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WASHINGTON, D.C. 20548

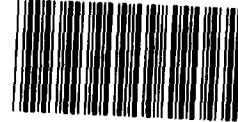
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PROCUREMENT, LOGISTICS,
AND READINESS DIVISION

B-209739

November 12, 1982

The Honorable Alan Cranston
United States Senate



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The Honorable Paul S. Sarbanes
United States Senate

Subject: Navy Procedures Used In Awarding Solicitation
#62474-82-R-0051 at the Naval Weapons Center,
China Lake, California (GAO/PLRD-83-15)

In your September 27, 1982, letter, you asked us to review certain Navy procedures used to award solicitation #62474-82-R-0051. The contract resulting from the solicitation will affect family housing maintenance, supply operations and warehousing, and vehicle operations and maintenance functions now being performed by Federal civilian personnel at the Naval Weapons Center (NWC), China Lake, California. Your letter expressed concern that the Navy initially decided it would cost almost \$3 million less to perform these functions in-house rather than by contract as subsequently decided. You asked us to respond to specific questions in your letter before the contract is awarded. On November 8, 1982, we sent a letter to the Secretary of the Navy recommending that he defer the award of the contract until our report has been received and reviewed.

BACKGROUND

NWC prepared its cost estimate to perform the support services in-house and had the estimate reviewed and certified by the Naval Audit Service. Bids were opened on June 29, 1982. NWC announced that based on a cost comparison the in-house cost to perform family housing maintenance, supply operations and warehousing, and vehicle operations and maintenance functions was about \$2.8 million less than the cost of contracting. Pan Am World Services, Inc., the low bidder, filed an appeal in July 1982, alleging deficiencies with the NWC in-house cost estimate. An appeals officer from the Naval Material Command (NAVMAT) in Washington, D.C., was appointed to review the appeal. A review team was established to assist the appeals officer.

In August 1982 the appeals officer concluded that after adjustments, which he had applied, the cost of contracting was \$364,000 less than the in-house estimate. Consequently, the

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decision to perform the activities in-house was reversed and the functions were to be contracted. In September, about 400 appeals from NWC employees and others, such as union and civic leaders in the China Lake area, were submitted claiming errors in the adjustments that showed contracting to be less costly. The same appeals officer was selected to evaluate the appeals, and on October 29, 1982, he decided to sustain his decision in favor of contracting for the services at NWC. The contract is expected to be awarded to Pan Am around November 15, 1982.

SCOPE AND METHODOLOGY

We evaluated the appeals officer's adjustments and discussed them with the appeals officer and officials of NWC and NAVMAT. Because of time constraints, we concentrated on areas where Pan Am suggested and where the appeals officer made large adjustments --one-time conversion cost, escalation cost, labor cost (hours), and general and administrative expenses. Also, we obtained the views of the Naval Audit Service, Western Region, San Diego, California, and the Naval Audit Service Headquarters, Washington, D.C., concerning the differences. In addition, we discussed the cost comparison and the adjustments with the leaders of unions representing NWC employees. We also discussed certain adjustments with officials of the Office of Management and Budget's (OMB's) Office of Federal Procurement Policy in Washington, D.C.

It should be emphasized that, because of the short time frame to perform the review, our findings and conclusions are based on our best judgment relevant to the data reviewed and the discussions held.

FINDINGS AND CONCLUSIONS

Questions raised in request

In response to your specific questions, we found the following:

Why did the Naval Audit Service not find discrepancies in NWC's cost estimate? Because of time limitations we were not able to examine this question fully. The auditors' review was concerned with mathematical accuracy and ensuring that NWC followed established procedures in preparing the in-house cost estimate. However, most of the items in question in the adjustments reflected differences in judgment and interpretation of policies by NWC and the appeals officer. Hence, it is doubtful the items questioned would normally be identified during the auditors' evaluation.

Why did the Navy review team not consult with Naval personnel experts? A member of the appeals review team said the team did not feel it was necessary to have personnel expertise because the team accepted the personnel rates NWC used. The team member said the team was only concerned about the number of hours and the number of people involved which, in their opinion, did not require an evaluation by personnel experts.

How was reduction-in-force (RIF) that would result from contracting out projected? NWC projected, as part of its one-time conversion cost, a "mock RIF." The mock RIF was used to estimate the cost to RIF Federal employees if the functions are contracted. The mock RIF was based on the number of personnel needed for the most efficient organization and assumed that all employees would be either RIFed or retired. (The policy on contracting out under OMB Circular A-76 and Public Law 96-342 require an activity considering contracting to base its in-house cost estimate on the most efficient and effective organization). The appeals officer adjusted this projection to correct what he considered to be a "worst case" projection. NWC's management agreed that it should have used some other assumptions, but disagreed with the extent of the appeals officer's adjustments. NWC agreed, for example, that it should have planned on some people going to work for the contractor. We agree that NWC should not have used the worst case projection.

Why did NAVMAT change the figures used to compute labor hours? Based on Pan Am's appeal, the appeals officer calculated the labor hours required for in-house performance by counting the actual workdays in the 3-year contract period to arrive at 2,088, 2,096, and 2,088 hours per year or 6,272 hours total. NWC used 2,080 hours per staff-year (6,240 hours for 3 years) the standard work-year hours used Government-wide and specified in the cost comparison handbook. The appeals officer's calculation increased the in-house cost by adding the cost of these additional 32 hours to each employee included in the in-house estimate. Using the hourly rates in NWC's estimate, this added about \$53,700 to the in-house cost. We believe the appeals officer's adjustment was more accurate because actual workdays were used.

What are the reasons for the changes in the appeals rules prohibiting a contractor from appealing elements of the study reviewed in the first appeal? The appeals rules were not changed to prohibit only the contractor from appealing those elements of a cost study reviewed in a first appeal. The appeals rules were changed to prohibit any party from appealing any elements reviewed in a first appeal. Before June 30, 1982, the Navy's Commercial Activities Program appeals procedures allowed only one opportunity to appeal. The decision of the appeals officer was final. On July 1, 1982, the appeals procedures were amended to allow appeals that were reversed during the initial appeals process to be appealed.

The right of appeal, however, was limited to questions concerning elements that were not considered during the first appeal.

What procedures were used in the appeals process? While it appears that NAVMAT followed the appeals procedures in its basic approach to the two appeals, there are some questionable aspects to the process that was used. For the first appeal, a review team headed by an appeals officer was appointed. The appeal officer was at an organizationally higher level than that of the official approving the initial decision to perform the work in-house, Commander, NWC. The team was assisted in its review at NWC by representatives from other NWC activities, and the Naval Audit Service reviewed the adjustments. The same appeals officer from the first appeal was responsible for reviewing the second appeal. Although there is no specific guidance on how second appeals should be handled, we question the practice that (1) the same appeals officer be used, particularly where, as in this case, his decisions are being challenged, and (2) elements in a first appeal are not appealable in a second appeal, especially when new data is introduced.

Questionable adjustments

Cost of organizing to reach the most efficient organization

In order for NWC to reach its most efficient organizational staffing level of 207 employees, the appeals officer said 40 NWC employees would have to be retrained, placed in other positions, etc. The appeals officer determined that the cost of repositioning these 40 employees should have been included in the in-house estimate. Since the one-time cost of repositioning these employees was not included in the in-house estimate, the appeals officer reduced the contractor's bid by about \$1 million (the estimated cost to reposition 40 employees).

NWC objected to most of the appeal officer's \$1 million adjustment on the basis that it was contrary to Navy instructions and OMB Circular A-76. NWC states that the instructions specify that the cost comparison should be between the in-house estimate (based on the most efficient organization) and the contractor's bid (including one-time conversion cost). We asked officials of OMB's Office of Federal Procurement Policy about the intent of OMB Circular A-76 in regard to the cost to reorganize to fit the most efficient organization in the cost comparison. These officials said the reorganization cost should not play any part in the cost comparison, that is, the cost should not be added or deducted, and the cost comparison should be against the mock RIF for the most efficient organization. The Office of Federal Procurement Policy officials did not know of any instances where any other agency had treated the cost of reorganizing to meet its most efficient organization in the manner it was treated by NAVMAT. We

see no basis for the \$1 million adjustment made for NWC reorganization costs because (1) reorganization costs associated with making an activity more efficient is a normal cost of Government and (2) reorganization costs would not be incurred if an activity is contracted.

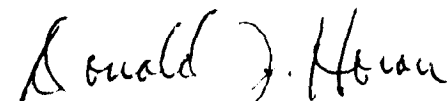
General and administrative expenses

The appeals officer adjusted the cost comparison to eliminate three general and administrative positions, which added about \$130,000 to the in-house cost estimate. While it was not determined where the losses would occur, it was assumed that the loss of about 200 employees by contracting would eliminate the need for three general and administrative employees. However, NWC says that this will not occur and that, at most, it might reduce some overtime. NWC also pointed out that its general and administrative people are currently running parallel payroll systems for a demonstration project, which has placed an extra burden on these people.

RECOMMENDATIONS

As discussed above, we believe there are serious questions that still need to be resolved. Because the cost margin between contracting or in-house performance is small and the decision is of tremendous importance to those parties affected, we believe careful consideration should be given to the issues raised. Therefore, we recommend that the Secretary of the Navy defer award of the contract for support services until the cost comparison has been thoroughly reevaluated. We also recommend that the Secretary revise the policy and procedures used in handling second appeals to (1) require that a different appeals officer be appointed and (2) allow elements in a first appeal to be reviewed again when new data is presented.

We are sending copies of this report to the Secretaries of Defense and the Navy; the Director, Office of Management and Budget; the Administrator, Office of Federal Procurement Policy; the Chairmen, Senate and House Committees on Appropriations and on Armed Services, Senate Committee on Governmental Affairs, and House Committee on Government Operations. We will also make copies available to others upon request.


Donald J. Horan
Director