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UNITED STATES GENERAL ACCOUNTING OFFICE

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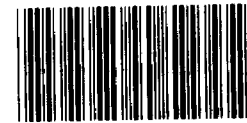
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PROCUREMENT AND SYSTEMS ACQUISITION DIVISION

B-200369

SEPTEMBER 19, 1980

The Honorable Carl M. Levin
Chairman, Subcommittee on
Oversight of Government Management
Committee on Governmental Affairs
United States Senate



113501

Dear Mr. Chairman:

Subject: [Army's Contracting Out of Installation
Support Functions at Selfridge Air National
Guard Base, Mt. Clemens, Michigan] (PSAD-80-79)

This is our response to your June 11, 1980, request that we examine the Army's tentative decision to contract out the installation support functions at Selfridge Air National Guard Base (SANGB), Mt. Clemens, Michigan. As agreed with your office on June 18, 1980, our main emphasis would be to evaluate the cost comparison to see if it was done properly.

The Army cost comparison for SANGB showed that it could save about \$3.1 million over a 3-year period if the functions were contracted out as opposed to being done in-house. Our review disclosed a few discrepancies in the Army cost comparison which increase the potential savings that could be realized through contracting out. We believe the potential savings would be over \$3.8 million. Our cost estimate, compared with that of the Army, is shown in enclosure I.

Contracting out at SANGB would affect 146 civilian employees--127 full time and 19 part time. All the part-time employees and probably 12 of the full-time employees could become unemployed, with the remainder being absorbed by the local major Army agency. In the process of absorbing these employees, the Army agency would probably need to terminate the employment of another 16 full-time personnel. Thus, there is a potential for 28 full-time and 19 part-time people becoming unemployed. However, there would probably be no overall reduction in employment for the SANGB area

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as the contractor would need to hire more people than the number of Government employees that may lose their jobs.

SCOPE OF REVIEW

The objective of this review was to evaluate the reasonableness of the cost comparison study on which the Army based its tentative decision to contract out certain functions at SANGB. To accomplish this objective, we specifically (1) reviewed the instructions and guidance in Office of Management and Budget (OMB) Circular A-76 and a supplemental cost comparison handbook that was used by the Army in performing the study, (2) reviewed the detailed schedules supporting the study results, (3) reviewed the results and detail of the Army Audit Agency's (AAA's) evaluation of the study, and (4) analyzed the reasonableness of study adjustments made by the Administrative Appeal Board. We also (1) evaluated the procedures followed in developing the cost study, (2) analyzed the makeup of costs for each element, including the allocation of costs to indirect cost pools such as material overhead, and (3) analyzed the low offeror's proposal. We also considered whether or not the treatment of specific costs was consistent with generally accepted accounting principles and cost accounting standards.

While the scope of our review was considered adequate for evaluating the reasonableness of the study for the specific 3-year period, there are certain one-time conversion costs--severance pay, relocation expenses, and retained pay--that were allocated over a 5-year period. Including such costs in their entirety within the 3-year period would change the difference between cost of performance in-house and contracting out, but would not change the conclusion that it would be more economical to contract out. Further, we did not attempt to evaluate the most economical method of performance beyond the 3-year period.

BACKGROUND

On January 29, 1979, the Army's Materiel Development and Readiness Command directed the Army's Tank-Automotive Materiel Readiness Command (TARCOM), Warren, Michigan, to review all support activities at SANGB to determine if they could be more cost effectively performed by contracting out. The review at SANGB was a part of the Materiel Development and Readiness Command's fiscal year 1980 commitment to review and complete conversions to contract of about 2,800 civilian positions if contracting proved more economical. This commitment stemmed from the Government's policy,

stated in OMB Circular A-76, to rely upon the private sector for needed products and services to the maximum extent consistent with economical and effective accomplishment of assigned missions.

The Army's Tank-Automotive Materiel Readiness Command Support Activity (TARCOMSA) at SANGB is a subordinate command of TARCOM. This installation support activity provides many logistical services for military personnel and elements located at SANGB and in the Detroit metropolitan area. Logistical service support responsibilities of TARCOMSA are accomplished through indirect and direct means. Indirect means pertain to base-wide services provided by the Michigan Air National Guard (for example, base security and fire protection). The Army reimburses the Air National Guard for its pro rata share.

TARCOMSA has grouped its direct responsibilities under six installation support functional areas--base administration, facilities engineering, family housing, transportation, installation clubs, and morale support and community affairs. All these direct support functions were included in the study except the nonappropriated fund activities--installation clubs and morale support and community affairs. A brief description of the four installation support functions is contained in enclosure II.

HOW THE ARMY PERFORMED THE STUDY

The methodology used for the cost comparison study was based on the guidance provided by OMB Circular A-76, as revised March 29, 1979, and an accompanying supplemental cost comparison handbook. The cost data was compiled by two separate teams under the coordination of the Deputy Comptroller of TARCOM. One team was responsible for preparing the in-house cost estimate; the other for the cost to contract out. The teams were insulated from each other to assure unbiased, independent estimates.

The basic documents underlying the cost estimates--both in-house cost and the cost of contracting out--were detailed statements of work applicable to each function. These statements of work consisted of a narrative description of duties and responsibilities, governing regulations, historical data, facilities available, property inventory, required reports, and hours of operation. Managers of the TARCOMSA activities assisted in preparing and reviewing the statements of work to assure their completeness and accuracy.

In-house cost estimate

For the in-house estimate, TARCOMSA developed a proposed organization that consisted of 176 civilian personnel. TARCOMSA managers, in developing the proposed organization, first determined how best to fulfill the statements of work. They then identified required job positions, number needed, and the necessary level of skill.

The proposed organization included a few more people than the current authorized strength at SANGB--full-time civilian and military personnel--plus temporary employees. In arriving at the proposed organization, some current jobs were eliminated and others added. Further, less than the current complement of military positions were converted to civilian positions and incorporated into this organization. Because the statements of work reflect what TARCOM desires to have accomplished at SANGB and not the current lower level of effort nor state of maintenance at SANGB, the proposed organization requires more personnel than currently authorized.

TARCOM used this proposed organization to develop the in-house direct and indirect labor costs and associated fringe benefits. To complete the in-house cost estimate, TARCOM identified the various elements of cost and most current cost data associated with the TARCOMSA functions through its accounting system and detailed records. The costs related to such items as materials, supplies, utilities, purchased services, rentals, and overtime pay. These costs, as well as labor and fringe benefits, were adjusted upward to reflect fiscal year 1981 costs.

Contracting-out cost estimate

The contracting-out cost estimate consisted of (1) the lowest offer by potential contractors, (2) costs that will be incurred by the Army, and (3) certain one-time conversion costs. The cost breakdown is shown in enclosure I.

TARCOM received proposals from three offerors in response to a solicitation based upon the statements of work. The solicitation stated that the contract award, if applicable, would go to the lowest responsive and responsible offeror. Through various means TARCOM assured itself that each offeror was technically capable, financially responsible, responsive to the solicitation requirements, and understood the performance requirements.

To determine responsiveness and understanding, a technical evaluation of each proposal was performed by functional experts from each affected TARCOMSA division and TARCOM procurement personnel. The criteria used for these evaluations included:

- Quality and depth of the proposal's narrative description of the proposed organization and its performance responsibilities.
- Proposed methods of work task accomplishment and workflow.
- Completeness of the proposal (that is, whether it covered all of the work tasks).
- Familiarity with Government regulations and their effect on performance.
- Proposed organization and its manloading (that is, manpower, employee classifications, and so forth).
- Realism of the proposal.

Questions surfaced during the evaluations were presented to the offerors during negotiations. The offerors responded by providing additional information, altering their manpower data, and more fully explaining their management and manpower utilization. All the proposals were found to be technically acceptable.

Internal review

As required by Army regulations, AAA reviewed the cost comparison study. It evaluated the reasonableness of the in-house cost estimate and those in-house costs related to contracting out to determine if it followed OMB and Army guidelines. It also determined that the statements of work provided a reasonable basis for preparing comparable estimates. While the AAA review included the verification of in-house costs to accounting records, it did not include a detailed verification of cost accounting procedures and records.

AAA identified cost omissions and clerical errors totaling about \$61,000, some of which were applicable to in-house costs and others to costs of contracting out. TARCOM accepted and made these adjustments, but it did not accept another AAA adjustment of about \$943,000 related to depreciation

of capital assets. We did not attempt to resolve this matter since there would be no impact on the final result of the cost comparison. (That is, the costs apply to both the in-house and contracting-out calculations.) AAA concluded that the cost comparison was reasonable and conformed to Army and OMB guidelines.

An Administrative Appeal Board was convened in response to an appeal by Local 1658 of the American Federation of Government Employees. During its deliberations, the Board made adjustments to the study that reduced the advantages of contracting out by about \$1.9 million. Even with these changes, the Board concluded it was more economical to contract out.

The cost comparison has been reviewed by the Materiel Development and Readiness Command and currently is under review at the Department of the Army level.

RESULTS OF ARMY COST COMPARISON STUDY

The cost comparison study showed that the Army could achieve a potential savings of about \$5 million over a 3-year period by contracting out. The Administrative Appeal Board adjustments narrowed the contracting-out advantage to about \$3.1 million. The basic difference between the in-house and contract-out estimates is labor costs, since all materials, supplies, facilities, property, utilities, and so forth, are furnished by the Army under either alternative.

The estimated in-house costs were about \$32.1 million. Based on the Appeal Board deliberations, such costs were reduced by about \$700,000 to about \$31.4 million. About \$400,000 of the reduction compensated for the performance of maintenance not included in the statement of work. The remaining \$299,000 adjustment was to eliminate the future inflation applied to selected Government wages, thereby achieving comparability with the low offeror's proposal. Generally, the low offeror, in accordance with solicitation instructions, did not include inflation in future years' salaries.

The Appeal Board also increased the estimated cost of contracting out by about \$1.2 million, from about \$27.1 million to about \$28.3 million. Three major adjustments accounted for the bulk of this change. One upward adjustment was to include about \$1.2 million of expense applicable to purchased services that had been inadvertently overlooked by the cost study group. The other upward adjustment for

\$572,000 was to bring the low offeror's labor rates in line with current Department of Labor wage rates; the proposal included rates established in late 1979. The wage rates used in the invitation for bid were current but had changed by the time the Appeal Board began its review. Therefore, they felt that to be fair and equitable the contract price should reflect this increase to be consistent with the wage rates used in the in-house cost estimate. We agree with this position. The other adjustment reduced the cost of contracting out by about \$547,000. In this instance, the Board found that the costs of refuse collection and custodial services had been added to the cost of contracting out even though the low offeror already included these costs in its proposal. Thus, the costs had been added twice to the cost of contracting out.

Over the 3-year period used in the study, it was estimated that the Army would spend about \$12.8 million for labor costs to perform the four functions in-house. The Army's cost to contract out the labor was estimated to be about \$7.3 million, based on the current Department of Labor wage rates. The difference of about \$5.5 million can be attributed to the use of less manpower by the low offeror and lower labor and fringe benefit costs to the Army for outside employees.

OUR EVALUATION

Our review disclosed that three additional changes totaling about \$2.2 million should be made to the cost comparison study. These adjustments increase the advantage of contracting out by about \$800,000. While TARCOM has agreed with two adjustments totaling about \$1.8 million which increase the contracting-out advantage by about \$500,000, no changes to the study will be made until the Department of the Army reviews this report. TARCOM believes it has already compensated for the remaining adjustment of about \$410,000, reducing the cost of contracting out.

Contracting out would reduce full-time civilian employment at SANGB by 127 people. This reduction would be accomplished through retirements, discharges, and transfers to TARCOM. The transfers would require TARCOM to institute normal reduction in force procedures. This entails bumping of personnel based on work experience, veterans preference, and so forth. Personnel transferred to lower paying positions retain their current pay rate for up to 2 years.

OMB Circular A-76 states that retention in pay should be included as a cost of contracting out. Based on a TARCOM conducted mock reduction in force involving 188 full-time people, 127 at SANGB and 61 at TARCOM, about 89 people would be transferred to lower paying positions. TARCOM estimated that the cost of retaining these people at their current pay scale would be about \$1.2 million. Since this cost omission was an oversight on its part, TARCOM believes that the cost of contracting out should be adjusted upward by \$710,000. This constitutes three-fifths of the cost, as it will be spread over 5 years as provided in OMB Circular A-76.

The estimated cost of contracting out included material overhead costs of about \$1.4 million that are similar to in-house costs. The overhead cost pool included about \$1.1 million of personnel-related costs--wages and fringes, overtime pay, and personnel insurance--for job positions also included in the low offeror's proposal. Thus, the personnel-related costs in this pool are a duplication. TARCOM agrees that the cost of contracting out should be reduced by about \$1.1 million.

The general and administrative (G&A) expense pool also includes personnel costs--about \$1.3 million--for job positions included in the low offeror's bid. Again, including these costs is a duplication. TARCOM believes that because the entire cost pool was not applied, the amount of G&A charged to contracting out is proper. The entire G&A pool was not charged as contended by TARCOM, but the charges do exceed the G&A expenses less the duplicated personnel costs.

OMB Circular A-76 states that the G&A expense pool should include only those costs that will be incurred regardless of whether the services are performed in-house or contracted out. Since the cost pool includes about \$1.3 million in personnel costs that will not be incurred if the services are contracted out, G&A charges to contracting out should not exceed the costs in the pool exclusive of those personnel costs. It does so by about \$410,000, and we believe an adjustment for this amount is appropriate.

CONCLUSION

The cost comparison study applicable to the potential contracting out of certain installation support functions at SANGB shows that it is more cost effective to contract out. We found the potential cost savings to be about \$3.8 million, or almost 3 times greater than the established savings criteria for contracting out set forth in OMB Circular

A-76. The required savings for the SANGB study would be \$1.3 million, 10 percent of the total labor-related costs applicable to in-house performance.


If the Army contracts out the four functions, about 47 people could lose their jobs--28 full-time and 19 part-time employees. Since the potential contractor must give current TARCOMSA personnel first employment rights, it is difficult to gage what the final impact on Government personnel will be. However, there probably will be an increase in total employment locally, as the low offeror will need to hire far more people than the Government would release.

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As directed by your office, we did not obtain written comments from Defense or Army officials. However, the results of our review were informally discussed with Army officials, and their comments were considered in preparing this report.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 10 days from the date of the report. At that time we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,


W. H. Sheley, Jr.
Acting Director

Enclosures - 2

COMPARISON OF ARMY AND GAO IN-HOUSE/
CONTRACT COST ESTIMATE FOR INSTALLATION
SUPPORT FUNCTIONS AT SELFRIDGE AIR NATIONAL
GUARD BASE, MT. CLEMENS, MICHIGAN (3-YEAR PERIOD)

<u>Cost factors</u>	TARCOM	Appeal Board		GAO	
	estimate (note a)	Adjustments (note b)	Estimate	Adjustments (note b)	Estimate
----- (thousands) -----					
In-house performance:					
Direct material	\$ 3,431	\$ -	\$ 3,431	\$ -	\$ 3,431
Material overhead	1,375	-	1,375	-	1,375
Direct labor	5,354	-293	5,061	-	5,061
Fringes on direct labor	1,374	-76	1,298	-	1,298
Operations overhead	9,172	-	9,172	-	9,172
Other direct costs	9,542	-	9,542	-	9,542
General & administrative expense	2,514	-31	2,483	-	2,483
Inflation	1,309	-299	1,010	-	1,010
Cost of capital	140	-	140	-	140
Reimbursable expenses	<u>-2,137</u>	<u>-</u>	<u>-2,137</u>	<u>-</u>	<u>-2,137</u>
Total	<u>32,074</u>	<u>\$ -699</u>	<u>31,375</u>	<u>-</u>	<u>31,375</u>
Contract performance:					
Contract price	6,895	572	7,467	-	7,467
Common costs (note c)	18,586	640	19,226	-1,506	17,720
One-time costs	71	-	71	714	785
Conversion differential	1,307	-	1,307	-	1,307
Contract administration	276	23	299	-	299
Other general & administrative expense	23	2	25	-	25
Federal income taxes	<u>-69</u>	<u>-6</u>	<u>-75</u>	<u>-</u>	<u>-75</u>
Total	<u>27,089</u>	<u>\$1,231</u>	<u>28,320</u>	<u>\$ -792</u>	<u>27,528</u>
Savings by contract	<u>\$ 4,985</u>		<u>\$ 3,055</u>		<u>\$ 3,847</u>

a/Tank-Automotive Materiel Readiness Command estimate.

b/Detail in letter may not add to enclosure due to rounding.

c/These costs will be incurred regardless of whether the services are contracted out or performed in-house. Examples of common costs are materials, supplies, and utilities.

DESCRIPTION OF INSTALLATION SUPPORTFUNCTIONS BEING CONSIDERED FOR CONTRACTING OUTAT SELFRIDGE AIR NATIONAL GUARD BASEBASE ADMINISTRATION

The base administration function involves centralized administrative support, security, and safety services for all Tank-Automotive Materiel Readiness Command Support Activity (TARCOMSA) activities. These services include general administration, publications management and distribution, maintenance of the TARCOMSA reference library, security reports management, security programs, fire prevention, safety and accident prevention, coordination and maintenance of disaster preparedness plans, control and distribution of classified documents, and coordination between TARCOMSA and the Tank-Automotive Materiel Readiness Command (TARCOM). Many of these services are coordinated with the Michigan Air National Guard.

FACILITIES ENGINEERING

The facilities engineering function involves planning, directing, and coordinating all operations pertaining to the maintenance and repair of real property and utilities for all TARCOM installations located at Selfridge Air National Guard Base (SANGB). Included under this function are engineering design reviews for repairs and revisions of SANGB buildings and utilities, and performance or contracting out for maintenance, repair, and improvement of buildings, roads, grounds, and drainage systems. Other services include pest control, refuse collection and disposal, custodian services, restoration of facilities damaged by disaster, and minor construction.

FAMILY HOUSING

The family housing function involves the centralized management and administration of more than 1,000 housing units located at SANGB and the Detroit Arsenal, Warren, Michigan. Specific responsibilities under this function include exercising supervision over the development, execution, and review of all housing activities; controlling and budgeting for maintenance, repair, replacement, storage, handling, and distribution of furniture and household equipment to support the housing units; and handling the transition of occupants entering and departing the housing units.

TRANSPORTATION

The transportation function involves managing and operating transportation services for military and other Department of Defense personnel, located on SANGB, in a 35-county area of lower Michigan and adjacent areas in Canada. Services generally include the shipping and receiving of military supplies and personal property to and from SANGB, providing passenger travel, and operating a motor pool. Specific services include arranging for the shipment and storage of personal property through commercial carriers; inspecting commercial warehouses for compliance with military storage standards; and inspecting personal property upon pickup or delivery to assure a carrier compliance with military standards. Also included is the arranging for various transportation services, such as buses, that are provided by outside contractors.