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United States General Accounting Office

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Report to the Honorable Herbert H. Bateman, House of Representatives

October 1988

ARMY PROCUREMENT

No Savings From Contracting for Support Services at Fort Eustis, Virginia

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GAO

United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-230910

October 31, 1988

The Honorable Herbert H. Bateman
House of Representatives

Dear Mr. Bateman:

As you requested, we have reviewed the cost-plus-award-fee contract[1] awarded by the Army's Fort Eustis on November 8, 1982, to Northrop Worldwide Aircraft Services, Inc., for Directorate of Logistics (DOL) support services. The results of our review are summarized in this letter and discussed in more detail in appendix I. Our objectives, scope, and methodology are discussed in appendix II.

Prior to this contract, most of the DOL services, such as food and laundry services, were performed by government employees with supplemental support for some functions by government contractors. As required by Office of Management and Budget (OMB) Circular A-76, Fort Eustis officials reviewed the DOL functions and determined that all could be performed by private industry. Fort Eustis officials solicited offers for the work for a 4-3/4-year period from private industry. They compared the estimated cost of contracting out with the estimated cost of performing the work in-house and projected that $13.9 million could be saved over the 4-3/4-year period by contracting out for the services. Based on this analysis, Fort Eustis awarded a $28 million contract to Northrop for a reduced period of 4-1/2 years and disbanded the in-house work force.

Results in Brief

If Fort Eustis had considered all probable costs of contracting out for the DOL functions during the cost comparison process, the estimated savings would have been $7.1 million instead of $13.5 million.[2] However, these estimated savings were not realized. In fact, contracting out probably resulted in additional cost to the government of about $600,000 over the cost of in-house performance.

[1]A cost-reimbursement contract provides for payment of allowable costs incurred to the extent prescribed in the contract. This type of contract specifies an estimate of total cost for the purpose of obligating funds and establishing a ceiling that the contractor may not exceed, except at its own risk, without the approval of the contracting officer. A cost-plus-award-fee contract is a cost-reimbursement contract that provides a fee consisting of (1) a base amount fixed at the inception of the contract and (2) an award amount, based upon a judgmental evaluation by the government, sufficient to provide motivation for excellence in contract performance.

[2]Fort Eustis officials estimated savings of $13.9 million based on an anticipated contract period of 4-3/4 years. We adjusted this estimate to $13.5 million to reflect the actual contract period.

Since the Federal Acquisition Regulation (FAR) encourages the conversion of cost-reimbursement contracts to fixed-price contracts as quickly as possible, Fort Eustis should have made the effort during the DOL contract to develop the specifications needed to convert the DOL functions to a fixed-price basis for the planned follow-on contract.

Fort Eustis Overstated Estimated Savings

If Fort Eustis' comparison of the estimated cost of contractor performance to the estimated cost of in-house performance had been based on the contract's actual 4-1/2-year period, the projection would have shown that contracting out would produce an estimated savings to the government of $13.5 million. However, had Fort Eustis considered all probable costs known at the time, the cost comparison would have shown an estimated savings of only $7.1 million. In evaluating Northrop's $29.0 million, 4-3/4-year offer for cost realism and technical capability, Fort Eustis' Source Selection Evaluation Board concluded that several cost items in the offer were understated. They determined a more realistic contract cost, generally referred to as the most probable cost estimate, would be $32.6 million—$3.6 million more than Northrop offered.

The Board's largest adjustment, $2.5 million, was made because Northrop's offer for certain maintenance subcontract functions was less than $360,000. The solicitation upon which the offer was based stated that these maintenance services were costing the government over $600,000 a year, or about $2.9 million for the planned contract period. Northrop proposed to contract out the functions as had the government, but its estimated cost was considered extremely low by the Board.

Our evaluation, using the contract's actual 4-1/2-year life, showed that the Board's estimate of Northrop's most probable cost was low. We believe the most probable cost should have been about $34.4 million, or about $6.4 million more than the $28.0 million proposed for the period.

- The maintenance subcontract cost estimate of over $600,000 a year provided to the contractors was understated. Fort Eustis was actually paying about $1.4 million a year to contract for these services. Fort Eustis' in-house estimate for the same scope of work reflected a cost of $1.1 million a year to contract out for this effort. Since this estimate was based on information available at the time the cost comparison was done, the Northrop proposal could have been adjusted by about $4.6 million instead of the $2.5 million identified by the Board.

- Northrop proposed and Fort Eustis accepted a general and administrative expense rate that was less than its historical rate. The lower rate was based on the contingency of Northrop's being awarded additional contracts for which it had submitted offers. We believe inadequate support was provided to justify the lower rate. Adjusting the offer to the historical rate would have increased Northrop's most probable cost by about $523,000.
- The government and other offerors based labor costs on 2,080 hours per person per year while Northrop based its costs on 1,976 hours per person per year. Had Northrop's offer been made on the same basis as other offers, Northrop's most probable cost would have increased by nearly $746,000.

These adjustments would have also affected the estimated cost of other categories, such as contract administration and base and award fees, for an additional $560,000 adjustment to the most probable cost, or a total adjustment of $6.4 million. Although the $7.1 million savings would have been considerably less than the $13.5 million projected, the adjusted savings still would have supported the decision to contract out the DOL functions.

DOL Contract Understated at Its Inception

The Source Selection Evaluation Board noted in its evaluation that the Northrop offer was significantly understated. However, Fort Eustis officials did not negotiate or otherwise resolve the questionable costs, as required by Department of Defense and OMB guidance in effect at the time, with Northrop before awarding the contract, nor did they ensure that the contract contained provisions to control future costs for the questionable areas.

During the contract's base period,[3] the contractor submitted a revised proposal that, when negotiated, increased the first year option period's estimated cost from $6.1 million to $8.9 million—a 46-percent increase. The Memorandum of Negotiation attributed $1.3 million of the cost growth to increases in employee wages and benefits mandated by the Department of Labor. However, at least $1.2 million of the remaining increases was due to understatements in the original offer. For example:

- The maintenance subcontract, which was noted by the Board as being significantly understated in the contractor's best and final offer, increased from $73,000 to $1.1 million.

[3]The contract time frame included a base period of 6 months and four 1-year option periods.

- The general and administrative expense rate increased from about 1.8 to about 3.5 percent. Coupled with increased costs in the base upon which general and administrative expenses are calculated, the estimated cost increased from $100,000 to $300,000.

Contracting Out Did Not Result in Savings

The DOL contract experienced a cost growth of 70 percent, or about $19.5 million—from $28.0 million to $47.5 million. According to Fort Eustis officials, $8.8 million of the increase was due to increases in wage rates and employee benefits mandated by the Department of Labor for government contractor employees. An additional $5.0 million was for the contractor's understatement of cost for the maintenance subcontract, $3.3 million was for scope-of-work changes, and the remaining $2.4 million was for other miscellaneous increases.

Actual Cost Has Exceeded Likely Cost of Performance by Government Employees

As you requested, we compared the cost of performing DOL contract functions in-house to actual payments made to the contractor. We considered only changes in labor costs because (1) labor is the main cost component of the contract and (2) we assumed the cost of materials, utilities, and other similar costs would be essentially the same for either government or contractor performance of the DOL functions.

We used the government's in-house estimate as our starting point for analysis as it was very similar to the contractor's proposed work force in makeup and numbers of personnel. We adjusted the in-house estimate by adding or subtracting employees to match the contractor's changes over the period of the contract. We relied on Fort Eustis officials to determine the type and grade of government employees that would be required for equivalent positions. We followed OMB guidelines to calculate wage rates, and we factored in all government cost-of-living increases during the contract period.

The results indicate that, although the labor costs would have been more for in-house performance as compared to contractor performance, the total cost of performing the functions would have been about $600,000 less had the functions remained in-house. The greater cost for contracting out was due to such factors as contract administration and contract fees.

Data Not Developed to Permit Use of a Fixed-Price Contract for a Follow-On DOL Award

The FAR states that contracting officers should avoid protracted use of a cost-reimbursement contract after experience provides a basis for firmer pricing. However, during the life of the contract, Fort Eustis officials have not obtained the data needed to ensure that any follow-on award could be made on a fixed-price basis.

Fort Eustis justified the use of a cost-plus-award-fee contract for the original DOL solicitation on the basis that it was a first-time effort and sufficient data was not available to adequately define the work needed to permit fixed-price contracting. Officials said that because of staffing shortages, the additional workload data needed to allow the use of a fixed-price contract on the DOL replacement contract has not been gathered. Fort Eustis officials told us that for this reason the follow-on award will also be a cost-plus-award-fee contract.

Actions Taken by Fort Eustis to Improve the Contracting Process

Fort Eustis has improved the new DOL solicitation package and evaluation procedures based on its experience with the current contract. For example:

- Offerors are required to bid 2,080 hours per person per year when calculating labor costs.
- At the time of contract award a cap will be placed on the contractor's general and administrative expense rate to preclude renegotiating to higher rates at a later date.
- Verification of specific costs, such as historical general and administrative rates, will be requested from the Defense Contract Audit Agency.

Recommendations

We recommend that the Secretary of the Army direct the Fort Eustis Commanding Officer to take the following actions for the follow-on DOL contract and future A-76 cost comparisons and contracts:

- In accordance with the FAR, expedite the preparation of a requirements work statement that will permit contracting DOL functions on a fixed-price basis as soon as the statement is available rather than exercising follow-on options on a cost-reimbursement basis.
- Ensure that cost comparisons include all probable costs for in-house and contract performance.
- Ensure that variations between proposed costs and the most probable cost developed by the Board are negotiated with the contractor or otherwise resolved prior to any contract award.

As requested, we did not obtain agency comments on a draft of this report. However, we discussed its contents with Fort Eustis, Army Headquarters, Defense Department, and OMB officials and have incorporated their views where appropriate.

As agreed with your office, unless you publicly release the contents of this report earlier, we plan no further distribution of the report until 10 days from its issue date. At that time we will send copies to the Secretaries of Defense and the Army and to the Director, Office of Management and Budget. Copies will be made available to others on request.

Sincerely yours,

David A. Littleton

Frank C. Conahan for
Assistant Comptroller General

Contents

Abbreviations

DOD	Department of Defense
DOL	Directorate of Logistics
FAR	Federal Acquisition Regulation
OMB	Office of Management and Budget

A-76 Process As Applied to Directorate of Logistics Support Services, Fort Eustis

Fort Eustis, in accordance with the process described in Office of Management and Budget (OMB) Circular A-76, awarded a contract in 1982 for the performance of Directorate of Logistics (DOL) support services. Fort Eustis estimated that performance of these services by the contractor, compared to performance by government employees, would save the government an estimated $13.5 million[1] over a 4-1/2-year period. The Honorable Herbert H. Bateman asked us to review the award of this contract and determine whether the estimated savings were achieved. We found that (1) estimated savings were considerably overstated, (2) the contract price was understated at its inception, (3) estimated savings were not realized, and (4) actual contract cost has exceeded likely cost of performance by government employees. Also, data needed to permit use of a fixed-price contract for a follow-on award has not been developed.

Overview of the A-76 Process

OMB Circular A-76 (revised) states that, as a general policy, the government relies on the private sector for products and services when they are available, cost-effective, and consistent with other requirements. Circular A-76 also sets forth policies and procedures for determining when activities should be performed by contractor or government personnel.

If contractor performance is determined to be feasible, estimated contract and in-house costs for the functions must be compared to determine the most cost-effective approach. OMB's Cost Comparison Handbook, a supplement to the circular, furnishes the guidance for computing cost comparison amounts. Department of Defense (DOD) Instruction 4100.33 and Army Regulation 5-20 furnish additional implementation guidance.

The activity responsible for evaluating potential commercial activities conducts a management study and develops a performance work statement (description of the work required) that describes all of the functions to be evaluated. It also prepares a most efficient organization document that contains the government's estimate of the lowest number and types of employees required to perform the functions described in the work statement. From this data and other estimated costs associated with in-house performance, a total estimated cost for in-house performance is prepared. For contractor performance, the selected bid or offer is

[1]See footnote 2, page 1.

added to other estimated costs, such as contract administration, to develop a total estimated cost for contracting out.

The two estimates are compared to determine which alternative is more cost-effective. If the total estimated cost to contract out shows a savings of more than 10 percent of the estimated in-house personnel costs when compared to the estimated cost of in-house performance, a contract is awarded and the government work force is reassigned or terminated. If the functions remain in-house, the activity performing those functions is required to realign itself to conform with the most efficient organization document to ensure that the anticipated cost savings are realized.

History of the DOL Contract

In 1982, the Fort Eustis Directorate of Contracting solicited offers from private contractors to perform DOL support functions for a 4-3/4-year period. Government employees, with supplemental support from government contractors, were performing those functions at that time. In its comparison between estimated contracting costs and estimated in-house costs, Fort Eustis officials concluded that the functions could be performed by a private contractor at an estimated savings of $13.9 million. Therefore, Fort Eustis awarded a cost-plus-award-fee contract[2] to the low bidder, Northrop Worldwide Aircraft Services, Inc., on November 8, 1982.

The contract required Northrop to perform food, supply, transportation, maintenance, and laundry service functions over a 4-1/2-year period beginning April 1, 1983, and ending September 30, 1987. The contract time frame included a base period of 6 months and four 1-year option periods for an estimated cost of $28 million. Because of delays in making the award, the contract period was reduced to 4-1/2 years rather than the originally planned 4-3/4-year period. The estimated contract amount was adjusted accordingly from $29 million to $28 million.

Prior to the end of the base and each option period, Northrop submitted a revised proposal to accomplish the next year's work. The options were exercised through contract change orders. The revised proposals and other contract changes were reviewed and negotiated by the Fort Eustis Directorate of Contracting.

Fort Eustis officials said that because of administrative difficulties, scope-of-work changes, and other problems, a replacement contract

[2]See footnote 1, page 1.

could not be awarded by the end of the final contract period in 1987. Therefore, the existing contract will be extended until a new DOL contract can be awarded. According to the contract administrator, as of June 1988, the extension had totaled $11.7 million. Award of the new contract is not expected until February 1, 1989.

Fort Eustis Overestimated Savings

The OMB and DOD cost comparison handbooks in effect when Fort Eustis made the DOL comparison contains A-76 implementing guidance stating that

"to ensure an equitable comparison, both cost figures [government and contractor] must be based on the same scope of work, and include all significant identifiable costs that would be incurred by the Government under either alternative."

Fort Eustis officials compared the estimated cost of contractor performance to the estimated cost of in-house performance to determine whether to contract out the DOL functions. Based on a 4-3/4-year contract life, Fort Eustis projected an estimated savings of $13.9 million by contracting out. (We adjusted the estimated savings to $13.5 million to reflect the actual contract period of 4-1/2 years.)

Fort Eustis officials evaluated the offers received for technical merit and cost reliability through a Source Selection Evaluation Board. The Board calculated the most probable cost for each of the offers and assessed each contractor's technical capabilities to perform the functions. The Board developed the most probable cost by (1) using each contractor's offer as a base figure, (2) determining areas that appeared to be overstated or understated, and (3) adjusting the result to reflect, as determined by the technical evaluation, the offeror's capability to perform as proposed.

Such analyses of contractor offers are proper. For solicitations in which a cost-reimbursement contract is involved, the contracting agency's cost realism analysis of the offerors' proposed costs is a fundamental part of the proposal evaluation process. Further, with this type of contract, the government, within certain limits, bears the risk of loss due to cost overruns.

The Board concluded that a more realistic contract cost estimate for Northrop's performance of the DOL services would be $32.6 million, or $3.6 million more than the $29.0 million Northrop offered for the 4-3/4-year period. For example:

- The solicitation included information that maintenance work proposed to be subcontracted under the overall contract was currently costing the government over $600,000 per year, or $2.9 million for the anticipated contract period. Northrop, however, proposed less than $360,000 for the maintenance subcontract for the entire 4-3/4-year period. The Board recognized this shortcoming and added $2.5 million to the offer.
- In its best and final offer, Northrop proposed a general and administrative rate of about 1.8 percent for the contract term, although historically its general and administrative rate was about 3.5 percent. The reduced rate was based on the contingency of being awarded additional contracts for which Northrop had submitted offers. The Board added $71,000 to Northrop's general and administrative expense cost estimate to compensate for other adjustments made to the contractor's best and final offer but did not adjust for the percentage proposed by Northrop. The other contracts did not materialize, and during the base period, Northrop requested and received an increase in the rate to about 3.5 percent.

We concluded that the most probable cost was underestimated by the Board. We believe the most probable cost should have been about $34.4 million, or about $6.4 million more than the $28.0 million proposed for the actual contract period.

- It was discovered after contract award that the $600,000 a year included in the solicitation for maintenance subcontract functions was an understatement. Actual costs were about $1.4 million a year. However, the higher cost was apparently recognized in the government's in-house estimate for the function. The government's in-house portion of the cost comparison showed an estimate of $4.9 million for the maintenance subcontract for 4-1/2 years. Since the contractor was proposing to accomplish the work in the same manner as previously done by the government—by contracting out—the less than $350,000 proposed for the function for 4-1/2 years was understated by about $4.6 million, or $2.1 million more than estimated by the Board.
- Had Northrop's general and administrative rate of about 1.8 percent proposed in the best and final offer been adjusted to its historical rate of about 3.5 percent, the most probable cost would have increased by nearly $523,000.
- The government and other offerors based labor costs on 2,080 hours per person per year. Northrop based its labor costs on 1,976 hours per person per year. Northrop's offer was not adjusted during the proposal evaluation process to make it comparable with other offers or with the government in-house estimate because the contractor assured officials the hours reflected its labor force experience. Had the offer been made

on the same basis as other offers, Northrop's most probable cost would have increased by nearly $746,000.

If these adjustments had been made, the resultant increases in contractor general administrative expenses, base and award fees, and contract administration would have increased costs by an additional $560,000. Therefore, the estimated total understatement would have been $6.4 million—a reduction in estimated savings to $7.1 million and a most probable contract cost of $34.4 million for the actual 4-1/2-year period. Although the savings would have been considerably less than estimated by Fort Eustis, the adjusted savings still would have supported the decision to contract out the DOL functions.

DOL Contract Understated at Its Inception

Although the Source Selection Evaluation Board noted in its evaluation that the Northrop offer was understated by $3.6 million, Fort Eustis did not resolve the questionable areas before awarding the contract. It is not clear why this was not done.

OMB and DOD guidance in effect at the time stated that cost-reimbursement contract offers were to be subjected to "meticulous" cost and technical evaluations to ensure the validity of the proposal. Adjustments to the offer were to be reviewed with the offeror and an adjusted contract price developed for use in the cost comparison process.

Fort Eustis officials did not resolve the discrepancies between Northrop's proposal and the Board's evaluation as called for in OMB and DOD guidance in effect at the time. They also did not use an adjusted figure in the cost comparison or add provisions to the contract to protect the government against cost growth in the questioned cost categories. The contract was not adjusted either through limitations on the compensations to be paid for the understated areas or through agreement prior to award of more realistic amounts for the apparently low cost categories.

During the base period, the contractor submitted a revised proposal that, through negotiation procedures, increased the first option period's estimated cost from $6.1 million to $8.9 million—a 46 percent increase. The Memorandum of Negotiations attributed $1.3 million of the increase to increases in employee wages and benefits mandated by the Department of Labor for government contractor employees. However, at least

$1.2 million of the increase was due to understatements in the original offer. For example:

- The maintenance subcontract, which was noted by the Board as being significantly understated in the contractor's best and final offer, increased from $73,000 to $1.1 million.
- General and administrative expense increased from 1.8 percent to 3.5 percent. Coupled with increased costs in the base upon which general and administrative expenses were calculated, the estimated cost increased from $100,000 to about $300,000.

Fort Eustis Has Not Realized Estimated Savings

The estimated savings of $13.5 million have not been realized. The DOL contract has experienced a cost growth of 70 percent, or about $19.5 million. While Northrop's best and final offer for the 4-1/2-year period was $28.0 million, actual payments have totaled over $47.5 million. Table I.1 shows the reasons for the contract cost growth as explained by Fort Eustis officials.

Table I.1: Reasons for Contract Cost Growth

Dollars in millions

Reason for Change	Amount of Increase	Total
Scope-of-work increase		
Continuing	$2.5	
Temporary	.8	$3.3
Department-of-Labor increase		
Wage rates	6.3	
Benefits	2.5	8.8
Understatement of offer		
Maintenance subcontract		5.0
Other		2.4
Total		**$19.5**

Actual Cost Has Exceeded Likely Cost of Performance by Government Employees

As requested, we compared the estimated cost of performing DOL contract functions in-house to actual payments made to the contractor. We focused our efforts on the labor portions of the contract cost as (1) labor is the main cost component of the contract and (2) we assumed that the costs of materials, utilities, and other similar costs would be essentially the same for either government or contractor performance.

We used Fort Eustis' estimate of the least number of government employees required to perform the specific DOL tasks as our starting point because it was similar to the proposed contractor work force in terms of the number and breakdown of personnel proposed. We then added or subtracted employees to the work force as had the contractor. Each civilian position added or deleted was converted to the equivalent government general scale or wage board position based on Fort Eustis officials' providing the equivalent position.

In calculating salary costs, we followed the A-76 guidance for doing cost comparisons. We computed full-time and part-time employees using 2,080 hours as a full-time work year and 1,040 hours as a part-time work year. All government cost-of-living increases during the contract period were also taken into account.

We discussed this methodology with appropriate Fort Eustis and Army officials. They agreed that this method should provide a reasonable estimate of in-house costs and that the estimate should be higher than actual costs would have been for in-house performance. The actual cost would have been lower because Fort Eustis could not have hired the additional workers as did the contractor because of hiring freezes. We also used higher numbers of work hours for full-time and part-time positions than the contractor used.

The results indicate that, although the labor costs alone would have been more for in-house performance as compared to contractor performance, the total cost of performing the functions would have been about $600,000 less had the functions remained in-house. The additional factors that made contractor performance more costly were primarily contract administration and base and award fee costs that would not have been paid for an in-house work force.

Data Not Developed to Permit Use of a Fixed-Price Contract for a Follow-On DOL Award

Fort Eustis justified the use of a cost-plus-award-fee contract for the original DOL solicitation on the basis that it was a first-time effort and sufficient data was not available to adequately define the work needed to permit fixed-price contracting. However, Fort Eustis officials said that because of staffing shortages, the workload data needed to allow the use of a fixed-price contract on the DOL replacement contract was not gathered. Therefore, the follow-on contract will also be a cost-plus-award-fee contract.

Cost-reimbursement contracts shift much of the cost risk to the government. The FAR encourages the use of fixed-price contracts as generally being in the government's interest. Cost-plus-award-fee contracts are considered suitable when the following three conditions are met:

"(i) The work to be performed is such that it is neither feasible nor effective to devise predetermined objective incentive targets applicable to cost, technical performance or schedule;

"(ii) The likelihood of meeting acquisition objectives will be enhanced by using a contract that effectively motivates the contractor toward exceptional performance and provides the Government with the flexibility to evaluate both actual performance and the conditions under which it was achieved; and

"(iii) Any additional administrative effort and cost required to monitor and evaluate performance are justified by the expected benefits."

The FAR also cautions that the contract amount, performance period, and expected benefits should be sufficient to warrant the additional administrative effort and cost involved. It further states that contracting officers should avoid protracted use of a cost-reimbursement contract after experience provides a basis for firmer pricing.

Fort Eustis officials justified the use of a cost-reimbursement contract for the original period by stating that as a first contract effort embracing a multitude of disparate services, it was impossible to draft detailed specifications for individual requirements needed for any other type of contract. For the current DOL solicitation, the cost-plus-award-fee contracting method was again selected. The justification was as follows:

"Difficulty in detailing specific requirements prohibits binding either the Government or the contractor to other than a cost type arrangement. A [cost-plus-award-fee] contract will properly motivate the contractor to excel in performance while also controlling cost. A cost-plus-fixed-fee contract is impractical because cost controls are insufficient and a cost-plus-incentive-fee contract was not considered because objective measurements for fee determination are lacking. The goal of A-76 is lowest economics with the enhancement of performance. A [cost-plus-award-fee] type contract best fits the need to motivate a contractor to achieve these goals."

We asked Fort Eustis contracting officials to explain the rationale for continuing to use a cost-plus-award-fee contract for the DOL functions because (1) many of the areas appear to be definable in terms of functions needed (i.e., food and laundry services), (2) Fort Eustis has had 5 years of experience in contracting out these functions, and (3) the original cost-plus-award-fee contract resulted in significant cost growth.

They said that they believe the contractor has responded well under this type of contract because the award fees being paid have consistently been above 90 percent of the available fee. They believe that the contract has been no more difficult to administer than a fixed-price contract. They also did not think the contract was more expensive than a fixed-price contract would have been because (1) Department of Labor wage rate and benefit increases apply to all types of contracts and (2) contractors sometimes try to make up for underbidding the original solicitation when negotiating change orders to fixed-price contracts.

We asked why Fort Eustis had not used the experience it had gained (4-1/2 years under the original contract and over 1/2 year under the extension) to develop better specifications. Officials said that because of staff shortages the workload data had not been accumulated to permit conversion to a fixed-price contract. They said, in fact, that they were probably in a worse position to develop specifications now than they were 5 years ago because of the loss of the government workers who had helped develop the original performance work statement for the DOL cost comparison.

The FAR also states that a cost-reimbusement contract may be used only when the contractor's accounting system is adequate for determining costs applicable to the contract and appropriate government surveillance during performance will provide reasonable assurance that efficient methods and cost controls are used. In addition, this contract provided an award fee to reward the contractor for efficient performance and cost control. Calculation of the award fee required detailed evaluations of the contractor's performance by government overseers.

Northrop's accounting system was deemed adequate prior to the award of the contract, and government surveillance of the work and its related costs has been provided during the life of the contract by the Fort Eustis

Directorate of Logistics. Therefore, it is unclear, especially considering the government surveillance needed to justify the payment of award fees, why neither Northrop nor Fort Eustis has been able to accumulate the workload data needed to allow the use of a fixed-price contract for the anticipated follow-on DOL contract.

Actions Taken by Fort Eustis to Improve the Contracting Process

Fort Eustis has improved the new DOL solicitation package and its evaluation procedures based on its experience with the current contract. The changes include the following:

- Offerors are required to bid 2,080 hours per person per year when calculating labor costs to ensure that all offers are calculated on the same basis.
- A cap will be placed on the contractor's general and administrative rate at the time of contract award, and renegotiation of the rate will not be allowed.
- A standard memorandum will be sent to each Defense Contract Audit Agency office evaluating contractor offers. The memorandum will request specific cost data verification.
- The Board will brief the Source Selection Authority on each offeror's most probable cost estimate as developed by the Board.

Objectives, Scope, and Methodology

Our objective was to determine whether the DOL contract was as cost-effective as originally envisioned in 1982 when the determination was made to contract out DOL functions. Specifically, we were asked to evaluate (1) the Fort Eustis cost comparison, (2) cost growth since the contract award, (3) the estimated cost of performing the functions in-house, and (4) reasons for using a cost-plus-award-fee contract in lieu of a fixed-price contract.

We interviewed program and acquisition officials at Fort Eustis, Army Headquarters, and the Department of Defense (DOD) and OMB officials responsible for A-76 matters. We also reviewed available documentation at Fort Eustis and conducted extensive computer analyses of the cost comparison, cost growth, and projected in-house costs. As our criteria for the cost comparison, we used OMB Circular A-76, OMB's Cost Comparison Handbook, and DOD's In-House vs Contract Commercial and Industrial Activities Cost Comparison Handbook (DOD 4100.33-H), which were in effect at the time of the DOL study and contract award. We used the FAR to evaluate whether a cost-plus-award-fee contract was appropriate.

To project the cost of in-house performance, we used as the starting point the Fort Eustis estimate of the least number of government employees required to perform the specific tasks in the DOL contract. The estimate was similar to the contractor's proposed number and breakdown of employees, and it was fairly well-defined in terms of work force makeup. We added or deleted positions to the Fort Eustis estimate on a one-for-one basis to match positions added or deleted by the contractor each year. We did not include the base period of the contract in our analysis as it was a start-up period and not representative of full-scale operations. This method should provide the highest probable cost for in-house performance as hiring freezes and other government cost-cutting programs would probably have precluded a one-for-one addition of government employees. It should also provide, therefore, the lowest probable, or minimum, projected savings for in-house performance over contractor performance.

As requested, we did not obtain formal agency comments on the report. However, we discussed the results of our analyses, as well as other information obtained, with Fort Eustis, Army Headquarters, DOD, and OMB officials, and we incorporated their views where appropriate.

We conducted our review from September 1987 through August 1988 in accordance with generally accepted government auditing standards.

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