Audit Report

OFFICE OF THE INSPECTOR GENERAL

PROCUREMENT OF SUPPORT SERVICES BY THE AIR FORCE ELECTRONIC SYSTEMS CENTER, HANSCOM AIR FORCE BASE, MASSACHUSETTS

Report No. 94-112

May 27, 1994

Department of Defense

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Acronyms

CAAS	Contracted Advisory and Assistance Services
DCMAO	Defense Contract Management Area Operations
ESC	Electronic Systems Center
FAR	Federal Acquisition Regulation
HTI	Horizon Technology, Incorporated
OMB	Office of Management and Budget
TEMS	Technical Engineering and Management Support

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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ARLINGTON, VIRGINIA 22202-2884

May 27, 1994

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION AND TECHNOLOGY
UNDER SECRETARY OF DEFENSE (PERSONNEL AND READINESS)
COMPTROLLER OF THE DEPARTMENT OF DEFENSE
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Audit Report on Procurement of Support Services by the Air Force Electronic Systems Center, Hanscom Air Force Base, Massachusetts (Report No. 94-112)

We are providing this report for your review and comments. This report is the first in a series of reports being issued in conjunction with the statutorily required annual audit of contracted advisory and assistance services. Comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Based on management comments, we revised one recommendation, added one recommendation, and expanded another. Therefore, we request that the Under Secretary of Defense for Acquisition and Technology, the Under Secretary of Defense (Personnel and Readiness), and the Air Force provide comments on the unresolved recommendations and monetary benefits by July 27, 1994. We also ask for additional comments from the Air Force on the internal control weaknesses.

The courtesies extended to the audit staff are appreciated. If you have any questions on this audit, please contact Ms. Kimberley A. Caprio, Audit Project Manager, at (703) 692-3024 (DSN 222-3024). Copies of the report will be distributed to the organizations listed in Appendix F. The audit team members are listed inside the back cover.

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Office of the Inspector General, DoD

Report No. 94-112 **May 27, 1994**
(Project No. 2CH-3003)

PROCUREMENT OF SUPPORT SERVICES BY THE AIR FORCE ELECTRONIC SYSTEMS CENTER, HANSCOM AIR FORCE BASE, MASSACHUSETTS

EXECUTIVE SUMMARY

Introduction. This report is the first in a series of reports being issued in conjunction with the statutorily required annual audit of contracted advisory and assistance services. The Air Force Electronic Systems Center, Air Force Materiel Command, Hanscom Air Force Base, Massachusetts, develops and acquires command, control, communications, computer, and intelligence systems. The workforce consists of DoD organic (civilian and military), and contractor personnel. The Electronic Systems Center obtains contractor support by issuing multiple technical engineering and management support contracts. Since FY 1984, the Electronic Systems Center has contracted for services totaling $772 million. Labor hours for contractor employees acquired under technical engineering and management support contracts have increased from $68.4 million in FY 1984 to $371 million in FY 1993.

Objectives. The objectives of the overall audit of contracted advisory and assistance services were to evaluate progress DoD has made to establish effective management controls and to improve the accuracy and completeness of information reported on contracted advisory and assistance services contracts. We also evaluated the extent to which contracted advisory and assistance services contracts have been used by the Military Departments to compensate for DoD staffing shortages. This report addresses the second audit objective as it applies to the Electronic Systems Center. A summary report will address both audit objectives as they apply to all of the Military Departments. We reviewed the adequacy of internal controls and management's implementation of the DoD Internal Management Control Program as they applied to the audit objectives.

Audit Results. The Electronic Systems Center procured contractor support services that were not as cost-effective as using organic DoD personnel, that had characteristics of personal services, and that placed contractor personnel in the position of potentially performing inherently governmental functions (Finding A). The Electronic Systems Center did not make cost adjustments when contractor personnel used Government-furnished facilities (Finding B). The Electronic Systems Center did not enforce procurement regulations that require small businesses to perform at least 50 percent of total personnel costs on contracts and did not establish adequate management controls over the processing of invoices for the support service contracts (Finding C).

Internal Controls. Internal controls were not adequate to preclude contractor employees from performing personal services or potentially performing inherently governmental functions. Further, the Electronic Systems Center did not establish internal controls to require contractor rate adjustments when Government-furnished facilities were used or to prevent contractors from having access to invoices after approval and before payment, thus allowing for potential alterations to the documents. We consider these internal control weaknesses to be material. See Part I for a

discussion of internal controls reviewed and Electronic Systems Center implementation of the DoD Internal Management Control Program. See the findings in Part II for details on the internal control weaknesses.

Potential Benefits of Audit. Implementation of the recommendations will improve internal controls over the acquisition, use, and payment of the support contracts. Also, we estimate a cost reduction of up to $39 million over 5 years if work currently contracted for is performed by in-house DoD organic personnel. We also estimate a cost reduction of up to $26.4 million if contractor rates are adjusted to reflect when Government-furnished facilities are provided for contractor use. Appendix D summarizes the potential benefits resulting from the audit.

Summary of Recommendations. We recommend that the Under Secretary of Defense (Personnel and Readiness) establish a program to manage downsizing the DoD civilian workforce that allows for increases to the civilian workforce or increased contracting for services when more cost-effective. We recommend that the Under Secretary of Defense for Acquisition and Technology establish procedures to verify compliance with DoD requirements to perform cost comparisons before contracting for contracted advisory and assistance services. We recommend that the Comptroller of the Department of Defense make funds available for expanded in-house support when more cost-effective than contracts. We recommend that the Under Secretary of the Air Force authorize the Electronic Systems Center to convert previously authorized contractor positions to in-house; evaluate support contracts for cost-effectiveness; recoup costs when Government-furnished facilities are provided for contractor use; establish controls over allocating work to small businesses; preclude contractors from receiving approved invoices before payment; and discontinue the use of support contracts to obtain personal services.

Management Comments. The Under Secretary of Defense (Personnel and Readiness) nonconcurred with the draft recommendations to consider contractor employees a part of total workforce requirements. The Comptroller of the Department of Defense stated that managers are already given flexibility to allocate funds between programs and personnel. The Air Force generally concurred with recommendations to conduct analyses to determine how best to allocate decreased funding and personnel, and to comply with requirements for limiting subcontracting for small businesses, and has already implemented an internal control to preclude contractor access to approved invoices. The Air Force nonconcurred with recommendations to lift the suspension on previously approved conversions of contractor positions at the Electronic Systems Center because of Air Force end-strength ceilings or to recoup costs where Government-furnished facilities are provided. See Part II for a full discussion of management's responsiveness and Part IV for the complete text of the comments.

Audit Response. We revised the recommendations addressed to the Under Secretary of Defense (Personnel and Readiness) in the draft report, and added a recommendation to the Under Secretary of Defense for Acquisition and Technology. We consider the Air Force comments generally responsive except for the comments on contracting for personal services by the Air Mobility Command and the recoupment of costs for Government-furnished facilities. We request that the Under Secretary of Defense (Personnel and Readiness), the Under Secretary of Defense for Acquisition and Technology, and the Air Force provide comments on the final report by July 27, 1994.

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This report was prepared by the Contract Management Directorate, Office of the Assistant Inspector General for Auditing, DoD.

Part I - Introduction

Background

Air Force Electronic Systems Center Organization. Electronic Systems Center (ESC), Air Force Materiel Command, Hanscom Air Force Base, Massachusetts, develops and acquires command, control, communications, computer, and intelligence systems. In FY 1993, the ESC budget was $2.6 billion. To accomplish its mission, ESC allocated requirements among program offices, with a workforce made up of DoD civilian and military personnel (organic resources), personnel obtained by contract, and personnel from MITRE Corporation, a federally funded research and development center.

Types of Support Contracts. ESC obtains contractor support under two types of contracts: scientific engineering and technical assistance contracts and technical engineering and management support (TEMS) contracts. Scientific engineering and technical assistance contracts provide system-specific support to a program or group of programs. TEMS contracts provide support for program offices in disciplines including engineering, configuration management, data management, logistics support, financial management, quality assurance, and test evaluation. ESC established a centralized contracting organization to award, manage, and monitor TEMS contracts.

ESC has issued four series of TEMS contracts since 1984. The TEMS contracts were indefinite delivery/indefinite quantity contracts. Each contract specified a minimum number of labor hours for which the Government was responsible and a maximum number of labor hours and a price ceiling that the contractor could not exceed. Table 1 provides details of the four series of TEMS contracts used by ESC since 1984.

Table 1. TEMS Contracts Used by ESC Since 1984

Contract Series (year awarded)	Years in Contracts	Number of Contracts	Minimum Labor Hours[1]	Maximum Labor Hours[2] (millions)	Contractor Price Ceiling (millions)
TEMS I (1984)	3	3	NA[3]	1.8	$ 68.4
TEMS II (1987)	3	5	NA[3]	3.0	141.3
TEMS III (1991)	3	5	200,000	3.6	191.2
TEMS IV (1993)	5	8	200,000	8.8	371.0

[1]Minimum of 40,000 labor hours per contractor for TEMS III and 25,000 labor hours per contractor for TEMS IV.
[2]Maximum of 0.72 million labor hours per contractor for TEMS III and 1.1 million labor hours per contractor for TEMS IV.
[3]Data not available.

Recent Concerns About Use of Contracted Services. Both Congress and the Office of Management and Budget (OMB) have voiced concerns regarding the use of contracted services. Reviews initiated by Senator David Pryor over the years have shown that Federal agencies often contract out services that are sensitive in nature, at a cost that is 25 percent to 40 percent greater than if DoD

civilian employees had been used. In addition, Senator Pryor has voiced concerns about the need for a means to measure all aspects of the Government's workforce, including contractor as well as civil service personnel, to obtain a more realistic picture of the actual size of the workforce employed by the Government for purposes of decisionmaking.

Results of OMB Review of Service Contracting Practices. In March 1993, the Director, OMB, concerned with the extensive and growing use of contracted services, directed Federal agencies to review their policies regarding the acquisition and use of service contracts. OMB estimated that service contract costs Government-wide amounted to more than $103 billion in 1993, of which more than $61 billion is attributable to DoD. The review focused on three issues:

o Are existing contracts accomplishing what was intended?

o Are adequate procedures in place to monitor contractor services, to evaluate cost-effectiveness, to hold contractors accountable for results, and to ensure the Government gets what it pays for?

o Are the contractors performing inherently governmental functions?

In January 1994, OMB issued a "Summary Report of Agencies' Service Contracting Practices." The Director, Defense Procurement, was a major contributor to the review. The report stated that service contracting is the fastest-growing area of Government procurement, and has increased to the point that contracts for services now account for 53 percent of Executive agency procurement expenditures. Specific problems identified in the report included the following.

o Statements of work were written so broadly and imprecisely that vendors were unable to determine agency requirements, thus reducing the number of bidders, limiting competition, and making assessments of contractor performance difficult.

o Cost analyses and independent Government cost estimates frequently were not performed by agencies before renewal, extension, or re-competition of existing contracts, and in some instances, before new contracts. Several agencies reported examples in which the Government might save millions of dollars by performing functions in-house rather than having them performed by contract.

o Contracting personnel concentrated on the awarding of contracts and the obligation of funds. Post-award administration was often performed by agency program staff, not by contract personnel.

On February 4, 1994, the Administrator, Office of Federal Procurement Policy, OMB, published Supplement No. 1 to Office of Federal Procurement Policy Letter 93-1, "Management Oversight of Service Contracting." The supplement revises the Policy Letter with a goal of establishing a more "results-oriented" approach to providing agencies with "best practices" to use in managing and

administering service contracts. The intent of the supplement is to encourage the use of good management practices and contract administration techniques, rather than to establish mandatory auditable guidance.

Objectives

This report is the first in a series of reports resulting from the audit of DoD use of contracted advisory and assistance services (CAAS). United States Code, title 31, section 1114(b), requires that the Inspector General, DoD, annually submit a report to Congress on CAAS. The objectives of the overall CAAS audit were to:

o evaluate progress DoD has made in establishing effective management controls and in improving the accuracy and completeness of information reported on CAAS contracts, and

o evaluate the extent to which CAAS contracts have been used by the Military Departments to compensate for DoD staffing shortages.

This report addresses the second audit objective as it applies to ESC. A summary report will address both audit objectives as they apply to all of the Military Departments.

Scope and Methodology

Methodology and Judgmental Sample. We reviewed support services obtained under TEMS III and TEMS IV contracts awarded September 1989 through July 1993. As of July 1993, the total value of all orders placed under the five TEMS III contracts was $191.2 million. The total ceiling price allowed for the eight TEMS IV contracts, as of October 1993, was $371 million. Appendix A summarizes the universe of TEMS III and TEMS IV contracts. We judgmentally sampled 59 delivery orders, totaling $33.8 million, issued to two of the five TEMS III contractors from October 1991 through June 1993. We also reviewed all 106 delivery orders, totaling $36.8 million, that were placed under TEMS IV contracts from June 1993 through October 1993.

For each of the TEMS III and TEMS IV contracts, we reviewed pre-award documentation, determinations and findings, statements of work, delivery orders, and invoices. We interviewed contracting, budget, program, and manpower officials at ESC as well as personnel from the Defense Contract Audit Agency; the Defense Contract Management Area Operations (DCMAO)-Boston, Massachusetts; and the Air Force Audit Agency. We also interviewed officials from the Office of the Under Secretary of Defense (Personnel and Readiness); the Office of the Assistant Secretary of the Air Force (Financial

Management and Comptroller); the Office of the Assistant Secretary of the Air Force (Manpower, Reserve Affairs, Installations, and Environment); and the Directorate of Personnel, Air Force Materiel Command.

Audit Period and Standards. We performed this economy and efficiency audit from April 1993 through December 1993. We did not rely on computer-processed data to conduct this audit. The audit was performed in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included tests of internal controls considered necessary. The organizations visited or contacted are listed in Appendix E.

Internal Controls

Internal Controls Reviewed. We limited our evaluation of ESC's implementation of the DoD Internal Management Control Program to the adequacy of internal controls applicable to determining the need for contractor support services and internal controls over acquiring and administering contractor support services at ESC.

Internal Control Weaknesses Identified. The audit disclosed material internal control weaknesses as defined by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. ESC did not establish adequate controls to preclude contractor employees from performing personal services or potentially performing inherently governmental functions. In addition, ESC did not implement controls to establish different contractor rates when Government-furnished facilities were provided for contractor use.

We also identified a lack of internal controls over two aspects of contract administration. The ESC contracting officer for TEMS III did not institute adequate controls to verify that a small business performed at least 50 percent of total personnel costs. Also, ESC did not establish adequate controls to prevent contractors from having access to invoices after approval and before payment, thus allowing for potential alterations to the documents.

We also reviewed the portion of the Internal Management Control Program applicable to determining the need for contractor support services and internal controls over acquiring and administering contractor support services at ESC. The Program failed to detect the internal control weaknesses because it did not include these issues as assessable units.

Potential Benefits. We estimate that ESC can realize a cost reduction of $26.4 million if contractor rates under the TEMS IV contracts are adjusted when Government-furnished facilities are used and if costs are recouped under TEMS III contracts in which Government-furnished facilities were used. We did not identify any monetary benefits resulting from improved internal controls over contract administration. Appendix D summarizes the potential benefits resulting from the audit. Implementation of Recommendations A.5.c., A.5.d.,

A.6., and C. in this report will correct the internal control weaknesses. A copy of the report will be provided to the senior official responsible for internal controls within the Department of the Air Force.

Prior Audits and Other Reviews

The General Accounting Office issued Report No. GAO/GGD-94-95, "Government Contractors: Measuring Costs of Service Contractors Versus Federal Employees," March 10, 1994 (OSD Case No. 9612). The report reviewed the universe of recent cost comparison studies on contracting for CAAS versus performing the services in-house by Government employees. The report recommended that OMB extend a cost comparison requirement to CAAS, provide for consideration of non-cost factors in performing the cost comparison, and to work with Congress to explore ways to meet workforce reductions while providing agencies with sufficient authority and flexibility to accomplish the work in the most efficient and effective manner--either by using Government employees or by contract, or a combination of both.

Also, the Inspector General, DoD, issued six reports since 1991 that addressed the acquisition and use of contractor support services. In addition, the Air Force Audit Agency issued four reports on the acquisition of support services at ESC that identified findings similar to those identified in this report. See Finding A for a discussion of the repeat findings and Appendix B for a summary of each prior audit report.

Other Matters of Interest

The House Committee on Armed Services, House of Representatives Report 103-499, "National Defense Authorization Act for Fiscal Year 1995," May 10, 1994, addresses the issue of using in-house or contractor personnel for CAAS. The committee noted that DoD and Department of Energy studies demonstrated that considerable savings could be achieved by having some CAAS performed by in-house Federal employees instead of contractor employees. The committee recommended that the Secretary of Defense establish procedures to require DoD managers to conduct a standardized cost analysis that compares using in-house Federal employees instead of contractors before contracting for CAAS.

Part II - Findings and Recommendations

Finding A. Acquisition of Technical Engineering and Management Support Services

Since FY 1984, ESC has contracted for TEMS services totaling $772 million to supplement organic resources without considering the cost-effectiveness of contracting out versus performing the services through increased organic resources. Also, the TEMS contracts did not comply with laws governing the procurement of CAAS, had characteristics of personal services, and placed contractor employees in the position of potentially performing inherently governmental functions. ESC contracted for the TEMS services since FY 1984 because of increased program responsibilities and decreased staff levels. Although ESC performed annual needs assessments before contracting for services, the ESC analysis did not consider the cost-effectiveness of contracting out versus performing the work with organic resources. We estimate that ESC can realize a potential monetary benefit of $39 million through the next 5 years if planned work under TEMS IV contracts is performed by organic resources.

Mission, Staffing, and Funding Requirements and Limitations

Increasing ESC Mission Requirements and Funding. Program requirements and responsibilities assigned to ESC have increased since FY 1984. ESC funding to perform mission requirements has increased from $1.9 billion in FY 1990 to $2.6 billion in FY 1993.

Decreasing ESC Manpower. Since 1990, the number of DoD organic personnel assigned to ESC decreased 22 percent, from 2,548 staff-years in FY 1990 to 1,992 staff-years in FY 1993. The Vice-Commander, ESC, stated that, since 1989, although contractor support has decreased, the number of organic resources has decreased more. The number of contracted staff-years acquired to support ESC programs decreased by 17 percent, and staff-years acquired through the MITRE Corporation decreased 24 percent. In 1987, the labor force mix at ESC was about 33 percent organic and about 67 percent contractor support. By FY 1993, the mix changed to approximately 47 percent organic, 27 percent MITRE Corporation support, and 26 percent contractor support. Table 2 depicts the changes in program funding and manpower allocations from FYs 1990 through 1993.

Table 2. ESC Program Funding and Manpower Allocations From FYs 1990 Through 1993

Fiscal Year	Program Budget (billions)	Manpower Allocations (staff-years)
1990	$1.9	2,548
1991	1.5	2,374
1992	2.2	2,251
1993	2.6	1,992

The significant loss of organic resources forced ESC to procure contractor support to avoid disrupting mission accomplishment. The Vice Commander, ESC, stated that organic resources were decreasing at a faster pace than contractor support; therefore, program managers were forced to obtain contract support through TEMS or other support-type contracts. Further, a senior ESC official and ESC program managers told us that unless the mission requirements decrease, they intend to continue, and likely increase, reliance on contracted services to compensate for downsizing of organic resources.

Future ESC Staff-Year Allocations. The Director of Personnel, ESC, estimates that, from FYs 1994 through 1997, organic resources will decrease approximately 13.3 percent, and contractor support will decrease by 14.2 percent as demonstrated in Table 3.

Table 3. Estimated Staff-Year Use at ESC From FYs 1994 Through 1997

	FY 1994	FY 1995	FY 1996	FY 1997	Total Decrease (percent)
Organic Resources	2,237	2,143	2,074	1,940	13.3
MITRE	1,121	1,062	1,000	1,000	10.8
TEMS*	1,088	1,034	983	934	14.2

*Includes scientific engineering and technical assistance contracts being phased out at ESC.

The expected decreases in organic staff-years are anticipated to be a result of positions vacated through attrition, suspension of a previously approved program at ESC to convert 167 contractor position to organic positions (37 slots remain to be filled), cancellation of programs or segments of programs, and Presidentially mandated staffing cuts.

ESC Acquisition Work Force Management Initiative Test. In 1987, because of concerns that two-thirds of the ESC work force was contractor personnel, the Executive Director, ESC, conducted a study to determine whether contracting for long-term support services was cost-effective. The study estimated a potential savings of $17.3 million if 500 ESC engineering- and acquisition-related positions were performed by organic rather than contractor personnel.

The study focused on engineering- and acquisition-related positions because of concerns that contractor employees were required to perform inherently governmental functions within those job categories. For various reasons, delays in approval prevented the conversion of the contractor positions to organic positions until FY 1992.

Conversion of ESC Contractor Positions to Organic Positions. In FY 1992, the Air Force approved conversion of 167 of the 500 ESC contractor positions to organic positions. Additionally, 100 contractor positions at the Space and Missile Systems Center, Los Angeles, California, were approved for conversion to organic positions. ESC received approximately 5,000 applications for the 167 positions, used existing personnel to process the applications, and did not incur additional costs to make the conversions.

Transfer of Funds to Support Conversion. As part of the conversion, OMB authorized the transfer of funds from research and development funds used for program support to operations and maintenance funds for staff. The funds transfer enabled ESC officials responsible for the conversion to manage one pool of funds and to allocate those funds in the most efficient and cost-effective means between program and staff requirements without restrictions.

Quality of Employees Hired. In September 1993, at the request of the Deputy Assistant Secretary of the Air Force (Acquisition), the Air Force Inspector General reviewed the conversion effort. The review determined that the employees hired under the conversion effort were either equal to or better qualified than the contractor employees they replaced. The review did not address cost-effectiveness. The Air Force Inspector General planned to evaluate cost-effectiveness once all conversions were completed.

Suspension of Conversion Effort. On September 10, 1993, the Deputy Assistant Secretary of the Air Force (Acquisition) suspended the conversion effort based upon the National Performance Review Report. The suspension was imposed to allow the Air Force time to assess the impact of the report on current and future staffing levels. As of the time of the suspension, ESC had converted 130 of the 167 slots. The Executive Director, ESC, stated that any further hiring of civilians will be constrained because of the National Performance Review and mandates from the President that the Federal civilian work force be cut. However, he stated that every effort will be made to protect the performance of inherently governmental functions and, where such functions are presently being performed by contractor employees, those positions will be converted to organic resources regardless of the suspension.

Integration of Contractors in ESC Workforce. In November 1992, the Air Force Materiel Command issued Air Force Materiel Command Regulation 500-11, "White Paper," that establishes a new methodology for managing weapon systems. Part of the methodology is an "integrated product team" management concept that integrates functional and special interest groups concurrently in the development and qualification of a total system. According to the Vice Commander, ESC, the integrated product team concept encourages

the support of contractors and requires that contractor employees be fully incorporated into program offices, as well as collocated with Government personnel, to accomplish mission functions most effectively.

Procurement of Support Services

TEMS Contractor Responsibilities. The support services that were contracted for under the TEMS contracts included a wide range of functions, such as engineering, acquisition, logistics, and financial management, to supplement the work of ESC organic resources. TEMS contractor employees either worked off-site or worked in the same offices as organic resources. Contractors assigned task leaders to act as liaisons between organic resources and contractor employees and to oversee work performed by contractor employees. Task leaders were contractor employees performing tasks under the contracts who were assigned the additional duties of task leader.

Appropriate Use of CAAS. CAAS procurements may be used to obtain outside points of view, to obtain expert advice and knowledge, or to improve the efficiency or effectiveness of organizational or managerial operations. Short-term CAAS acquisitions allow for flexibility in adapting to fluctuating needs and give the opportunity to obtain state-of-the-art expertise. OMB Circular A-120, "Guidelines for the Use of Advisory and Assistance Services," January 4, 1988, establishes policy for the use of CAAS, and DoD Directive 4205.2, "Acquiring and Managing CAAS," February 10, 1992, implements the circular. The directive states that acquiring CAAS is appropriate when suitable organic capability is unavailable or cannot be obtained in time to meet the needs of the DoD Component, when establishing an organic capability is not cost-effective, or when the requirement is anticipated to be short term. In addition, the directive states that the requiring activity shall certify that the services have been reviewed for the most cost-effective or efficient means of accomplishment. If the requirement is for a long period or continuing period, an analysis should be performed to determine whether performing the work using organic resources would be more cost-effective.

ESC Use of CAAS. Many of the support services ESC procured under the TEMS contracts were CAAS and were acquired on a long-term basis. In FY 1992, ESC issued TEMS delivery orders totaling $60 million and reported $181,228 as CAAS. According to our review of 30 delivery orders totaling $32 million, we determined that all $32 million should have been reported as CAAS. ESC officials agreed that the orders should have been identified as CAAS. ESC officials also stated that no analysis was performed in compliance with DoD Directive 4205.2, prior to issuing the TEMS IV contracts, to determine if contracting for support services was more operationally effective or cost-effective that performing the services using DoD organic resources.

Program offices at ESC procured CAAS on a long-term basis to supplement organic resource shortages. Of the 15 program offices reviewed, 6 procured the same support services for 5 years or more. The program offices wrote delivery

orders for 1-year periods; however, the work requirements existed for several years, and in many cases, the same CAAS contractor employee performed the same job for those years. The following are examples of the ESC use of CAAS.

Joint Stars Program Office. The Office of Manufacturing Quality in the Joint Stars Program Office employs 12, of which 6 are contractor employees obtained under TEMS contracts. The contractor employees perform quality assurance and reliability and maintainability tasks, including evaluating contractor's manufacturing schedules and management approaches for manufacturing. The contractor employees provide written reports or verbal advice either directly to the Director, Manufacturing Quality, or through a contractor task leader. The Joint Stars Program Office does not consider the evaluation work performed by the six contractors to be CAAS. We disagree, because the functions are advisory in nature.

The same contractor employees have performed these advisory tasks since as early as 1985. For example, two contractor employees were originally obtained from ARINC Research Corporation under TEMS II awarded in 1987, then under a basic ordering agreement with ARINC Research Corporation during TEMS III because ARINC Research Corporation did not win a TEMS III contract. These same employees are now performing Joint Stars work under the TEMS IV contract with ARINC Research Corporation again.

Automated Weather Distribution Systems Program Office. The Automated Weather Distribution Systems Program Office has employed 13 TEMS employees from Horizon Technology, Incorporated (HTI), since 1988, including communications specialists, acquisition engineers, and environmental engineers. The HTI employees perform tasks that include reviewing, analyzing, and evaluating Air Force bases' weather equipment capability to forecast weather conditions and providing results in the form of reports and advice to Government personnel. We consider these support services to be CAAS. The contractor personnel initially began working for ESC under the TEMS III contract with HTI. A program official stated that the program office specifically requested the services of the same employees under TEMS IV to retain continuity. However, because HTI was not awarded a contract under TEMS IV, the same employees are working for HTI under a subcontract agreement with MEI Technology, Incorporated, which was awarded one of the eight TEMS IV contracts. The Automated Weather Distribution Systems Program Manager cited the need to continue the same support received since 1988; otherwise, programs would be seriously impacted.

Program Officials Evaluation of Program Needs. For the Joint Stars Program Office, ESC did attempt to obtain additional organic resources through various means, including writing to the Assistant Secretary of the Air Force (Acquisition). The letter stated that the Joint Stars Program Office was seriously understaffed, and that the shortfall could not be eliminated by hiring organic resources because of congressional restrictions on hiring. The letter further requested that the congressional restrictions on Joint Stars and all

acquisition programs be lifted, and stated that if not lifted, then the resulting shortfalls posed an extremely serious threat to effective Air Force management of acquisition program execution.

Personal Services

Criteria for Personal Services Contracting. A personal service contract is defined as a contract that, by its terms or administration, causes contractor personnel to appear to be Government employees. Obtaining personal services by contract, rather than by direct hire under the competitive appointment procedures, circumvents civil service laws. Federal Acquisition Regulation (FAR) 37.104, "Personal Service Contracts," prescribes guidelines for assessing whether a service contract is personal in nature. Guidelines include on-site performance, use of Government-furnished equipment, direct application of services to integral efforts of the agency, performance of comparable services by civilian personnel, and direct or indirect Government supervision of contractor employees.

Determination of Personal Services. Personal service contracting is controversial and has led to a number of Comptroller General decisions in which the "test" of "Federal employment" has been used to determine whether contracted services were personal services. The "test" generally includes a determination of whether the function is normally performed by Government personnel and whether supervision or direction is provided by a Federal official. While each contract must be judged based on its own facts and circumstances, the key is generally to determine whether an employer-employee relationship exists under the contract and whether contractor employees are subject to relatively continuous supervision and control by Government employees.

Use of Contractor Employees for Personal Services. ESC Regulation 26-1, "Manpower Resource Management," October 1, 1993, prescribes requirements and restrictions for acquiring and managing contractor personnel to avoid their performing personal services. The regulation details "do's and don't's" to follow to ensure that a proper relationship with contractor employees is maintained. The regulation also states that personal services may occur when the contract's terms and conditions, or the manner of contract administration during performance, subject contractor personnel to relatively continuous supervision and control by a Government employee.

ESC program offices obtained thousands of contractor labor hours to assist organic program personnel in performing day-to-day tasks on a regular basis. Often, little differentiated between contractor employees and organic resources. TEMS contractor employees were collocated with organic resources, performed similar functions, actively interacted on a day-to-day basis, and were assigned responsibilities and were provided feedback directly from organic resources. In addition, since 1990, the integrated product team management concept

promoted a close, integrated working relationship between organic resources and contractor employees. We considered the performance of many of these tasks to have characteristics of personal services. The following are examples.

Air Base Decision Systems Program Office. The Air Base Decision Systems Program Office employs 8 organic staff and 6 contractor employees as well as 13 employees from MITRE Corporation. The program manager stated that he plans to continue to use the TEMS contractor employees through FY 1998 to perform deployment planning, scheduling, tests, and evaluations of software that the contractor employees have performed since TEMS I. The contractor personnel are collocated with the organic personnel, use Government-furnished facilities, and perform tasks that are directly applicable to the functions of the program office. According to the program manager, he directly manages the contractor employees on a day-to-day basis and provides informal input into contractor performance but is not formally responsible for contractor performance appraisals. Delivery orders are written initially to identify long-term tasks in general terms; however, the program manager relies on daily interaction with the contractor employees to discuss specific taskings, job progress, and adjustments to job requirements.

Constant Source Program Office. The Constant Source Program Office employs 20 contractor employees in addition to 30 organic staff and 20 MITRE staff. According to the program manager, the TEMS contractor employees perform essentially the same acquisition, logistics, and systems support tasks as the organic staff. The same TEMS contractor employees have been used in this program office for 5 years, and the program manager intends to retain these TEMS contractor employees through the end of the project in FY 1998. The contractor employees are also collocated with organic personnel and use Government-furnished facilities, and contractor employees provide work that is integral to the overall performance of the program office. In addition, the program manager, in delegating work requirements, stated that he directly manages the TEMS contractor employees as if they were organic resources. He does not, however, participate in rating the TEMS contractor employees. The TEMS contractor task leaders are used as regular contractor employees, with additional responsibilities for tracking time and attendance of TEMS contractor employees.

Air Force Audit Agency Report

Similar Air Force Audit Agency Findings. In July 1989, the Air Force Audit Agency issued Report No. 325-9-22, "Contracting for Engineering Services to Support Air Force Systems Command Weapon Systems Acquisitions, Electronic Systems Division, Hanscom Air Force Base, MA" (Appendix B). The report states that engineering services contracts had the appearance of personal services because contractor employees were physically located in Government offices, used Government equipment and facilities, interfaced daily with Government employees to accomplish program missions, and were supervised by Government employees. Air Force management nonconcurred with the finding,

stating that "continuous supervision of all contractor employees should be the critical test of personal services," and that the Air Force Audit Agency did not adequately prove that point. The Air Force Audit Agency agreed that continuous supervision and control over contractor personnel is a key element in determining whether a contract is personal services. The Air Force Audit Agency comments also stated, however, that when combined with other elements of personal services as cited in the FAR, the potential for Government supervision of contractor employees exists.

In April 1990, the use of personal services at ESC was also addressed in Air Force Audit Agency Report No. 9066410, "Contracting for Engineering Services to Support Air Force Systems Command Weapon Systems Acquisitions" (Appendix B). Air Force management and the Air Force Audit Agency mutually concurred that clearer guidance was necessary and that revised FAR and Defense Federal Acquisition Regulation Supplement requirements (issued in June 1990) should provide the necessary guidance.

Air Force Audit Agency Findings Consistent with Inspector General, DoD, Findings. We believe that the TEMS contractor employees are essentially functioning as organic resources even though some program offices may have contractor task leaders in place to function as intermediaries and to avoid the appearance of direct supervision. TEMS contractor employees use Government facilities, perform tasks similar to those performed by organic resources, interact on a day-to-day basis directly with organic resources, and are often supervised by organic resources. We disagree with the Air Force comments on the audit report. The FAR and the Comptroller General of the United States interpretations of the FAR do not cite the requirement for "continuous" supervision, but indicate that contractor personnel subject to "relatively continuous direct or indirect supervision," are providing personal services. We believe that our examples demonstrate frequent day-to-day supervision, both direct and indirect.

OIG, DoD, Opinion on Personal Services. The issue of personal services is controversial and subject to varying interpretations. However, we consider the critical issues to be the need to evaluate whether using contractor support in the long-term is the most effective and cost-efficient means to accomplish program goals and whether contractor employees are performing inherently governmental functions. If ESC officials address the feasibility and cost-effectiveness of increasing organic support as part of the process of evaluating and planning for manpower needs annually, we believe that the issue of personal services can be resolved. The organizational design within the program offices that combines organic, MITRE, and TEMS contractor employee support appears to have worked effectively for several years to accomplish program goals. However, TEMS contractor employees are essentially an extension of the organic staff, performing work at a higher cost.

Air Mobility Command Use of Contractor Employees for Personal Services. We identified one example where TEMS was used to continue personal services formerly obtained under other alternative procurement methods. The Air Mobility Command, Scott Air Force Base, Illinois, issued a delivery order for $130,000 on September 8, 1992, to ESC to continue a data standardization

project. The project was being performed by one software engineer previously obtained from Atlantic Research Corporation under an interagency agreement with the Tennessee Valley Authority. In Inspector General, DoD, Report No. 94-008, "DoD Procurements Through the Tennessee Valley Authority Technology Brokering Program," October 20, 1993, we stated that the Air Mobility Command issued Economy Act orders totaling $60,000 to the Tennessee Valley Authority to obtain personal services and to retain the services of the same software engineer to complete work on the data standardization project that was not completed under an expiring Air Force contract. In October 1993, in response to our report, the Air Force stated that it no longer used the services of the software engineer. However, the same software engineer continued to perform work for the data standardization project at the Air Mobility Command under TEMS III contractor Sumaria. Under TEMS IV, because Sumaria was not awarded a contract, the software engineer is now employed as a consultant to Atlantic Research Corporation, a subcontractor to the TEMS IV contractor, Abacus Corporation. The Air Mobility Command program manager stated that retaining the same employee, collocating him with Government employees at the Air Mobility Command for continuity, and providing direct supervision was important to the program's success.

We consider the method used by the Air Mobility Command to retain the services of the software engineer to be both personal services and directed subcontracting. As such, the Air Mobility Command has circumvented both procurement and civil service hiring regulations, and paid unnecessary additional costs to obtain the services indirectly through the Tennessee Valley Authority or ESC, rather than through direct procurement channels.

Contractor Performance of Inherently Governmental Functions

Criteria for Inherently Governmental Functions. Office of Federal Procurement Policy Letter 92-1, "Inherently Governmental Functions," September 1992, states that such functions are:

> so intimately related to the public interest as to mandate performance by Government officers or employees. Such functions include:
>
> (i) any activity that requires the exercise of discretion in applying Government authority or the use of value judgment in making decisions for the Government,
>
> (ii) determination of agency policy, such as the content and application of regulations;
>
> (iii) management of Government programs;
>
> (iv) determination of program priorities or budget request; or
>
> (v) administration of Government contracts.

The policy letter further prohibits the use of service contracts for performance of inherently governmental functions and requires greater scrutiny and enhanced management oversight when contracting for functions that closely support performance of inherently governmental functions. FAR 37.102, "Service Contracts," prohibits contracting officers from awarding contracts for the performance of inherently governmental functions.

Performance of Core Functions. The Report of the National Performance Review dated September 7, 1993, stated that DoD will implement a comprehensive program of contracting non-core functions competitively.

ESC Study of Inherently Governmental Functions. As part of the Acquisition Work Force Management Initiative performed in 1987, ESC attempted to identify, and convert to in-house positions, those functions performed by contractor employees determined to be inherently governmental. As stated previously, only 167 positions were approved, and 137 actually converted at ESC.

In addition, according to the Executive Director, ESC, in a study performed in 1993 by ESC on a judgmental sample of contracts, no inherently governmental functions were identified as being performed by contractor personnel. The review was limited, however, to an examination of delivery orders and not a review of actual work as performed. The Executive Director, ESC, stated, however, that if positions are identified as inherently governmental, every effort will be made to convert those positions to organic positions regardless of staff ceilings.

Inherently Governmental Functions at ESC. We identified examples of tasks assigned to contractor personnel to be performed within program offices at ESC that provided the potential for contractor personnel to perform inherently governmental functions.

Intelligence Center Program Office. The Intelligence Center Program Office, which provides computer networking systems to various intelligence agencies, employs 10 organic personnel and 27 TEMS contractor employees. The TEMS contractor employees assist in pre-contract award by determining user requirements, drafting requests for proposals and statements of work, overseeing installations by other contractors, and acting as a liaison between the Government and the installation contractors. The program manager stated that, because her organic staff is limited, and because she and her staff cannot be present at multiple, concurrent installations, she must rely on contractor managers to make decisions that could impact both time (for example, delays, overtime) and costs. The program manager stated that the TEMS contractor employees act as organic personnel; however, contractor employees are not allowed to make decisions for the Government. Placing contractor employees in the position of having to make decisions on behalf of the Government creates the potential for contractor employees to perform inherently governmental functions. If TEMS employees are at an installation and a deficiency is found, because the TEMS personnel do not have the authority to make a decision, she has had to call back the TEMS personnel from the field or delay installations until a Government official is available to travel to the site or to make a

decision. We believe that the program manager has made every effort to avoid the performance of inherently governmental functions by contractor employees, to date. The program manager stated that, if her customer base continues to grow as it has, she will have to rely increasingly on TEMS personnel. As such, the potential increases for contractor employees to perform inherently governmental functions by exercising discretion in making decisions for the Government.

Network Capabilities Program Office. The Network Capabilities Program Office provides networking capabilities to organizations throughout DoD through a contract with Infotech Development, Incorporated. Because the program office does not have adequate Government personnel to effectively administer the contract, the program office uses TEMS contractor employees to assist in contract administration of the Infotech Development, Incorporated, contract. The delivery order for the TEMS contractor did not define work requirements, but referred to clauses in the basic statement of work. The statement of work clauses stated that the contractor should analyze service reports and actions on hardware, software, and Government-furnished equipment and recommend to the program office acquisition contractor actions necessary to minimize impact to the program. The TEMS employees actually performed tasks that included identifying DoD customers needs, writing delivery orders, and reviewing and advising the program manager whether or not to approve Infotech Development, Incorporated, invoices. Relying on a contractor employee to identify customers needs and to approve the expenditure of DoD funds placed the contractor in the position of potentially performing functions that may be considered inherently governmental.

In both the examples, the program offices placed contractor employees in positions in which contractor employees may be relied on to perform functions or make decisions that should be made or performed by Government personnel. Performing work or making judgment decisions that impact the performance of programs or expenditure of Government funds are considered inherently governmental. The potential exists for program offices to, therefore, rely on those contractor employees to make decisions and perform functions that are inherently governmental. By increasing the number of organic employees and decreasing reliance on TEMS contractor employees, ESC can improve internal controls, and the potential for contractor employees performing inherently governmental functions can be reduced.

ESC Efforts to Avoid the Use of Inherently Governmental Functions. We commend ESC's efforts to identify and convert positions identified as inherently governmental functions. To effectively accomplish its examination of functions that may potentially fall into that category, ESC needs to evaluate actual work performed within the program offices instead of relying on the work as defined in the delivery orders. This is necessary to confirm that contractors are not performing inherently governmental functions. In addition, the long-term use of contractor personnel within program offices results in those personnel developing institutional knowledge of the organization and programs and specialized skills that are integral to the operation of those programs. Because

ESC uses contractor support extensively, contractor employees are at risk of making inherently governmental decisions and performing inherently governmental functions.

Costs for Contractor Support

Government Policy for Contracting Out. OMB Circular A-76, "Performance of Commercial Activities," states that it is the policy of the Government to use private commercial sources for supplies and services. Under the Circular, the Government is prohibited from starting or carrying on any activity to provide a commercial product or service if the product or service can be procured more economically from a commercial source. The Circular also requires that a comparison of the cost of contracting for support services with the cost of in-house performance be conducted to determine who will perform the work. Thus, consideration should be given to retaining work in-house or performing work in-house when it can be shown that the required services can be provided more economically in-house.

Annual ESC Resource Allocation Process. At the beginning of each year, a Resources Management Council at ESC performs a command-wide assessment to determine staff needs and to allocate resources. The Council, chaired by a general officer, assesses staff needs by functional element and uses an algorithm "Workload Assessment Model," to determine the number of contractor employees needed. Each determination by the Council is predicated upon end strength organic authorizations and ceilings for contractor and MITRE support. The results are reviewed by the Deputy Assistant Secretary of the Air Force (Acquisition).

The assessments evaluate total force requirements including organic, MITRE, and contractor support. The assessments do not, however, include analyses to determine whether contracting for services is cost-effective or whether additional organic personnel should be hired to replace TEMS contractor employees when needs are long-term. The Director of Contracted Support Management stated that, because the conversions that were initiated as a result of the Acquisition Work Force Management Initiative had not been fully implemented, cost-benefit analyses to identify additional conversions of contractor to in-house resources have not been performed. We determined, however, that the TEMS contracts were not as cost-effective as using in-house personnel.

Costs Incurred for Contractor Support. The TEMS contracts that ESC awarded identified labor rates for each of the job categories listed in the request for proposal. As work was performed, each contractor submitted invoices using the labor rates established in the contracts. Overhead, general and administrative, or other expenses were incorporated into the labor rates and were not identified separately on invoices. Only travel costs incurred by the contractors were identified on invoices in addition to the labor costs.

Comparison of Contractor Costs and Organic Costs. We compared labor rates negotiated for each of the eight contracts awarded under TEMS IV with equivalent Government labor rates. We compared the rates charged by the eight contractors for each labor category with burdened rates for equivalent DoD employees. We obtained the assistance of the Directorate of Personnel, Air Force Materiel Command, to determine the job categories and grade of equivalent Government personnel. Based upon the Government pay scale, we burdened the Government pay rates for each of the labor categories. Because the TEMS IV contracts allow for option years through FY 1997, we also adjusted the burdened Government rates for cost of living allowances according to OMB Circular A-76, "Transmittal Memorandum No. 12," March 26, 1993, which updates Federal pay raise assumptions and inflation factors through FY 1997.

According to a comparison of the labor rates for each of the eight TEMS IV contractors to the burdened Government equivalent rates, we determined that over the life of the eight TEMS IV contracts, ESC could have potential monetary benefits of $39 million if the work was performed by organic, rather than contractor, personnel. Appendix C provides an analysis of the potential reduction in costs.

Future Use of Contracting at the Electronic Systems Center

Executive Director, ESC, Opinion of Organic Resources. The Executive Director, ESC, stated that he believes that organic resources are less expensive than contractor support, and that by managing funds rather than personnel, the Government in general, and ESC in particular, could save costs. The downsizing effort to reduce Government spending could be more cost-effective if ESC could manage one set of funds or could have the flexibility to use the funds in the most cost-effective manner by hiring more organic employees and by eliminating more costly contractor employees. This could be accomplished by converting program funds now used to obtain contractor support to manpower funds, as has been done under the conversion effort.

Comptroller Opinion on Funding Transfers. In response to a draft of this report, the Comptroller of the Department of Defense stated that DoD managers are given total flexibility to determine how their programs are executed and to allocate personnel resources as needed. In addition, the Assistant Director for Air Force Operations, Office of the Comptroller of the Department of Defense stated that DoD managers can include adjustments of funds from program to manpower in budget requests without approval of the Comptroller.

Recent Review of ESC Acquisition Work Force Management Initiative Test. In December 1993, at the request of the Deputy Assistant Secretary of the Air Force (Acquisition), the Inspector General, Air Force Materiel Command, performed a review of the conversion initiative at ESC. The review focused on the reporting chains for support contractors at ESC, and on identifying historical trends, from before the conversion to the present, in the

total number of support contractor employees. According to interviews with 67 persons, including Government supervisors, contractor task leaders, and contractor personnel, the Inspector General's report concluded the following.

o The majority of those interviewed acknowledge that contractor task leaders direct contractor employees.

o Contractors see their Government support as limited to desk space, a telephone, and sometimes a computer. Most contractor employees have home offices that they use occasionally.

o Contractor and Government employees were aware of correct procedures to be followed concerning providing direction and supervision to contractor employees.

o Civil service employees hired under the conversion were enthusiastic over the advantages of working directly for the Government because they were able to represent the Government, assume greater responsibilities, and perform more duties. Also, reporting channels were simplified and streamlined.

The report further stated that the conversion initiative has been such a success for replacing contractor employees that hiring should continue until all new hires are in place. The conversion saves money, improves morale, and increases the Government's ability to get the job done better.

Conclusion

Recognition of ESC Efforts. We recognize the need for ESC to supplement its organic work force with contractor support in areas of specialization or for short-term needs. ESC appears to have accomplished program objectives effectively for many years by supplementing its organic work force with TEMS and scientific engineering and technical assistance contractor employees. ESC also appears to have in place detailed policies and procedures to analyze overall annual manpower needs, train personnel in the administration of TEMS contracts, and perform program needs effectively by using combinations of organic, MITRE Corporation, and contractor personnel. The conversion study initiated in 1987 demonstrated that cost savings could be realized by converting contractor positions to organic positions, and the Executive Director, ESC, also supports the potential for cost reductions through conversions. Further, ESC has requested relief from organic resources restrictions from various sources, including the Assistant Secretary of the Air Force (Acquisition).

Increased Costs Likely. Given the mandate to downsize DoD civilian and military staff, and given organic manpower ceilings imposed by the Air Force, if program requirements are not cut at ESC, overall program costs are likely to increase when more costly contractor services are procured to compensate for organic shortfalls. The need for ESC managers specifically, and DoD managers

in general, to manage personnel and funds efficiently is particularly important now, given increasingly scarce resources. As such, allocating scarce resources in a prudent fashion among organic and contractor resources is critical.

Government-wide Policies Impacting ESC. The National Performance Review emphasized prudent management, empowered managers to contract out work when it makes operational and economic sense, and advocated that personnel ceilings should be eliminated and that Federal managers should be permitted to manage budgets using ceilings on operating costs to control spending. The review recognized that personnel ceilings could cause agencies to contract out work that could be done better and cheaper in-house.

In conjunction with the National Performance Review, the Secretary of Defense February 1994 memorandum on "Implementing the DoD Plan to Streamline the Budget," states that the DoD civilian workforce will be reduced by 18 percent between FYs 1993 and 1999. The memorandum also cautions that, to accomplish civilian manpower cuts while maintaining a high-quality work force, that DoD reductions must not take the form of across-the-board cuts. The memorandum also states DoD will track how management changes enable the reduction of the DoD civilian work force.

Office of Federal Procurement Policy Letter 91-1, "Management Oversight of Service Contracting," November 19, 1994, reemphasized the importance of seeking cost-effectiveness in contracting for support services. OMB is also considering expanding the cost-comparison requirements to advisory and assistance services as part of its ongoing effort to revise OMB Circular A-76, "Performance of Commercial Activities," August 8, 1983.

Need for Clarification. The support services contracted for under the TEMS contracts are generally specialized and technical, and the contracts are written for 5 years. Personnel ceilings have been a major factor in the decision to contract for these support services. The Air Force needs to clarify whether ESC has the authority to hire additional, needed, in-house employees when a cost comparison indicates that in-house performance is desirable and substantially more cost-effective, or whether the goal of downsizing the Federal workforce has placed DoD in a position of having to contract for services regardless of what is more desirable and cost-effective.

The evaluation of manpower resources should include consideration of total force requirements, which includes contractor, as well as military and DoD civilian personnel. In this regard, we believe that ESC should be encouraged to perform analyses of long-term needs to determine the most cost-effective and efficient means to meet staffing needs. The Air Force should encourage ESC to identify "total force requirements," including contractor as well as organic personnel, to accurately reflect total personnel costs. In addition, ESC should then be provided the flexibility to manage both program dollars and staff dollars to accomplish mission requirements using a combination of organic and contractor manpower support in the most efficient and cost-effective manner. If ESC managers are allowed to manage the total labor work force, rather than

being limited to individual labor categories, they will have greater flexibility to make trade-off decisions to obtain the best mix of organic and contractor resources to perform mission requirements.

The Under Secretary of Defense for Acquisition and Technology should establish procedures to verify that DoD managers conduct a standardized cost analysis that compares the use of in-house Federal employees instead of contractors before contracting for CAAS. The requirement for a cost analysis is in DoD Directive 4205.2, "Managing and Acquiring CAAS," but the cost analysis is not occurring.

In addition, the Under Secretary of Defense (Personnel and Readiness) should establish a program to manage downsizing DoD personnel that considers the operational and cost-effectiveness of both in-house and contractor support. The system should allow for rational downsizing to include increased downsizing when appropriate, and the conversion of functions to in-house when shown to be operationally and economically sensible.

Recommendations, Management Comments, and Audit Response

Revised, Added, and Renumbered Recommendations. We replaced draft report Recommendation A.1. with revised Recommendation A.1. We added Recommendation A.2. to the Under Secretary of Defense for Acquisition and Technology. Accordingly, draft report Recommendations A.2. through A.5. to the Comptroller of the Department of Defense and to the Air Force, were renumbered as Recommendations A.3. through A.6. We also revised draft report Recommendation A.5. (now Recommendation A.6.) to request appropriate disciplinary action be taken against Air Force officials who knowingly continue to use personal services after the Air Force's decision to discontinue use.

1. We recommend that the Under Secretary of Defense (Personnel and Readiness) establish a program to manage the downsizing of the DoD civilian workforce that allows for increases in DoD civilian resources when shown to be more operationally effective and cost-effective or when needed to perform inherently governmental functions. The program should also allow for increased downsizing of functions that are shown to be more economical if contracted out.

Management Comments. Draft report Recommendation A.1. to the Under Secretary of Defense (Personnel and Readiness) required accountability of total force requirements including contractor and in-house employees and recognition of both requirements in manpower and budget documents, and permitting the Air Force to adjust end-strengths for in-house DoD employees when in-house support is more cost effective than contractor employees. The Under Secretary of Defense (Personnel and Readiness) nonconcurred with the draft report recommendations and stated that long-standing DoD policy dictates that

Government employees be used only when necessary and that the Government should not compete with the private sector. Further, because of the major reductions in force occurring in DoD, the Under Secretary stated that contractor support provides the flexibility to accommodate workload variations while complying with mandated manpower reductions. In addition, the Under Secretary stated that collection of information on contractor personnel performing on Government contracts amounts to Government interference in private industry.

Audit Response. We believe the Under Secretary of Defense (Personnel and Readiness) must recognize that it is not wise to continue long term contract efforts for contracted advisory and assistance services when it costs less to use in-house employees. DoD must have some planning guidance during the overall downsizing of the Department that will permit increases of in-house employees in cases when it is cost effective to replace long term contrator support. Likewise, the plan should allow managers to increase contract efforts when it is more cost effective to replace in-house personnel. We request the Under Secretary of Defense (Personnel and Readiness) to comment on the new Recommendation A.1. in response to the final report.

2. We recommend that the Under Secretary of Defense for Acquisition and Technology establish procedures to verify that DoD managers comply with DoD Directive 4205.2, "Managing and Acquiring CAAS," February 10, 1992, including certifying that contracting for contracted advisory and assistance services, versus performing the services in-house, is the most cost-effective or efficient means of acquiring the services.

Management Comments and Audit Response. Based on management comments, the recent General Accounting Office Report GAO/GGD 94-95, "Government Contractors: Measuring Costs of Service Contractors Versus Federal Employees," (see Appendix B), the House Committee on Armed Services Report 103-499, "National Defense Authorization Act for Fiscal Year 1995," May 10, 1994, and DoD Directive 4205.2, we added Recommendation A.2. to verify that DoD managers are complying with existing DoD guidance. Both reports recommend that a study be performed prior to contracting for CAAS to compare the cost of performing the services by DoD employees versus contracting out. DoD Directive 4205.2 requires that activities certify that the services have been reviewed for the most cost-effective or efficient means of accomplishment. Further, the directive states that if the requirement is for a long or continuing period, the analysis should determine whether performing the work using organic resources would be more cost-effective. Therefore, we request the Under Secretary of Defense for Acquisition and Technology to provide comments on the recommendation in response to the final report.

3. We recommend that the Comptroller of the Department of Defense, in coordination with the Under Secretary of Defense (Personnel and Readiness), identify a means to make funds available for in-house manpower support where the Department of the Air Force can demonstrate that long-term services can be performed more efficiently and cost-effectively through organic resources than through contractor support.

Management Comments. The Comptroller of the Department of Defense stated that no action is required by the Comptroller because DoD Components already have the necessary flexibility to allocate personnel resources as required, to achieve the greatest cost-efficiency. DoD managers are given total flexibility to determine how their programs are executed, and neither the Comptroller nor the Under Secretary of Defense (Personnel and Readiness) restrict how DoD Components allocate their personnel resources.

Audit Response. We consider the Comptroller comments responsive to the recommendation. We agree with the Comptroller comments that reaffirm that DoD Components have the flexibility to allocate resources among Military, DoD civilian, and contractor personnel to achieve cost efficiency. Accordingly, DoD Components are not restricted by budget limitations when deciding whether to use DoD organic resources or contractor resources, but instead can make budget adjustments based upon which alternative is more cost-efficient.

4. We recommend that the Under Secretary of the Air Force authorize the Air Force Electronic Systems Center, Air Force Materiel Command, to:

a. Lift the suspension at the Electronic Systems Center to allow the conversion of the remaining positions to organic resources as initially authorized under the Acquisition Workforce Management Initiative Test.

Management Comments. The Air Force nonconcurred with the recommendation and stated that the recommendation should have been addressed more appropriately to the Assistant Secretary of the Air Force (Acquisition). However, the Assistant Secretary of the Air Force (Acquisition) will not lift the suspension because of end-strength ceilings mandated by the President and the Office of the Secretary of Defense through 1999. Therefore, hiring the remaining personnel authorized under the conversion would generate a reduction in force for each new Government employee hired.

Audit Response. We acknowledge the limitations imposed on the Air Force by mandates from the President and the Office of the Secretary of Defense, and consider the comments responsive pending comments from the Under Secretary of Defense (Personnel and Readiness) and the Under Secretary of Defense for Acquisition and Technology on Recommendation A.1. and A.2.

b. Convene a task force made up of manpower, acquisition, and comptroller personnel to determine how to best allocate decreased funding among staff and program needs to best accomplish program needs. Make appropriate funding adjustments in the budget.

Management Comments. The Air Force concurred and stated that an executive group consisting of general officers representing the operational customers, acquisition community, manpower resource allocation, and the Air Force Comptroller has been formed and is currently meeting in support of the FYs 1996 through 2001 Program Objective Memorandum. The executive group is reviewing acquisition programs and developing recommendations for

senior Air Force leadership on the retention of programs and the allocation of scarce resources. Once the recommendations are finalized and approved by Air Force leadership, the budget will be adjusted.

Audit Response. We consider the Air Force comments to be responsive to the recommendation. We request the Air Force to provide actual or estimated completion dates for the proposed actions in response to the final report.

c. Convert contractor positions to organic positions when conversion is determined to be more cost-effective.

Management Comments. The Air Force concurred in part, stating that if relief is granted from end-strength ceilings, the Air Force would perform formal cost comparisons to substantiate cost savings of conversions and would aggressively convert additional contractor positions to in-house where proven to be more cost-effective.

Audit Response. We acknowledge the limitations imposed on Air Force by mandates from the President and the Office of the Secretary of Defense, and we consider the comments responsive pending comments from the Under Secretary of Defense (Personnel and Readiness) and the Under Secretary of Defense for Acquisition and Technology on Recommendations A.1. and A.2..

5. We recommend that the Commander, Air Force Electronic Systems Center, Air Force Materiel Command:

a. Determine DoD civilian personnel requirements needed to satisfy mission requirements.

Management Comments. The Air Force concurred in part, stating that the determination is already made annually through the ESC Resource Management Council, which evaluates total manpower requirements and then determines the appropriate mix of organic and contractor support. The comments further stated that, during the planning phase of TEMS IV, ESC identified alternative means to satisfy requirements, including requesting additional organic support from Congress where more cost-effective. Also, ESC performed a cost comparison of contractor versus organic manpower as part of the Acquisition Workforce Management Initiative test.

Audit Response. We consider the Air Force comments to be partially responsive. ESC did not perform cost comparisons of contractor versus organic resources before issuing the TEMS IV contracts. Further, according to documentation provided, the ESC Resource Management Council calculates the appropriate mix of manpower based on pre-established ceilings for organic and contractor personnel, and allocates available personnel among program offices, rather than considering increasing the overall proportion of organic compared with contractor personnel. We request that the Air Force reconsider its position in its response to the final report.

b. Convert contractor positions to organic positions when it is determined to be more cost-effective.

Management Comments. The Air Force concurred in part with the recommendation, stating that it is ready to proceed with conversions of contractor personnel when given proper authority. However, the Air Force stressed that barriers will need to be lifted including a hiring freeze exemption, relief from high-grade restrictions, and authority to use program funds for DoD civilian pay.

Audit Response. We consider the Air Force comments responsive pending final comments to be provided by the Under Secretary of Defense (Personnel and Readiness) and the Under Secretary of Defense for Acquisition and Technology on Recommendations A.1. and A.2..

c. Perform a cost-benefit analysis on all job categories identified under the eight technical engineering and management support contracts, and convert contractor positions to in-house when determined to be more cost-effective.

Management Comments. The Air Force concurred in part and stated that the ESC will perform a cost-benefit analysis as part of its annual manpower reviews. The analysis will compare TEMS costs by labor category with the cost for equivalent organic resources for all job categories identified under the eight TEMS IV contracts. However, until the barriers are lifted, ESC does not have the authority to convert positions to in-house when determined to be more cost-effective.

Audit Response. We consider the Air Force comments to be responsive to the recommendation. We request the Air Force to provide actual or estimated completion dates for the proposed actions in response to the final report.

d. Obtain a legal review of Electronic Systems Center program offices that evaluates actual work performed to verify that contractor employees are not performing personal services or inherently governmental functions, and eliminate such performance when the review identifies that such functions are being performed.

Management Comments. The Air Force concurred in part and stated that ESC already has a well-defined system designed to preclude the performance of personal services or inherently governmental functions. The system includes policy guidance, emphasis in TEMS contracts that work must be performed consistent with contract terms and work statements, and discussion of acceptable roles and behaviors of contractor and Government personnel during training and contractor meetings. The Air Force strongly disagreed with the audit portrayal of the existence of personal services at ESC and stated that the number of examples cited in the report was limited, and that, because the examples cited only met four of the six criteria for personal services identified in FAR 37.104(b), "Personal Service Contracts," that the report did not adequately demonstrate that the appearance of personal services does indeed exist.

Regarding inherently governmental functions, the Air Force stated that the audit report failed to distinguish between the actual performance and the potential for performing inherently governmental functions, and failed to demonstrate that

ESC does not adequately control the use of inherently governmental functions. Further, the comments stated that ESC has taken numerous steps under the TEMS contracts to develop procedures to avoid contracting for inherently governmental functions and to ensure the vital separation of duties by carefully reviewing and structuring support contract requirements, training Government administrators, and implementing program reviews to monitor specific contractor performance. The Air Force stated that the examples cited in the report fall into the category of work that may approach inherently governmental functions according to Office of Federal Procurement Policy Letter 92-1, "Inherently Governmental Functions," because of the way in which the contractor performs the contract or the manner in which the Government administers contractor performance. However, the Air Force further stated that Policy Letter 92-1 does not predetermine the appropriateness of such contracts, but provides guidance for evaluation, prescribes additional management attention to the terms of the contract and the manner of performance, and leaves the management judgment to the agency.

The Air Force stated, however, that notwithstanding internal controls already in place, ESC will conduct a self-inspection of the program offices using a team of functional (that is, technical, legal, manpower, and contracting) personnel. Program offices will be advised of the purpose of the inspection, and will be made aware that any improprieties will result in loss of inappropriate contracted support.

Audit Response. We consider the Air Force comments on the recommendation responsive. We believe that ESC has policies and procedures that address the need to avoid personal services and inherently governmental functions and has included language within the TEMS contracts that address their avoidance. However, in actual practice, because of the extensive and long-term reliance on TEMS support and the limited number of organic personnel in some offices, the appearance of the performance of personal services and potential for the performance of inherently governmental functions in fact exists.

We believe that the planned self-inspection by ESC of actual work performed, rather than a review of work statements, should verify the adequacy of internal controls to avoid the performance of personal services and inherently governmental functions by contractor employees. We request that the Air Force provide actual or estimated completion dates for the proposed action in response to the final report.

e. Perform cost-benefit analyses on procurements of contracted advisory and assistance service contracts that have been ongoing for more than 5 years to determine whether use of organic or contractor resources is the most efficient means of performance. These analyses should include a sample of the delivery orders on the TEMS IV contracts.

Management Comments. The Air Force concurred in part and stated that ESC will perform cost-benefit analyses on procurements of CAAS anticipated to be on-going for more than 5 years before issuance or renewal. The analyses will determine which contracts or delivery orders could or should be considered for conversion to in-house. The Air Force further stated that cost-effectiveness

studies were performed as part of the process in contracting for manpower support, and therefore, delivery orders on existing contracts and indefinite delivery/indefinite quantity contracts will not be analyzed.

Audit Response. We consider the Air Force comments to be partially responsive. We agree with the planned cost-benefit analyses for future contracts or delivery orders for CAAS. However, the TEMS IV contracts are indefinite delivery/indefinite quantity contracts, and delivery orders under the TEMS IV contracts can be issued for up to $371 million through 1998. Therefore, we maintain that at least a sample of the TEMS IV delivery orders should also be analyzed, and we revised the recommendation accordingly. We request the Air Force, in their comments on the final report, to provide actual or estimated completion dates for the cost-benefit analyses on new contract actions, and to reconsider its position on performing such analyses on ongoing contracts and delivery orders.

6. We recommend that the Commander, Air Force Air Mobility Command, discontinue the use of personal services, discontinue the use of technical engineering and management support contracts to obtain such services, and take appropriate disciplinary actions against officials who knowingly continued the use of the personal services subsequent to the Air Force stating it no longer would.

Management Comments. The Air Force nonconcurred with the recommendation and stated that the services referred to in the report are not personal services and that the Air Mobility Command did not specifically use the TEMS III or TEMS IV contracts to obtain the services of a particular software engineer.

Audit Response. We consider the Air Force comments to be nonresponsive to the recommendation. As stated in this report, we identified the directed contracting by the Air Mobility Command to obtain the services of the software engineer in Inspector General, DoD, Report No. 94-008, "DoD Procurements Through the Tennessee Valley Authority Technology Brokering Program," October 20, 1993. In response to the report, the Deputy Assistant Secretary of the Air Force (Acquisition) specifically stated that the Air Mobility Command discontinued the acquisition of the software engineer through the Tennessee Valley Authority, and that services of the software engineer are no longer being used. However, the Air Mobility Command continued to procure the services of the software engineer after specifically stating that the services were discontinued. Further, the Air Mobility Command obtained the services through other than normal DoD procurement channels. The Air Mobility Command should have used alternative contracting means, such as a short-term individual contract with the consultant directly, to obtain the services, rather than obtaining the services indirectly through ESC, a TEMS contractor, and a subcontractor to the TEMS contractor. Because the Air Force continued to obtain personal services after stating it no longer would, we added to the recommendation that the Air Force take disciplinary actions against those officials who knowingly continued the use of personal services at the Air Mobility Command. We request that the Commander, Air Force Air Mobility

Command, consult with the Deputy Assistant Secretary of the Air Force (Acquisition) on his prior response, and provide additional comments when responding to the final report.

Responses Required Per Recommendation

Responses to the final report are required from the addressees shown for the items indicated with an "X" in the table below.

		Responses Should Cover			
Number	Addressee	Concur/ Nonconcur	Proposed Action	Completion Date	Related Issues
1.	USD(P&R)[1]	X	X	X	
2.	USD for A&T[2]	X	X	X	
4.b.	Air Force			X	
5.a.	Air Force	X	X	X	
5.c.	Air Force			X	IC[3]
5.d.	Air Force			X	IC
5.e.	Air Force	X	X	X	
6.	Air Force	X	X	X	

[1]Under Secretary of Defense (Personnel and Readiness)
[2]Under Secretary of Defense for Acquisition and Technology
[3]Internal controls

Finding B. Use of Government-Furnished Facilities

ESC program offices were charged the same rates by TEMS contractors when services were performed off-site and when Government-furnished facilities were provided for contractor use. The reason why on-site or off-site charges were not different was because, when awarding the contracts, ESC contracting officials did not require contractors to identify different rates for on-site and off-site work. ESC can reduce costs by approximately $18.7 million if contractor rates are adjusted in the TEMS IV contracts when Government-furnished facilities are provided for contractor use. Also, ESC can realize a potential cost reduction of approximately $7.7 million if funds are recouped for Government-furnished facilities provided for contractor use under TEMS III contracts.

Compensation for Government-Furnished Facilities

ESC did not require proposals for either the TEMS III or the TEMS IV contracts to specify rate adjustments for work performed off-site versus work performed at Government-furnished facilities. The TEMS contracts required all costs to be incorporated into the proposed labor rates, including general and administrative, overhead, and facilities costs.

The TEMS II contracts issued by ESC also did not require that contractor proposals specify separate rates for work performed off-site and work performed at Government-furnished facilities. Under TEMS II, however, the Government specified that, when the contractor employee performed work at a Government-furnished facility, a fee of $25 per contractor employee per day be calculated and deducted by the contractor from invoices submitted for payment. ESC relied on the contractors to identify applicable employees and make the appropriate deductions and did not establish controls to verify that the deductions were made. The TEMS contracting officer, ESC, stated that the method was not applied to TEMS III or TEMS IV contracts because administration was too difficult to manage. In addition, the Defense Finance and Accounting Support Center paid the invoices without confirming the existence or accuracy of deductions made for the use of Government-furnished facilities.

Government-Furnished Facilities Under TEMS III and IV

Information in the TEMS III and TEMS IV contracts on collocation requirements were conflicting. Under both TEMS III and TEMS IV contracts, the collocation requirements had to be in writing and had to be directed by the contracting officer.

TEMS III Requirements. The TEMS III contracts stated that the TEMS contractors must be capable of housing sufficient employees to support all delivery orders; however, the Government reserved the right to require collocation at any time. According to the contracts, if provided, Government facilities would include working space, material, equipment, services (including automatic data processing) or other support (including communication services). Under the TEMS III contracts, the Government estimated that approximately 20 percent of labor hours would require collocation, and the Government would provide the facilities at no charge. According to the contracting officer, approximately 50 percent, not 20 percent, of contractor employees were collocated.

The draft request for proposal for TEMS III included the $25 per employee per day requirement for collocation of contractor employees that was included in the TEMS II contracts. In addition, the draft request for proposal stated that

> "... in the event that the Government requires collocation of more or less than 20 percent of contract employees performing on delivery orders, that this will not provide the basis for any equitable adjustment to the price, terms and/or conditions of the contract."

ESC legal counsel questioned the enforceability and practicality of the collocation language in the proposal for TEMS III. Specifically, ESC legal counsel questioned whether the terminology meant that unless exactly 20 percent of contractor employees were collocated, that the contractor would be charged, and also questioned who would track the number of contractor employees actually located at the Government facilities each day. We are not aware that any final determination was made based on ESC legal counsel's comments. However, ESC deleted the $25 per employee per day collocation fee from the request for proposal, and did not make revisions to the proposal or to the TEMS III contracts to require cost adjustments where more or less than 20 percent collocation existed.

TEMS IV Requirements. Under TEMS IV, the Government required the TEMS contractors to maintain facilities capable of housing 50 percent of the TEMS contractor employees at any time. Also, under TEMS IV, ESC estimated that approximately 68 percent of total labor hours would require collocation. Again, the contracts stipulated that Government facilities would be provided at no charge and the value would be included in consideration as part of the Government contract. In contrast to TEMS III, Government-furnished facilities were limited to a desk, a chair, and a phone.

Collocation of Contractor Employees

We reviewed all 106 delivery orders issued under TEMS IV contracts through October 1993 and determined that 87 percent of labor hours to be performed under the delivery orders required collocation for the duration of each order. In addition, while the TEMS IV contracts stated that, if Government-furnished facilities were used, the Government would provide only a desk, chair, and a telephone, the program officials interviewed stated that the contractor employees also had access to Government-owned computers, printers, copiers, paper supplies, and other office facilities.

Because the Government incurs costs to maintain the facilities used by contractor employees, either those costs should be charged to the contractors or the contractor rates should be adjusted to allow for the Government-furnished facilities. ESC acknowledged the need to account for contractor use of Government-furnished facilities under TEMS II by levying a $25 per employee per day fee. ESC also considered including the $25 fee in the TEMS III contracts, but decided not to include the fee because of the administrative difficulties involved.

Potential Cost Reductions

We calculated that ESC could realize a potential cost reduction of up to $26.4 million if contractor rates are adjusted to accommodate the Government-furnished facilities. The $26.4 million includes $18.7 million in potential future cost reductions if adjustments are made to future work performed under TEMS IV, and $7.7 million in potential cost reductions if funds are recouped from TEMS III contracts. We calculated the savings by applying the $25 per contractor employee per day rate used under the TEMS II contract to the TEMS III and TEMS IV contracts and assumed that 68 percent of the work was performed on-site under the TEMS III contracts or would be performed on-site under TEMS IV contracts.

Table 4 demonstrates how the potential cost reductions were calculated.

Table 4. Potential Recoupment for Government-Furnished Facilities

Contract Series	Maximum Hours Under Contract (millions)	Applicable Number of Days[1]	Cost Reduction[2]
TEMS III	3.6	306,000	$ 7,650,000
TEMS IV	8.8	748,000	18,700,000
Total			$26,350,000

[1]Applicable number of days = (maximum number of hours under TEMS contracts divided by 8 hours per day) x 68 percent on-site rate per TEMS IV contract clause.
[2]Applicable number of days x $25 per day.

Because work under the TEMS III contracts has already been completed, we believe that ESC should identify a means to calculate an equitable cost adjustment under the five TEMS III contracts when Government-furnished facilities were used. Those costs identified should be recouped from contractors where Government-furnished facilities were provided.

Recommendations, Management Comments, and Audit Response

We recommend that the Commander, Air Force Electronic Systems Center, Air Force Materiel Command:

1. Calculate an equitable cost adjustment under the five TEMS III contracts for Government-furnished facilities and recoup costs from contractors where Government-furnished facilities were provided.

Management Comments. The Air Force nonconcurred with the recommendation and stated that the contracts were competitively awarded according to rates that took the collocation into consideration. In addition, the Air Force stated that legal counsel advised ESC that language in the contract precludes the Government from recouping any costs because the contract states that any equitable adjustment to the price, terms, or conditions is not possible if more or less than 20 percent of contractor employees are collocated.

Audit Response. We do not consider the Air Force comments to be responsive. Data provided by ESC to support the legal opinion did not state that the Government was precluded from recouping costs. In fact, the legal opinion interpreted the contract clause to imply that the Government would make equitable cost adjustments whenever more or less than 20 percent of contractor employees were collocated. Further, ESC considered the inclusion of the $25 per employee per day collocation fee for the TEMS III contracts, but chose to not include the clause primarily for administrative reasons. Because the TEMS III contract clause was vague, the $25 per employee per day

collocation fee was deleted. We determined that contractor employees were collocated at Government-furnished facilities at least 50 percent of the time. We maintain that costs should be recouped from the TEMS III contractors when more than 20 percent of contractor employees' were located at Government-furnished facilities. We request that the Air Force reconsider its response and provide additional comments when responding to the final report.

2. Amend the eight TEMS IV contracts to identify procedures to recoup on-site costs when Government-furnished facilities are provided for contractor use.

Management Comments. The Air Force nonconcurred with the recommendation and stated that the contracts were awarded through an intensely competitive source selection based on fixed rates that considered a 68-percent collocation rate. The Air Force believes that the competitiveness of the procurement adequately preserved any benefits that might be realized by the Government versus amending the contracts with separate rates for on-site and off-site activities. In addition, the Air Force believes that the time required for the Government to renegotiate new rates for 8 contractors, 41 labor categories, and 5 years would not be cost beneficial.

Audit Response. We do not consider the Air Force comments to be responsive. The negotiated rates for TEMS IV were generally comparable to negotiated rates for the fifth year under TEMS III. However, under TEMS III, the collocation rate to be used by contractors was 20 percent compared with 68 percent under TEMS IV. Further, according to a sample of delivery orders reviewed, closer to 87 percent of contractor employees were, in fact, collocated at Government-furnished facilities under TEMS IV. Because of the magnitude of the TEMS IV contracts ($371 million), the $18.7 million of benefits, the variations in the projected and actual percent of collocation, and the Air Force not including a collocation fee for administrative purposes, we believe that it is cost effective for the Air Force to attempt to negotiate and recover on-site costs when Government-furnished facilities are provided for contractor use. We request that the Air Force reconsider its response and provide additional comments when responding to the final report.

Finding C. Contract Administration

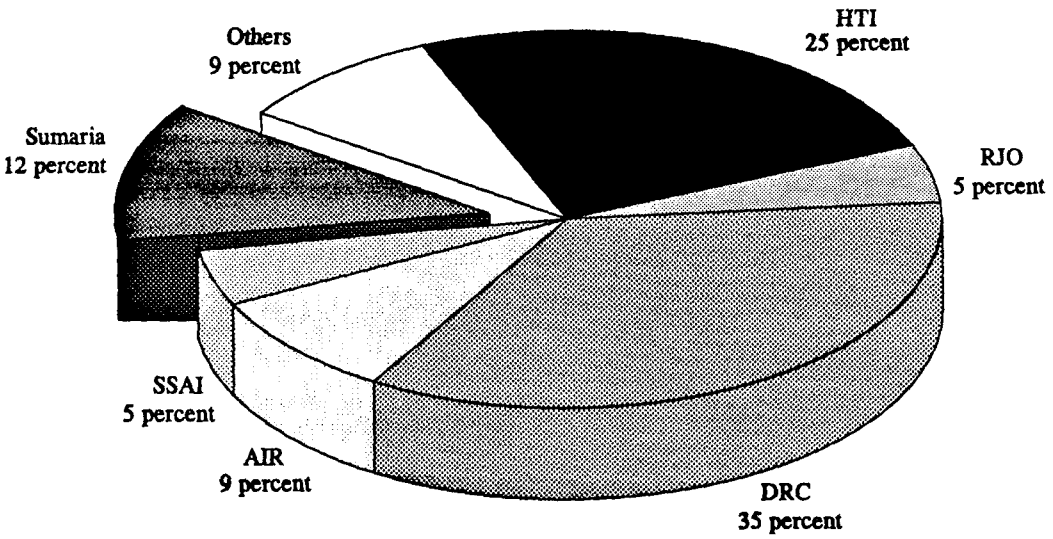
ESC did not enforce procurement regulations that require small businesses, not subcontractors, to perform at least 50 percent of total personnel costs on contracts. Further, ESC personnel returned reviewed and approved contractor invoices to the TEMS contractors to forward to the Defense Contract Management Area Operations (DCMAO)-Boston for approval and payment rather than submitting the approved invoices directly themselves. The ESC contracting office designated two other TEMS III contractors to perform work as subcontractors to Sumaria Systems, Incorporated (Sumaria), because Sumaria had not reached the maximum labor-hours under its TEMS III contract. Further, no formal policy exists to require ESC to send the invoices directly to the DCMAO-Boston once approved, and ESC program officials desired to assist TEMS contractors in more expeditiously receiving payment for work performed by allowing the contractors to directly process invoices to the DCMAO-Boston rather than processing the invoices through ESC. As a result, Sumaria unfairly received contracts for services that required subcontracting to accomplish the requirements. By allowing TEMS contractors access to invoices after ESC approval, ESC allowed the opportunity for fraud should the approved invoices be altered before submission to DCMAO-Boston.

Small Business Subcontracting

Requirements for Work Performed by Small Businesses. FAR 52.219-14, "Limitations on Subcontracting," requires that:

> At least 50 percent of the cost of contract performance incurred for personnel (under service contracts) shall be expended for employees of the small business.

The TEMS III contract with the small business, Sumaria, referred to this FAR requirement. However, by delegating work to subcontractors of Sumaria, ESC violated the FAR. Thirteen Sumaria subcontractors incurred 88 percent of the total labor costs, accounting for $30.2 million of the total of $34.3 million paid to Sumaria over the 5-year life of the contract. The following figure identifies the breakout of subcontracted costs by Sumaria.



AIR	American Institute for Research
DRC	Dynamics Research Corporation
HTI	Horizon Technology, Incorporated
RJO	RJO Enterprises, Incorporated
SSAI	Support Systems Associates, Incorporated
Sumaria	Sumaria Systems, Incorporated

Percent of Funds Paid to Sumaria and Each Sumaria Subcontractor

Use of Subcontractors. The subcontractors to Sumaria under the TEMS III contract included Horizons Technology, Incorporated, and Dynamics Research Corporation, which were also awarded TEMS III contracts as prime contractors along with Sumaria. However, as of December 1992, both Horizons Technology, Incorporated, and Dynamics Research Corporation had almost performed the maximum allowed labor-hours as stipulated in each of the TEMS III contracts. The TEMS III contracting officer stated that the program offices that used Horizons Technology, Incorporated, and Dynamics Research Corporation wished to continue obtaining support services from those firms despite their reaching the maximum hours allowed under the contracts. ESC officials stated that the imbalance in the allocation of work was a result of delays in awarding the small business set aside portion of the TEMS III contracts. Therefore, providing uninterrupted support to ESC programs, especially near the last year of the program, required deviation from the FAR rather than allowing sole-source amendments to contractors that had neared their contractual ceilings. The contracting officer approved the subcontracting of work to Horizons Technology, Incorporated, and Dynamics Research Corporation through Sumaria, which had not reached its maximum labor-hours allowed.

By subcontracting 88 percent of the work, the ESC contracting officer did not provide Sumaria the opportunity to perform under the Government contract. ESC, in effect, made Sumaria a "broker," thus violating FAR 52.219-14.

Control of Contractor Invoices

Functional Area Evaluator Responsibilities. Functional area evaluators at ESC perform as contracting officer's technical representatives within program offices. The functional area evaluator duties include monitoring contractor performance and reviewing and approving invoiced costs before payment. The contracting officer describes the responsibilities and applicable policies to the functional area evaluators in letters of delegation.

Contractor Invoice Processing Procedures. ESC contracting officials stated that the functional area evaluator letters of delegation do not identify specific policies to prescribe how invoices submitted by TEMS contractors should be processed, except that invoices for labor and travel are submitted to the functional area evaluators for review and approval. According to six functional area evaluators interviewed, the process for reviewing, approving, and paying TEMS contractor invoices for labor and travel is as follows.

o TEMS contractors submit invoices for labor hours and travel costs to the designated functional area evaluators for review and approval.

o The functional area evaluators approve the invoices based on first-hand knowledge of work performed and trips conducted or feedback obtained from program managers.

o Once approved, the functional area evaluators return the invoices directly to the contractors.

Processing Invoices Directly to DCMAO-Boston. ESC program officials stated that they desired to assist TEMS contractors in more expeditiously receiving payment for work performed by allowing the contractors to directly process invoices to the DCMAO-Boston rather than by processing the invoices through ESC. The contractors then hand-carry the approved labor-hour invoices to DCMAO-Boston, which acts as the administrative contracting office for invoice approval purposes. Invoices for travel costs are forwarded to the Defense Contract Audit Agency by the contractors. Officials at DCMAO-Boston and the Defense Contract Audit Agency stated that their reviews are limited to a cursory review for reasonableness of costs incurred and that they do not examine any detailed supporting documentation. Once reviewed, the DCMAO-Boston forwards the invoices to the Defense Finance and Accounting Services Center for payment to the contractor. Each of the TEMS contracts do, however, provide for close-out audits to be performed by the Defense Contract Audit Agency at the conclusion of each contract. These close-out audits allow for adjustments where appropriate.

2. Establish procedures to require that invoiced costs approved by functional area evaluators be forwarded directly to the appropriate Defense Contract Management Area Operations or the Defense Contract Audit Agency for further processing and that contractors be excluded from the process.

Management Comments. The Air Force concurred with the recommendation and stated that it agrees with the sensitivity of the issue, and has enhanced an existing management control in spite of the fact that no abuses have been noted. Program offices now electronically transmit a copy of approved invoices to the administrative contracting officer for comparison with the original invoice submitted by the contractor. Also, the electronically transmitted copy is marked "Not for Payment" to preclude administrative difficulties such as double payments.

Part III - Additional Information

Appendix B. Summary of Prior Audits and Other Reviews

U.S. General Accounting Office

Report No. GAO/GGD-94-95, "Government Contracting: Measuring Costs of Service Contractors Versus Federal Employees," March 10, 1994. The report states that Federal agencies are not currently required to conduct cost comparisons in determining whether to contract for CAAS. However, the General Accounting Office determined that cost comparisons can be a useful management tool for assisting Government agencies in deciding how to acquire needed services in the most cost-effective manner. The General Accounting Office stated that items included in OMB Circular No. A-76 could serve as useful criteria for cost comparisons of CAAS. The report also suggested that other non-cost factors should be considered, such as the quality or timeliness of the services required, or whether the CAAS is to be procured for a short-term or a nonrecurring purpose. Further, the report cautioned that OMB will need to resolve a potential conflict between the proposals of the National Performance Review to provide agencies greater flexibility in accomplishing their missions and current efforts to downsize the Government. The National Performance Review encourages allowing Federal managers the flexibility to obtain needed services from the best source possible. However, concurrently the administration is committed to reducing the Federal workforce by 252,000 which, in effect, creates personnel ceilings rather than eliminate them. The result may force agencies to contract out to meet downsizing goals regardless of what cost-comparisons show. The report recommended that the Director, OMB, extend cost comparison requirements to CAAS and work with Congress to explore ways to meet administration's workforce reduction objectives and provide agencies sufficient authority and flexibility to accomplish work in the most efficient and effective manner--either by using Government employees or by contract, or some combination of both. OMB generally concurred with the recommendation to extend cost comparisons to CAAS, but did not address the need to resolve the disparity between the administration's goals of workforce reductions versus providing managers flexibility in managing programs (OSD Case No. 9612).

Inspector General, DoD

Report No. 94-008, "DoD Procurements Through the Tennessee Valley Authority Technology Brokering Program," October 20, 1993. The report states that DoD activities issued Economy Act orders to the Tennessee Valley Authority (TVA) Technology Brokering Program that circumvented the Federal

procurement process, that DoD activities did not provide for adequate contract administration and contract audits to verify that work was performed in accordance with the TVA cooperative agreements, and that TVA earned about $139.4 million in interest on DoD funds by requiring DoD to make payments before receiving the goods and services. The report recommended DoD establish procedures to prevent further circumvention of the Federal procurement process, define requirements for Federal information processing resources, and implement controls over classified information; the Air Mobility Command assign program management functions to Government employees to prevent the procurement of personal services; the Military Department strengthen the administration of Economy Act orders; the issuance of guidance addressing the payment on Economy Act orders to agencies with commercial bank accounts; and DoD recoup the interest earned by TVA on DoD funds. The Army, the Navy, and the Air Force generally agreed with the recommendations.

Report No. 92-128, "Selected Service Contracts at Wright-Patterson Air Force Base," August 17, 1992. The report states that the Air Force Logistics Management Systems Center (the Center) issued contracts for program technical and administrative support services that had the characteristics of personal service contracts and were not as cost-effective as in-house personnel. Program officials contracted to obtain personnel support because the necessary expertise was not available in-house, and personnel freezes prohibited the Center from hiring DoD civilian employees. The audit estimated that in FY 1990, the Center paid an additional $4.7 million in costs for contractor work and could save up to $6.21 million if the work performed under the remaining option years of existing service support contracts were accomplished through DoD civilian resources. The report recommended that the Air Force eliminate personnel ceilings and require managers to justify the most cost-effective mix of in-house or contractor personnel resources for program requirements within the Center, evaluate support service contracts for cost-effectiveness, make budget adjustments to shift funds from contracts to civilian staff, and terminate the contract with the IMPACT Corporation. The Deputy Chief of Staff of the Air Force (Logistics), concurred with recommendations on performing cost analyses for determining the most cost-effective mix of contractor and in-house DoD civilian personnel for contracts. However, the Center did not agree to terminate the option for the IMPACT Corporation contract and did not agree with the potential monetary benefits. Resolution of the Center's disagreement is in progress.

Report No. 92-010, "Consulting Services," October 30, 1991. The report states that, in FY 1989 and 1990, DoD Components underreported CAAS procurements by $20.4 million and $19.2 million, respectively. These errors were because of unclear, conflicting, and inadequate guidance used in making CAAS determinations. Additionally, DoD Components narrowly interpreted and applied the CAAS definition, and thus reported conservative data to avoid potential budget cuts by Congress. The report recommended a revision of the CAAS definition to include clarification on reporting automated data processing and task order contracts and training of DoD program managers on the identification and reporting of CAAS. Management generally agreed with all recommendations.

Report No. 91-115, "Consulting Services Contracts for Operational and Test Evaluation," August 22, 1991. The report states that the Military Departments' operational test and evaluation agencies frequently used the same service contractors to support operational tests for major Defense acquisition systems that participated in the development of the systems. Further, the Military Departments spent more than $44 million annually for contractor assistance that was not as cost-effective as developing a DoD in-house capability. The report recommended implementation of additional procedures, legislative changes, internal controls, and replacement of service contractors with in-house civilian employees. The Director of Operational Test and Evaluation agreed with all recommendations except a need for legislation that would allow Military Departments to obtain waivers to use the same service contractors to support operational tests. The Army, the Navy, and the Air Force concurred with the recommendation to insert conflict of interest clauses in service contracts and to direct contracting officers to enforce the provisions. The Director, the Assistant Secretary of Defense (Force Management and Personnel), and the Navy nonconcurred to hiring additional DoD civilian personnel, thus reducing their reliance on services contractors. Resolution of the nonconcurrence is in progress.

Report No. 91-041, "Contracted Advisory and Assistance Services (CAAS) Contracts," February 1, 1991. The report states that management controls over CAAS needed improvement and that DoD significantly underreported CAAS expenditures. The report estimates that DoD Components did not identify and report between $4 billion and $9 billion of CAAS procurements because of unclear CAAS guidance, untimely updating of implementing regulations within the Military Departments, and insufficient training. The report recommended revisions and clarifications to DoD Directive 4205.2, "DoD Contracted Advisory and Assistance Services," January 27, 1986; increased training; and better budget and accounting systems to provide detailed support to CAAS estimates in the PB-27 Budget Exhibits. The report recommended that guidance be issued to define inherently governmental functions that should be performed by DoD civilian and military employees; that requests for CAAS only be approved after completion of cost comparisons that demonstrate that contracting for services is more economical; and that a zero-base review be performed on all CAAS contracts to determine whether performing the requirements in-house or through a contract would be more cost-effective. In response to the report, DoD established an action plan to revise regulations, clarify definitions, and improve training to strengthen the management and reporting of CAAS.

Report No. 91-030, "Justification for Use of Time-and-Materials Contracts," January 8, 1991. The report states that in FY 1987, ongoing work was continued for 22 task-order-type contracts, valued at $72 million, for technical and engineering support services. This problem primarily occurred because the award was made before the technical personnel identified the need for such services or because technical personnel neglected to use available performance and historical cost data to develop the detailed statements of work and estimate contract costs. The report recommended that the Deputy Assistant Secretary of Defense (Procurement) issue additional guidance to all DoD buying commands to limit the use of time-and-materials contracts. Other recommendations required the Assistant Secretary of the Army (Research, Development, and

Acquisition); Assistant Secretary of the Navy (Research, Development, and Acquisition); and the Assistant Secretary of the Air Force (Acquisition) to establish minimum training requirements for technical personnel, to increase the level of training for contracting officers, to assess the utilization of historical cost and performance data, and to require buying commands to include a determination and finding regarding the use of time-and-materials contracts. The Deputy Assistant Secretary of Defense (Procurement); the Assistant Secretary of the Army (Research, Development, and Acquisition); the Assistant Secretary of the Navy (Research, Development, and Acquisition); and the Assistant Secretary of the Air Force (Acquisition) concurred with most of the recommendations. The Office of Management and Budget issued additional guidance.

Air Force Audit Agency

Project No. 91064041. "Contracting for Advisory and Assistance Services," June 4, 1992. The report states that contracting officers did not obtain required certified cost and pricing data for 17 of 20 contracts reviewed; did not perform market research before awarding sole-source contracts for 11 of the 20 contracts; restricted competition on 12 contracts; did not require competitive selection of subcontractors for 10 contracts; included inherently governmental functions in 10 contracts; and did not identify 15 contracts as CAAS. The report recommended that major commands obtain cost and pricing data when negotiating CAAS orders, perform market evaluations before exercising options on CAAS contracts, prohibit the use of indefinite delivery/indefinite quantity contracts for CAAS, comply with FAR requirements for subcontracting, provide a clear definition of inherently governmental functions, and provide training on CAAS requirements. Management disagreed with the report regarding the application of FAR provisions to CAAS, but agreed to consider the use of indefinite delivery/indefinite quantity contracts. Air Force Audit Agency considered management's response and management actions taken or planned to be responsive.

Report No. 325-0-28, "Follow-up of Contracting for Engineering Services to Support Air Force Systems Command Weapon Systems Acquisition, Electronic Systems Division, Hanscom Air Force Base, Massachusetts," July 11, 1990. The report states that management had generally taken measures to ensure that accounts receivable procedures and collection controls over collocation fees due to the Government were established. Management stated that they had coordinated with personnel to ensure credits were included on monthly invoices and that collocation fees were collected from TEMS contractors. The report recommended that the administrative contracting officer at the Defense Contract Administration Services Management Area promptly collect collocation fees due the Government and provide written replies when contractor fees were settled. Management concurred with the finding and recommendations.

Report No. 9066410, "Contracting for Engineering Services to Support Air Force Systems Command Weapon Systems Acquisitions," April 2, 1990. The

report states that Air Force activities, including ESC, awarded engineering services task orders that included personal services. This occurred because specific Air Force Systems Command guidance implementing FAR requirements on personal services was not available. The report recommended that the Air Force Systems Command provide more specific instructions to buying organizations on what constitutes personal services and direct that the use of personal services be discontinued. Management and Air Force Audit Agency mutually concurred that clearer guidance was necessary, and that the revised FAR and Defense Federal Acquisition Regulations Supplement (issued in June 1990) should provide the necessary guidance.

Report No. 325-9-22, "Contracting for Engineering Services to Support Air Force Systems Command Weapon Systems Acquisitions, Electronic Systems Division, Hanscom Air Force Base, MA," July 27, 1989. The report states that engineering service contracts had the characteristics of personal service contracts and that contractor personnel worked in Government program offices using Government equipment and facilities. These contractor personnel interfaced daily with Government employees to accomplish the program office mission while the Government's program office maintained time and attendance records for both Government and contractor personnel. The arrangement gave the appearance that contractor employees were performing as Government employees. The report also states that the Government could realize potential recoupments of $1.56 million if procedures were better defined for authorizing contractor collocation. The report did not make recommendations concerning the issue of personal services. Management agreed to recoup costs for collocation of contractor personnel at Government-furnished facilities. Management nonconcurred with the finding that contractor personnel were used to circumvent civil service laws or to perform personal services. Management stated that violations of FAR part 37 only occur when all contractor personnel are continuously supervised by Government employees. After considering management's response, Air Force Audit Agency closed out the finding, citing a difference in interpretation of the FAR requirement for personal services, and agreed that all contractor employees were not continuously supervised by Government personnel.

Appendix C. Potential Benefits From Personnel Conversions

Contractor	TEMS IV Costs[1]	Government Costs[2]	Potential Cost Reduction[3]
ABACUS	$ 43,352,785	$ 34,798,496	$ 8,554,289
ARINC	43,269,631	34,798,496	8,471,135
ASEC	41,048,911	34,798,496	6,250,415
CTA	37,556,370	34,798,496	2,757,874
MEI	37,247,331	34,798,496	2,448,835
SENCOM	39,285,711	34,798,496	4,487,215
SRC	41,895,280	34,798,496	7,096,784
SSAI	33,920,145	34,798,496	(878,351)
Total	$317,576,164	$278,387,968	$39,188,196

ABACUS	ABACUS Technology Corporation
ARINC	ARINC Research Corporation
ASEC	Analytical Systems Engineering Corporation
CTA	CTA, Incorporated
MEI	MEI Technology, Incorporated
SENCOM	SENCOM, Incorporated
SRC	Systems Resources Corporation
SSAI	Support Systems Associates, Incorporated

[1]Based on the contractor's best and final offer.
[2]Based on Office of Management and Budget Circular No. A-76, "Transmittal Memorandum #12," March 26, 1993, which updated the Federal pay raise assumptions.
[3]Calculated by subtracting the Government costs from the TEMS IV costs.

Appendix D. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
A.1.	Economy and Efficiency. Establish procedures to verify compliance with DoD guidance to certify that contracting for CAAS, versus contracting out, is cost-effective.	Undeterminable.*
A.2.	Economy and Efficiency. Establish a program to manage the downsizing of DoD civilian workforce that allows for increasing DoD civilian resources or contractor support when shown to be more operationally-effective or cost-effective.	Undeterminable.*
A.3.	Economy and Efficiency. Identifies a means to make funds available for in-house support when more cost effective.	Undeterminable.*
A.4.a.	Program Results. Authorizes conversion of previously approved positions to in-house.	Nonmonetary.
A.4.b.	Program Results. Authorizes an ESC task force to determine allocation of funding among program and staff to best accomplish program needs.	Undeterminable.*
A.4.c.	Program Results. Converts contractor positions to in-house when more cost-effective.	Undeterminable.*

*Exact amount of monetary benefits will be determined based on results of future ESC efforts.

Appendix D. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
A.5.a.	Economy and Efficiency. Determines in-house civilian personnel requirements needed to perform mission.	Nonmonetary.
A.5.b.	Program Results. Converts contractor positions to organic when more cost-effective.	Undeterminable.*
A.5.c.	Economy and Efficiency and Internal Controls. Performs a cost-benefit analysis and converts TEMS contractor slots to organic resources when more cost-effective.	Funds put to better use of $39 million in FYs 1994 through 1997 appropriations.
A.5.d.	Program Results and Internal Controls. Obtains legal review of contracted work under TEMS and implements internal controls when determined that contractor employees are performing personal services and inherently governmental functions.	Nonmonetary.
A.5.e.	Economy and Efficiency. Performs cost-benefit analyses on all procurements for CAAS procured for more than 5 years to determine whether organic performance would be more cost-effective.	Undeterminable.*
A.6.	Internal Controls. Requires the Air Mobility Command to discontinue the use of TEMS contracts to obtain personal services and initiate disciplinary actions where appropriate.	Nonmonetary.

*Exact amount of monetary benefits will be determined based on results of future ESC efforts.

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
B.1.	Economy and Efficiency. Calculates an equitable cost adjustment under TEMS III contracts when Government-furnished facilities were provided, and recoups costs.	Questioned costs of $7.7 million.
B.2.	Economy and Efficiency. Amends TEMS IV contracts to require recoupment of costs when Government-furnished facilities are used by contractors. Recoups costs for delivery orders already issued.	FYs 1994 through 1997 funds put to better use of $18.7 million.
C.1.	Internal Controls. Requires contracting officers to comply with subcontracting limitations for small businesses.	Nonmonetary.
C.2.	Internal Controls. Requires approved invoiced costs to be forwarded directly to the DCMAO or Defense Contract Audit Agency for processing.	Nonmonetary.

Appendix E. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology, Washington, DC
Under Secretary of Defense (Personnel and Readiness), Washington, DC
Comptroller of the Department of Defense, Washington, DC
Director, DoD Contract Advisory and Assistance Services, Washington, DC

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller), Washington, DC
Assistant Secretary of the Air Force (Manpower, Reserve Affairs, Installations, and Environment), Washington, DC
Directorate of Personnel, Air Force Materiel Command, Wright-Patterson Air Force Base, OH
Air Force Electronic Systems Center, Hanscom Air Force Base, MA
Area Audit Office, Air Force Audit Agency, Bedford, MA

Defense Organizations

Defense Contract Audit Agency, Alexandria, VA
  Defense Contract Audit Agency Regional Office, Burlington, MA
Defense Contract Management Area Operations-Boston, MA

Appendix F. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
Under Secretary of Defense (Personnel and Readiness)
Comptroller of the Department of Defense
Director, Defense Procurement
Assistant to the Secretary of Defense (Public Affairs)
Deputy Under Secretary of Defense (Environmental Security)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Auditor General, Naval Audit Service

Department of the Air Force

Secretary of the Air Force
Under Secretary of the Air Force
Assistant Secretary of the Air Force (Financial Management and Comptroller)
Deputy Assistant Secretary of the Air Force (Budget)
Deputy Assistant Secretary of the Air Force (Force Support and Personnel)
Commander, Air Force Materiel Command
Commander, Air Mobility Command
Commander, Air Force Electronic Systems Center
Auditor General, Air Force Audit Agency

Defense Organizations

Director, Defense Contract Audit Agency
Commander, Defense Contract Management Area Operations-Boston
Director, Defense Logistics Agency
Inspector General, Defense Intelligence Agency
Inspector General, National Security Agency
Director, Defense Logistics Studies Information Exchange

Non-Defense Federal Organizations

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division, General Accounting Office

Chairman and Ranking Minority Member of Each of the Following Congressional Committees and Subcommittees:

- Senate Committee on Appropriations
- Senate Subcommittee on Defense, Committee on Appropriations
- Senate Committee on Armed Services
- Senate Committee on Governmental Affairs
- House Committee on Appropriations
- House Subcommittee on Defense, Committee on Appropriations
- House Committee on Armed Services
- House Committee on Government Operations
- House Subcommittee on Legislation and National Security, Committee on Government Operations

Senator David Pryor, U.S. Senate

Part IV - Management Comments

Under Secretary of Defense (Personnel and Readiness) Comments

Final Report Reference

THE UNDER SECRETARY OF DEFENSE
4000 DEFENSE PENTAGON
WASHINGTON, DC 20301-4000

PERSONNEL AND READINESS

MEMORANDUM FOR DIRECTOR CONTRACT MANAGEMENT, DODIG

SUBJECT: Draft Audit Report on Procurement of Support Services by the Air Force Electronic Systems Center, Hanscom Air Force Base (Project No 2CH-3003)

The referenced draft audit report identifies potential financial savings if contracted activities were performed by organic Defense labor instead of contract labor in support of the Air Force Electronic Systems Center. The report then recommends Defense-wide accounting and procedural changes.

Revised

I disagree with the draft recommendation that would require the Department to undertake a major study to ascertain the value of organic labor instead of contract labor. Long standing DoD policy dictates that the Department shall not be in competition with the private sector, and that government employees will be used only where necessary.

Revised

The draft recommendation also has implications for labor accounting across Defense and throughout the public sector. Implementation would involve issues other than inherently manpower-related considerations; for example, the Defense Department would be required to collect and report civilian employment information in private industry. This amounts to government interference in private industry.

The Department is currently undergoing a major reduction in its major force programs, missions, and workloads. Use of contractor support allows DoD managers the flexibility to accommodate workload variations while achieving Defense missions and complying with mandated manpower reductions.

I recommend that you change the draft report to eliminate the requirement for the study of contract labor.

for Edwin Dorn

Comptroller of the Department of Defense Comments

OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

APR 19 1994

(Program/Budget)

MEMORANDUM FOR OFFICE OF THE INSPECTOR GENERAL, DOD

SUBJECT: Audit Report on Procurement of Support Services by the Air Force Electronic System Center, Hanscom Air Force Base, Massachusetts (Project No.2CH-3003)

This is in response to Recommendation 2 of Finding A. Managers within the Department are given total flexibility to determine how their programs are executed. Neither the DoD Comptroller nor the ASD (Personnel & Readiness) restrict how Components allocate their personnel resources. Although DoD Components are given end strength and workyear targets, they can allocate their personnel resources as required in order to achieve the greatest cost efficiency.

Since the Components already have the necessary flexibility to allocate personnel resources no Comptroller action is required.

John A. Flinn
Director for Operations

Department of the Air Force Comments

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC

OFFICE OF THE ASSISTANT SECRETARY

20 APR 1994

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING
OFFICE OF THE INSPECTOR GENERAL
DEPARTMENT OF DEFENSE

FROM: SAF/AQ
1060 Air Force, Pentagon
Washington, DC 20330-1060

SUBJECT: Draft Report on the Audit of Procurement of Support Services by the Air Force Electronics Systems Center, Hanscom Air Force Base, Massachusetts, February 18,1994, Project No. 2CH-3003 - INFORMATION MEMORANDUM

This is in reply to your memorandum for Assistant Secretary of the Air Force (Financial Management and Comptroller) requesting comments on the findings and recommendations made in the subject report.

The draft report, in our view, should not be released as a final report in its present form. The audit findings relate to perceived internal control weaknesses and improper use of contractor personnel. We take exception to this perception which appears to be based on a few isolated incidences.

We also take issue with the recommendations which would require adjustment of competitively awarded contracts and provide no monetary benefit to the government.

Although we do not necessarily disagree with recommendations directed toward conversion of contract support personnel to organic positions, we are unable at this time to comply with these requests due to the mandated end-strength ceilings.

Our specific comments are attached. We appreciate the opportunity to provide comments on the draft report, and we encourage your reconsideration of its conclusions.

JAMES J. MATTICE
Deputy Assistant Secretary
(Research & Engineering)

1 Atch
Comments

Final Report Reference

AIR FORCE COMMENTS
ON
DOD IG DRAFT REPORT ON THE AUDIT
OF
PROCUREMENT OF SUPPORT SERVICES BY THE AIR FORCE ELECTRONICS SYSTEMS CENTER, HANSCOM AIR FORCE BASE, MASSACHUSETTS
PROJECT NO. 2CH-3003

FINDING A: Acquisition of Technical Engineering and Management Support Services

RECOMMENDATION 3. The Under Secretary of the Air Force authorize the Air Force Electronic Systems Center, Air Force Material Command, to:

Renumbered Recommendation A.4.

a. Lift the suspension at the Electronic Systems Center to allow the conversion of the remaining positions to organic resources as initially authorized under the Acquisition Workforce Management Initiative Test.

NON CONCUR

The Acquisition Workforce Management Initiative Test also known as "Coral Convert" was approved by the Assistant Secretary of the Air force (Acquisition) (SAF/AQ), not the Under Secretary of the Air Force. Recommend this finding be addressed to the Assistant Secretary and not the Under Secretary.

We agree with the audit and believe that completion of the Coral Convert test will ultimately prove that governmental functions can be accomplished with less cost by government personnel. At this time, SAF/AQ will not lift the suspension on the Coral Convert for the following reason. The President and the Office of the Secretary of Defense continue to mandate end-strength ceilings for the Air Force through 1998. The ceilings have been established to meet the President's five year goal of reducing the size of the Government by over a quarter of a million personnel. The ceilings set limits on the number of personnel to be employed by the Air Force. Hiring of additional government personnel, without relief from the end-strength ceilings would be counter to the President's goal. The Air Force has plans to meet the end-strength ceilings currently imposed by the Office of the Secretary of Defense. Hiring the remaining personnel authorized by the Acquisition Workforce Management Initiative Test would generate a reduction in force for each new government employee hired.

b. Convene a task force made up of manpower, acquisition, and comptroller personnel to determine how to best allocate decreased funding among staff and program needs to best accomplish program needs. Make appropriate funding adjustments in the budget.

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CONCUR

An Executive Group consisting of General Officers representing the operational customers, acquisition community, manpower resource allocation and the comptroller has been formed and is currently meeting in support of the FY 96-01 POM. The Executive Group is reviewing acquisition programs and developing recommendations to either "keep or kill" programs. This Executive Group will develop recommendations for the most senior Air Force leadership for the allocation of scarce resources in these areas. Once finalized, and approved by Air Force leadership, the budget will be adjusted.

c. Convert contractor positions to organic positions when it is determined to be more cost-effective.

CONCUR IN PART

If relief is granted from the end-strength ceilings discussed in (a) above, we would aggressively convert additional contractor positions to in-house positions where it has proven to be more cost effective. If relief is granted from the end-strength ceilings levied by the Office of the Secretary of Defense, formal cost comparisons would be performed to substantiate the cost savings of conversion prior to any additional positions being approved for conversion from contractor resources to organic resources.

Revised and Renumbered Recommendation A.5.

RECOMMENDATION 4. The Commander, Air Force Electronic Systems Center, Air Force Material Command:

a. Determine DoD civilian personnel requirements needed to satisfy mission requirements

CONCUR IN PART

This determination is already made annually through the ESC Resource Management Council (RMC) activities. The RMC addresses the total manpower requirement, and then the appropriate mix of organic, FFRDC, and contractor support. The next cycle will be completed by the end of the first quarter of FY 95.

The audit failed to recognize the efforts already being undertaken in the name of cost-effectiveness to reduce overall reliance upon TEMS. An ESC work-load survey was conducted in FY 91 prior to the TEMS IV procurement. This survey identified a requirement for 5,000 labor years of effort for FY 93-97. The Program Start Review identified the alternatives which were considered as a means of satisfying this requirement. One of the alternatives considered obtaining Congressional authorization to hire additional organic resources if cost comparisons indicated use of organic resources would be less costly. However, this was not a viable option because of the mandate to downsize DOD civilian and military staff. Members of the ESC Resource Management Council spent

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substantial time explaining the ESC plan to reduce contracted support by 5% per year, and how such a reduction has been achieved in each of the previous four years. The ESC is committed to reduce reliance upon TEMS. However, this would certainly not preclude a particular program office from receiving an increased allotment in any given year, dependent upon its mission requirements.

At the program office level, the audit seems to have missed some pertinent information. For example, on page 13, the audit alleges that program offices "did not attempt to obtain organic resources..." In the case of Joint STARS, this topic was discussed with the PEO on numerous occasions, and was brought to the ESC Resource Management Council for decisions. Records are available to indicate these actions.

b. Convert contractor positions to organic positions when it is determined to be more cost-effective.

CONCUR IN PART

Realizing that cost-effectiveness is but one of several factors to be considered, ESC stands ready to proceed with conversions when given proper authority

Given a successful conclusion to the CORAL CONVERT initiative, a lifting of barriers is required. At a minimum, this includes a hiring freeze exemption, relief from high-grade restrictions, and authority to use program funds for civilian pay.

c. Perform a cost-benefit analysis on all job categories identified under the eight technical engineering and management support contracts, and convert contractor positions to in-house when determined to be more cost-effective.

CONCUR IN PART

ESC will perform a cost-benefit analysis on all job categories identified under the eight TEMS contracts. This will include a comparison of TEMS cost by labor category to the cost for an equivalent organic resource. They will perform these analyses as part of their annual manpower reviews. However, if it is determined to more cost-effective to convert the positions to in-house, ESC does not have the authority to proceed with the conversions until the barriers stated in (b) above are lifted.

d. Obtain a legal review of Electronic Systems Center program offices based on actual work performed to verify that contractor employees are not performing personal services or inherently Governmental functions, and eliminate such performance when the review identifies that such functions are being performed.

CONCUR IN PART

ESC already has a well-defined system, designed to preclude the performance of personal services or inherently Governmental functions. Regulatory requirements such as ESDR 26-1 emphasizes the concepts of personal services and inherently governmental

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Revised
Page 13

functions. TEMS contracts also emphasize that work must be performed consistent with contract terms and work statement. Additionally, acceptable and unacceptable roles and behaviors of Government and contractor personnel are stressed through FAE (Functional Area Evaluator) training and contractor meetings.

We believe the existence of personal services at ESC has been inaccurately portrayed. On page 14, the audit implies that "thousands of hours" were obtained for the purpose of performing personal services. This is not only a distortion, but totally unsupported by the facts. The audit further characterizes TEMS employees as equating to organic, and even states that TEMS contractor are "...often supervised by organic resources." We strongly disagree with this as well.

The test for personal services is essentially whether the characteristics of an employer-employee relationship exist. The DOD IG should be sensitive to the fact that use of the term "employ" drives one to the legal conclusion that personal services are involved. The draft audit report states that the Joint STARS Office of Manufacturing Quality "employs" 12 persons, six of which are contractor employees. Given the use of such loaded language, it is not surprising that the DOD IG finds problems with use of manpower support. If those six individuals are actually employed by the Joint STARS program office, the conclusion would be inescapable that those individuals were rendering personal services. The contractor employees are not "employed" by the Joint STARS program office. This use of the term "employee" and several like references throughout the draft report should be revised to eliminate the use of such loaded language.

The draft report states that the performance of many tasks have characteristics of personal services. The report cites three examples which each address four of the six descriptive elements which FAR 37.104 (d) provides as a guide in assessing whether or not a contract is personal in nature. While the meeting of these criteria could result in a determination that the services were personal, it may not. However, FAR 37.104 (c)(2) states: "The sporadic unauthorized supervision of only one of a large number of contractor employees might reasonably be considered not relevant." Three examples out of over three hundred delivery orders does not appear to be statistically relevant.

With respect to inherently governmental functions, the audit fails to distinguish between the actual performance and the potential of performing these functions. The OFPP Policy Letter 92-1 distinguishes between activities which are clearly governmental, and others which may be similar because of the way the contractor performs the contract, or the manner in which the Government administers contractor performance.

While many of the activities performed by TEMS contractors are in support of governmental functions, none of the tasks performed under the TEMS contracts are inherently governmental. ESC has taken numerous steps under our TEMS contracts to develop procedures to avoid contracting out for inherently governmental services and to insure this vital separation. These procedures include: carefully reviewing and structuring support contract requirements; training government administrators to ensure that TEMS personnel perform to the stated contract requirements; and implementing program reviews to monitor specific contractor performance. These procedures are in place and provide prudent controls for TEMS contracting at ESC and help insure that inherently governmental functions continue to be properly performed by government personnel. While we cannot be absolutely sure that all our procedures work all the time, we are

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confident that our approach is sound. We agree that manpower support contractors may not perform inherently governmental functions. It is, however, advantageous and necessary to use manpower support contracts to assist the Government in performing its inherently governmental functions. This is the proper application of support services.

The draft report indicates that contractor employees are determining user requirements at the Intelligence Data Handling Systems Program Office. This is clearly not the case. The contractor employees merely assist the Government with the requirements determination process. The Government program manager is always the final authority on requirements confirmation with the user; this is the inherently governmental function.

Additionally, the draft audit report was critical of the Network Capabilities Program Office because the contractor had performed tasks that included "identifying DOD customer needs, writing delivery orders, and reviewing and advising the program manager whether or not to approve Infotech Development Incorporated, invoices." Support contractors do advise customers on the type actions (i.e., mission statements, funding documents, etc.) which the Government program office has established as necessary; however, all correspondence sent to potential users is developed and signed by Government program managers. The Government program manager, in conjunction with the user, structures a program to address the needs of the user. Preparation of delivery orders is a clerical function; support contractors do not have the authority to, and do not, approve delivery orders. Support contractors collect data concerning Infotech invoices and provide such information to the Government program manager who exercises all decision authority for approval of invoices. All decisions relevant to cost, schedule, and performance in the programs cited are made by Government personnel; support contractors may raise issues of this nature to the Government program office for resolution, but the decision authority is always with Government personnel.

The examples cited in the audit report fall into the category (Appendix B, OFPP Policy Letter 92-1) of work which may approach inherently governmental functions because of the way in which the contractor performs the contract or the manner in which government administers contractor performance. OFPP Policy Letter 92-1 does not pre-determine the appropriateness of such contracts but provides guidance for evaluation, proscribes additional management attention to the terms of the contract and the manner of performance, and leaves the management judgment to the agency. ESC has consistently applied the guidance, and has aggressively implemented extensive management controls, which were not reflected in the audit report. The report fails to demonstrate that agency control of inherently governmental functions is not preserved at ESC.

Notwithstanding the internal controls already in place, ESC will conduct a self-inspection of the program offices utilizing a team of functional (i.e., technical, legal, manpower, and contracting) personnel. Program offices will be advised of the purpose of the inspection, and will be made aware that any improprieties will result in loss of inappropriate contracted support.

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e. Perform a cost benefit analyses on all procurements of contracted advisory and assistance service contracts that have been on-going for more than 5 years to determine whether use of organic or contractor resources is the most efficient means of performance.

CONCUR IN PART

ESC will conduct cost-benefit analyses on CAAS procurements that are anticipated to be on-going for more than five years. They will take a prospective look at these contracts or delivery orders to determine which could or should be considered for conversion. Timing of these analyses will be prior to issuance or renewal of CAAS covered contracts

Program officials were criticized for not doing cost-effectiveness analyses before issuing individual delivery order under existing contracts. Cost-effectiveness studies are performed as part of the process leading to the decision to contract for manpower support. Delivery orders issued under an ID/IQ contract are not stand-alone contracts. ESC will not perform cost analyses of on-going delivery orders

Revised and Renumbered Recommendation A.6.

RECOMMENDATION 5. The Commander, Air Force Air Mobility Command, discontinue the use of personal services and technical engineering and management support contracts to obtain such services.

NON CONCUR

The audit report alleges that AMC used the TEMS III contract to acquire personal services. We do not believe the referenced services constituted personal services. Dynamics Research Corporation (DRC), as the prime contractor, priced the data standardization project based on their existing company-owned capabilities. When DRC started working on the project, they realized that data dictionary system needed additional documentation, and also realized schedule compliance was dependent on finding additional knowledgeable people. DRC acquired the services of a subcontractor who previously worked on the project and who employed the referenced software engineer as a consultant to complete the task. AMC did not direct or request a specific software engineer DRC bought the resources, at no additional cost to the government, necessary to complete their contractual obligations. We don't believe AMC specifically used the TEMS III contract to obtain a "personal services" contract. We support AMC's use of ESC's TEMS III contract to accomplish DOD-directed modeling and assist data administration.

The audit report refers to the use of a software engineer under the TEMS IV contract. AMC is not using the TEMS IV contract for a specific software engineer as stated in the draft report.

The audit report also references an alleged statement made by an AMC program manager concerning the importance of a specific software engineer. We were unable to trace the source or context in which this statement was made. It is commonly understood that the contribution of contractor personnel who have expertise and specific experience on a project for several years save the government time and money because of a significant learning curve for a new individual However, if a program manager made such a

statement, it does not mean the services were acquired through inappropriate methods. To the best of our knowledge, AMC did not request or direct any contractor hire or assign a specific software engineer.

FINDING B: Use of Government-Furnished Facilities

RECOMMENDATION 1. The Commander, Air Force Electronic Systems Center, Air Force Material Command calculate an equitable adjustment under the five TEMS III contracts for Government-furnished facilities and recoup costs from contractors where Government-furnished facilities were provided.

NON CONCUR

The TEMS III contract was awarded through an intensely competitive source selection in which offerors were instructed to make fixed rate offers based on a collocation mix specified in the RFP. The Contractors were informed to assume that 20% of labor hours would be collocated with the Program Offices and bid accordingly. Therefore, "on-site" costs were considered during negotiations, and inherent to the negotiated rates are reductions due to collocation.

Additionally, the contract contains the following statement, which ESC was advised by legal council, precludes the Government from recouping any costs: "In the event that the Government requires collocation of more or less than 20% of contract employees performing on delivery orders, this will not provide the basis for any equitable adjustment to the price, terms and/or conditions of the contract."

RECOMMENDATION 2. The Commander, Air Force Electronic Systems Center, Air Force Material Command amend the eight TEMS IV contracts to identify procedures for recoupment of on-site costs when Government-furnished facilities are provided for contractor use.

NON CONCUR

The TEMS IV contract was awarded through an intensely competitive source selection in which offerors were instructed to make fixed rate offers based on a collocation mix specified in the RFP. The Contractors were informed to assume that 68% of labor hours would be collocated with the Program Offices and bid accordingly. Therefore, "on-site" costs were considered during negotiations, and inherent to the negotiated rates are reductions due to collocation. We believe the competitiveness of this procurement adequately preserved any benefits that might inure to the Government versus amending the contracts with separate rates for on-site and off-site activities. Any amount gained from negotiating a separate reduction rate for Government facilities would be more than offset by increased rates the Government would have to negotiate with contractors no longer driven by competitive forces. In addition, the cost to the Government in time and resources required to re negotiate 41 labor categories per year for five years, with eight

contractors (41 x 5 x 8 = 1,640 labor rates) would be significant. To incur such costs with no benefit to the Government (and probable financial harm) would be unjustifiable.

FINDING C: Contract Administration

RECOMMENDATION 1. The Commander, Air Force Electronic Systems Center, Air Force Material Command establish internal control procedures to monitor contracting officials compliance with Federal Acquisition Regulation 52.219-14, "Limitations on Subcontracting for Small Businesses," when approving subcontractors to small businesses and when placing delivery orders.

CONCUR

A management control currently exists in that the work statement permits discussion of this type of topic at the semi-annual Program Management Reviews (PMR). Under the TEMS IV, the successor contract, the very first PMR included this topic. All subsequent PMRs will also include this topic.

In the single circumstance cited under TEMS III, an imbalance was permitted to occur so as to ensure uninterrupted support to numerous ESC program offices. The situation developed at contract award when two protests under the Small Business Set Aside portion caused a six month delay resulting in an imbalance of orders to several contractors. During TEMS III performance, ESC was alerted to the problem, and a business decision had to be made. ESC considered this a problem for the TEMS contractor to resolve since it is incumbent upon the contractor to manage its own subcontracts program. Towards the latter part of the performance of TEMS III, it became evident that it was in the best interest of the Government to allow contractor to exceed this limitation, thus ensuring uninterrupted support to ESC programs.

RECOMMENDATION 2. The Commander, Air Force Electronic Systems Center, Air Force Material Command establish procedures to require that invoiced costs approved by functional area evaluators be forwarded directly to the appropriate Defense Contract Management Area Office or the Defense Contract Audit Agency for further processing and that contractors be excluded from the process.

CONCUR (Action Completed)

While a management control currently exists, this control has been enhanced. The program offices now FAX a copy of the approved invoice to the Administrative Contracting Officer (ACO) for comparison to the original invoice to be submitted by the Contractor. The Faxed copy is marked "Not For Payment" to preclude administrative difficulties, such as double payments.

Of the $772M referenced in the draft audit as being placed on the various TEMS contracts, neither ESC nor any inspectors have found any improprieties in the history of TEMS. An impropriety of the type suggested would amount to fraud, and there are

criminal and civil statutes which address improper actions of individuals. Perhaps more significant is the corporate risk that a contractor would be debarred from receiving future Government contracts. Finally, as a check, one of the responsibilities of the assigned FAE is to perform a monthly comparison of the contractor's rate of labor and funds usage, and report any discrepancies to the Contracting Officer.

Nevertheless, we share the same sensitivity as the auditor with this topic, and have enhanced our internal control, in spite of the fact that no abuses have been noted.