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[Proposal To Convert Base Support Functions from In-house to Contract Operations]. LCD-78-320; B-158685. July 27, 1978. 4 pp. + 3 enclosures (11 pp.).

Report to Sen. Sam Nunn, Chairman, Senate Committee on Armed Services: Manpower and Personnel Subcommittee; by Elmer E. Staats, Comptroller General.

Issue Area: Facilities and Material Management: Operation and Maintenance of Facilities (708); Federal Procurement of Goods and Services: OMB Guidelines for Relying on the Private Sector to Supply Federal Needs (1906).

Contact: Logistics and Communications Div.

Budget Function: National Defense: Department of Defense - Military (except procurement & contracts) (051).

Organization Concerned: Department of Defense; Department of the Army; Department of the Army: Fort Gordon, GA.

Congressional Relevance: Senate Committee on Armed Services: Manpower and Personnel Subcommittee. Sen. Sam Nunn.

Authority: Department of Defense Appropriation Act of 1978. OMB Circular A-76. DOD Directive 4100.15. Army Regulation 11-28.

The Army has proposed to convert 19 base support functions at Fort Gordon, Georgia, from in-house to contract operations. A 1977 feasibility study showed potential cost savings of about \$5.5 million by converting to contracting. The Army's study, however, did not accurately estimate the costs of in-house and contract performance. For contract costs, the study used an unreliable estimating technique instead of firm bids and incorrectly determined the one-time retirement cost or savings for civil service employees chargeable to a contract operation. For in-house costs, it did not include all military personnel benefit costs and incorrectly determined benefits for temporary civilian employees. In-house personnel costs were based on a combination of military and civilian personnel. Since it is widely recognized that a civilian work force is cheaper to maintain than is a military work force, Fort Gordon should convert the military spaces in its cost study to civilian spaces and, if less costly, compare the civilian work force operation to contract performance. This would insure that the least costly form of staffing is identified. The Secretary of the Army should insure that, in considering contracting, Fort Gordon should determine the least costly form of staffing in-house operations and correct its comparative cost study to properly estimate personnel retirement costs and temporary civilian employee benefit costs. (RRS)

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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B-158685

JULY 27, 1978

The Honorable Sam Nunn
Chairman, Subcommittee on
Manpower and Personnel
Committee on Armed Services
United States Senate

Dear Mr. Chairman:

Your letter of June 3, 1977, asked us to monitor and analyze the Army's proposal to convert certain base support functions at Fort Gordon, Georgia, from in-house to contract operations.

Under the proposal, the Army plans to consider contracting out 19 base support functions. (See enc. II.) A cost study will be made comparing the costs of in-house operations with solicited firm bids from contractors. If a contractor's cost is lower, one contract will be awarded for all 19 functions.

Contracting a group of functions was originally recommended by the Army's Training and Doctrine Command in an October 1974 feasibility study. This study was prompted by a May 1974 memorandum from the Deputy Secretary of Defense urging the military departments to expand contracting for base support functions under Office of Management and Budget Circular A-76. The Command's study concluded that grouped base operating functions could be performed at lower cost by a contractor and would be large enough to attract private industry.

The Command recommended considering such an arrangement at four installations, including Fort Gordon. However, the Army did not approve the recommendation because of questions about the reliability of the cost estimates and the potential personnel disruption. In February 1976, the Command submitted a revised proposal, with an updated cost study, to contract a group of base support functions only at Fort Gordon. On March 22, 1977, the Secretary of Defense approved the revised proposal.

LCD-78-320
(945320)

In July 1977 Fort Gordon prepared an updated feasibility study which estimated the costs of performing 19 base support functions in-house or under a contract over 2-1/2 years. The study showed potential cost savings of about \$5.5 million by contracting.

Section 852 of the 1978 Department of Defense Appropriation Act restricted Defense from converting base operating support functions, except real property maintenance and repair, to contract during fiscal year 1978. Accordingly, the Army will make no effort to convert base support services at Fort Gordon during that period. However, when the restriction is lifted, the Army will again consider this option. Another cost comparison will have to be made at that time to determine whether contracting is cheaper than in-house performance.

As agreed, we limited our review to the Army's July 1977 feasibility and comparative cost study concerning the 19 base support functions at Fort Gordon. We evaluated the procedures, rationale, and assumptions used in computing costs for each method of providing the services. The Army has requested that the cost estimates for in-house and contract operations and the numbers of employees involved not be disclosed to maintain confidentiality for any future cost comparison. Accordingly, we have limited the cost and staffing information presented to that needed to explain our evaluation of this study in enclosure I.

The Army's study did not accurately estimate the costs of in-house and contract performance. For contract costs, the installation used an unreliable estimating technique, instead of firm bids, and incorrectly determined the one-time retirement cost or savings for civil service employees chargeable to a contract operation. For in-house costs, it did not include all military personnel benefit costs and incorrectly determined benefits for temporary civilian employees.

The in-house personnel costs were based on a combination of military and civilian personnel. It is widely recognized that a civilian work force is cheaper to maintain than a military work force. Fort Gordon should convert the military spaces in its cost study to civilian spaces and, if less costly, compare the civilian work force operation to contract performance. This would insure that

the least costly form of staffing (military, civilian, or contract) is identified.

In commenting on a draft of this report, the Army stated that firm bid procedures would be used to obtain contractors' bids in future cost comparisons. It also recognized the merit of converting military spaces to civilian spaces in determining the least costly method of doing the work at Fort Gordon. However, it pointed out that converting to a civilian work force could not be done quickly because the additional civilian end strengths and appropriated funds would not have been programed. The Army's comments are included as enclosure III.

RECOMMENDATIONS

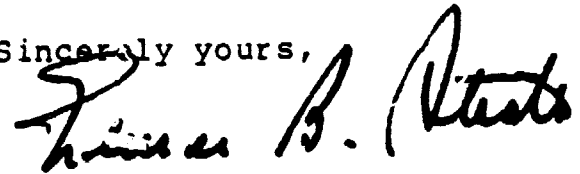
We recommend that the Secretary of the Army insure that, in further considering contracting, Fort Gordon (1) determine the least costly form of staffing in-house operations and (2) correct its comparative cost study to properly estimate personnel retirement costs and temporary civilian employee benefit costs. If converting to an all civilian work force for base support functions would be less costly than contracting or maintaining the present mix of in-house military and civilian personnel, the Army should develop and implement the programing actions for such a conversion.

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As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time we will send copies to the Secretary of the Army to set in motion the requirements of section 236 of the Legislative Reorganization Act of 1970. We will also send copies to the Secretary of Defense; the Director, Office of Management and Budget; and the Chairmen, Senate Committee on Governmental Affairs, House Committee on Government

Operations, and House and Senate Committees on Appropriations and Armed Services. Copies will also be made available to other interested parties and will be furnished to others upon request.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Thomas B. Atkins". The signature is written in a cursive style with a large initial "T" and a long, sweeping underline.

Comptroller General
of the United States

Enclosures - 3

EVALUATION OF FORT GORDON'S
COMPARATIVE COST STUDY

BACKGROUND

Office of Management and Budget Circular A-76 sets forth the Government's general policy that Federal agencies shall rely on the private sector for commercial or industrial products and services. Agencies can, however, perform functions in-house (with military or civilian personnel) when it is in the national interest.

It is in the national interest to rely on in-house resources when (1) procuring a product or service commercially would disrupt or materially delay an agency's program, (2) the Government has to conduct a commercial or industrial activity to provide combat support, to retrain military personnel, or to maintain or strengthen mobilization readiness, (3) a satisfactory commercial source is not available and cannot be developed in time to provide a product or service when it is needed, (4) the product or service is available from another Federal agency, or (5) procuring a product or service commercially would be more costly. The circular requires that in-house activities justified because of lower cost be supported by periodic cost analyses.

Department of Defense Directive 4100.15 and Instruction 4100.33 implement this policy and establish procedures to be followed in making cost analyses, including the cost elements to be used by the military services and Defense agencies. The Army's proposal to contract base support functions at Fort Gordon falls within these guidelines.

Proposed changes in Circular A-76

On June 13, 1977, the Director of the Office of Management and Budget and the Administrator for Federal Procurement Policy announced a comprehensive review of the circular and its implementation. The review was to develop guidelines for implementing the circular that would ensure consistent, equitable application of the policy throughout the executive branch. Cost comparison methodologies and factors to be used in cost comparisons were considered.

On November 21, 1977, the Administrator announced proposed changes to the circular. Department of Defense

procedures and instructions for cost comparisons are subject to revision when the proposed changes are officially issued. Among the changes are a 20.4-percent factor for civil service system retirement costs, a cost differential factor favoring the continuance of in-house performance equal to 10 percent of the estimated personnel-related costs, and detailed guidance for cost comparisons.

These changes will affect any future comparison by Fort Gordon of the costs of contracting support functions versus performing them in-house.

EVALUATION OF COST COMPARISON

The July 1977 cost study was to provide updated estimates of the costs to perform 19 base support functions in-house or under a contract over 2-1/2 years. Enclosure II lists the functions that Fort Gordon is considering contracting. The study showed that contracting could save about \$5.5 million compared with in-house performance using a combination of military and civilian personnel. In evaluating this study, we found that certain assumptions were not valid and that the bases for estimating in-house staff-year requirements and personnel costs were incorrect.

Estimate of contractor's bid price

Fort Gordon estimated that the contractor's bid price for performing the 19 base support functions would be 20 percent less than the cost of in-house performance, based on its analysis of the October 1974 cost comparison for 15 base support functions. Informational quotes were solicited and the lowest responsive quotation was used in the 1974 study.

Fort Gordon's analysis of 13 of the 15 support functions indicated that the contractor's informational quote ranged from 14 to 54 percent less than the in-house costs. Based on this analysis, the installation assumed that the low bid on the 19 support functions in the July 1977 study would be at least 20 percent less than in-house costs.

The Army Audit Agency audited the current and previous comparative cost studies. The Agency concluded that the contract operations would not necessarily be less costly because the contractor's bid estimate is predicated on the

following basic assumptions that are not subject to an audit determination.

- The low firm's informational quotation is a valid estimate of actual bids, even though the contractor was told that the Government did not intend to award a contract on the basis of the quotation or pay for the information.
- The estimates of contractor costs for the functions for which informational quotations were not solicited are reasonable.

In our report "How To Improve Procedures For Deciding Between Contractor and In-House Military Base Support Services" (LCD-76-347, Mar. 28, 1977), we noted that, in comparative cost studies considering possible procurement from commercial sources, estimates or informational quotations, instead of firm bids, were used for commercial costs. These techniques did not result in reliable estimates of contract costs. We reported that Defense had taken corrective action directing the use of firm bids for commercial costs in comparative cost studies.

In May 1977 the Army directed Fort Gordon to replace its contractor bid estimating practices with the firm bid procedures. Under these procedures, firm bids will be solicited from potential contractors and a contract will be awarded if a contractor's bid is lower than the cost of in-house performance. In its comments on this report, the Army reaffirmed that these procedures will be followed.

Military personnel costs

The in-house operations are performed by a combination of military and civilian personnel. Fort Gordon estimated the cost of the military personnel based on the authorized grade and strength for the base support functions.

Circular A-76 prescribes that the costs of all elements of compensation and allowances for military and civilian personnel, including the costs of retirement systems and other benefits, should be included as a cost of the in-house operations. In March 1977 the Army directed all installations to use the percentage factors prescribed in Army Regulation 11-28 for determining the Government's cost of military retirement and other benefits in comparative

cost studies (25 percent of officers' pay and 40 percent of enlisted personnel pay).

Fort Gordon did not include the cost of these benefits in its July 1977 study because of the impending enactment of the Department of Defense Appropriation Authorization Act for 1978. That act prohibited converting in-house activities to contract operation, except under policies and regulations in effect before June 30, 1976. In October 1977, the Army notified all installations that they would have to use policies and regulations in effect before the June 1976 date.

The act's prohibition on contracting was to expire on the earlier of either March 15, 1978, or the end of the 90-day period beginning when Defense submitted a report reviewing its criteria for determining whether to contract activities. In the December 1977 report, Defense noted that the procedures and instructions developed for cost comparisons were valid, but were subject to revision because of the proposed changes in Circular A-76. On March 16, 1978, the Army instructed all installations to use the percentage factors for military personnel benefits in the cost comparisons.

We applied the Army's percentage factors to the military personnel standard pay rates in the cost study. We computed a 2-1/2-year cost of over \$7 million for military benefits that were omitted from the in-house costs.

Temporary civilian employee benefits

Fort Gordon estimated the Government's costs for civilian personnel benefits using the 18.1-percent factor prescribed by Circular A-76 at the time of the July 1977 study. This factor consists of 14.1 percent of pay for civil service retirement system costs and 4.0 percent for Federal health and life insurance program costs.

At Fort Gordon 44 employees held temporary positions under social security. The Government's cost of social security for these employees was 5.85 percent of their pay, or about \$95,500 less than Fort Gordon estimated using the civil service factors.

One-time costs for retirement benefits

When an ongoing Government activity changes to contract services, three possible outcomes affect the civil service retirement fund: (1) employees accept normal retirement when they could continue working for the Government, (2) employees ineligible for normal retirement accept involuntary retirement, and (3) employees ineligible for normal or involuntary retirement withdraw their contributions from the fund or accept a retirement annuity beginning at age 62.

As a result, the Government retirement fund can either gain or lose. The fund will gain when a large number of employees withdraw their contributions, thereby releasing the Government from having to pay future benefits. Conversely, the Government will usually incur increased costs when employees retire earlier than anticipated.

In its July 1977 study, Fort Gordon determined the cost of early retirement benefits chargeable to a contract operation to be about \$913,000. The installation assumed that, of those eligible for early retirement but not regular retirement, 25 percent would elect to take involuntary retirement. This figure was based on the Training and Doctrine Command's experience at other installations. Because the actual personnel affected had not been identified, the cost was computed using the average grade, years of service, and annual salaries of all employees eligible for involuntary retirement.

Fort Gordon's method of estimating the retirement cost has the following shortcomings.

- It made no allowance for the potential savings to the civil service retirement fund from the termination of employees not eligible for retirement and not relocated to other Government jobs.
- It assumed that 80 percent of the employees eligible for normal retirement would elect to retire, but it did not consider the effect on costs resulting from these employees retiring earlier than normal.
- It based the increased costs of earlier retirements on the assumption that all employees would live until age 72, instead of on a table of life survival probabilities for the different age groups of its employees eligible for retirement.

- In determining the increased costs, it did not consider the offsetting factor of potential salary increases between the employees' early retirement age and normal retirement age and correspondingly higher retirement payments.
- It considered survivors' benefits for all employees estimated to take early retirement, but all may not elect to receive such benefits or may not have an eligible dependent.
- It assumed that all employees taking involuntary retirement would normally have retired at age 62. It should have used the actual rates of normal retirement reported by the Board of Actuaries of the Civil Service Retirement System in its 52d annual report.
- In determining the increased costs, it did not increase the cost of annuity payments to retirees for cost-of-living adjustments.
- It did not discount future payments to early retirees to present value 1/ in determining the current cost to the Government.

Early retirement costs cannot be accurately estimated until a change has actually taken place and the eligible employees make their decisions. Nevertheless, Fort Gordon should correct its method of calculating these costs to prepare the best estimate possible for potential retirements.

Least costly form of staffing in-house operations not considered

Fort Gordon based its estimate of in-house personnel costs on the combined military and civilian personnel workload for the base support functions. However, it did not determine whether converting the military spaces to civilian

1/Present value is a concept that recognizes the time value of money. Discounting is a technique for determining the amount of money which, if invested today at a given interest rate, would be sufficient to meet expected future costs.

spaces would be cheaper than maintaining the present composition. We believe that this should be done so that the least costly form of staffing can be determined in comparing costs of in-house and contract performance.

Our report "Opportunities Exist for Substantial Savings in Administration of Military Skill Training Programs" (FPCD-78-13, Feb. 14, 1978), noted that it is widely recognized that civilians and contractors can provide commercial services at lower cost than military personnel can. We reported that the Congress, the Office of Management and Budget, and Defense policy have advocated increased use of these options. For example, in the fiscal year 1975 Defense Appropriations Authorization Act, the Congress told Defense to use the least costly form of staffing consistent with military requirements and other needs. The Secretary of Defense was directed to consider the advantages of converting from one form of staffing to another (military, civilian, or contract) for each specific job.

The Army recognized the merit of converting military spaces to civilian spaces in determining the least costly staff composition at Fort Gordon. However, it pointed out that such a conversion could not be done quickly because the additional civilian end strengths and appropriated funds would not have been programmed.

Fort Gordon should review its workload requirements to determine the least costly form of staffing for comparing in-house with contract performance. If in-house civilian personnel would be less costly than contractor personnel, the Army should develop and implement the programming actions for making the conversion.

REQUEST FOR SMALL BUSINESS SET-ASIDE

On July 21, 1977, the Small Business Administration requested Fort Gordon to separate its planned solicitation for all 19 functions under one contract into four solicitations (housing, maintenance, supply and services, and transportation), which would be limited to small businesses.

The request was denied, because the Department of the Army had approved the single contract concept and Fort Gordon did not have the authority to break up the package. The installation pointed out the following reasons for continuing the single procurement package approach.

- Previous attempts to obtain informational quotations for the four functional areas did not generally elicit cost-effective responses.
- The functional areas required considerable interaction, which is not possible with four contractors.
- Administering four contracts would be more costly.

On August 19, 1977, the Small Business Administration appealed to the Secretary of the Army. The Army responded that the planned procurement at Fort Gordon was suspended because of the 1978 Defense Appropriation Act moratorium on contracting out and that, when the moratorium was lifted, the Army would again consider a single contract. The Army added, however, that it would consider including certain requirements in the contract for subcontracting to small and minority firms. It believes that this would insure that a significant portion of the contract payments for base maintenance services would go to such firms.

FUNCTIONS TO BE CONTRACTED

1. Aircraft (avionics) maintenance
2. Noncombat vehicle maintenance
3. Communications and electronics equipment maintenance
4. Special purpose equipment maintenance
5. Armament equipment maintenance
6. Containers (textiles, tents, and tarpaulins)
7. Metal working
8. Installation bus operations
9. Laundry and drycleaning service
10. Food service program (less commissary resale store)
11. Furniture repair
12. Office machine equipment maintenance
13. Motor vehicle operations
14. Motor vehicle maintenance
15. Supply operations (includes self-service supply, clothing sales store, ammunition, and materiel management)
16. Housing operations
17. Troop issue operations (subsistence)
18. Transportation movements (passenger/freight)
19. Comsec equipment maintenance



DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY
WASHINGTON, D.C. 20310

2 JUN 1978

Mr. F. J. Shafer
Director
Logistics and Communications Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Shafer:

This is in reply to your letter to the Secretary of Defense regarding your draft report dated 3 April 1978, on the Army Proposal to Convert Certain Base Support Functions at Fort Gordon, Georgia, from In-House to Contract Operations, OSD Case 4859, the GAO Code Number LCD 78-320. The following comments are offered:

a. The procedure of comparing the cost analysis of in-house operations against the cost analysis of the potential bidder has been superseded by the firm bid procedure. This procedure will be used in all future Commercial and Industrial-Type Activities actions.

b. The theory of converting military spaces to civilian spaces (civilianization) has merit; however, in this action, civilianization was not considered to be a practical solution. It is recognized that the cost of maintaining a civilian workforce is cheaper than maintaining a military workforce. However, problems could be created in converting to a civilian workforce should the government be the low bidder. In this case, the additional civilian end strength and OMA dollars would not have been programmed. The commander could be placed in a position of having a workload requirement that previously had been performed, but no longer could be accomplished because of the lack of personnel and fund authorization.

c. [See GAO note, p. 11.]

d.

[See GAO note.]

2. In conclusion, the cost analysis for future conversions to include Fort Gordon must be completed in accordance with guidance contained in OMB Circular A-76.

3. Recommend the following changes to the draft report:

a. [See GAO note.]

b. [See GAO note.]

c. Where workloads actually performed by military personnel are compared to contractor proposals based on estimates for conversion to the use of in-house civilian personnel, then, in the event in-house performance is less costly, sufficient time must be allowed for the Service to develop and implement orderly programs for conversion to civilian manning.



Alan J. Gibbs
Assistant Secretary of the Army
(Installations, Logistics and
Financial Management)

GAO note: The deleted comments relate to statements that were in the draft report and have been omitted from this report.