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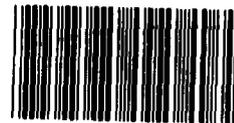


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DECEMBER 4, 1980

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B-200614



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The Honorable Herbert E. Harris II
Chairman, Subcommittee on Human Resources
Committee on Post Office and Civil Service
House of Representatives

The Honorable Benjamin A. Gilman
House of Representatives

Subject: [Contracting Out of Selected In-House
Commercial and Industrial-Type Activities
at the U.S. Military Academy, West Point,
New York] (PSAD-81-4)

In your May 27, 1980, letter, you asked that we audit the costs of performing four functions with in-house personnel and by contract. The functions are: custodial services, laundry and drycleaning, and refuse collection at the U.S. Military Academy (USMA) and maintenance services at the Stewart Army Subpost (STAS). The maintenance services at STAS had been contracted out for over a year, and the other three functions at USMA are being contracted out after cost comparisons were made in accordance with the Office of Management and Budget's (OMB's) Circular A-76.

We found that the actual first year savings at STAS exceeded the cost comparison estimated savings, and the laundry and drycleaning contract and refuse contract will result in sufficient savings to justify contracting out. However, the custodial services cost comparison, adjusted by our findings, indicates that contracting out will not generate sufficient savings to meet the minimum OMB requirements. OMB requires that before an in-house activity can be converted to contractor performance, the savings from contracting must at least equal 10 percent of the estimated Government personnel costs. Because some of the custodial service cost estimates involve proprietary information, they have not been included in this report, but will be provided to you in a separate letter (PSAD-81-4(A)).

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In performing our audit, we considered the appeals submitted by the American Federation of Governmental Employees (AFGE) and the Federal Managers Association (FMA) on the custodial services, laundry and drycleaning, and refuse contracts and did a followup review of the contract at STAS comparing the original cost estimate with the actual first year experience. The review work on the custodial services, laundry and drycleaning, and refuse collection contracts was performed at USMA, West Point, New York, and the review of the STAS contract was performed at USMA and STAS. Our work on the custodial services and laundry and drycleaning functions involved reviewing the cost comparisons, the OMB A-76 procedures, and the USMA's position on the AFGE and FMA appeal issues. Our work on the STAS contract involved reviewing the cost comparison prepared by USMA after the first year, verifying the actual contract costs, and meeting with members of the contract administration team and the contractor's management team at STAS. We did not verify the USMA estimate of first year costs for in-house performance at STAS because of time constraints. However, we had reviewed the original estimate prepared under the old A-76 guidance and noted that the current estimate could have been even higher under the current A-76 guidance, thereby increasing the savings by contracting out. Because of limited time, our review work on the refuse contract was limited to determining what impact the appeal issues would have on the decision to contract out. Meetings were held with AFGE and FMA representatives on all the cost comparisons to further clarify the issues.

The following discussion focuses on the Army's treatment of certain elements in the cost comparison for custodial services which we find questionable. These relate to the proposed contract price, contract administration, and other adjustments which result from a change in these elements. Enclosure I presents a comparison of the Army's and our cost estimates for custodial services, exclusive of proprietary data. Enclosures II through IV present our analysis of the cost comparison for laundry and drycleaning, the RCA contract at STAS (comparison of estimated and actual first year costs), and refuse collection.

PROPOSED CONTRACT PRICE

The proposed contract price is understated because an outdated Department of Labor (DOL) wage determination was supplied to the offerors. If the offerors had been supplied with the appropriate wage determination, the proposed prices could have increased considerably.

In May 1979 the USMA Purchase and Contracting Division requested a wage determination from DOL for custodial services to begin at USMA in January 1980. DOL responded that the minimum hourly wage that could be paid as of February 2, 1979, was \$4.11. After the USMA's request for the wage determination, the solicitation and performance dates slipped to December 1979 and August 1980, respectively. Despite these changes, the Purchase and Contracting Division did not ask for a new wage determination and advised offerors that the appropriate wage determination should be \$4.11 an hour.

We questioned the DOL official who made the wage determination used by USMA. He said that if the performance date supplied by the requestor to DOL is over a year from the last wage determination, the requestor will usually be provided with a new determination. In this case, performance was planned for 18 months after the last wage determination. The official went on to say that if USMA had asked for a new wage determination for a December 1979 solicitation and an August 1980 performance date, DOL would have given them a wage determination of \$4.65 an hour. We have concluded that the use of a new wage rate could have increased the offerors' prices considerably.

We cannot assume, however, that a new wage rate would affect all offerors equally. It may well be that some offerors were already paying wages at or above those in the new determination so that the price would not have increased at all. Thus, it is possible that the proposed contract, if amended to reflect the higher wage rate, would no longer represent the most favorable price to the Government.

CONTRACT ADMINISTRATION

The cost of contract administration was understated by \$71,157 because at the time that USMA prepared the cost comparison, 4 percent of the contract price was used to calculate the cost instead of the actual expected cost of contract administration.

Chapter I, paragraph D of the OMB Cost Comparison Handbook, which implements the cost comparison principles contained in OMB Circular A-76, requires that cost comparisons:

"* * * be aimed at full cost, to the maximum extent practical in all cases. All significant Government

costs * * * must be considered, both for direct Government performance and for administration of a contract."

We found that USMA had done considerable work to establish a staffing level of six positions as necessary to support the contract administration function before completion of the cost comparison. With this information, USMA could have easily calculated the actual cost of these positions. Instead, it used 4 percent of the proposed contract price, or \$46,905, to reflect the actual cost of contract administration. While use of the 4-percent estimate is permitted by the OMB Cost Comparison Handbook, we think it more reasonable to use actual costs when they can be calculated. Therefore, we concluded that USMA should have used \$118,062 as the cost of contract administration which includes \$116,488 for six contract inspectors and \$1,574 for transportation cost.

OTHER ADJUSTMENTS

As a result of the above changes, other adjustments to the cost of contracting out would be necessary. Two cost elements were affected: general and administrative expense increased \$5,081 and the additions and deductions to contracting out decreased.

The general and administrative expense is computed by applying the appropriate general and administrative rate (7.14 percent) to the costs of contract administration and Government-furnished property. Therefore, the adjustment to contract administration increased the general and administrative expense by \$5,081.

The second adjustment resulted in a decrease in the contracting out estimate to reflect the potential increase in Federal income tax revenues that is expected to occur as a result of the increased contract price. The logic is that a portion of any increase to the contractor's price will be returned to the Government through increased income tax revenues, and therefore, the net cost to the Government of increases in the contractor's price is somewhat less than the actual increase.

RECOMMENDATIONS

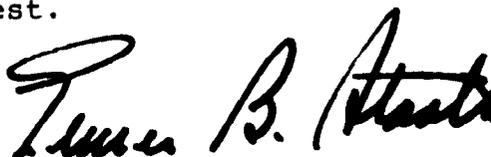
The Secretary of the Army should direct USMA to (1) cancel the request for proposals for custodial services since it does not contain the appropriate wage determination, (2) resolicit the requirement using a current DOL wage

determination, and (3) prepare an updated cost comparison which uses the actual expected cost of contract administration.

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At your request, we did not obtain agency comments.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 5 days from the date of the report. At that time we will send copies to the Secretaries of the Army and Defense and other interested parties and make copies available to others upon request.



Comptroller General
of the United States

Enclosures - 4

CUSTODIAL SERVICES--
COMPARISON OF ARMY
AND GAO COST ESTIMATES

<u>Cost element</u>	<u>Annual costs</u>		
	<u>Army</u>	<u>GAO</u>	<u>Difference</u>
Contracting out:			
Contract price	\$1,172,622	\$ (a)	\$ -
Contract administration	46,905	b/118,062	71,157
Government-furnished property	44,921	44,921	-
General & administrative (G&A) expense	6,556	11,637	5,081
Additions and deductions to contracting out performance	<u>48,320</u>	<u>(a)</u>	<u>-</u>
Total	<u>1,319,324</u>		
In-house performance:			
Direct material	58,522	58,522	-
Material overhead	8,603	8,603	-
Direct labor	1,003,726	1,003,726	-
Fringe benefits on direct labor	260,969	260,969	-
Operations overhead	179,237	179,237	-
G&A expense	107,889	107,889	-
Additions and deductions to in-house performance	<u>4,219</u>	<u>4,219</u>	<u>-</u>
Total	<u>1,623,165</u>	<u>\$1,623,165</u>	
Annual savings or loss (-) from contracting out	<u>\$ 303,841</u>	(c)	

a/GAO did not include its adjustments and final costs for these items because of proprietary data that could compromise the bidders' positions.

b/Includes \$116,488 for six contract inspectors and \$1,574 for transportation cost.

c/GAO's estimated savings are less than the 10 percent required by the Office of Management and Budget (OMB) to justify contracting out.

LAUNDRY AND DRYCLEANING--COMPARISON OF ARMY
AND GAO COST ESTIMATES

<u>Cost element</u>	<u>Costs</u>		
	<u>Army</u>	<u>GAO</u>	<u>Difference</u>
Contracting out:			
Contract price	\$2,983,015	\$2,983,015	\$ -
Contract administration	119,320	183,735	64,415
Government-furnished property	1,018,404	1,018,404	-
G & A expense	81,233	85,832	4,599
Additions and deductions to contracting out performance	<u>742,698</u>	<u>751,203</u>	<u>8,505</u>
Total	<u>4,944,670</u>	<u>5,022,189</u>	<u>77,519</u>
In-house performance:			
Direct material	453,837	453,837	-
Material overhead	66,714	66,714	-
Direct labor	2,952,927	2,952,927	-
Fringe benefits on direct labor	591,753	591,753	-
Operations overhead	2,111,295	2,111,295	-
G & A expense	441,003	441,003	-
Inflation	269,113	77,096	-192,017
Additions and deductions to in-house performance	<u>436,233</u>	<u>436,233</u>	<u>-</u>
Total	<u>\$7,322,875</u>	<u>\$7,130,858</u>	<u>\$-192,017</u>
Savings or loss (-) from contracting out (note a)	<u>\$2,378,205</u>	<u>\$2,108,669</u>	

a/The minimum cost differential for conversion is \$482,124 and is equal to 10 percent of the estimated Government personnel costs for direct and indirect labor included in the above in-house cost elements. The cost differential was established by OMB as a margin which must be exceeded in savings before converting an in-house activity to contract performance.

LAUNDRY AND DRYCLEANING

We reviewed the U.S. Military Academy's (USMA's) 3-year cost comparison, supporting documents, and the American Federation of Government Employees (AFGE) Appeal. Based on our review, adjustments were made to the costs of contracting out and the in-house estimate, but these adjustments would not change the decision to contract out.

We adjusted contract costs by \$77,519 as follows:

- Contract administration was increased by \$64,415 to reflect USMA's projected need of three personnel to administer the contract.
- G&A expense was increased by \$4,599 to reflect the above increase in contract administration costs. G&A expense is based on a computed percentage of contract administration and Government-furnished property costs.
- Additions and Deductions to contracting out performance was increased by \$8,505 to add in the G&A costs that should have been applied to the one-time conversion costs.

Total contract operations for 3 years is estimated to cost the Government \$5,022,189 rather than the \$4,944,670 used in the USMA cost comparison.

The in-house estimate was decreased by \$192,017 to subtract out the inflation factor applied to the in-house personnel costs for the second and third years of the comparison. The adjustment was made based on Department of the Army guidance issued 5 weeks before the cost comparison was prepared but after the in-house estimate was completed.

In-house estimated costs now total \$7,130,858 rather than the \$7,322,875 used in the USMA cost comparison. The 3-year savings resulting from contracting out is estimated at \$2,108,669.

RCA CONTRACT AT THE
STEWART ARMY SUBPOST--
COMPARISON OF ESTIMATED
AND ACTUAL FIRST YEAR COSTS

<u>Cost element</u>	<u>Estimated</u> (note a)	<u>Annual costs</u>	
		<u>Actual</u>	<u>Difference</u>
Contracting out:			
Contract price	\$466,347	\$ 488,427	\$ 22,080
Contract administration	142,541	141,681	-860
Materials & supplies	b/131,396	167,632	36,236
Other costs	<u>13,800</u>	<u>13,800</u>	<u>-</u>
Total	<u>754,084</u>	<u>811,540</u>	<u>57,456</u>
<u>Estimated</u>			
In-house performance:			
Military personnel services	26,571	26,659	88
Civilian personnel services	696,353	762,418	66,065
Materials & supplies	131,396	c/167,632	36,236
Overhead costs	27,149	27,527	378
Other costs	<u>28,807</u>	<u>31,572</u>	<u>2,765</u>
Total	<u>910,276</u>	<u>1,015,808</u>	<u>\$105,532</u>
Annual savings or loss			
(-) from contracting out	<u>\$156,192</u>	<u>\$ 204,268</u>	

a/GAO's original estimate less \$31,925 from the contract price for job corps employees that did not materialize.

b/In-house estimate applied to contractor's costs.

c/Contractor's actual cost applied to in-house costs.

RCA CONTRACT AT STEWART ARMY SUBPOST

We were asked to examine the RCA contract at the Stewart Army Subpost (STAS) and compare its first year actual costs with the estimates used in the original USMA cost comparison. We reviewed the original USMA cost comparison, our briefing paper prepared on the original cost comparison, the cost comparison prepared by USMA after the first year, and supporting documents provided by USMA's Comptroller's Office and the contract administration team at STAS. The contracting out figures are the actual expenses for the first year while the in-house figures are USMA's estimated in-house costs. While the contracting costs increased \$57,456 over the original estimate, the first year savings were \$204,268 as opposed to the original \$156,192 estimate.

The increases in the contracting out estimated and actual figures are accounted for as follows:

- Contract price was increased by \$22,080 due to an increased scope of activities covered under the contract.
- Materials and supplies were increased by \$36,236 because of a higher priority placed on maintenance activities at STAS and the larger number of work orders completed by the contractor.

We believe that the actual first year savings are understated because the in-house figures were prepared using Army Regulation 235-5 guidance instead of the OMB A-76 handbook. If the A-76 handbook had been used, the in-house costs and resulting contracting out savings would have been greater because of higher in-house fringe benefit rates and more sophisticated in-house cost allocation formulas required by the handbook.

REFUSE COLLECTION--COMPARISON OF ARMYCOST ESTIMATE TO AFGE APPEAL ISSUES (note a)

<u>Cost element</u>	<u>Costs</u>		
	<u>Army</u>	<u>AFGE appeal issues</u>	<u>Army estimates adjusted for AFGE appeal issues</u>
Contracting out:			
Contract price	\$295,200	\$ -	\$295,200
Contract administration	11,808	14,000	25,808
Government-furnished property	790	-	790
G&A expense	900	49	949
Additions and deductions to contracting out performance	<u>36,588</u>	<u>153,000</u>	<u>189,588</u>
Total	<u>345,286</u>	<u>167,049</u>	<u>512,335</u>
In-house performance:			
Direct material	14,718	-1,068	13,650
Material overhead	2,163	-230	1,933
Direct labor	263,043	-5,618	257,425
Fringe benefits on direct labor	68,391	-1,461	66,930
Operations overhead	430,968	-43,145	387,823
G&A expense	55,641	-18,199	37,442
Inflation	15,186	-	15,186
Additions and deductions to in-house performance	<u>12,048</u>	<u>-3,000</u>	<u>9,048</u>
Total	<u>\$862,158</u>	<u>\$-72,721</u>	<u>\$789,437</u>
Savings or loss (-) from contracting out (note b)	<u>\$516,872</u>		<u>\$277,102</u>

a/The purpose of this enclosure is to illustrate that all AFGE issues, if accepted, would not reverse the decision to contract out. Time restrictions did not allow us to render an opinion on the validity of the issues.

b/The minimum cost differential for conversion is \$49,638. This is equal to 10 percent of the estimated Government personnel costs for direct and indirect labor included in the above in-house cost elements. The cost differential was established by OMB as a margin which must be exceeded in savings before converting an in-house activity to contract performance.

REFUSE COLLECTION

Because of time restrictions, we were unable to render an opinion on the validity of AFGE appeal issues; however, we did analyze their dollar impact to find out what effect they could have on the contracting out decision. We found that if all AFGE issues were accepted, it would still not reverse the decision to contract out. Adjusting the in-house and contracting out estimates by the AFGE issues showed that total contract operations for 3 years would total \$512,335 as opposed to \$789,437 for in-house operations; therefore, contracting out would still result in significant savings.

We did examine the largest AFGE appeal issue--a \$100,000 increase in the contractor's price for the use of USMA equipment. The contractor bid the contract under both the Government Owned, Contractor Operated option and the Contractor Owned, Contractor Operated option. USMA chose to negotiate with the contractor under the Contractor Owned, Contractor Operated option since it was more advantageous to the Government. The AFGE appeal issue was based on the erroneous assumption that the contractor was selected under the Government Owned, Contractor Operated option.

