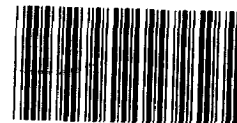




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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548



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PROCUREMENT AND SYSTEMS  
ACQUISITION DIVISION

MARCH 4, 1981

B-199590 **RESTRICTED** — Not to be released outside the General Accounting Office except on the basis of specific approval by the Office of Congressional Relations.

The Honorable Charles E. Bennett  
House of Representatives

RELEASED

Dear Mr. Bennett:

Subject: [Contracting Out Vehicle Maintenance  
and Operations Functions at U.S. Naval  
Station, Mayport, Florida] (MASAD-81-8)

In response to your letters of May 14, May 23, and June 25, 1980, we reviewed the cost comparison that was used by the Navy to justify its decision to convert in-house vehicle maintenance and operations functions at the U.S. Naval Station, Mayport, Florida, to contractor performance.

We provided you with a written response to several of your specific concerns (see enc. I) and a briefing on the progress of our other work on June 25, 1980. We informed you that we had some significant open questions about the comparison because, in part, the Naval Station could not support some of the cost data used.

When it became apparent that our open questions would not be readily resolved, we again met with you on June 30, 1980, and proposed several courses of action that could be taken before Government employee reduction-in-force actions became effective on July 25, 1980. Contractor performance had started on June 29, 1980, under the contract that had been awarded on May 12, 1980. The information we had by then strongly indicated that in-house performance was less costly and that the Navy should reexamine its contracting-out decision. The proposal you accepted was for us to meet with appropriate Navy officials in your office that same day and convey our concerns to them.

The Navy officials met with us and agreed to respond to you by July 25, 1980. Also, we understood from that meeting that although you did not expect any further reporting from

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us, you might request further assistance. For your use and convenience, this report (1) documents the work that we performed, (2) evaluates the Navy's response to you, and (3) summarizes our conclusions on the matter.

OBJECTIVE, SCOPE, AND METHODOLOGY

Due to the short time frame between your initial request and the start of contractor performance (about 7 weeks), we limited our review at the Naval Station and directed our evaluation toward (1) the specific concerns of the American Federation of Government Employees Local 2010 on which your request was based and (2) the identification of other gross errors that would materially affect the outcome of the comparison. During that period, we reviewed selected documentation supporting the comparison, the contract file, and other pertinent records and correspondence. We also interviewed responsible officials at the Naval Station and a representative of the American Federation of Government Employees Local 2010. In addition, we analyzed the Naval Audit Service evaluation of the comparison in the report provided to you in relation to the policy and regulations governing the comparison, including the Office of Management and Budget Circular A-76, revised August 30, 1967. ✓

EVALUATION OF COST COMPARISON  
AND NAVY'S RESPONSE

DMB Crenshaw

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The Navy responded to our questions in its report to you of July 24, 1980. (See enc. II.) The report showed that revisions to the comparison which reduced the estimated contracting-out savings of about \$178,000 over a 3-year period by about \$103,000, were appropriate. It stated, however, that contractor performance was still more economical by about \$75,000 over the 3-year period. In our opinion, the report did not adequately resolve some of the questions raised nor demonstrate the validity of the comparison.

We believe that further revisions to the comparison are appropriate. Based on our cost estimates, in-house costs should be decreased by about \$207,000 and contract costs should be increased by about \$87,000. The revisions result in a cost advantage for in-house performance of about \$218,000 over the 3-year period.

Our cost estimate, compared with the Navy's original and revised estimates, is shown in enclosure III. Detailed explanations of our adjustments are also given.

The Navy prepared the comparison generally using guidance, as directed by the Department of Defense, that was in effect before June 30, 1976. (Enc. I provides a detailed discussion on why this rather than more current guidance was used.) We used the same guidance in evaluating the comparison, but it differs considerably from guidance now in effect.

If a comparison were prepared using the current guidance, however, we believe that it would probably support the Navy's decision to contract out. The reason for this is because the current guidance generally tends to increase in-house costs and decrease contract costs. For example, in computing civilian personnel costs, a factor of 8.44 percent was applied to base pay to cover fringe benefits, such as retirement. The current guidance requires a fringe benefit factor of 26 percent to be used. Considering only this one change in the guidelines, the use of the higher factor would increase our estimated cost of Government operation by over \$464,000. Thus, the \$218,000 cost advantage we estimated for in-house performance using the older guidance would be eliminated and contractor performance would be more economical by over \$246,000. Because of the above and the additional work that would have been required, we did not prepare a comparison based on the new guidelines.

#### CONCLUSION

The Navy's decision to contract out vehicle maintenance and operations functions at the Naval Station is not supported by the cost comparison that was made. However, the guidelines used to develop the comparison are no longer in effect. If a new comparison using the current guidelines were prepared, we believe that it would probably support the Navy's decision. Therefore, we are not making a recommendation to the Secretary of the Navy to reexamine the decision made.


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Unless you publicly announce its contents earlier, we plan no further distribution of this report until 5 days from the date of the report. At that time we will send copies

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to interested parties and make copies available to others on request.

Sincerely yours,



W. H. Sheley, Jr.  
Director

Enclosures - 3



UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

PROCUREMENT AND SYSTEMS  
ACQUISITION DIVISION

JUN 25 1980

The Honorable Charles E. Bennett  
House of Representatives

Dear Mr. Bennett:

In response to your letters of May 14, 1980, and May 23, 1980, we have been reviewing the Navy's decision to convert in-house vehicle maintenance and operations functions at the U.S. Naval Station, Mayport, Florida, to contractor performance.

Subsequent to those letters, in a meeting on June 2, 1980, with my staff, you requested a written report of our findings by June 30, 1980, so that, if warranted, you would have time to request the Navy to reconsider its decision before contractor performance began. At that time, contractor performance was expected to begin on July 6, 1980. We have been advised that contractor performance is now scheduled to begin a week earlier on June 29, 1980.

This change, coupled with as yet unresolved but significant questions which we have raised about the cost comparison that was used to justify the contracting-out decision, make it impossible and impractical for us to fully respond to you in writing by the originally planned date. We can, however, respond at this time to several of your specific concerns.

Questions raised by American Federation of Government Employees (AFGE) Local 2010 at Mayport, which prompted your request, included the following which we believe must be answered in the negative:

- Should the Navy have applied a 10 percent cost differential favoring in-house performance in its cost comparison?
- Did the Navy convert the in-house functions to contract performance to circumvent any civilian personnel ceiling?

AFGE Local 2010 believed that a 10 percent cost differential was applicable because it is required by revised Office of Management and Budget Circular A-76, "Policies for Acquiring Commercial or Industrial Products and Services Needed by the Government." The Circular, which was issued on March 29, 1979, generally became effective within the executive branch on May 1, 1979. In the Department of Defense, however, the effective date was delayed until October 1, 1979, by section 814 of the Defense Appropriation Authorization Act, 1979. <sup>1/</sup> Section 814, among other things, prohibited conversions to contract during fiscal year 1979 unless they would have been allowed by the policy and regulations in effect before June 30, 1976.

As of October 1, 1979, however, Defense had not yet issued its implementing guidance for the revised Circular. Therefore, on October 5, 1979, after coordinating with the Office of Management and Budget, it issued interim guidance so that Defense components would know what rules to apply to ongoing cost comparison studies as of October 1, 1979.

The guidance advised Defense components that the rules in effect during fiscal year 1979 could be used on solicitations that satisfied all of the following criteria:

1. The cost comparison analysis was announced for initiation in fiscal year 1979.
2. The solicitation was issued prior to October 1, 1979.
3. Offers would be received and opened prior to November 15, 1979.
4. The solicitation, when issued, called for use of the fiscal year 1979 rules.

In all other cases, unless a specific exception was granted, the requirements of the revised Circular were to be applied.

Since the solicitation issued by the Naval Station satisfied these criteria, the cost comparison that it prepared was subject to the rules in effect during 1979. These rules did not provide for a 10 percent cost differential favoring in-house performance.

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<sup>1/</sup>Public Law 95-485, 92 Stat. 1611.


AFGE Local 2010 also believed that a memorandum of May 16, 1979, from the Chief of Naval Operations, concerning the proposed conversion at the Naval Station, appeared to be a violation of Section 806(a) of the Department of Defense Authorization Act, 1980. <sup>1/</sup> Section 806(a), which applies to the vehicle services contract awarded by the Naval Station on May 12, 1980, prohibits the conversion of in-house functions to contract performance to circumvent any civilian personnel ceiling.

The memorandum, as pointed out by AFGE, assessed a civil service end strength reduction which could be applied toward meeting a fiscal year ceiling assigned to the Commander in Chief, U.S. Atlantic Fleet. We noted, however, that the memorandum conveyed approval for the solicitation of bids, and the taking of subsequent contracting-out and reduction-in-force actions, only if economical. Thus, we do not believe that this memorandum, or any other documents reviewed by us, demonstrate that personnel ceilings were considered in reaching the contracting-out decision.

To be as responsive to your needs as is possible, we will, as arranged with you, present a detailed briefing to you on June 25, 1980, on the results of our work to date. Answers to some of our open questions could provide a basis for you to request the Navy to reconsider its decision.

This letter and our briefing should be helpful to you at this time, but we will, of course, provide any additional assistance you desire.

Sincerely yours,

  
W. H. Sheley, Jr.  
Acting Director

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<sup>1/</sup>Public Law 96-107, 93 Stat. 803.



DEPARTMENT OF THE NAVY  
OFFICE OF THE CHIEF OF NAVAL OPERATIONS  
WASHINGTON, D.C. 20350

IN REPLY REFER TO  
Ser 443C/732845  
24 July 1980

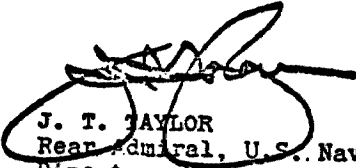
Dear Mr. Chairman,

In response to your request during the meeting you held on June 30th with representatives from the Navy and the General Accounting Office, the Chief of Naval Operations and the Naval Audit Service have reviewed the cost study conducted concerning the operation and maintenance of motor vehicles at Naval Station, Mayport. Their review focused around the following areas in response to questions raised during the meeting of June 30th by you and by the GAO representatives:

1. The amounts included in the Government's proposal for overtime
2. The amounts included in the Government's proposal for contract administration costs
3. The applicability of discounts to material costs provided to the bidder
4. The amount of costs associated with the contractor's leasing of tools from the Government.
5. The addition of grounds maintenance functions to Navy's contract after award.

The findings in these areas are discussed in detail in the attached enclosure.

In brief, the review revealed some minor revisions to the original cost study were appropriate. These revisions would, however, still result in contractual performance being more economical by \$75,187 over the next three years. Since the rules in effect at the time of the cost study dictated a conversion in the event of any estimated savings, the review confirms the appropriateness of Navy's decision to contract.

  
J. T. TAYLOR  
Rear Admiral, U.S. Navy  
Director, Shore Activities  
Planning and Programming  
Division

The Honorable Charles E. Bennett  
Chairman, Subcommittee on Seapower  
Armed Services Committee  
House of Representatives  
Washington, D.C. 20515

Blind copy to:



**REVIEW OF COMMERCIAL AND INDUSTRIAL-TYPE ACTIVITY  
(CITA) COST COMPARISON FOR THE OPERATION AND  
MAINTENANCE OF MOTOR VEHICLES AT THE NAVAL STATION, MAYPORT**

The results of the review by the Naval Audit Service and the Chief of Naval Operations for each area in question are as follows:

**1. The amounts included in the Government's proposal for overtime**

Overtime costs noted in the Government's cost proposal were included to account for overtime labor required to compensate for unscheduled employee leave. As such, the inclusion of such costs are appropriate since they represent the government's cost of performing to the specifications of the Invitation for Bid (IFB). Failure to include them would not provide a fair comparison since the contractor's bid represented his total cost of performing to the specifications of the IFB. The contractor will not, under the terms of the IFB, be reimbursed for any overtime costs he incurs within normal working hours. Hence, no overtime costs are included in the contractor's bid.

The General Accounting Office (GAO) did note that an amendment to the contract negotiated subsequent to award would result in overtime requirements outside normal shifts. This amendment was added to correct an omission in the initial cost comparison since the original IFB did not include provisions for the payment of overtime outside normal working hours. The projected overtime over a three year period would result in additional cost of \$151,350 to the in-house costs and \$170,116 to the contract costs or a net increase in the cost of contracting equal to \$18,766.

**2. The amounts included in the Government's proposal for contract administration costs**

The GAO has asserted that, based upon its limited review, it appears that Naval Station Mayport underestimated the contract administration costs. The GAO review noted that Naval Station Mayport expects to use four positions for an annual contract administration cost of \$80,320. In fact, Naval Station Mayport will be using only two additional personnel to administer the

contract. Naval Station Mayport has hired two Quality Assurance Specialists, GS-1910-9, Step 5 at an annual cost of \$41,874. Over the three year comparison period, the cost of these personnel equals \$125,622. The figure is slightly less than the 4% contract administration costs that have been used in the cost comparison.

3. The applicability of discounts to material costs provided to the bidder.

The GAO has asserted that the use of an estimated 20 percent discount factor in the computation of the material expenditures resulted in an understating of the retail value of the material costs of the CITA function and a corresponding increase in the net costs associated with contracting. The Naval Audit Service concurred. In addition, the Naval Audit Service's review revealed that the actual annual costs for parts and materials had been overstated by \$8,327. The use of the government's actual 27 percent discount factor with the corrected actual costs of parts and material results in a retail value for parts and materials of \$343,459 versus the \$320,000 noted in the IFB. This corrected cost of materials when applied against the contractor's 20 percent discount over a three-year period will result in a net increase in the costs of contracting. This amount of the increase is derived by applying the contractor's discount to the corrected retail value of the parts and material. Such application yields an annual cost of \$274,767 for parts and materials supplied by the contractor or a net annual increase of \$18,768 per year over the amount included in the contractor's bid. Over the three year comparison period, this increase equals \$56,304.

4. The amount of costs associated with the contractor's leasing of tools from the government

As noted in the meeting on June 30th, the leasing of tools from the government by the contractor resulted from a misunderstanding concerning the amount of government-furnished equipment that would be provided the contractor. The government has, as a result, agreed to lease tools to the contractor for \$225 per month. Because the government is being reimbursed for its expenses in this area via the leasing arrangement and because the contractor is not being compensated under the contract for this item, the costs associated with the provision of tools will not affect the outcome of the cost comparison.

5. The addition of grounds maintenance functions to the contract after award

The functions in question are motor vehicle operations in support of grounds maintenance. They were inadvertently omitted from the specifications of the IFB. Accordingly, upon

discovery of the omission, a change order was negotiated after award to include these functions. The change did not significantly alter the scope of the contract and had no effect upon the cost comparison. Because the change gave the appearance of circumvention of the firm bid/offer procedures, the change order was cancelled.

The net effect of these actions results in a three year total cost of in-house performance of \$3,915,901 as compared to a total cost of contractor performance of 3,840,714 for the same period. The cost advantage to the government associated with contracting is \$75,187.

COMPARISON OF NAVY AND OUR IN-HOUSE  
AND CONTRACT COST ESTIMATES FOR  
VEHICLE MAINTENANCE AND OPERATIONS FUNCTIONS AT  
U.S. NAVAL STATION, MAYPORT, FLORIDA (3-YEAR PERIOD)

<u>Cost factors</u>	<u>Navy estimates</u>		<u>Our</u>	
	<u>Original</u>	<u>Revised</u>	<u>Adjustments</u>	<u>Estimate</u>
Government operation:				
Civilian personnel	\$2,826,489	\$2,977,839	\$-110,795	\$2,867,044
Materials, supplies, utilities, and other services	777,156	752,175	-	752,175
Maintenance and repair	16,974	16,974	-	16,974
Federal taxes	47,622	51,017	-	51,017
Opportunity cost	31,715	31,715	-20,740	10,975
Insurance	10,863	11,241	-332	10,909
Other indirect cost	72,411	74,940	-74,940	-
<b>Total</b>	<b>3,783,230</b>	<b>3,915,901</b>	<b>-206,807</b>	<b>3,709,094</b>
Contract operation:				
Contractor bid	3,174,735	3,401,156	-	3,401,156
Contract administra- tion	126,990	136,046	86,554	222,600
Other cost	303,512	303,512	-	303,512
<b>Total</b>	<b>3,605,237</b>	<b>3,840,714</b>	<b>\$ 86,554</b>	<b>3,927,268</b>
Savings by contract	\$ 177,993	\$ 75,187		
Savings by Government operation				\$ 218,174

Note: The Navy and our cost estimates do not reflect actual increases in the wages of Government and contractor employees. We did not include the increases because its preliminary calculations indicated that they would approximately offset one another and thereby would not affect the outcome of the comparison.

OUR ADJUSTMENTS

Civilian personnel

We believe that this estimate should be decreased because it includes costs for services not covered by the specifications in the invitation for bids.

On June 29, 1980, the contract was modified to include services that Government employees were performing which had been inadvertently omitted from the specifications in the invitation for bids and the basic contract. The Navy reported that the added services did not significantly alter the scope of the contract or affect the cost comparison. We do not agree with that conclusion.

Services added by the contract modification involve a total of 3,708-labor hours, including (1) 2,083-labor hours for bus services between the Naval Station and the Naval Air Station, Jacksonville, Florida, (2) 1,111-labor hours for miscellaneous grounds maintenance service, and (3) 514-labor hours for miscellaneous public works support services. Labor hours for several other services covered by the basic contract, such as taxi and school bus services were decreased by offsetting amounts. An official of the Naval Station said that services already covered were decreased, not because of a decrease in requirements for the services, but to avoid an initial increase in the contract price.

The Navy also reported that the modification has been canceled because it gave the appearance of circumvention of procurement procedures. That action does not alter the fact that the in-house estimate and contractor's bid were not based on comparable workloads.

Accordingly, we believe that the in-house estimate is overstated and should be reduced to the extent that costs were included for the added services. The average labor rate applicable to these services is \$9.96 an hour. At that rate, 3,708-labor hours would cost \$110,795 over the 3-year period covered by the comparison.

#### Opportunity cost

We believe that this estimated cost should be substantially reduced because the contractor is leasing Government-owned tooling and equipment instead of furnishing its own. The Navy report discussed the leasing arrangement but concluded that it did not impact the cost comparison. We do not agree with that conclusion.

Specifications in the Navy's invitation for bids, as well as those in the basic contract, require the contractor to furnish the tools and equipment--except for some Government-owned hydraulic lifts and compressors--required for vehicle inspection, maintenance, and overhaul. On the basis of that requirement, the estimated cost of in-house performance included an opportunity cost of \$31,715, which

represented the estimated market value of Government-owned vehicles, tools, and equipment that would be available for other uses or disposal upon conversion to contractor performance. In effect, the opportunity cost is a one-time savings which would accrue to the Government from contractor performance, but which would be lost by continuing in-house performance.

However, after the contract was awarded, but before contractor performance started, the Navy agreed to lease most of the tools and equipment having a value of about \$28,840 to the contractor for a fee of \$225 a month, which would total \$8,100 over the 3-year period covered by the comparison. We believe that the opportunity cost (\$31,715) should be reduced by the difference between the value of the tools and equipment leased (\$28,840) and the amount of the rental proceeds for 3 years (\$8,100). On this basis, the opportunity cost should be reduced by \$20,740.

#### Insurance

Decrease is due to decrease in cost of civilian personnel. Insurance costs are estimated at 0.3 percent of the total cost of (1) civilian personnel, (2) materials, supplies, utilities, and other services, and (3) maintenance and repair.

#### Other indirect cost

We believe that this estimated cost should be excluded from the comparison because it is based on Navy instructions that are inconsistent with applicable guidance provided in the Office of Management and Budget Circular A-76, revised August 30, 1967.

The Navy's estimates were computed according to a Navy instruction which requires adding to the cost of Government operation 2 percent of certain other in-house costs, such as (1) civilian personnel, (2) materials, supplies, utilities, and other services, and (3) maintenance and repair. These estimates represented the cost of various central administrative services above the installation level, such as centralized accounting, personnel, and legal assistance.

Circular A-76, however, requires costs to be included in a comparison only if actual costs are expected to change. In our opinion, changes in administrative services above the installation level are unlikely for an action such as this which affected only 44 employees.

Contract administration

We believe that this cost should be substantially increased because (1) it may not reflect the number of additional people needed to properly administer the contract and (2) it is based on guidance that was not applicable at the time of comparison.

The Navy's estimates were computed according to a May 1979 directive from the Chief of Naval Operations which required using a 4-percent cost factor applied to the contractor's bid. Naval Station officials said at the time of our review that the original estimate of \$126,990 for the 3-year period would provide for less than two of the four additional people needed to properly administer the contract. Information they provided indicated that an appropriate level of contract administration would cost about \$222,600 for the 3-year period.

In this regard, Naval Station officials said that only two additional people had been authorized for contract administration. They also said, however, that if two more people were not added to the station's personnel ceiling, an effort would be made to obtain the positions from other functions at the station.

The Navy's report stated that only two additional people would be used to administer the contract. The report indicated that two GS-9 Quality Assurance Specialists had been hired at a cost of \$41,874 a year. The hiring of only two additional people at this point in time does not indicate that more are not needed or will not be used in the future.

Further, the 4-percent factor which was apparently based on one of many revisions made to the Office of Management and Budget Circular A-76 on March 29, 1979, was provided in May 1979, while the comparison was to be prepared using the policy and regulations in effect before June 30, 1976, as required by the Department of Defense.

Other American Federation of Government Employees

The American Federation of Government Employees Local 2010 also questioned whether the in-house estimate and contractor's bid were based on the same labor requirement for crane operations.

The in-house estimate and contractor's bid for crane operations appear to be based on comparable requirements, but we cannot be certain because they were developed from different criteria. The in-house estimate was based on the combined number of labor hours provided by affected employees for both crane and construction equipment operations whereas the contractor's bid was based on a weekly charge for crane operations only, without regard to labor-hour requirements.

This question was apparently based on a comparison of the in-house estimate and the invitation for bids as originally prepared by the Naval Station. The in-house estimate was based on 8,750-labor hours which included both crane and construction equipment operations. The original invitation for bids specified 6,200-labor hours for crane operations only. An official of the Naval Station said that the invitation included labor-hour requirements for construction equipment operations under a different line item.

Several additional questions of the American Federation of Government Employees Local 2010, which we answered in the negative in our letter to you of June 25, 1980, were as follows:

- Should the Navy have applied a 10-percent cost differential favoring in-house performance in its cost comparison?
- Did the Navy convert the in-house functions to contract performance to circumvent any civilian personnel ceiling?