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WASHINGTON, D.C. 20548

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B-168700

The Honorable Dominick V. Daniels
House of Representatives



Dear Mr. Daniels:

This is in response to your request for a review of the Army's Military Traffic Management Command's proposal to contract for all cargo handling at the Military Ocean Terminal, Bayonne, New Jersey. As agreed with you on May 19, 1976, we limited our review to evaluating the Army Audit Agency's methodology for analyzing Army studies. These studies were used to justify contracting for work which was previously done by civil service personnel.

BACKGROUND

Army practice at the Bayonne terminal had been to process cargo both by contractor (about 88 percent) and by civil service personnel (about 12 percent). In February 1975 the Traffic Command completed a study to determine whether the mixed operation should be continued or whether the entire cargo handling operation could be performed more economically by the private sector.

The decision to study this was in accordance with the Federal policy of relying on the private enterprise system to the maximum extent for products and services. That policy is set forth in the Office of Management and Budget circular A-76, which states that agencies should rely on private enterprise to supply their needs, except where it is in the interest of the Government to provide directly the products and services they use. One of the criteria which permits an agency to continue to provide a service in-house is that use of the private sector would result in much higher costs to the Government. Continuing an activity in-house should ordinarily be shown to cost the Government at least 10 percent less than contracting for that activity. A decision to continue to provide a service in-house, for reasons of cost, must be supported by a comparative cost analysis.

The Traffic Command's study concluded that use of the private sector was more economical, and it requested the Army Audit Agency to review its conclusion.

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B-168700

Army Audit Agency analysis

In May 1975 the Army Audit Agency completed its review of the Traffic Command's proposal to contract with the private sector for the entire cargo handling operation. The Traffic Command had concluded that the contract would result in lowering costs by about \$1,871,000 over the first 3 years--about 12 percent lower than the estimated in-house costs. The Audit Agency disagreed. It concluded cargo handling costs would increase \$881,000 for the first 3 years--about 8 percent higher than in-house costs. The net cost increase would be \$452,000 over a 10-year period.

On August 22, 1975, the Army Deputy Chief of Staff for Logistics concurred with the Traffic Command's proposal to contract the cargo handling functions. He noted that the costs to the Government--as analyzed by either the Audit Agency or the Traffic Command--were within Army guidelines, which allow a 10 percent higher cost when the private sector provides the product or services needed.

Subsequent to the decision, the Traffic Command provided revised data on the cargo rate for handling tri-wall containers and on personnel costs to the Audit Agency. The revised data and its impact are briefly discussed below. The following table shows various comparative cost analyses for the first 3-year period. Details of the comparisons are enclosed.

Costs to Provide Cargo Handling Service

Traffic Command analysis	<u>Army Audit Agency analysis</u>				
	<u>3-year total</u>	<u>Initial analysis 3-year total</u>	<u>Revised analysis</u>		
			<u>1st year</u>	<u>2d year (note a)</u>	<u>3-year total</u>
------(000 omitted)-----					
Contractor operation	\$12,757	\$11,637	b/\$5,806	\$3,269	\$12,344
Government operation	14,628	10,756	4,182	3,735	11,650
Savings (or cost) from using con- tractor	1,871	(881)	(1,624)	466	(694)

a/Except for \$1,400 decreased Government interest expense,
3d year costs were identical to 2d year costs.

b/Includes one-time costs to convert to contract including sep-
aration and early retirement.

Revised cargo rate

The Audit Agency estimated contract costs on the basis of existing contract rates and tonnage forecasts in effect during fiscal year 1975. The actual rate for loading tri-wall containers was not available under the existing contract at the Bayonne ocean terminal. Because of this, the Audit Agency used a rate of \$19.39 a ton from a Government Louisiana port contract which was based on loading 1,000 tons a year. The annual tonnage to be handled at Bayonne, however, was estimated at about 12,000 tons. Therefore, Traffic Command believed a lower rate should be used to determine contract costs and provided the Audit Agency with a contractor's informational quote of \$6.26 a ton. ^{1/} The Audit Agency accepted the rate and reduced the estimate of annual contract costs for handling tri-wall containers by about \$158,000.

Revised personnel costs

Annual costs for civil service personnel were first estimated by the Traffic Command to be about \$2.8 million. This estimate was based on 230 authorized spaces of which 63 were erroneously considered to be vacant. Filled positions were costed at actual salaries and vacant positions at the authorized grade level, step 3, of the October 1974 pay schedule.

Traffic Command later determined that those positions which had been erroneously considered vacant were actually filled, and at salaries higher than originally estimated. The revised computation accepted by the Audit Agency showed that annual civil service personnel costs were about \$294,000 higher than the first estimate.

After considering the Traffic Command's revised data, the Audit Agency's revised analysis showed contract costs would exceed in-house costs by \$1,623,000 in the first year. This reflected one-time costs to convert to contract— including separation and early retirement for over 150

^{1/}We did not verify the validity of these quotes. Such a variance--\$19.39 vs. \$6.26--would ordinarily result in further review to determine the validity of the quotes. In this case, however, use of the lower quote was not the deciding factor in determining which method was more economical.

B-168700

employees expected to be affected by the decision. Savings under the contract would average about \$500,000 a year thereafter.

We discussed with the Audit Agency personnel their standards and audit techniques and the rationale they used during their review. We did not audit the data included in the studies. We found that the Audit Agency's standards and performance were acceptable. Our limited review did not reveal any deficiency significant enough to cause us to reject the Audit Agency's analysis.

Current status

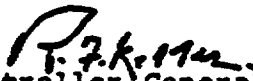
On May 12, 1976, the Army exercised a contract option under which the contractor would--by June 14, 1976--take over the cargo handling formerly done by civil service personnel. The advantages were stated to be improved economy, greater flexibility in adjusting to workload fluctuations, and the reallocation of the manpower authorizations to support combat forces.

On July 30, 1976, Traffic Command told us that by implementing the contract it affected civil service employees as follows: 137 retired; 29 were separated and received severance pay; and 5 were separated and did not receive benefits. The remaining employees were reassigned to other civil service jobs.

In assessing the impact of the proposed decision to contract for these services, the Army noted that the action would decrease the number of federally employed people, but increase the number of commercially employed people. The Army concluded that the proposal was not a major action and that it would not result in a significant impact.

Your request also addressed the proposed move of the Navy International Logistics Control Office from Bayonne to Philadelphia. We are continuing our review in that area and will report our findings to you.

Sincerely yours,


ACTING Comptroller General
of the United States

Enclosure

COMPARATIVE ANALYSIS OF COSTS TO PROVIDE
CARGO HANDLING SERVICES AT BAYONNE, NEW JERSEY
CONTRACTOR VS IN-HOUSE OPERATIONS

	<u>1st year</u>	<u>2d year</u>	<u>3d year</u>	<u>3-year total</u>
Traffic Command analysis (note a):				
Contractor operations:				
Contract cost	\$3,490,449	\$3,490,449	\$3,490,449	
Contract administra- tion	498,057	339,860	339,860	
Other costs	<u>670,370</u>	<u>437,353</u>	<u>0</u>	
Total	<u>\$4,658,876</u>	<u>\$4,267,662</u>	<u>\$3,830,309</u>	<u>\$12,756,847</u>
Government operations:				
Military personnel	\$ 109,939	\$ 109,939	\$ 109,939	
Civilian personnel	2,815,247	2,815,247	2,815,247	
Other personnel costs	2,230	2,230	2,230	
Materials supplies, etc. (note b)	574,142	574,142	574,142	
Maintenance and re- pair	320,754	320,754	320,754	
Federal taxes	63,875	63,875	63,875	
Depreciation (note c)	1,618,857	223,617	223,617	
Interest (note d)	228,173	213,280	198,387	
Insurance	11,467	11,467	11,467	
Other indirect costs	<u>76,446</u>	<u>76,446</u>	<u>76,446</u>	
Total	<u>\$5,821,130</u>	<u>\$4,410,997</u>	<u>\$4,396,104</u>	<u>\$14,628,231</u>
Savings (or costs) using contractor	\$1,162,254	\$ 143,335	\$ 565,795	\$ 1,871,384

a/For purposes of making the comparative analysis, the Traffic Command assumed:

- The rate of inflation is the same for both contractor and Government operations.
- The type and mix of vessels would continue in the future.
- The portion of the workload handled by Government employees would remain constant over the next 3 years.

b/The Army Audit Agency revised this figure because watercraft operations were incorrectly included in the computation.

c/The depreciation was on Government equipment. The Army Audit Agency revised this figure to exclude watercraft (barge-derrick and tug) and to reflect only the annual depreciation of new or additional equipment which would be required if the terminal functions were to continue in-house. The remaining fair market value of existing equipment was written off in the first year.

d/Interest was overstated because equipment replacement was incorrectly scheduled.

ENCLOSURE I

ENCLOSURE I

	<u>1st year</u>	<u>2d year</u>	<u>3d year</u>	<u>3-year total</u>
Army Audit Agency analysis (initial analysis):				
Contractor operations:				
Contract cost	\$3,090,527	\$3,090,527	\$3,090,527	
Contract administration	494,309	336,091	336,091	
Other costs	<u>700,911</u>	<u>498,220</u>	<u>0</u>	
Total	<u>\$4,285,747</u>	<u>\$3,924,838</u>	<u>\$3,426,618</u>	<u>\$11,637,203</u>
Government operations:				
Military personnel	\$ 108,158	\$ 108,158	\$ 108,158	
Civilian personnel	2,815,247	2,815,247	2,815,247	
Other personnel costs	2,230	2,230	2,230	
Materials supplies, etc.	67,962	67,962	67,962	
Maintenance and repair	277,469	277,469	277,469	
Federal taxes	56,557	56,557	56,557	
Depreciation	465,879	19,639	19,639	
Interest	15,341	14,037	12,733	
Insurance	9,813	9,813	9,813	
Other indirect costs	<u>65,421</u>	<u>65,421</u>	<u>65,421</u>	
Total	<u>\$3,884,077</u>	<u>\$3,436,533</u>	<u>\$3,435,229</u>	<u>\$10,755,839</u>
Savings (or costs using contractor)	(\$401,670)	(\$488,305)	\$8,611	(\$881,364)
	<u>Projected 10-year costs</u>			
	<u>Contract</u>	<u>Government</u>	<u>Difference</u>	
	\$35,623,599	\$35,171,183	(\$452,416)	

ENCLOSURE I

ENCLOSURE I

	<u>1st year</u>	<u>2d year</u>	<u>3d year</u>	<u>3-year total</u>
Army Audit Agency (revised analysis):				
Contractor operations:				
Contractor cost	\$2,932,967	\$2,932,967	\$2,932,967	
Contract administration	494,309	336,091	336,091	
Other costs (note a)	<u>2,378,424</u>	<u>0</u>	<u>0</u>	
Total	<u>\$5,805,700</u>	<u>\$3,269,058</u>	<u>\$3,269,058</u>	<u>\$12,343,816</u>
Government operations:				
Military personnel	\$ 108,158	\$ 108,158	\$ 108,158	
Civilian personnel	3,109,530	3,109,530	3,109,530	
Other personnel costs	2,230	2,230	2,230	
Materials supplies, etc.	67,962	67,962	67,962	
Maintenance and repair	277,469	277,460	277,469	
Federal taxes	53,673	53,673	53,673	
Depreciation	465,879	19,639	19,639	
Interest	15,341	14,037	12,733	
Insurance	10,696	10,696	10,696	
Other indirect costs	<u>71,307</u>	<u>71,307</u>	<u>71,307</u>	
Total	<u>\$4,182,245</u>	<u>\$3,734,701</u>	<u>\$3,733,397</u>	<u>\$11,650,343</u>
Savings (or costs using contractor)	(\$1,623,455)	\$465,643	\$464,339	(\$693,473)

	<u>Projected 10-year cost</u>	<u>Difference</u>
	<u>Contract</u>	<u>Government</u>
	\$35,277,222	\$38,152,863
		\$2,925,641

a/The Army Audit Agency significantly increased these costs because of a more accurate identification of employees who were to be retired or separated.