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UNITED STATES GENERAL ACCOUNTING OFFICE

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STATEMENT OF
ROBERT M. GILROY, SENIOR ASSOCIATE DIRECTOR
PROCUREMENT, LOGISTICS AND READINESS DIVISION
BEFORE THE
SUBCOMMITTEE ON CIVIL SERVICE, POST OFFICE
AND GENERAL SERVICES
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
ON
PROCEDURES USED BY NAVY IN REVIEWING IN-HOUSE
VERSUS CONTRACT COSTS FOR ACTIVITIES AT THE
NAVAL WEAPONS CENTER, CHINA LAKE, CALIFORNIA



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Mr. Chairman and Members of the Subcommittee:

We are here at your request to discuss the results of work we performed at the request of Senators Alan Cranston and Paul S. Sarbanes relevant to the procedures used by the Naval Materiel Command appeals team in reversing an earlier decision made by the Naval Weapons Center (NWC) to perform various activities at the Naval Weapons Center, China Lake, in-house rather than by contract. The activities the Navy intends to contract are family housing maintenance, supply operations and warehousing, and vehicle operations and maintenance.

As you are aware, Office of Management and Budget Circular A-76 generally requires a cost comparison to determine if it is less costly to perform an activity in-house or to contract. The circular also requires agencies to establish appeal procedures to resolve questions arising from determinations to either continue in-house performance or to contract out. Agency appeals decisions are final.

The Naval Weapons Center, China Lake, performed a cost comparison and determined it would be about \$2.8 million less over a 3-year period to perform the activities in-house than to contract. This decision was appealed by the contractor submitting the low bid and in the appeals process the previous decision was reversed because it was determined that the cost to perform the activities would be less costly by about \$364,000 if they were contracted.

Senators Cranston and Sarbanes posed specific questions to GAO regarding the appeals review and requested that we report to them before the Navy awarded the contract which was scheduled at

that time for about the 15th of November. Since we had approximately 2 weeks to answer the request, we looked primarily at areas involving large cost adjustments to the initial study, such as one-time conversion costs, escalation costs, and general and administrative expenses. In our November 12 response to the request questions, we found in summary that:

--In regard to the question on why the Naval Audit Service did not identify the same discrepancies in NWC's in-house estimate that were found in the appeals process, we found that the items questioned in the appeals review reflected differences in judgment and interpretation while it was the responsibility of the auditors to determine mathematical accuracy and ensure that NWC followed established procedures. Thus, it is doubtful, in our view, that the items questioned in the appeal would be identified in the auditors evaluation.

--In answer to why the appeals review team did not consult Naval personnel experts in performing their review, we found that they were only concerned about the number of hours and the number of people involved which, in their opinion, did not require personnel experts.

--In response to the question on how the reduction-in-force (RIF) that would result from contracting was projected, we found that the appeals team adjusted the "mock RIF" to

correct what was considered a "worst case" projection. NWC agreed that it should have used some other assumptions, but disagreed with the extent of the appeals team adjustment. We agreed that the worst case projection should not have been used.

--In answer to the question of why the appeals team changed figures used to compute labor hours, we found the appeals team adjusted labor costs on the basis of actual hours in the 3-year contract period. We agreed that these adjustments were more accurate because of the use of actual work hours rather than a standard.

--In response to the question of why the appeals rules were changed to prohibit a contractor from appealing elements reviewed in the first appeal, we found that Navy appeals rules were amended to allow appeals when a decision was reversed as the result of an initial appeal. However, the right of appeal was limited, not only to contractors but to any party, to questions concerning elements that were not considered in the first appeal.

--The final question concerned the procedures used in the appeals process. While it appears that Navy followed the appeals procedures in its basic approach to the two appeals, we question the practice that allows (1) the same appeals officer to be used on both cases, particularly since his decisions on the first appeal are being challenged and (2) only cost issues not raised in the first appeal to be raised in the second appeal even when new data is available.

In addition to responding to the request questions, our report also questioned the appeals team's reduction of one-time conversion costs by about \$1 million for 40 employees. This issue is very confusing, but it is our understanding that the 40 employees consist of 9 employees which the appeals team said would be RIFed and 31 employees that would be downgraded even if the functions were not contracted out. Therefore, the appeals team position is that the cost of the 9 employees and the cost associated with maintaining the 31 employees in downgraded positions should not be considered in the one-time conversion cost. It appears that the appeals team in its computation did not recognize that the one time conversion cost associated with the 31 employees related to RIF costs if the functions are contracted out, not to the cost related to maintaining the employees in downgrade positions. Had the appeals team recognized RIF costs the reduction would have been substantially less than \$1 million.

In addition, the appeals team adjusted the cost comparison to include the cost of three general and administrative positions which added about \$130,000 to the in-house cost estimate. NWC says that contracting out the targeted functions will not reduce general and administrative positions and should not be added to the in-house costs. Based on information provided during our review, we believe NWC's position is reasonable.

We have not yet received Navy's response to our report, but it is my understanding that a detailed response is forthcoming.

Mr. Chairman, we will submit a copy of our report for the record. This concludes my statement and I will be happy to respond to any questions you may have at this time.