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**Report to Secretary, Department of Defense; by Fred J. Shafer, Director, Logistics and Communications Div.**

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The Government's policy for obtaining military base support services is to rely on the private enterprise system unless the Government must supply them or can supply them less expensively. In spite of this policy, about 77% of base support expenditures were for activities operated and managed by Government personnel. GAO evaluated the effectiveness of the Department of Defense's (DOD's) efforts to improve the implementation of the base support service policy. An examination conducted at 14 different military installations included agency cost studies, reviews, and inventory reports. Findings/Conclusions: Improvements are needed in DOD's management of its own improvement program. Its military services' reviews of commercial and industrial activities have not been effective because the services have been unable to identify many activities and to associate all costs with the activities for contracting consideration. Many commercial and industrial activities have been improperly excluded from contracting consideration. Military installations' annual inventories of activities were unreliable for directing and controlling reviews to determine whether in-house or contract performance was best for the Government. Recommendations: The Secretary of Defense should: redefine DOD's classification of industrial and commercial activities to facilitate the military services' identification of activities to be reviewed; require the military services to exclude from contracting consideration only those activities properly excludable under the terms of OMB Circular A-76 and to reconsider the many activities previously excluded improperly; direct the military services to avoid delays in the review and approval processes; and insure that all real property maintenance and repair activities are reviewed under the Circular. (QM)



*UNITED STATES  
GENERAL ACCOUNTING OFFICE*

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# How To Improve Procedures For Deciding Between Contractor And In-House Military Base Support Services

Department of Defense

The military services spend about \$2 billion a year for base support activities, about 77 percent done by Department of Defense personnel and 23 percent by contractors. Government policy generally is to use private enterprise unless in-house support is cheaper or essential.

Recent instructions were issued to improve the accuracy of comparative cost studies. However, many support services are inappropriately excluded from contracting consideration because of other administrative problems in reviewing and reporting base support services.

GAO is making recommendations to the Secretary of Defense to strengthen management of the program.



UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

LOGISTICS AND COMMUNICATIONS  
DIVISION

B-158685

The Honorable  
The Secretary of Defense

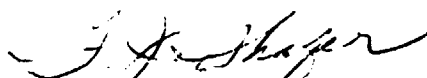
Dear Mr. Secretary:

This report discusses the Department of Defense's administration of the Government's policy of relying on the private sector for base support services as stated in Office of Management and Budget Circular A-76. Particular emphasis was given to Defense's system for defining and controlling the types of base support activities for which contracting should be considered. In view of recent Office of Management and Budget actions to further the objective of maximum reliance on the private sector, the observations and recommendations in this report assume further importance.

This report contains recommendations to you on page 20. As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Director, Office of Management and Budget; the Chairmen, House and Senate Committees on Appropriations and Armed Services; the Chairmen, House Committee on Government Operations and Senate Committee on Governmental Affairs; and the Secretaries of the Army, the Navy, and the Air Force.

Sincerely yours,

  
F. J. Shafer  
Director

GENERAL ACCOUNTING OFFICE REPORT  
TO THE SECRETARY OF DEFENSE

HOW TO IMPROVE PROCEDURES  
FOR DECIDING BETWEEN  
CONTRACTOR AND IN-HOUSE  
MILITARY BASE SUPPORT  
SERVICES

Department of Defense

D I G E S T

The Army, Navy, and Air Force spent over \$2 billion in fiscal year 1975 to provide their installations with base support services such as bus, food, and custodial services and repair, alteration, and minor construction of real property. The Government's policy for obtaining these activities is to rely on the private enterprise system unless the Government can provide them less expensively or must provide them because of military readiness or other exceptions. This policy is stated in Office of Management and Budget Circular A-76.

In spite of this policy, about 77 percent of these expenditures were for base support activities operated and managed by Government personnel. (See p. 1.)

The Office of Management and Budget and the Department of Defense recently issued instructions to correct inaccuracies in the services' cost studies of contracting versus performing support work in-house, a common problem. (See ch. 2.) There are other administrative problems in reviewing and reporting support services subject to Circular A-76, however, and GAO recommends that the Secretary of Defense do the following:

- Redefine Defense's classification of commercial and industrial activities to facilitate the military services' identification of activities to be inventoried and reviewed.
- Require the military services to exclude from contracting consideration only those

activities properly excludable under the terms of Circular A-76, and to reconsider the many activities previously excluded improperly.

- Direct the military services to avoid delays in the review and approval processes.
- Amend Defense's Directive 1135.2 and Instruction 4100.33, to insure that all real property maintenance and repair activities are reviewed under Circular A-76. (See pp. 20 and 21.)

Each Government agency is required to maintain an inventory of commercial and industrial activities and to review each activity at least once every 3 years to insure that in-house performance is justified. (See p. 1.) Defense's inventories of its commercial and industrial activities were unreliable because of

- installation personnel not identifying all activities and allocating all costs,
- inappropriate justifications given for continuing in-house performance, and
- difficulty in matching Defense's classification of commercial and industrial activities with the military services activities. (See pp. 13 to 16.)

The services had excluded from contracting consideration many commercial and industrial activities. As a result cost studies were not made to determine if potential savings were available from contracting.

For example, in fiscal year 1975 the services spent over \$1 billion for the maintenance and repair of real property at installations. A considerable portion of this amount was spent on routine and recurring maintenance and repair work performed by Government personnel.

These activities were not reviewed nor required to be reported pursuant to Circular A-76,

because of the lack of clarity in Defense's instruction implementing the Circular and because of a Defense directive prescribing the use of Government civilian employees for real property maintenance and repair. (See pp. 16 to 20.)

Other commercial and industrial activities excluded by installations were food, bus, and custodial services. Of 27 studies which were made of these same types of activities GAO reviewed at installations, 22 showed contractors to be less costly by a total of about \$3.7 million. (See pp. 18 to 20.)

Cost studies understated the costs of in-house performance because the factor contained in Defense's guidelines for use in computing the costs of civilian personnel retirement and insurance benefits was much too low. This deficiency should be avoided in future Defense studies, since the Office of Management and Budget has recently prescribed the use of rates it has determined cover the full cost of civilian personnel benefits. GAO evaluated the retirement cost factor, which comprises the bulk of the benefits, and concluded it is reasonable. GAO suggested, however, that the Office of Management and Budget consider developing

--a series of retirement rates tailored to each type of activity and

--a similar cost factor for cost comparison purposes applicable to private sector employees' retirement benefits under the Social Security system. (See pp. 7 to 9.)

In comparing costs of in-house performance with possible procurement from commercial sources, the Air Force used firm bids for contractor costs, whereas the Army and the Navy often used estimates or informational quotes.

Defense has recently directed the Army and the Navy to use firm bids for contractor costs in comparative cost studies. (See pp. 9 to 12.)

Officials of the Department of Defense have been given an opportunity to review and comment on the contents of this report, and their views were considered in its preparation. (See p. 22.)

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### ABBREVIATIONS

DOD	Department of Defense
GAO	General Accounting Office
OMB	Office of Management and Budget



## CHAPTER 1

### INTRODUCTION

The Government's policy for obtaining commercial or industrial products and services is to rely on the private enterprise system unless the Government can provide them less expensively or the national interest requires a Government agency to provide them in-house (with military or civil service personnel). This policy is stated in Office of Management and Budget (OMB) Circular A-76, originally issued March 3, 1966, and revised on August 30, 1967.

The policies and requirements of Circular A-76 were implemented by the Department of Defense (DOD) in July 1966 revisions to its Directive 4100.15 and Instruction 4100.33. DOD has identified 101 types of commercial or industrial (manufacturing or service) activities which it operates and manages and which are obtainable from the private sector. This report concerns 24 of the service type activities which are common to the routine day-to-day operations of an installation. For purposes of this report we have referred to these 24 activities as base support services which include such activities as bus, food, and custodial services and the repair, alteration, and minor construction of real property. The other 77 activities excluded from this report pertain to activities such as depot maintenance, which involves repair, overhaul, and modification of equipment beyond the capability of operational units.

DOD's fiscal year 1975 inventory of the 24 base support activities included in this report showed that over \$2 billion was spent by the Army, Navy, and Air Force to provide their installations with these activities. About 77 percent of these expenditures were for the base support activities operated and managed by Government personnel.

	<u>Operated and managed in-house</u>		<u>Contractor</u>		<u>Total cost</u>
	<u>Cost</u>	<u>Percent</u>	<u>Cost</u>	<u>Percent</u>	
	(millions)		(millions)		(millions)
Army	\$ 516	70	\$219	30	\$ 735
Navy	509	82	111	18	620
Air Force	<u>561</u>	79	<u>150</u>	21	<u>711</u>
Total	<u>\$1,586</u>	77	<u>\$480</u>	23	<u>\$2,066</u>

The above includes expenditures reported for the repair of real property. It does not include additional undetermined amounts the military services spent for the maintenance and repair incident to maintenance of real property at installations but did not report under the requirements of Circular A-76. (See pp. 16 and 17.)

### CIRCULAR A-76 POLICY

Circular A-76 allows Government agencies to provide services or products in-house when

- procurement from a commercial source would disrupt or materially delay an agency's program;
- it is necessary for combat support, military personnel retraining, or mobilization readiness;
- a commercial source is not available and could not be developed in time to provide the product or service when needed;
- the product or service is available from another Government agency; or
- procurement from a commercial source will result in higher cost to the Government.

The Circular requires each Government agency to:

- Issue implementing instructions and provide management support to insure that the policy is followed.
- Compile and maintain an inventory of its commercial and industrial activities.
- Review its activities every 3 years to determine whether in-house performance should be continued, except for designated activities exempted from review by the agency head or his designee.

The Congress has not enacted legislation establishing a national policy of reliance on the private sector. However, in August 1974 Public Law 93-400 established the Office of Federal Procurement Policy within OMB to provide overall direction of Federal procurement policy and prescribe Government-wide policies and regulations for procuring goods and services. One of its specific statutory functions is to

monitor and revise policies, regulations, procedures, and forms relating to reliance by the Federal Government on the private sector to provide needed property and services.

In a July 27, 1976, letter, OMB outlined Presidential management initiatives to be taken by Federal agencies for evaluating and reducing the burden of Federal regulation, reducing cost, and improving personnel management. One of these initiatives concerned actions to further the objective of maximum reliance on the private sector for commercial and industrial products and services under Circular A-76. Federal agencies were required (1) by August 23, 1976, to submit to OMB initial plans for increasing their reliance on the private sector to carry out overhead or program functions in accordance with the Circular, and (2) by September 21, 1976, to review and revise their implementing instructions and procedures for contracting to insure that all in-house commercial and industrial activities are reviewed and terminated if they cannot be justified under the exceptions permitted by the Circular.

On August 27, 1976, DOD provided to OMB the following five functions or activities which would be considered for increasing its reliance on the private sector:

- Clothing alteration activity at Fort Leonard Wood, Missouri.
- Base operations support functions at Fort Gordon, Georgia.
- Refuse collection and disposal services at all Air Force installations not already under contract.
- Motor vehicle operation and maintenance activities at 11 Air Force installations.
- Maintenance and storage of industrial plant equipment at the Defense Depot, Tracy, California.

These functions or activities will be contracted if the costs are less than in-house performance.

In response to the second OMB requirement, DOD informed OMB that it had already undertaken a program to further the objective of maximum reliance on the private sector in accordance with the Circular. In several August 1976 memorandums issued to the military services and Defense agencies, DOD

changed procedures to more effectively implement the Circular. Three of these changes related to problems we noted in our review. (See pp. 7, 9, and 16.) DOD also is performing an audit of the program to insure compliance by the military services and Defense agencies.

### DOD'S PROGRAM IMPLEMENTING THE OMB CIRCULAR

The Deputy Secretary of Defense has delegated overall program responsibility to the Assistant Secretary of Defense (Installations and Logistics). This responsibility includes formulating the policy and requirements of the DOD program and insuring that the military services and Defense agencies carry out the program. Designated officials of the military services and Defense agencies are authorized to make decisions needed to continue, discontinue, or curtail existing commercial or industrial activities, and to approve or disapprove the establishment of any new activities.

DOD's regulations implementing Circular A-76--Directive 4100.15 and Instruction 4100.33--were revised in April 1969 to recognize the August 1967 revision to Circular A-76, and again in July 1971 in an attempt to correct management weaknesses in its program. These weaknesses were discussed in our report "Better Controls Needed in Reviewing Selection of In-House or Contract Performance of Support Activities" (B-158685, Mar. 17, 1972).

In that report, we stated that the military services' reviews of activities had not been effective because (1) justifications for continued in-house performance of activities were not supported, (2) significant activities were not reviewed, (3) reviews were untimely, and (4) cost studies were made of activities already under contract although not required by Circular A-76, without determining whether the costs of indepth studies were warranted by the potential savings available. The inventories of commercial and industrial activities also had not included all required activities.

Because most of DOD's corrective actions mentioned in our previous report were contained in the 1971 revisions of the DOD instruction and directive, we made the current review to ascertain whether DOD's administration of the program had improved. In our review particular emphasis was given to DOD's system for defining and controlling the types of base support activities for which contracting should be considered, and the methods of cost comparisons used by the Army, Navy, and Air Force.

We recently issued a report to the Secretary of Defense entitled "Should Aircraft Depot Maintenance Be In-House or Contracted? Controls and Revised Criteria Needed" (FPCD-76-49, Oct. 20, 1976). In that report we discussed DOD's work distribution policies and practices for aircraft depot maintenance, and the application of Circular A-76. The report included several recommendations concerning clarification of DOD's policies on contracting depot maintenance and insuring that cost comparisons are made in accordance with the Circular.

## CHAPTER 2

### EVALUATION OF COST STUDIES

The military services' comparative cost studies consistently understated the costs of in-house performance. This was so because Department of Defense guidelines understated a civilian personnel benefit cost computation factor. Also, in many instances the Army and Navy used unreliable estimates or informational quotations for commercial costs in comparative cost studies when considering possible procurement from commercial sources.

The Office of Management and Budget recently directed Federal agencies to recognize what it has determined to be the full cost of civilian personnel benefits in cost studies. DOD has also provided instructions to the Army and Navy to use firm bids for commercial costs in comparative cost studies.

We reviewed 64 comparative cost studies prepared by 12 selected Army, Navy, and Air Force installations. These studies were made to determine whether (1) in-house performance should be continued or the activity contracted because of lower cost and (2) existing contract support services should be continued. Of the 64 studies, 17 used firm bids as the basis for comparing commercial costs with in-house performance, 24 used estimates or informational quotes, and 23 used prior or existing contract prices. The potential savings illustrated by the results of the installations' cost studies are summarized below.

Service	Number of studies	Basis for contract cost			Cost of performance by		Potential annual savings	
		Firm bid (note a)	Informational quotes or estimates (note a)	Prior or existing contract prices (note b)	In-house	Contractor	Amount	Percent of annual cost (note c)
<b>Contracting less costly:</b>								
Army	7	-	-	7	\$ 5,099,113	\$ 3,757,077	\$1,342,036	26.3
Navy	14	-	4	10	6,876,105	5,771,879	1,104,226	16.1
Air Force	14	14	-	-	7,138,368	4,877,212	2,261,156	31.7
<b>Total</b>	<b>35</b>	<b>14</b>	<b>4</b>	<b>17</b>	<b>\$19,113,586</b>	<b>\$14,406,168</b>	<b>\$4,707,418</b>	<b>24.6</b>
<b>In-house less costly:</b>								
Army	11	-	8	3	\$ 5,468,217	\$ 9,553,454	\$4,085,237	42.8
Navy	15	-	12	3	5,629,111	7,177,967	1,548,856	21.6
Air Force	3	3	-	-	151,642	190,071	38,431	20.2
<b>Total</b>	<b>29</b>	<b>3</b>	<b>20</b>	<b>6</b>	<b>\$11,248,970</b>	<b>\$16,921,494</b>	<b>\$5,672,524</b>	<b>33.5</b>

a/These 41 studies were made to compare existing in-house performance with possible procurement from commercial sources to determine which is less costly.

b/These 23 studies were made to compare existing contracts with potential in-house performance to determine which is less costly.

c/The percentage of annual savings is based on the higher cost of performance shown in the installations' comparative cost studies. However, the actual cost of performance at the time of the study would not be the higher cost in all cases (see notes a and b).

GOVERNMENT COSTS UNDERSTATED  
FOR CIVILIAN PERSONNEL BENEFITS

Subject to OMB approval, DOD included in Instruction 4100.33 a factor of 8.44 percent of civilian base pay when computing the Government's cost of providing civilian personnel benefits. This factor represents a combination of 7.14 percent for retirement costs and 1.3 percent for health and life insurance. Recently the Government's cost for these benefits has been determined to be substantially more than 8.44 percent of pay.

Consequently, in an October 18, 1976, transmittal memorandum regarding Circular A-76 cost studies, OMB instructed Federal agencies to use stipulated percentage factors to reflect the Government's share of the cost of providing retirement and insurance benefits to civilian employees. These factors, developed by the Civil Service Commission for OMB, were 24.7 percent of pay for retirement and 4 percent for insurance. The calculation of the retirement percentage factor was based on certain economic assumptions prescribed by OMB regarding future pay increases and inflation and interest rates. The OMB memorandum states that these factors represent the Government contributions to employee insurance programs and the full cost to the Government of the civil service retirement system.

In response to a Congressional inquiry, we evaluated the reasonableness of the 24.7 percent retirement cost factor and the economic assumptions used in calculating it. In reporting our findings (PSAD-77-6 and 77-7, Nov. 5, 1976), we pointed out that the Government's annual retirement costs are greater than 7 percent of payroll regardless of whether reference is being made to net Government outlays from the retirement fund, the Government's annual contributions to the retirement fund, or the Government's share of the value of currently accruing benefit rights earned by active employees during the year. However, when discussing the Government's retirement costs as an element of current annual employment costs, we believe the appropriate reference is to the Government's share of currently accruing pension benefits. We also pointed out that

estimates of the retirement system's dynamic normal cost 1/ can vary considerably depending upon the assumptions made regarding future real wage increases and real interest rates. By their very nature, these economic assumptions cannot be judged for validity on the basis of their precision or accuracy, but rather should be considered in terms of their reasonableness. Our report concluded that, based on the economic assumptions used, the OMB estimated retirement cost factor was reasonable. We did suggest, however, that OMB give consideration to developing a series of retirement cost factors tailored to each type of activity that is a candidate for contracting out, such as guard services, grounds maintenance, and food service, since it is improbable that pension cost factors are the same for all occupations.

We also pointed out that in making cost comparisons to determine whether activities should be performed in-house or contracted, it is very important that proper consideration be given to costs under both alternatives. With regard to contracting, we reported that the current employer and employee contributions to the Social Security system may be insufficient to cover the full cost of employee benefits accruing under the system. Further, we commented that since there is a possibility that some portion of any additional costs will eventually be borne by the Federal Government, we believe that consideration should be given by OMB to developing a factor for cost comparison purposes that could be applied to labor costs of private sector employees to reflect the full annual accrual of retirement benefits of employees under the Social Security system on a dynamic basis.

Because a retirement cost factor of only 7.14 percent was used, civilian personnel costs have been significantly understated in prior DOD cost studies. The significance of the understatement is illustrated by adjusting the in-house civilian personnel costs shown in DOD cost studies to reflect OMB's retirement cost factor of 24.7 percent and by comparing

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1/In actuarial terminology the value of benefit rights earned (accruing) annually by employees covered under a retirement system is referred to as the "normal cost" of the system and is frequently expressed as a percentage of the total payroll. Normal cost can be calculated on either a "static" or "dynamic" basis. Under the static basis, no consideration is given to future general pay increases or cost-of-living annuity adjustments, while under the dynamic basis consideration is given to such increases.



the results to the costs previously computed in the studies. Use of the revised cost factor will have the effect of increasing the potential savings that may be realized from contractor performance or of decreasing those realized from in-house performance, and could potentially affect decisions to contract activities. However, for the studies shown below the adjusted in-house costs would not have reversed any of the services' decisions to either continue in-house performance or to contract the activities.

<u>Service</u>	Number of studies (note a)	<u>Civilian personnel costs</u>		Retirement costs understated in studies
		<u>DOD estimate</u>	<u>DOD estimate after adjustment</u>	
Army	11	\$ 4,366,608	\$ 5,105,723	\$ 739,115
Navy	13	6,914,058	7,909,972	995,914
Air Force	15	5,730,668	6,617,575	886,907
Total	39	<u>\$17,011,334</u>	<u>\$19,633,270</u>	<u>\$2,621,936</u>

a/Although we obtained 64 studies from the services, information was not readily available from 25 studies for a calculation of the understatement of civilian retirement costs.

The understated costs indicated in the above table would be even greater if the DOD personnel cost estimates were also adjusted to reflect OMB's 4-percent cost factor for health and life insurance in lieu of the 1.3 percent used by DOD.

The Deputy Assistant Secretary of Defense (Procurement) has issued a memorandum instructing the military services and all Defense agencies to use the personnel benefit cost factors specified by OMB in all cost studies not completed as of September 30, 1976. Further, the military services and Defense agencies were instructed to restudy during fiscal year 1977, using the OMB cost factors, 680 commercial and industrial activities justified for retention in-house in fiscal year 1975 on the basis of cost.

#### UNRELIABLE CONTRACT COST ESTIMATES

DOD requires the military services to determine contract cost in cost studies by using actual contract costs incurred in those activities currently being performed under contract and, in the case of in-house activities, anticipated prices from commercial sources. According to DOD, the "going" contract price from commercial sources should normally be used

in determining the anticipated prices, rather than estimates or informational quotes. Whereas the Air Force used firm bids, the Army and Navy used estimates or informational quotes in all studies we reviewed which compared in-house performance to possible procurement from commercial sources. We found that these techniques did not result in reliable contract costs in cost studies.

The Air Force requires its installations to rely on firm bids from contractors when comparing in-house performance with proposed procurement from commercial sources. Procedures have been developed whereby actual contract costs from bids are entered in the cost studies. When the comparison shows the contractor to be cheaper, a contract is awarded. These procedures resulted in awarding contracts in 14 of the 17 studies, while the other 3 studies showed in-house performance to be less costly.

Of the 47 Army and Navy studies included in our review, 24 compared in-house performance with possible procurement from commercial sources. The remaining 23 studies compared existing contracts with potential in-house performance. In the 24 cases comparing in-house performance with potential commercial performance, contract costs were based on estimates--frequently engineering estimates--or informational quotes. None of the Army studies and only 4 Navy studies showed contractors to be less costly. The Navy installations recommended conversion to contracts in 3 of the 4 studies, while the other study indicated conversion was not possible because of essential military manpower needs. Some of the problems we identified in the services' determination of contract costs were

- apparently overstating the costs to justify continuance of in-house performance;
- unsupported assumptions made in estimating costs;  
and
- unreliable cost estimates from informational quotes.

#### Problems with informational quotations

The Armed Services Procurement Regulation allows the services to request informational quotations from contractors for planning purposes. The services are generally prohibited from paying the costs of preparing these quotations, and all such requests must state that the Government does not intend

to award a contract on the basis of the quotation or otherwise pay for the solicited information. DOD Instruction 4100.33 states that these quotations should not be considered a valid expression of contract costs unless there is reasonable assurance that the contractor is capable and willing to provide the service for the quoted price. Further, the instruction recommends against any widespread use of this technique.

The following cases illustrated some of the problems which were experienced when informational quotes were used in comparative cost studies.

- An installation received three quotes ranging in price from \$96,000 to \$264,000, and used the highest because the reviewing official believed it was more competitive with the cost of in-house performance.
- Five quotes ranging in price from \$356,000 to \$879,000 were received by an installation, which took the average of the quotes for comparison, \$600,323. However, there were no quotes for this amount.
- An installation published a synopsis of one of its activities stating that the Government did not intend to award a contract on the basis of the request or pay for the solicitation. Potential contractors were not interested in submitting quotes for informational purposes, so the installation officials concluded the activity should be continued in-house.

The Defense Manpower Commission created by the Congress in 1973 to study overall manpower requirements in DOD submitted its final report in April 1976. One of its findings was that the Army and the Navy often made their own estimates of contractors' costs. The Commission indicated that estimates of contractors' costs were one reason that Army and Navy cost comparisons tended to show in-house performance to be less costly. The Commission reported that Air Force cost comparisons, using firm bids, showed contractors to be less costly in about 89 percent of the cases. In our review, the Air Force showed contractors to be less costly in about 82 percent of its 17 studies, while the Army and Navy showed contractors to be less costly in about 17 percent of the 24 studies comparing in-house performance with potential commercial performance.

DOD has recently initiated corrective action directing the Army and Navy to use firm bids for commercial costs in

comparative cost studies. In an August 1976 memorandum, the Principal Deputy Assistant Secretary of Defense (Installations and Logistics) noted that DOD's record for contracting out in consonance with Circular A-76 has remained stable over the past 3 years and directed the military services and the Defense Supply Agency to implement several procedures for more effective implementation of the Circular. One of these procedures requires the Army and Navy to adapt the Air Force firm bid concept to their organizations when comparing in-house performance with proposed procurement from commercial sources.

### CONCLUSIONS

Comparative cost studies understated the costs of in-house performance because the factor used to estimate the costs of civilian personnel benefits was understated. The Army and Navy installations also used unreliable estimates or informational quotes, instead of firm bids, for commercial costs. For these reasons the cost studies have not been as reliable or as useful as they should have been in complying with the Circular's policy. However, the changes being made should make them more useful.

CHAPTER 3  
IMPROVEMENTS NEEDED IN  
MANAGEMENT OF THE PROGRAM

Our March 1972 report described the ineffectiveness of the military services' reviews of commercial and industrial activities. The Department of Defense told us that it had initiated action on most of our recommendations for improving the management of the inventory and review program by revising DOD Instruction 4100.33 and DOD Directive 4100.15. Nevertheless, we believe DOD needs to take additional actions to strengthen the management of the program to insure that inventories of commercial and industrial activities are complete and accurate and that activities are reviewed to determine whether in-house or contract performance is best. More specifically, we found that:

- Installation inventories used for directing and controlling program reviews were unreliable.
- Justifications for continuing in-house performance have been inadequately supported in terms of Circular A-76 requirements.
- DOD's classification of commercial and industrial activities does not conform to the way in which the military services are organized to accomplish this work, thereby resulting in inability of the services to identify many activities for contracting consideration.
- Many commercial and industrial activities were not reviewed for contracting consideration, precluding determination of any potential savings available from contracting.

INVENTORIES OF COMMERCIAL AND  
INDUSTRIAL ACTIVITIES SHOULD BE  
MORE COMPLETE AND MORE ACCURATE

Our March 1972 report disclosed that installation inventories of commercial and industrial activities did not include all required functions and a need existed for standard guidelines insuring that all activities were included. DOD revised its instruction to increase the number of identified categories of commercial and industrial activities

from 53 to 101 to insure all activities were included in the inventories. At the installations we visited, the inventories still omitted many required activities and contained much inaccurate information concerning (1) why an activity is performed in-house and (2) personnel and other operating costs associated with in-house and contractor performance. Some of the inventory problems identified at installations illustrating the unreliability of the reports are included in appendix I.

The inventories of commercial and industrial activities as required by Circular A-76 should provide DOD and the military services with complete and accurate information for directing and controlling reviews to determine whether in-house or contract performance is best for the Government. The Circular requires each agency to compile and maintain an inventory of its commercial and industrial activities having \$50,000 or more in annual output in products or services or a capital investment of \$25,000 or more. DOD inventories should show the number and annual cost of personnel, the cost of supplies, the Government's capital investment, and the basis for continuing the activity.

The omissions and inaccurate information in the inventories at the installations visited were caused by (1) installation personnel not identifying all activities and allocating all costs, (2) inadequately supported justifications given for continuing in-house performance, and (3) difficulty in matching the military services' commercial and industrial codes with DOD's list of 101 activities. Some of these problems are discussed below.

#### Inadequately supported justifications

Contrary to the requirements of the Circular, the military services reported justifications for continuing in-house performance which were not supported by explanations of how the decisions were reached. Some of these report errors apparently resulted from inadequate or confusing guidance.

Air Force headquarters officials told us that the inventory reports often show unsupported justifications for continuing in-house performance. These justifications were either reported by installations or added at headquarters level, because (1) reviews had not been made or done in sufficient detail to support a decision to contract the activity and (2) Air Force headquarters determined the activity should not be contracted for reasons not allowed under the Circular.

Army installations reported that Government-owned utility systems must be continued because contracting would delay or disrupt the installations' programs. However, no studies had been made to justify these decisions. In May 1974, the Army directed the Office of the Chief of Engineers to perform the reviews of all of these systems and determine whether contracting would be cost effective. As of December 1976, this office had not completed its review of any utility activities.

Difficulty in relating  
DOD's classification of activities

DOD has identified 101 categories of commercial and industrial activities which each military service is required to review and report on. The 101 categories of activities do not conform to the way in which the services account for their costs or manage and operate their installations. The services have attempted to relate their commercial and industrial activities with DOD's, but confusion and conflict existed in identifying those activities to be inventoried. The services were also unable to identify all costs of installation activities and properly consider whether contracting would be in the best interest of the Government.

The Air Force has related about 200 of its 978 functional codes with 66 of DOD's 101 categories of commercial and industrial activities. For some types of DOD activities, there were no corresponding Air Force codes. The Army and Navy have also attempted to relate their functional codes to DOD's; however, both have experienced difficulty and admit all costs and activities have not been identified.

Some of the identification problems and the effect on activities to be reviewed and inventoried are illustrated below.

- The Air Force decided that the packing and crating function could not be contracted because it is an integral part of the overall transportation function and cannot be isolated without restructuring the shipment and distribution process.
- The Air Force concluded that laboratory acceptance testing of supplies and material is an activity which cuts across functional lines, and cannot be treated as a separately identifiable function for review purposes.

--At an Army base we were told that the costs of installation bus service and motor vehicle operations were accounted for by different base organizations. An Army audit report recommended that a more equitable cost comparison presentation be made by consolidating installation bus service and motor vehicle operations into one cost presentation because the drivers, dispatchers, and mechanics are interchangeable for the two functions. The Department of the Army decided, however, that the proposed consolidation could not be accomplished because the functional areas must be identified separately, as specified by DOD.

--At another Army base, we were told that maintenance of noncombat and administrative vehicles was performed by both the maintenance and transportation divisions, making contracting of the subdivided functions impractical due to the way DOD had identified the activity.

#### MORE ACTIVITIES SHOULD BE GIVEN CONTRACTING CONSIDERATION

Contrary to the requirements of Circular A-76, the military services had excluded from contracting consideration many commercial and industrial activities. These exclusions resulted in the services not performing cost studies to determine if potential savings were available from contracting.

The various justifications to exclude activities from contracting consideration also resulted in unreliable inventory reports from installations, as previously discussed. Other decisions used to justify continued in-house performance resulted from (1) ambiguity in the DOD instruction implementing Circular A-76 and a DOD policy Directive indicating a preference for in-house real property maintenance and (2) delays in disseminating decisions to installations.

#### Real property maintenance

In fiscal year 1975 the military services spent over \$1 billion for the maintenance and repair of real property at installations. A significant portion of this amount was spent on routine, recurring maintenance and repair work performed by Government personnel. However, the military services were not reviewing real property maintenance activities under Circular A-76 to determine whether there were savings available by contracting. This exclusion is contrary to the intent of the Circular. Government agencies must review all



commercial and industrial activities and document the rationale to exclude activities from contracting under the exceptions permitted in the Circular.

We believe that the exclusion of real property maintenance activities occurred because the language in DOD Instruction 4100.33 appeared to permit such exclusion when considered in conjunction with DOD Directive 1135.2.

DOD Instruction 4100.33 required the military services to review, in accordance with Circular A-76, those commercial or industrial activities relating to the repair, alteration, and minor construction of real property (exclusive of repair incident to maintenance and military construction funded projects). DOD officials said that the original intent was to exclude from review only military construction projects. But the Instruction specified also the exclusion of repair incident to maintenance.

DOD Directive 1135.2 established the policy that construction, repair, maintenance, and operation of real property will be accomplished with the most economic means available. The Directive states, however, that consistent with this policy "\* \* \* Civil Service personnel will normally accomplish regular routine, recurring maintenance, and repair incident to maintenance."

While the direction in 1135.2 is inconsistent with the intent of Circular A-76, the military services in apparent reliance thereon and in conjunction with the instructions in 4100.33 excluded real property maintenance activities from review and reporting.

The Army and Navy had included the directive's policy statement in instructions to installations:

- In a message to installations clarifying Army regulations, the Army excluded real property maintenance from the program by stating that the normal function of the facilities engineer is to perform maintenance on existing facilities and provide an organization capable of handling recurring maintenance of a reasonably predictable nature.
- The Navy's contracting manual states, "It is the general policy of the DOD to accomplish with civil service employees the regular routine recurring maintenance and upkeep work at those activities that have traditionally employed such a force."

In his memorandum of August 1976, the Principal Deputy Assistant Secretary of Defense (Installations and Logistics) instructed the military services and the Defense Supply Agency to revise on an interim basis their implementation of DOD Instruction 4100.33 to include real property maintenance, pending DOD revision of the instruction. He also directed the military services to thoroughly explore and expand contracting real property maintenance and repair activities at installations. However, DOD Directive 1135.2 was not changed. As of February 1977, DOD plans to coordinate the revised DOD Instruction 4100.33 with the military services before it is finalized.

#### Activities not reviewed

As previously discussed, the inventory reports did not include all activities and showed inadequately supported justifications for continuing in-house performance. Further, DOD's fiscal year 1975 inventory showed that a substantial amount of in-house activities of the types subject to Circular A-76 had not been reviewed by the military services and other Defense agencies. About \$184 million of these in-house activities was for the 24 base support services at Army, Navy, and Air Force installations included in our review such as bus, food, and custodial services and the repair, alteration, and minor construction of real property. Air Force installations excluded many activities from review pending Air Force headquarters' authorization to proceed with comparative cost studies. Army and Navy installations also were performing commercial and industrial activities in-house without cost studies having been made.

Before Air Force installations can make cost studies under the Circular, the Air Force headquarters must make a decision on whether the activity (1) is no longer needed for military reasons and (2) can be contracted at less cost. As of February 1976, the headquarters had reviewed most of the 66 types of commercial and industrial activities which it was able to relate to DOD's list of 101. However, final decisions on only six classes of activities had been disseminated to installations.

For example, the headquarters determined in 1974 that portions of motor vehicle operations and maintenance could be contracted if less costly. However, the decision had not been disseminated to installations as of February 1976. Headquarters officials told us that final decisions to installations are delayed because of the need to have a methodical

approach to avoid sudden base disruptions. In response to the Office of Management and Budget's July 1976 letter directing Federal agencies to increase their reliance on the private sector (see p. 3), the Air Force indicated that 11 Air Force installations would make cost studies of the motor vehicle operation and maintenance activities to determine if contracting would be less costly than in-house performance.

On the other hand, delays in evaluation and approval postpone the realization of any potential savings that may be available through contracting. In this regard, information available on four of the six types of activities on which headquarters decisions were disseminated to installations to perform cost studies showed contractors less costly than in-house performance in many instances.

<u>Activities</u>	<u>Number of cost studies</u>	<u>Cost studies showing contractors less costly</u>	
		<u>Number</u>	<u>Percent</u>
Food service and mess attendants	98	89	91
Laundry and dry cleaning	16	7	44
Custodial services	41	41	100
Installation bus service	<u>53</u>	<u>13</u>	25
Total	<u>208</u>	<u>150</u>	72

At the Army and Navy installations we visited, commercial and industrial activities were also being performed by Government employees without reviews being made. These activities included food service, installation bus service, and custodial services. We noted that in cases where cost studies were made of these types of activities, installations found contractors less costly in most instances. Of the 64 studies we reviewed (see p. 6), 27 such studies were made of these activities and all but 5 studies showed contractors to be less costly.

<u>Activity</u>	<u>Contractors less costly</u>		<u>In-house less costly</u>	
	<u>Number</u>	<u>Savings (note a)</u>	<u>Number</u>	<u>Savings (note a)</u>
Custodial services	10	\$1,582,000	1	\$ 46,000
Food service	8	1,930,000	0	0
Installation bus service	<u>4</u>	<u>204,000</u>	<u>4</u>	<u>91,000</u>
Total	<u>22</u>	<u>\$3,716,000</u>	<u>5</u>	<u>\$137,000</u>

a/The potential savings to be realized from contractor performance is understated, while that from in-house performance is overstated because of the understatement of costs associated with Government employees. (See p. 6.)

### CONCLUSIONS

Improvements are needed in DOD's management of the program. The military services' reviews of commercial and industrial activities have not been effective because the services have (1) been unable to identify many activities and to associate all costs with the activities for contracting consideration and (2) improperly excluded from contracting consideration many commercial and industrial activities. Installations' annual inventories of activities were unreliable for directing and controlling reviews to determine whether in-house or contract performance was best for the Government.

DOD has recently instructed the military services to revise their implementation of DOD Instruction 4100.33 to include real property maintenance activities under Circular A-76. A revision of the Instruction, to this effect, is underway. However, DOD Directive 1135.2 governing the use of personnel services for real property should also be revised.

### RECOMMENDATIONS TO THE SECRETARY OF DEFENSE

We recommend that the Secretary of Defense:

- Redefine DOD's classification of commercial and industrial activities to facilitate the military services' identification of activities to be inventoried and reviewed.

- Require the military services to exclude from contracting consideration only those activities properly excludable under the terms of Circular A-76 and to reconsider the many activities previously excluded improperly.
- Direct the military services to avoid delays in the review and approval processes.
- Amend DOD Directive 1135.2 and DOD Instruction 4100.33 to insure that all real property maintenance and repair activities are reviewed under Circular A-76.

## CHAPTER 4

### SCOPE OF REVIEW

We evaluated the effectiveness of the Department of Defense's efforts to improve the military services' implementation of the Government's policy on providing commercial and industrial products and services. We reviewed Circular A-76 and related DOD, Army, Navy, and Air Force regulations, directives, and records and discussed the policies and procedures for the program with key officials at headquarters and installation levels. Our examination at installations included agency cost studies, reviews, and inventory reports. The installations included in our review were

- Fort Campbell, Kentucky;
- Fort Lewis, Washington;
- Fort Knox, Kentucky;
- Fort McPherson, Georgia;
- Fort Rucker, Alabama;
- China Lake Naval Weapons Center, California;
- Whidbey Island Naval Air Station, Washington;
- Keyport Torpedo Station, Washington;
- Fairchild Air Force Base, Washington;
- Glasgow Air Force Base, Montana;
- McChord Air Force Base, Washington;
- Sheppard Air Force Base, Texas;
- Tinker Air Force Base, Oklahoma; and
- Vance Air Force Base, Oklahoma.

DOD officials have been given an opportunity to review a draft of this report and provided us with their comments on November 22, 1976. We have considered the comments and have made a number of changes in the report to give recognition to the comments.

PROBLEMS IDENTIFIED AT INSTALLATIONS--  
ILLUSTRATING UNRELIABILITY OF INVENTORY REPORTS  
FOR FISCAL YEAR 1975

ARMY

<u>Installation</u>	<u>Problem</u>
Fort Lewis	All costs associated with in-house activities such as custodial services and motor vehicle operations not reported.  Improper justification reported for continuing in-house performance of Government-owned utility systems.
Fort Knox	Some in-house activities, including those associated with the maintenance and repair of real property, not reported.  Over \$5.8 million in costs associated with various installation maintenance activities not allocated and reported.

NAVY

Whidbey Island Naval Air Station	Some in-house activities such as custodial services and those associated with the maintenance of real property not reported.
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AIR FORCE

Sheppard Air Force Base	Overstated contracted costs by about \$1.8 million for structural maintenance of family housing.  Overstated by \$31,000 the cost associated with the in-house performance of installation bus service.
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AIR FORCE (continued)

<u>Installation</u>	<u>Problem</u>
McChord Air Force Base	Some in-house activities such as installation bus service and custodial services not reported.
Vance Air Force Base	About \$10 million in contracted base support activities not reported.