAO analysis of survey and interview data from state officials.

[a]The percentages for TANF and Food Stamps are for the same EBT contract. We did not receive contract values from Missouri and Pennsylvania.

[b]In cases where we did not list a percentage, the programs did not provide estimates of cost savings.

The contractors we interviewed confirmed that performing services offshore would typically cost states less than performing services within

[16]State officials did not report performing any cost comparisons for the child support enforcement program.

the United States or within a specific state, and the average cost savings figures they provided mirrored those reported by state officials.[17] Contractors providing EBT services, for example, said that reasons for offshoring call centers to India were to reduce operating costs, improve the quality of customer service, and find people who were willing to work overnight. Contractors we interviewed also told us that they consider multiple factors, including state requirements, volume of work, and competitive pricing, in pricing services performed within and outside of the United States. These contractors also consider the methods for determining a price to be a trade secret. When calculating the price increase to move services from an offshore location to the United States, contractors generally take into account the planning of resources to manage the transition, install equipment, train staff, evaluate the need for subcontracting, and manage quality assurance.

Few State Officials Identified Problems Associated with Offshoring

Most state officials we interviewed did not report any problems with the quality of services by offshore contractors. However, it is unclear how much these reports reflect the actual extent of performance problems of offshore providers in these programs. While some state officials may be knowledgeable of the performance of their offshore subcontractors, others may rely on their primary contractors to monitor these subcontractors.

Few of the 38 state program directors with either current contracts with offshoring or contracts where services were recently performed offshore but were relocated to the United States identified any problems with offshore service providers. The three officials that indicated problems with offshored services in their contracts said that those problems were related to difficulties in understanding the English of software programmers and customer service representatives in India. Other state officials offered positive reactions to the work of their offshore service providers. For example, six officials with contracts where EBT call centers were located in India said that the offshore call centers posed no challenges and reported specifically that customer service representatives performed well. Two of these six officials said that the call centers were of high

[17] According to several business studies, the primary reasons that organizations engage in offshoring are to reduce costs and to gain access to a workforce in another country that can enable them to work around the clock to meet worldwide customer needs. For more discussion on the incentives for offshoring see GAO, *Offshoring of Services: An Overview of the Issues*, GAO-06-5 (Washington, D.C.: Nov. 28, 2005).

quality based on their monitoring of calls between customer service representatives in India and benefit recipients in the United States. One official said that a benefit of having software programming contractors based in Poland was that the contractors conducted work overnight and had products ready for state staff the next day.

All but four[18] state officials that reported some services in their contracts were offshored also reported that the contracted services had never been performed by state employees. In some cases, such as with EBT, the services were new to states, while in other cases, the services were not new but had previously been outsourced. In some contracts with offshoring, state officials reported that the decision to outsource services stemmed, in part, from a lack of state employees with the needed expertise. For example, officials in New York stated that they had difficulty finding persons with the skill set for a certain software programming language. The salaries offered by the state government could not meet the higher salaries demanded by persons with the required skills, according to state officials.

[18]The circumstances varied in these four states—Connecticut, District of Columbia, Florida, and Montana. For example, in Florida, state employees gradually moved out of the software programming positions through downsizing, transfers to employment with the contractor, or general attrition over a 10-year period. In Montana, contractors were not replacing the state employees, according to a Montana state official. In Connecticut, state employees had previously performed some of the services that were outsourced but not the specific service that was offshored—maintenance on an automated response system.

Few States Have Taken Actions to Ban Offshoring and No Federal Provisions Specifically Restrict Offshoring of Services in the Six Human Services Programs We Reviewed

While numerous actions have been proposed at the state and federal levels to limit offshoring by government agencies, few restrictions have been enacted—and only at the state level—with respect to the six programs we reviewed. In addition, eight state programs have required contractors to relocate previously offshored services to U.S. locations. There are no federal prohibitions specifically relating to the offshoring of services in the six programs we reviewed.[19]

State Actions Affecting Offshoring Vary from Bans to Reporting Requirements

Actions have been proposed in many states to limit offshoring but few states have actually taken actions to limit offshoring. State actions pertaining to offshoring range from outright bans on offshoring, to requirements for contractors to disclose the locations where they will perform work, to requirements for state officials to report periodically on the extent of offshoring. These actions have been taken through various mechanisms, including executive orders, state laws, and agency rules.

Two states—New Jersey and Arizona—have banned offshoring in state contracts. Through a state law, New Jersey has prohibited offshoring in all state contracts for services. In a procurement agency directive, Arizona prohibited offshoring in state contracts and required state agencies to include a specific clause in contracts and future requests for proposals that specifies that work must be performed in the United States. Arizona's prohibition does not apply to indirect services, back up services, or services deemed incidental to the performance of the contract. Kansas prohibited offshoring related to its EBT services and work performed by one agency for a limited time in a state appropriations act, but as of June 2005, this provision was no longer in effect.

[19]The Trade Agreements Act of 1979 (19 U.S.C. 2511) allows the U.S. government to procure products and services from entities in designated countries (generally those with which the United States maintains certain trade agreements). However, it prohibits procurement from entities in countries that are not "designated countries." (19 U.S.C. 2512.) Neither this act nor the Buy American Act (41 U.S.C. 10a) nor their implementing regulations expressly mention procurement of services from contractors whose employees are located outside the United States.

At least five states—Alaska, Colorado, Illinois, Minnesota, and Missouri—have taken actions that do not directly limit offshoring but require that information be provided on the location where contracted work is performed. For example, Missouri requires contractors to provide information in bids for state contracts about the location where work will be performed. Missouri allows offshoring if the contractor or subcontractor has what the state considers a significant business presence in the state and performs a small portion of work under the contract outside of the United States or the cost is significantly lower than what it would cost to have all of the services provided within the United States. In Illinois, contractors are required to disclose the location where services will be performed prior to signing a contract. Illinois also allows the state to make the requirement for disclosure a part of an agency's request for proposals and gives the chief procurement officer authority to consider the location where services will be performed in making award decisions. In addition to requiring contractors to disclose where they will perform work, Minnesota and Illinois also require periodic reports on the extent of offshoring in state contracts.

Varied perspectives on the potential effects of services offshoring have influenced states' decisions about offshoring.[20] For example, executive orders requiring disclosures by prospective contractors in Alaska, Minnesota, and Missouri cited concerns over aggravating unemployment, the possible detriment to state economies, and a potential reduction in protections for private and personal information. In contrast, legislators and elected officials in other states have expressed concerns about legislation that would seek to restrict contracting outside the United States. For example, in vetoing a bill seeking to prohibit offshoring in 2004, California's governor cited a possible increase in prices paid by the state for goods and services and the potential violation of international trade agreements. Other concerns expressed by states that did not pass proposed legislation restricting offshoring include increased administrative costs for agencies required to enforce the restrictions, added layers of contract approval processes, and the impediment of missions of certain agencies, such as tourism boards and economic development agencies.

[20] For an overview of expert views of the positive and negative impacts of services offshoring on the U.S. standard of living, employment and job loss, income distribution, and security and privacy, as well as the types of policies that have been proposed in response to offshoring, see GAO, *Offshoring of Services: An Overview of the Issues*, GAO-06-5 (Washington, D.C.: Nov. 28, 2005).

State Actions on Offshoring Include Relocating Offshored Services to the United States

State actions on offshoring also include the relocation of services to the United States from their previously offshored locations in some cases. For example, in the four state-administered programs we examined, eight states have relocated offshored EBT call center services to U.S locations.[21] State program directors said that these moves were not required because of problems associated with the quality of the services performed offshore. Rather, the moves were undertaken by state governments to promote local employment and because of concerns raised about protections of private client information. One of these states—North Carolina—converted the EBT call center into a state-run operation and hired local residents to work as customer service representatives. These moves often mean that the states will incur increased costs. For example, North Carolina now pays an additional $1 million per year to operate its own EBT call center. A state official in Arizona estimated that it costs an additional $1.2 million annually to have its EBT call center operated within the United States; and state officials in some other states indicated that, while certain services are currently performed offshore, there were plans for relocating these services to the United States. Three states—Nebraska, Utah, and West Virginia—chose not to relocate offshored services because of the increased costs that they would have incurred.

No Specific Federal Restrictions Exist on Offshoring of Services in the Six Programs We Reviewed

Actions have been proposed at the federal level to restrict offshoring in government programs, but there are no current federal restrictions on offshoring in the six programs we reviewed. Federal proposals to limit offshoring have targeted the Food Stamp and TANF programs. For example, proposed legislation to restrict federal funding in a 2004 appropriations bill would have withheld the federal Food Stamp funding match for any state with offshoring in its Food Stamp program, but the provision was not passed. Similarly, the House version of the Deficit Reduction Act of 2005 would have prohibited the use of federal TANF funds for contracts with companies that offshore directly or through subcontractors, but this prohibition was also not enacted.

[21]These states are Alaska, Connecticut, Missouri, New Jersey, North Carolina, Oregon, Pennsylvania, and Wisconsin. This is current as of October 2005 when we completed our data gathering.

Concluding Observations

Our work provides insights into the occurrence and nature of offshoring in six human services programs. Despite the widespread media attention, our findings show that offshoring of services in state level contracts is not a major practice in the four state-administered programs we reviewed. Looking forward, there are various factors that could influence offshoring in these state programs. As some state legislatures move to restrict offshoring, the private sector continues to increase the use of offshore resources—often seen as a good business practice. Tighter budgets have demanded that states find ways to effectively and efficiently perform their administrative work for lower costs. As such, some states will continue to see a need to outsource program functions to companies that offshore in order to achieve such savings. Other states, concerned about the impact of offshoring on their local economies or workforce, will see a need to restrict the occurrence of offshoring in state contracts. Differences in federal agencies' security-related policies for contractors also have implications for offshoring in federal human services programs. As we have seen, Education's security-related policies for contractors in the FFEL and Pell Grant programs restrict the ability to perform work offshore in these programs, whereas the security-related policies of the federal agencies for the state-administered programs we examined do not have this effect on state-level contracting. Such differences in policies may stimulate further debate about the most appropriate balance of policies pertaining to security and offshoring in various federal human services programs.

Agency Comments and Our Evaluation

The Departments of Agriculture, Education, Health and Human Services, and Labor did not have comments on this report. The Departments of Education and Labor provided technical comments that have been incorporated as appropriate.

Copies of this report are being sent to the Departments of Agriculture, Education, HHS, and Labor; appropriate congressional committees; and other interested parties. Copies will be made available to others upon request. The report is also available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-7215 or at nilsens@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Other contacts and staff acknowledgments are listed in appendix III.

Sigurd R. Nilsen
Director, Education, Workforce,
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List of Committees

The Honorable Michael B. Enzi
Chairman
The Honorable Edward M. Kennedy
Ranking Minority Member
Committee on Health, Education, Labor, and Pensions
United States Senate

The Honorable Saxby Chambliss
Chairman
The Honorable Tom Harkin
Ranking Democratic Member
Committee on Agriculture, Nutrition and Forestry
United States Senate

The Honorable Susan M. Collins
Chairman
The Honorable Joseph I. Lieberman
Ranking Minority Member
Committee on Homeland Security and Governmental Affairs
United States Senate

The Honorable Charles E. Grassley
Chairman
The Honorable Max Baucus
Ranking Minority Member
Committee on Finance
United States Senate

The Honorable Robert W. "Bob" Goodlatte
Chairman
The Honorable Collin C. Peterson
Ranking Minority Member
Committee on Agriculture
House of Representatives

The Honorable Howard P. "Buck" McKeon
Chairman
The Honorable George Miller
Ranking Minority Member
Committee on Education and the Workforce
House of Representatives

The Honorable William M. Thomas
Chairman
The Honorable Charles B. Rangel
Ranking Minority Member
Committee on Ways and Means
House of Representatives

The Honorable Tom Davis
Chairman
The Honorable Henry A. Waxman
Ranking Minority Member
Committee on Government Reform
House of Representatives

The Honorable Joe Barton
Chairman
The Honorable John D. Dingell
Ranking Minority Member
Committee on Energy and Commerce
House of Representatives

Appendix I: Objectives, Scope and Methodology

To obtain information to address our objectives for the four state programs, we administered two separate Web-based surveys. First, we surveyed 204 directors for the Child Support Enforcement, Food Stamp, Temporary Assistance for Needy Families, and Unemployment Insurance programs in all 50 states and the District of Columbia. We received responses from 190 of the directors, for a 93 percent response rate. Five state directors of Unemployment Insurance programs, one state director of Child Support Enforcement programs, three state directors of Food Stamp programs, and five state directors of TANF programs did not respond to our survey. We asked the directors about contracting policies and practices, as well as work performed outside of the United States. We also asked each program director to provide us with information on up to three contracts held by the program: the largest contracts with known offshoring or—if there were fewer than three contracts with offshoring, contracts where officials were uncertain, or there were no contracts with offshore—the largest contracts (in dollars). We then surveyed the contractors whose names were provided to determine the types of services provided to state programs and where these services are performed. Of the 469 contracts covered by the survey, contractors gave responses for 251 of them, for a response rate of 54 percent. The survey data was collected from May 2005 to November 2005.

We worked with social science survey specialists to develop the questionnaires. However, the practical difficulties of conducting any survey may introduce errors. For example, differences in how a particular question is interpreted, in the sources of information that are available to respondents, or how the data are entered into a database can introduce unwanted variability into the survey results. We took steps in the development of the questionnaires, the data collection, and the data analysis to minimize these errors. For example, prior to administering the survey, we tested the content and format of the questionnaires with several state officials and contractors to determine whether (1) the survey questions were clear, (2) the terms used were precise, (3) respondents were able to provide the information we were seeking, and (4) the questions were unbiased. We made changes to the content and format of the final questionnaires based on the results of these tests. In that these were Web-based surveys whereby respondents entered their responses directly into our database, the possibility of data entry error was minimized. We also performed computer analyses to identify errors such as inconsistencies in responses and contacted survey respondents as needed to correct errors and verify responses. In addition, a second independent analyst verified that the computer programs used to analyze the data were written correctly.

To further examine how state officials knew there was no offshoring in their contracts, we reviewed contracts. We selected contracts where state officials responded that there was no offshoring and that all services were listed in the contract. We requested 48 contracts. We contacted the state officials responsible for the contracts in our sample and requested a copy of the contracts. We received all but 1 of the 48 contracts.

To further understand the nature of contracting for these programs, we visited the states of Florida, Utah, and New York, where we interviewed state program officials and contractors and reviewed documents pertaining to program contracts. We selected these states because program directors stated that there were services offshored for at least two programs or multiple contracts with offshoring in one program. In addition, we conducted follow-up interviews with selected state program directors and contractors.

To examine work performed outside of the United States in two federal student aid programs, we interviewed officials from the Office of Federal Student Aid and the Office of Management at the U.S. Department of Education. We reviewed U.S. Department of Education departmental directives concerning contractor employee personnel security screenings and contract monitoring and contracting documents. We also examined previous GAO reports, Congressional Research Service reports, and reports from the Office of the Inspector General at the U.S. Department of Education.

To determine what legal actions state governments have taken related to offshoring in these programs, we reviewed current laws and executive orders identified by states through our survey. We also reviewed legislation proposed in 2005 and reports from legal experts and databases from policy and trade organizations. To determine what federal requirements exist that relate to offshoring, we reviewed applicable federal laws and regulations, including the Federal Acquisition Regulations and other policies and guidance.

Our work was conducted between January 2005 and February 2006 in accordance with generally accepted government auditing standards. Information that we gathered through our surveys, on our site visits, and during our interviews represent only the conditions present in the states and with contractors at the time of our review. We cannot comment on any changes that may have occurred after our fieldwork was completed. Furthermore, our interviews and site visits focused on in-depth analysis of only a few selected states, contractors and contracts. Based on our interviews, we cannot generalize our findings beyond the states and contractors we contacted.

Appendix II: GAO Contacts and Staff Acknowledgments

GAO Contacts

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Staff Acknowledgments

In addition to the contact named above, Andrew Sherrill, Assistant Director; Tahra Nichols, Analyst-in-Charge; Deborah Owolabi; Amy Sweet; Margaret Armen; Carolyn Boyce; Jay Smale; Robert Alarapon; and Tovah Rom made significant contributions to this report.

GAO Related Products

International Trade: Current Government Data Provide Limited Insight into Offshoring of Services. GAO-04-932. Washington, D.C.: September 22, 2004.

Higher Education: Federal Science, Technology, Engineering, and Mathematics Programs and Related Trends. GAO-06-114. Washington, D.C.: Oct. 12, 2005.

International Trade: U.S. and India Data on Offshoring Show Significant Differences. GAO-06-116. Washington, D.C.: October 27, 2005.

Offshoring of Services: An Overview of the Issues. GAO-06-5. Washington, D.C.: November 28, 2005.

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