



UNDER SECRETARY OF DEFENSE

4000 DEFENSE PENTAGON  
WASHINGTON, D.C. 20301-4000

PERSONNEL AND  
READINESS

JUN 25 2012

MEMORANDUM FOR: SEE DISTRIBUTION

SUBJECT: Application of Conversion Differential for Cost-Based In-sourcing Actions

This memorandum provides implementing direction with regard to the application of a conversion differential for cost-based in-sourcing decisions, in accordance with statutory changes to section 2463 of title 10, United States Code (10 U.S.C. 2463), made by section 938 of the National Defense Authorization Act for Fiscal Year 2012, Public Law 112-81, enacted December 31, 2011. The application of this memorandum only applies for cost based in-sourcing actions where workload is being considered for conversion from private sector to government performance. It does not apply for conversions of work that are determined to be inherently governmental, critical in nature, or may otherwise be exempted from private sector performance.

In accordance with title 10 requirements and guidance issued by the Deputy Secretary of Defense, the Department has used, and will continue to use, in-sourcing as an effective shaping tool to rebalance the workforce and re-align work from private sector performance that is more appropriately performed by civilian employees. In-sourcing of contracted services falls into three categories of justification - work that is determined, as it is being executed, to be:

1. inherently governmental, or closely associated with inherently governmental, in accordance with Office of Federal Procurement Policy (OFPP) Letter 11-01, "Performance of Inherently Governmental and Critical Functions"; or
2. critical in nature and/or exempted from private sector performance (for example, to mitigate risk, ensure continuity of operations, build internal capability, meet and/or maintain readiness to include many non-inherently governmental acquisition functions) as defined by the OFPP Letter 11-01 and in accordance with DoD Instruction 1100.22, "Policy and Procedures for Determining Workforce Mix"; or
3. more cost effectively delivered by civilians, based on a cost analysis conducted in accordance with Directive-Type Memorandum (DTM) 09-007, "Estimating and Comparing the Full Costs of Civilian and Military Manpower and Contractor Support" (or successor guidance).

The application of a conversion differential applies only to the third category above. Consistent with the statutory change enacted on December 31, 2011, any Component decision to in-source a contracted service to government civilian or military performance, based solely on cost as the justification for in-sourcing, must meet the conversion differential requirements set forth by 10 U.S.C. 2463:

“ensure that the difference in the cost of performing the function by a contractor compared to the cost of performing the function by Department of Defense civilian employees would be equal to or exceed the lesser of—

- (i) 10 percent of the personnel-related costs for performance of that function; or
- (ii) \$10,000,000.”

Cost analyses should be completed consistent with DTM 09-007 (or successor guidance), applying the full cost to the federal government cost methodology for personnel-related costs for Department of Defense (DoD) civilian employees and for private sector performance of functions when determining if a 10 percent or \$10,000,000 cost avoidance can be achieved by conversion.

Cost analyses should also consider the cost of performance of the function being considered for in-sourcing over a five fiscal year period, comparing the projected full cost of civilian performance against a five-year projection of the cost of contract performance. The estimate of contract performance should be based on the actual contract’s annual cost or, if not available, projected from the most current completed year’s cost of contract performance (or a combination thereof) for the same five fiscal year period. The cost analyses should apply inflation for both the projected full cost of civilian performance and projected cost of contract performance consistent with the most recent President’s Budget submission. Applicable inflation factors can be located in the Office of the Secretary of Defense Comptroller’s Green Book, which is released annually in support of the Department’s budget request, and is located under Budget Material at <http://comptroller.defense.gov>.

The Office of the Director, Cost Assessment and Program Evaluation, supported by my staff, is currently in the process of converting DTM 09-007 into a DoD Instruction and is developing a complementary web-based tool, the Full Cost of Manpower model, to assist DoD employees in estimating the full costs of civilian and military manpower.

Please ensure maximum distribution of this memorandum across your organization. Questions regarding application and implementation of this memorandum to in-sourcing actions should be addressed to my points of contact within the Office of Total Force Planning & Requirements: Mr. Thomas Hessel ([thomas.hessel@osd.mil](mailto:thomas.hessel@osd.mil) or 703-697-3402) and Ms. Amy Parker ([amy.parker@osd.mil](mailto:amy.parker@osd.mil) or 703-697-1735).



Erin C. Conaton

DISTRIBUTION:  
SECRETARIES OF THE MILITARY DEPARTMENTS  
CHAIRMAN OF THE JOINT CHIEFS OF STAFF  
UNDER SECRETARIES OF DEFENSE  
DEPUTY CHIEF MANAGEMENT OFFICER  
COMMANDERS OF THE COMBATANT COMMANDS  
DIRECTOR, COST ASSESSMENT AND PROGRAM EVALUATION  
DIRECTOR, OPERATIONAL TEST AND EVALUATION  
GENERAL COUNSEL OF THE DEPARTMENT OF DEFENSE  
INSPECTOR GENERAL OF THE DEPARTMENT OF DEFENSE  
ASSISTANT SECRETARIES OF DEFENSE  
DEPARTMENT OF DEFENSE CHIEF INFORMATION OFFICER  
ASSISTANTS TO THE SECRETARY OF DEFENSE  
DIRECTOR, ADMINISTRATION AND MANAGEMENT  
DIRECTOR, NET ASSESSMENT  
DIRECTORS OF THE DEFENSE AGENCIES  
DIRECTORS OF THE DOD FIELD ACTIVITIES