

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

**COST-EFFECTIVENESS OF CONTRACTING
FOR SERVICES**

Report No. 95-063

December 30, 1994

Department of Defense

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Acronyms

CECOM
OMB

Army Communications-Electronics Command
Office of Management and Budget



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884**



December 30, 1994

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION
AND TECHNOLOGY
UNDER SECRETARY OF DEFENSE FOR PERSONNEL
AND READINESS
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL
MANAGEMENT)
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Audit Report on the Cost-Effectiveness of Contracting for Services
(Report No. 95-063)

We are providing this report for your information and use. This report is the second in a series of reports issued in conjunction with the statutory requirement to annually audit contracted advisory and assistance services. Because this report contains no recommendations, comments were not required. The Army commented on the draft of this report; no further comments are required.

We appreciate the cooperation and courtesies extended to the audit staff. If you have any questions on this audit, please contact Ms. Kimberley A. Caprio, Audit Program Director, at (703) 604-9248 (DSN 664-9248). Appendix D lists the distribution of this report. The audit team members are listed inside the back cover.

David K. Steensma

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Office of the Inspector General, DoD

Report No. 95-063
(Project No. 2CH-3003.02)

December 30, 1994

COST-EFFECTIVENESS OF CONTRACTING FOR SERVICES

EXECUTIVE SUMMARY

Introduction. This report is the second in a series of reports issued as a result of the statutory requirement to annually audit contracted advisory and assistance services. Services contracting is the fastest growing area of Government procurement. Reviews over the years have shown that Federal agencies often contract for services at a cost that is 25 percent to 40 percent greater than if Federal employees had been used to perform the services.

Objectives. The objectives of the overall audit of contracted advisory and assistance services were to evaluate progress that DoD has made to establish effective management controls and to improve the accuracy and completeness of information reported to Congress, and in the Federal Procurement Data System on contracted advisory and assistance services. We also evaluated the extent to which the Military Departments have used contracted advisory and assistance services to compensate for DoD staffing shortages. This report discusses the second audit objective as it applies to the Army and the Navy. We also reviewed internal controls applicable to the audit objective. We issued Inspector General, DoD, Report No. 94-112, "Procurement of Support Services by the Air Force Electronic Systems Center, Hanscom Air Force Base, Massachusetts," May 27, 1994, that discusses the second objective as it applies to the Air Force Electronic Systems Center. A summary report will address the first objective as it applies to all the Military Departments.

Audit Results. The Army and the Navy did not perform required cost comparisons to determine whether or not in-house or contracting out is the most cost-effective way to obtain needed services for four contracts, valued at \$160 million. Without cost comparisons, the Government can not be assured that long-term needs for services are being satisfied most advantageously. For three contracts, it was more cost advantageous to use contractors. However, the Army can realize a potential monetary benefit of \$6.3 million through FY 1998 if planned work under an Army Communications-Electronics Command contract valued, at \$36.9 million, is performed by in-house Federal personnel. See Part II for details on the results of our review.

Internal Controls. The Navy did not have adequate internal controls to verify that required cost comparisons were performed when contracting for long-term services. However, we also recognize that DoD managers are under significant pressure and constraints so that DoD can meet the reductions mandated by the Federal Workforce Restructuring Act of 1994. As a result, we have decided to make no recommendations, but reserve the right to revisit this issue in the future. See Part I for a discussion of internal controls reviewed and Part II for details on the internal control weaknesses identified.

Potential Benefits of Audit and Summary of Recommendations. We estimate potential monetary benefits of up to \$6.3 million if work the Army Communications-Electronics Command contracted for through FY 1998 is performed by in-house Army personnel. However, the Federal Workforce Restructuring Act of

1994 has placed workforce constraints on the Federal Government by requiring the Office of Management and Budget to reduce the total Federal workforce by 202,300 full-time equivalent positions by FY 1999. Therefore, opportunities to retain or increase in-house capabilities when shown to be more efficient and cost-effective are limited. Thus, until clarification on opportunities to make manpower adjustments based on cost comparisons is approved, no recommendations are being made.

Management Comments. Because the report contained no recommendations, written comments were not required. However, the Army provided comments. The Army nonconcurred that a cost comparison is necessary, stating that DoD Directive 4205.2, "Acquiring and Managing Contracted Advisory and Assistance Services," February 10, 1992, should be interpreted to mean that, when in-house resources are not available or cannot be obtained in a timely manner, then a cost comparison need not be performed. See Part II for a summary of the Army comments and Part IV for the complete text of the Army comments.

Audit Response. We believe that the report conclusions remain valid. DoD Directive 4205.2 as well as Army Regulation 5-14, "Management of Contracted Advisory and Assistance Services," January 15, 1993, state that, for long-term requirements, a cost comparison shall be performed or a statement shall be provided citing actions taken to hire additional in-house resources or explaining why contracting out is necessary. In addition, the Federal Workforce Restructuring Act of 1994 states that the Government shall not increase the procurement of services to compensate for workforce reductions, except in cases in which a cost comparison demonstrates such contracts would be to the financial advantage of the Government.

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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

Introduction

This report is the second in a series of reports resulting from the audit of DoD use of contracted advisory and assistance services. United States Code, title 31, section 1114(b), requires that the Inspector General, DoD, annually submit a report to Congress on contracted advisory and assistance services along with the agency annual budget justification.

Background

Both the Office of Management and Budget (OMB) and Congress have voiced concerns regarding the use of services contracting, potential abuses related to its use, and the cost-effectiveness of services contracting instead of performing the work using in-house Federal personnel, particularly when the need is long-term.

OMB Comments on Services Contracting. The Director, OMB, stated that services contracting is the fastest growing area of Government procurement. OMB estimated that the Federal Government spent more than \$103 billion on services contracting in FY 1993. The use of services contracting accounts for 53 percent of all Executive Agency procurement spending. Of the \$103 billion in service contract costs, OMB attributed \$61 billion to DoD.

Congressional Comments on Service Contracting. Senator David Pryor initiated reviews over the years that have shown that Federal agencies often use services contracting at a cost that is 25 percent to 40 percent greater than if Federal employees had been used to perform the services. In addition, Senator Pryor has voiced concerns about the need for a means to measure all aspects of the Government workforce for purposes of decisionmaking. To obtain a more realistic picture of the actual size of the workforce employed by the Government, contractor as well as civil service personnel should be measured.

Recent Efforts to Mandate Cost Comparisons. When an evaluation is performed to determine whether to contract for services, the determination should include both cost comparisons and consideration of non-cost factors such as the quality of services, availability of Federal employees, duration and recurring nature of the services needed, and the consistency of workload. The Federal Workforce Restructuring Act of 1994 states that the Government shall not increase the procurement of service contracts to compensate for workforce reductions, except in cases where a cost comparison demonstrates such contracts would be to the financial advantage of the Government. A cost comparison is the method of developing an estimate of the cost of Government performance of a commercial activity and comparing it with the cost to the Government for contractor performance of that activity.

Objectives

The objectives of the overall contracted advisory and assistance services audit were to:

- o evaluate progress that DoD has made in establishing effective management controls and in improving the accuracy and completeness of information reported on contracted advisory and assistance services, and

- o evaluate the extent to which contracted advisory and assistance services have been used by the Military Departments to compensate for DoD staffing shortages.

This report discusses the second audit objective as it applies to the Army and the Navy. We issued Inspector General, DoD, Report No. 94-112, "Procurement of Support Services by the Air Force Electronic Systems Center, Hanscom Air Force Base, Massachusetts," May 27, 1994, that discusses the second objective as it applies to the Air Force Electronic Systems Center. A summary report will address the first objective as it applies to all the Military Departments.

Scope and Methodology

Audit Scope and Methodology. We judgmentally selected for review 4 contracts totaling \$73.8 million from a universe of 14 contracts totaling \$281 million. The 14 contracts were identified during the audit as long-term, recurring contracted advisory and assistance services requirements. Our sample of four contracts included one Army Communications-Electronics Command (CECOM) contract, one Army Missile Command (Missile Command) contract, and two Naval Sea Systems Command contracts.

Follow-on contracts were awarded to each of the four contracts to continue the same services. The total value of the four follow-on contracts, if all options are exercised, is \$160 million. For the remainder of the report, we will only discuss the four follow-on contracts. Table 1 identifies the four follow-on contracts.

Introduction

Table 1. Army and Navy Follow-On Contracts Reviewed

<u>Activity</u>	<u>Contract</u>	<u>Award Date</u>	<u>Value</u>
Army			
CECOM	DAAB07-93-D-A263	Sept. 13, 1993	\$ 36,893,320
Missile Command	DAAH01-94-C-0086	Feb. 3, 1994	9,525,506
Navy			
Naval Sea Systems Command	N00024-94-C-5613	Jan. 10, 1994	89,925,971
Naval Sea Systems Command	N00024-93-C-4082	Jan. 23, 1993	<u>24,008,378</u>
Total			<u>\$160,353,175</u>

For each contract, we reviewed preaward documentation, statements of work, contractor employee qualification requirements, and negotiated rates. We also reviewed task initiatives, invoices, and contract modifications.

We interviewed contracting and program officials at CECOM, Missile Command, and Naval Sea Systems Command. We contacted personnel specialists within the Total Army Personnel Command and the Navy Human Resources Office Crystal City that performed conversions of contractor labor categories to Government equivalents. We interviewed an official from the Office of the Assistant Secretary of Defense (Economic Security) responsible for compliance with OMB Circular A-76 requirements, including cost comparisons. We also interviewed officials from OMB, the General Accounting Office, and the Professional Services Council.

Audit Period and Standards. We performed this economy and efficiency audit from December 1993 through August 1994. We did not use computer-processed data or statistical sampling procedures 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 C.

Internal Controls

Internal Controls Reviewed. We limited our evaluation of the implementation of the DoD Internal Management Control Program to the adequacy of internal controls applicable to the acquisition of contracted advisory and assistance services.

Adequacy of Internal Controls. The Navy did not have procedures in place to verify that cost comparisons were performed when contracting for long-term

services under the four follow-on contracts reviewed, as required by DoD Directive 4205.2, "Acquiring and Managing Contracted Advisory and Assistance Services," February 10, 1992.

Potential Benefits. We did not identify any potential monetary benefits resulting from improved internal controls over the performance of cost-effectiveness analyses. However, when cost comparisons demonstrate a significant cost savings by performing the services in-house, we believe that monetary benefits can be realized. For example, we estimate that CECOM can realize a potential monetary benefit of \$6.3 million, based on a cost comparison, if the option years for contracted services for the contract through FY 1998 are not exercised and if in-house Federal personnel are used to satisfy the requirement.

The Federal Workforce Restructuring Act of 1994 has placed workforce constraints on the Federal Government by requiring OMB to reduce the total Federal workforce by 202,300 full-time equivalent positions by FY 1999. Therefore, until clarification is provided on opportunities to make manpower adjustments based on cost comparisons, we are not making recommendations.

Prior Audits and Other Reviews

The Office of the Inspector General, DoD, issued four reports since 1991 that discussed the acquisition and use of service contracting. In addition, the General Accounting Office, the Air Force Audit Agency, and OMB have issued a total of four reports on the cost-effectiveness of services contracting. See Appendix A for a summary of each prior audit report.

Part II - Results of Review

Cost-Effectiveness of Contracting for Services

For the four follow-on contracts reviewed, the Army and the Navy did not perform cost comparisons as required in the DoD Directive 4205.2. This directive requires program personnel to determine whether performing the services using in-house Federal personnel or contracting for the services was the most efficient and cost-effective means of obtaining the services. Army and Navy program personnel did not perform cost comparisons because they believed that:

- o the organizations lacked sufficient in-house Federal personnel capable of performing the services, and
- o personnel ceilings and staffing cutbacks made hiring in-house Federal personnel impossible, thus rendering cost comparisons useless.

Without cost comparisons, the Government was not assured that long-term needs for services were satisfied in the most efficient and cost-effective way. For example, the Army can realize a potential monetary benefit of \$6.3 million through FY 1998 if planned work under CECOM contract DAAB07-93-D-A263 is performed by in-house Federal personnel.

Background

Policy and Guidance On Contracted Services. Guidance on the procurement of contracted services, and more specifically on the value of contracting for services versus performing requirements using in-house Federal personnel, includes the following.

- o Office of Federal Procurement Policy Letter 93-1, "Management Oversight of Service Contracting," November 19, 1993, establishes Government-wide policy, assigns responsibilities, and provides guidance in managing the acquisition and use of services. The policy letter states that when contracting for services, services must be obtained in the most cost-effective manner, without barriers to full and open competition. The policy, however, does not require that a cost comparison be performed. Provisions from OMB Circular A-120, "Guidelines for the Use of Advisory and Assistance Services," the previous guidance on the use of contracted services, were incorporated into the policy letter.

- o OMB Circular A-76, "Performance of Commercial Activities," August 4, 1983, revision, establishes policy for the performance of commercial activities. The circular is the major vehicle for deciding whether to contract for support services. The circular, which has broad applicability, states that Government performance of a commercial activity is authorized if a cost

comparison demonstrates that the Government can operate the activity on an ongoing basis at an estimated cost lower than the cost of a qualified commercial source. The intent of the circular is to improve productivity and achieve savings, whether by contracting out or by returning the performance of a commercial activity performed under contract to in-house Government sources. OMB A-76, "Cost Comparison Handbook," April 3, 1992, a supplement to the circular, establishes guidance for computing the cost comparison amounts, including identifying specific cost categories to be included in the cost comparison.

- o DoD Directive 4205.2, "Acquiring and Managing Contracted Advisory and Assistance Services," February 10, 1992, revision, identifies procedures for the management, acquisition, and use of contracted advisory and assistance services. The directive requires that, for long-term or continuing requirements, an analysis should be performed to determine whether performing the services in-house or contracting out is the most efficient means of performance. The directive further requires that the requiring organization certify that such services have been reviewed for the most cost-effective or efficient means of accomplishment. In addition, if the requirement is long-term and is being contracted out, but could be more cost-effective if performed by in-house resources, the purchase request package shall include a statement citing action being taken to hire additional in-house resources or an explanation stating why contracting out is necessary.

Performing Cost Comparisons

Cost Comparisons Performed by Army and Navy Organizations. We determined that no cost comparisons were performed for any of the contracts (either the four original contracts or the four follow-on contracts) by either the program offices or by contracting personnel. By not performing cost comparisons, the three DoD organizations did not follow the requirements of DoD Directive 4205.2.

Contracting officials within the requiring organizations stated that no cost comparisons were performed because, even if the comparisons determined that a significant cost savings could be realized by performing the services in-house:

- o the organizations lacked sufficient in-house Federal personnel capable of performing the services, and

- o personnel ceilings and cutbacks precluded their hiring additional in-house personnel to perform the services.

CECOM completed a "Management Decision Document" as part of the procurement request. The document justified contracting for services by stating that limited technical resources were available in-house, and that the urgency and scheduling of completion of the tasks required contracting rather than seeking in-house resources.

Cost-Effectiveness of Contracting for Services

Contracts Reviewed. For purposes of this audit, we limited our cost comparison analysis to the four follow-on contracts. We identified the extent of cost comparisons performed by the requiring organizations, then independently performed comparisons to determine whether contracting for the services was the most efficient and cost-effective means of obtaining the needed services. See Appendix B for a description of the contracts reviewed.

Inspector General, DoD, Cost Comparisons. To determine whether the contracted services obtained under the sampled contracts could be performed more cost-effectively by using in-house Federal personnel, we performed cost analyses on the four follow-on contracts. The methodology used to perform the cost analyses included the application of a formula established by the Air Force Materiel Command to determine equivalent Government salaries. The formula has been used by the Inspector General, DoD, for cost analyses in prior audit reports. Specifically, the Air Force formula applied to Government salaries included the following: equipment, supplies, training, personnel office, secretaries, clerical personnel, administrative, computers, communications, copiers, support organizations, casualty and personnel insurance, water, sewage, trash, real property maintenance, and facilities. In addition to the Air Force methodology, we included other cost factors identified in OMB Circular A-76 cost comparison criteria such as conversion cost, contract administration, fringe benefits, and cost of living adjustments.

To convert contractor costs to comparable in-house Federal personnel costs, we:

- o obtained statements of work and lists of labor categories identified in each contract;
- o provided statements of work and labor category lists for each contract to Army and Navy personnel conversion specialists to facilitate the conversion of each labor category to General Schedule equivalents by personnel classifiers;
- o based on results provided by Army and Navy personnel classifiers, identified equivalent Government salaries using General Schedule salary tables;
- o adjusted equivalent Government salaries for cost of living for each year of contract (beyond 1994) based on criteria identified in OMB Circular A-76 (revised, transmittal memorandum no. 13, March 12, 1994);
- o calculated fully loaded Government salaries by applying a formula established by the Air Force Materiel Command to each straight Government salary plus fringe benefits;
- o determined hourly fully loaded Government rates by dividing fully loaded Government salaries by 2,087 hours in accordance with OMB Circular A-76;

Cost-Effectiveness of Contracting for Services

- o multiplied hours identified in the request for proposals for each labor category by the hourly fully loaded Government rates to determine the fully loaded Government cost to complete each contract if performed by in-house Federal personnel;
- o calculated conversion and contract administration costs; and
- o calculated the difference between contractor costs to perform the services versus cost if performed by in-house Federal personnel.

Results of Application of Methodology. By applying the methodology to the four follow-on contracts sampled, we determined that contracting for the services was more cost-effective for three of the four contracts, and less cost-effective for one of the four contracts. Specifically, Missile Command and Naval Sea Systems Command reduced the costs of operations by approximately \$28.7 million by contracting for \$123.4 million of services. However, CECOM can realize a potential monetary benefit of \$6.3 million on its contract totaling \$36.9 million if options for work through FY 1998 are not exercised and if services currently being obtained by contract are performed by in-house Federal personnel. Table 2 show the results of the cost comparisons for the four follow-on contracts.

<u>Organization</u>	<u>Contract</u>	<u>Cost Avoidance If Work Performed In-House (millions)</u>	<u>By Contractor (millions)</u>
Army			
CECOM	DAAB07-93-D-A263	\$6.3	
Missile Command	DAAH01-94-C-0086		\$ 4.4
Navy			
Naval Sea			
Systems Command	N00024-94-C-5613		17.6
Naval Sea			
Systems Command	N00024-93-C-4082	—	<u>6.7</u>
Total		<u>\$6.3</u>	<u>\$28.7</u>

Prior Inspector General, DoD, Reported Cost Analysis at Hanscom Air Force Base. In May 1994, the Inspector General, DoD, issued Report No. 94-112, "Procurement of Support Services by the Air Force Electronic Systems Center, Hanscom Air Force Base, Massachusetts" (Appendix A). The report identified results of cost-effectiveness analyses performed on eight contracts, totaling \$371 million, at Hanscom Air Force Base. The report stated that the Air Force Electronic Systems Center procured contractor support services that were not as cost-effective as using DoD personnel. The report estimated a potential monetary benefit of up to \$39 million over 5 years if work currently contracted out is performed by in-

house Federal personnel. The Air Force generally agreed with the report recommendations and stated that, if relief is granted from end-strength ceilings, the Air Force would perform formal cost comparisons to substantiate cost savings and would aggressively convert contractor positions to in-house when proven to be more cost-effective.

Impact of Audit Results

We acknowledge that the sample of four follow-on contracts evaluated in this audit is limited. However, we believe that the application of the cost-effectiveness methodology demonstrates that such analyses can be beneficial in determining the most efficient and cost-effective means of acquiring services. In the case of the four follow-on contracts, the methodology verified that DoD should realize a potential monetary benefit by contracting for services under three of the four follow-on contracts. However, had CECOM applied the methodology to the requirement before awarding a contract, DoD could have realized a potential monetary benefit of \$6.3 million if the services could have been provided through in-house Federal personnel. The application of the methodology used for this report, or a similar methodology such as that identified in OMB Circular A-76, can be applied to long-term or recurring services requirements by DoD organizations. The results, along with non-cost factors, can be used as a decision tool to determine how best to use scarce financial and staffing resources. Without cost comparisons, the Government cannot assure that long-term needs for services are accomplished by the most efficient and cost-effective means.

Conclusion

Need for Cost Comparisons. The acquisition of contracted services is a legitimate way to support DoD operations and help managers achieve maximum effectiveness or economy to meet mission requirements. The audit demonstrated that cost comparison analyses can prove worthwhile, given that three out of four contracts reviewed showed that the Government made good choices in contracting out. However, contracting out was less cost-effective for the Army contract reviewed based upon the application of our methodology.

The need for DoD officials to manage funds efficiently and cost-effectively is particularly important now, given increasingly scarce resources and Government workforce reductions. The Federal Workforce Restructuring Act of 1994 requires OMB to reduce the total Federal workforce by 202,300 full-time equivalent positions by FY 1999. To comply with the Federal Workforce Restructuring Act of 1994 mandate, DoD anticipates reducing the DoD civilian workforce by 18 percent by the end of FY 1999. 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.

Prior Recommendations Related to Cost-Effectiveness. In Inspector General, DoD, Report No. 94-112, we recommend that the Under Secretary of Defense for 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 increases in contractor manpower support when shown to be more operationally effective and cost-effective. Such a program should include consideration of "total force requirements," which includes contractor as well as military and DoD civilian personnel, to accurately reflect total personnel costs. In addition, flexibility should be provided so that managers can manage both program dollars and staff dollars to accomplish mission requirements using a combination of in-house Federal personnel and contractor personnel in the most efficient and cost-effective manner. If managers are allowed to manage the total labor workforce, rather than being limited to individual labor categories, they will have greater flexibility to make trade-off decisions to obtain the best mix of in-house Federal and contractor personnel to perform mission requirements.

The Under Secretary of Defense for Personnel and Readiness nonconcurred with our finding and stated that adequate policy already exists regarding the use of contract versus in-house Federal personnel, and that DoD policies governing staffing requirements determination are consistent with the Federal Workforce Restructuring Act of 1994. The Federal Workforce Restructuring Act of 1994 limits services contracts except for cases in which a cost comparison demonstrates that such contracts would be to the financial advantage of the Federal Government.

Impact of Current Guidance

We believe cost reductions can be realized when cost comparisons demonstrate a financial advantage by either contracting or by performing long-term services in-house. The analysis performed on the four follow-on contracts in this report demonstrate the potential advantages of cost comparisons. However, because of the required reduction in manpower in the Federal workforce, and the DoD interpretation of the Federal Workforce Restructuring Act of 1994, opportunities to increase in-house support, even when a financial advantage can be demonstrated, are limited. We are not making any recommendations in this report, until further clarification is provided on opportunities to make manpower adjustments, other than reductions based on cost comparisons.

Management Comments on the Audit Finding and Audit Response

We did not make recommendations in the report, but the Army submitted comments to the finding. See Part IV for the complete text of Army Comments.

Army Comments. The Deputy Under Secretary of the Army (Operations Research) disagreed with the finding that the Army did not perform a cost comparison and that internal controls were not adequate because a cost comparison was not performed by CECOM. The Army comments are based on the Army's interpretation of DoD Directive 4205.2 that cost comparisons are not necessary whenever contracting for services. The Army stated that cost comparisons are not necessary when in-house resources are not available and could not be hired through the normal hiring process. Therefore, for the contracts cited in the audit report, because the Army organizations did not have in-house support available, a cost comparison was not necessary.

Audit Response. We do not agree with the Army interpretation of DoD Directive 4205.2. We agree that when a requirement is necessary in the short term, and in-house resources are not available or cannot be acquired in a timely manner, that contracting for the needed services may be the logical alternative. However, when a need is anticipated to be long-term, the directive specifically states that each procurement request shall include a certification by the requiring activity that such services have been reviewed for the most cost-effective or efficient means of accomplishment. Further, the directive states that, if the requirement is considered long-term and could be more cost-effectively done by in-house resources, a statement shall be included citing actions taken to hire additional resources or an explanation of why contracting out is necessary. In addition, both Army Regulation 5-14, "Management of Contracted Advisory and Assistance Services," January 15, 1993, and the "Guide to Contracted Advisory and Assistance Services," April 3, 1992, require that a cost comparison be performed of in-house versus contracting for services.

The Federal Workforce Restructuring Act of 1994 states that the President will take action to ensure that there is no increase in the use of contracted services unless a cost comparison can prove it to be financially advantageous to the Government. The CECOM contract increased from \$15 million in the original contract to \$36.9 million in the follow-on contract. The Act was passed after CECOM awarded the contract so the Army is not in violation of the Act. We continue to believe a variety of factors need to be considered when deciding whether to contract for services, including avoiding the performance of inherently governmental functions by contractor employees; maintaining a core capability of in-house resources; and considering the length of the requirement, the availability of in-house resources, and the cost-effectiveness. When a requirement is anticipated to be long-term, adequate planning should provide for sufficient time to facilitate hiring in-house resources, if necessary. CECOM included a "Management Decision Document" in the procurement request. The document justified contracting for the needed services because of the urgency of the tasks and because of insufficient in-house technical capability. However,

the 1 year contract with 4 option years, was for the continuation of services being obtained previously under an expiring contract. Therefore, we believe the planning process for the follow-on contract should have included a cost comparison as well as a description of efforts being undertaken to perform the work in-house.

Because the report did not include recommendations, additional management comments are not required. Until further clarification is provided on opportunities to make staffing adjustments, other than reductions, additional recommendations are not worthwhile at this time.

Part III - Additional Information

Appendix A. Prior Audits and Other Reviews

General Accounting Office

Report No. GAO/GGD-94-95, OSD Case Number 96-12, "Government Contractors: Measuring Costs of Service Contractors Versus Federal Employees," March 1994. This report states that cost comparisons can be a useful tool in determining how to acquire services, as shown by the Department of Energy and DoD Inspectors General. In addition to the costs, agencies should be required to look at such factors as whether the services are long or short term and recurrent in nature, the quality and timeliness of services, and the availability of Federal employees to do the work. The report recommended that OMB extend OMB Circular A-76 to include advisory and assistance services and consider non-cost factors. Additionally, OMB should work with Congress to accomplish the administration's objective to downsize, while providing agencies with sufficient authority and flexibility to accomplish the Government's work in the most efficient and effective manner. The Department of Energy and DoD generally agreed with the presentation of the studies and provided suggestions that were incorporated into the report where appropriate. OMB generally agreed with the findings and conclusions.

Report No. GAO/RCED-91-186, "Energy Management: Using Department of Energy Employees Can Reduce Costs for Some Support Services," August 1991. The General Accounting Office reported that 11 of the 12 support services activities reviewed could result in a cost savings of 25 percent or more if the services were performed in-house. For FY 1990, the General Accounting Office estimated that Department of Energy paid \$5 million more for contracting the efforts out. The General Accounting Office determined that most of the contracts reviewed were issued because the Department of Energy lacked sufficient resources to perform the work. The General Accounting Office recommended that the Department of Energy require cost comparisons and use the results to support the requests for additional staff to OMB. Additionally, the General Accounting Office recommended that OMB establish guidance that would be needed to justify the conversions.

Inspector General, DoD

Report No. 94-112, "Procurement of Support Services By the Air Force Electronic Systems Center, Hanscom Air Force Base, Massachusetts," May 27, 1994. This report states that the Air Force Electronic Systems Center procured support services that were not as cost-effective as using DoD personnel, had characteristics of personal services, and placed contractor personnel in the position of potentially performing inherently governmental functions. The

Appendix A. Prior Audits and Other Reviews

Air Force Electronic Systems Center could realize a cost reduction of up to \$39 million over 5 years if work currently contracted for is performed by in-house DoD personnel. Also, the Air Force Electronic Systems Center could realize a cost savings of up to \$26.4 million if contractor rates are adjusted to reflect when Government-furnished facilities are provided for contractor use.

The report recommended that the Under Secretary of Defense for Personnel and Readiness establish a program to manage the DoD civilian workforce that allows for increases to the civilian workforce when it is more cost-effective; 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; Comptroller of the Department of Defense make funds available for expanded in-house support when more cost-effective than contracts; and Under Secretary of the Air Force convert previously authorized contractor positions to in-house and evaluate support contracts for cost-effectiveness.

The Air Force concurred with the recommendations to conduct cost analyses, but nonconcurred with recommendations to lift the suspension on previously approved conversions for contractor positions. The Under Secretary of Defense for Personnel and Readiness did not agree to establish a program to manage the downsizing of the DoD civilian workforce, and the Under Secretary of Defense for Acquisition and Technology stated that DoD Directive 4205.2 already includes appropriate verification and certification procedures.

Because the Federal Workforce Restructuring Act of 1994 requires reductions to the Federal workforce, we believe that opportunities to retain or increase in-house capabilities when shown to be more effective or cost-efficient are limited. Thus, until Congress and the Office of the Secretary of Defense clarify opportunities to make manpower adjustments, we will not pursue additional comments.

Report No. 94-077, "'Super' Scientific, Engineering, and Technical Assistance Contracts at the Ballistic Missile Defense Organization," April 8, 1994. This report states that services acquired through super scientific, engineering, and technical assistance contracts are more costly than using in-house DoD civilian and military employees. The report further states that the Ballistic Missile Defense Organization could reduce costs by about \$46 million for FYs 1995 through 1999 by gradually reducing super scientific, engineering, and technical assistance contract support by 275 staff years. The report recommended that the Ballistic Missile Defense Organization reduce contracted services and use more DoD civilian personnel to accomplish its mission, use completion and fixed-price type contracts, establish additional contract management and cost control procedures, and perform cost realism analyses. Management generally agreed with the recommendations.

Report No. 92-128, "Selected Service Contracts at Wright-Patterson Air Force Base," August 17, 1992. This report states that the Air Force Logistics Management Systems Center issued contracts for program technical and administrative support services that had characteristics of personal service contracts and were not as cost-effective as using in-house DoD personnel.

Appendix A. Prior Audits and Other Reviews

Program officials contracted to obtain personnel support because the necessary expertise was not available in-house, and personnel freezes prohibited the hiring of DoD civilian employees. The audit estimated that in FY 1990, the Air Force paid an additional \$4.7 million for contractor work and could save up to \$6.2 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, evaluate support service contracts for cost-effectiveness, make budget adjustments to shift funds from contracts to civilian staff, and terminate a contract with 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. The Air Force did not agree to terminate the option for the IMPACT Corporation contract and did not agree with the potential monetary benefits. In followup to the report, the Air Force agreed to take actions to comply with the recommendations.

Report No. 91-115, "Consulting Services Contracts for Operational and Test Evaluation," August 22, 1991. This 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, 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.

The recommendations to replace service contractors with DoD civilian personnel were referred to the Deputy Secretary of Defense for resolution. In an April 1992 memorandum, the Deputy Secretary of Defense directed that the Assistant Secretary of Defense (Force Management and Personnel) perform a review of the use of civilian employees and contractor support in DoD and provide recommendations by July 1, 1992. The review was never completed and recommendations were not provided to the Deputy Secretary of Defense.

Air Force Audit Agency

Project No. 94064002, "Cost-Effectiveness of Contracted Advisory and Assistance Services at Space and Missile Systems Center," June 9, 1994. The report states that the Space and Missile Systems Center was planning to renew three contracts in June 1994 with an estimated value of \$93 million over 5 years. However, Government personnel could perform the same work at a \$42 million savings. The report recommended that the Air Force replace contractor personnel with Government employees to accomplish the work in-house. Management agreed with the conclusions and recommendations. However, they were unable to implement immediate corrective action because of the current downsizing initiatives.

Office of Management and Budget

OMB/Office of Federal Procurement Policy, "Summary Report of Agencies' Service Contracting Practices," January 1994. This report summarizes the findings of 17 Government agencies. The purpose of the review was to determine whether service contracts were accomplishing what was intended, whether service contracts were cost-effective, and whether inherently governmental functions were being performed. Many agencies found that improvements were needed to ensure that the Government was getting its money's worth from service contractors. OMB attributed the problems to factors such as the requirements of Government to do more with less staff, contract administration functions being performed by untrained personnel, a cumbersome contracting process, and agencies not performing independent cost estimates. OMB also reported that cost analyses are not being performed because the assumption is that additional Government personnel will not be authorized, and statements of work are being written broadly, thus causing limited competition and an inability to assess contractor performance. The report states that Office of Federal Procurement Policy will issue guidance to alleviate the problems.

Appendix B. Contracts Reviewed

Missile Command Contract. On June 1, 1990, Missile Command awarded a 3-year, time-and-materials contract totaling \$22 million to CAS, Incorporated, for services including cost analysis, program analysis and evaluation, program management, risk assessment and analysis, systems analysis, and operation research support services. The original contract included 1 base year and 2 option years. In February 1994, Missile Command awarded contract DAAH01-94-C-0086, which was a cost-plus-award-fee contract, for the continuation of the same services to Coleman Research Corporation. The follow-on contract is for 3 years for an estimated cost of \$9.5 million. The prime contractor is a small set-aside business, which is subcontracting part of the work to five other contractors.

CECOM Contract. On June 30, 1990, CECOM awarded a time-and-materials contract totaling \$15 million for advisory services related to alternative telecommunications and satellite systems configurations; the identification and procurement of telecommunications and satellite equipment; communications support; and operation and maintenance, logistic support, program administration, installation, and related telecommunication and satellite support services to Technical and Management Services Corporation through the Small Business Administration. The contract was for 1 year with 4 option years. The contract reached its ceiling before all options could be exercised. On September 13, 1993, CECOM awarded contract DAAB07-93-D-A263 for the continuation of the same services to Technical and Management Services Corporation through the Small Business Administration. The follow-on contract is a time-and-materials contract for 1 base year and 4 option years. Estimated ceiling price of the contract is \$36.9 million.

Naval Sea Systems Command Contracts. We reviewed two Naval Sea Systems Command contracts as follows:

Navy Contract N00024-93-C-4082. On July 19, 1985, Naval Sea Systems Command awarded a cost-plus-fixed-fee contract totaling \$16.3 million to Research Analysis and Management Corporation for program documentation development, program information development and operational support, project planning and control support, training support, developing methodologies, ship design management support, database support, and automatic data processing program documentation development support. The contract was for 1 year with 2 option years. On January 21, 1993, Naval Sea Systems Command awarded contract N00024-93-C-4082, which was a cost-plus-fixed-fee follow-on contract, for the continuation of the same services to ROH, Incorporated. The estimated cost of the follow-on contract is \$24 million. The prime contractor is subcontracting part of the work to five other contractors.

Navy Contract N00024-94-C-5613. On January 16, 1987, Naval Sea Systems Command awarded a 3-year, cost-plus-award-fee contract totaling \$20.5 million to RCA Service Company for management support services for performance of overhaul requirements evaluations; tests and evaluations;

developing or evaluation of functional data requirements; program management plans; analysis and assessment of the status plans, schedules, and activities; development of management support tools; and conduct of risk analyses and feasibility evaluations. In January 1994, Naval Sea Systems Command awarded contract N00024-94-C-5613, a cost-plus-fixed-fee follow-on contract, for the continuation of the same services to American Systems Corporation. The contract is for 1 year with 4 option years, totaling \$90 million. The prime contractor is subcontracting part of the work to two other contractors.

Appendix C. Organizations Visited or Contacted

Office of the Secretary of Defense

Assistant Secretary of Defense (Economic Security), Washington, D.C.

Department of the Army

Total Army Personnel Command, Alexandria, VA
Army Communication-Electronics Command, Fort Monmouth, NJ
Army Missile Command, Huntsville, AL

Department of the Navy

Naval Sea Systems Command, Arlington, VA
Human Resources Center, Arlington, VA

Non-Defense Federal Organizations

General Accounting Office, Washington, D.C.
Office of Management and Budget, Washington, D.C.

Non-Government Organizations

Professional Services Council, Vienna, VA

Appendix D. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

Secretary of the Army
Assistant Secretary of the Army (Manpower and Reserve Affairs)
Deputy Under Secretary of the Army (Operations Research)
Commander, Total Army Personnel Command
Commander, Army Materiel Command
 Commander, Army Communications-Electronics Command
 Commander, Army Missile Command
Auditor General, Department of the Army

Department of the Navy

Secretary of the Navy
Assistant Secretary of the Navy (Financial Management)
Assistant Secretary of the Navy (Manpower and Reserve Affairs)
Comptroller of the Navy
Commander, Naval Sea Systems Command
 Director, Human Resources Center
Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
Director, National Security Agency

Appendix D. Report Distribution

Defense Organizations (cont'd)

Inspector General, Central Imagery Office
Inspector General, Defense Intelligence Agency
Inspector General, National Security Agency
Director, Defense Logistics Studies Information Exchange

Non-Defense Federal Organization

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

Part IV - Management Comments

Department of the Army Comments



DEPARTMENT OF THE ARMY
OFFICE OF THE UNDER SECRETARY
WASHINGTON, D.C. 20310-0102

November 28, 1994



SAUS-OR

MEMORANDUM FOR DOD INSPECTOR GENERAL, DIRECTOR CONTRACT
MANAGEMENT DIRECTORATE

SUBJECT: Comments on the Draft Audit Report on the Cost Effectiveness of
Contracting for Services (Project No. 2CH-3003.02)

After a careful review of the Draft Audit Report and analysis of the procedures taken by the Army activities obtaining the contractor support identified in the Draft Audit, the Army believes that the findings in the report are inaccurate. There appear to be two relevant points being made by the auditors. First, that the Army did not perform cost comparisons, as required by the current version of DoD Directive 4205.2, to determine whether or not in-house or contracting out is the most efficient way to obtain needed services. Second, that the Army did not have adequate internal controls to verify that cost comparisons were performed when contracting out for long term services received, also required by the current version of DoD Directive 4205.2. Both of these points rest on the interpretation that a cost comparison is necessary whenever a contract for services is considered. Based on discussions with the individual responsible for developing and implementing the current version of the DoD Directive, this is an inaccurate interpretation.

When the DoD Directive 4205.2 was written, a requirement to determine whether in-house support was available currently or could be obtained through the personnel process was included. If there were no in-house resources currently available and none could be hired through the normal hiring process then contractor support was the only alternative. If that were the case then performing a cost comparison was not necessary and would be deemed an unnecessary impediment to the accomplishment of the work required. Discussions with the individual responsible for the development of the current DoD Directive 4205.2 confirm that that is the correct interpretation of the intent of the Directive. In cases where in-house support was available or could be obtained through the personnel process a cost comparison would be necessary if contracting out for the service were to be considered. Neither of the organizations contracting for support and cited in the audit had in-house support either immediately available or available through the hiring process. Contracting out was the only alternative available, as noted above. No cost comparison was required.

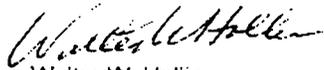
Department of the Army Comments

SAUS-OR

November 28, 1994

SUBJECT: Comments on the Draft Audit Report on the Cost Effectiveness of Contracting for Services (Project No. 2CH-3003.02)

The internal controls within the Army Regulation 5-14, dated 15 January 1993 require that the sponsoring organization determine the availability of in-house support and/or the ability of the personnel process to obtain additional in-house support to perform the service. If in-house support is available or can be obtained then the Army Regulation 5-14 requires the sponsor to compare the cost and benefits of in-house performance with those anticipated for contract performance. The accomplishment of these actions is included in the approval of the Management Decision Document (MDD) which is signed by a General Officer or Senior Executive Service member. These internal controls are fully in accordance with the specified guidance and intent of the DoD Directive 4205.2. Additionally, the Army Regulation was reviewed by the DoD Director for Contracted Advisory and Assistance Services (CAAS) prior to its publication and approved as meeting all the requirements of the Directive.



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