



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

National Security and
International Affairs Division

B-257959

July 28, 1994

The Honorable Earl Hutto
Chairman, Subcommittee on Readiness
Committee on Armed Services
House of Representatives

Dear Mr. Chairman:

At your request, we have reviewed a May 19, 1994 industry group letter (see encl. 1) commenting on our recent testimony, Depot Maintenance: Issues in Allocating Workload Between the Public and Private Sectors (GAO/T-NSIAD-94-161, Apr. 12, 1994). The industry group letter basically takes issue with our findings and conclusions. To help clarify the record, this letter addresses the major thrusts of the industry group letter--depot maintenance workload mix between the public and private sectors, the use of public-private competition as an allocation tool, and cost comparability between the public and private sectors.

DEPOT MAINTENANCE WORKLOAD MIX BETWEEN
THE PUBLIC AND PRIVATE SECTORS

The industry group letter stated that our testimony suggested "the private sector is receiving more than its 'share' of depot work." While our testimony stated that previous reports of workload mix between the public and private sectors understates the portion of funding going to the private sector, we did not state or imply that the private sector was receiving more than its share. We believe it is important to point out, however, the law controlling depot maintenance work does not provide that the private sector is guaranteed a percentage share of the depot work. There is no industry entitlement to a minimum share.

Current law limits the amount of depot maintenance work that the Department of Defense (DOD) may contract out to the private sector. Section 2466(a) of title 10, U.S. Code, requires that DOD not contract for performance by non-federal government personnel for more than 40 percent of the depot-level workload. The statute also requires that not

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less than 50 percent of the Army's aviation depot-level maintenance workload for fiscal year 1993, 55 percent for fiscal year 1994, and 60 percent for fiscal year 1995 be performed by DOD employees.

Our testimony noted that in recent years, statistics reported by DOD indicate that the mix of funding between the public and private sectors was 65 percent and 35 percent, respectively, and the amount of funding going to the private sector is much higher than reported. Because the data DOD used to derive the percentages it reported was not collected and reported uniformly by the services, a precise figure is not available. A range of estimates is possible depending upon what data is included or excluded from the calculation. Nevertheless, based on the evidence that is available, it appears that at least half of the depot maintenance funding currently goes to the private sector.

The industry group letter stated that the services have reported public-private workshares in terms of direct labor hours, not dollars, as indicated in our testimony. The industry assertion is incorrect. The services do not keep track of the number of hours associated with depot maintenance contracts awarded to the private sector. DOD has used dollar comparisons in its report to Congress regarding the depot-level maintenance workload, including that accomplished in DOD depots and in the private sector. The point in our testimony was that the dollar comparisons previously reported by DOD did not fully capture the total dollars spent in the private sector.

According to the "Report on Depot-Level Maintenance Performed By Employees of the Federal Government" DOD submitted to Congress on April 26, 1994, a new baseline was established--identical to the one used by the Defense Science Board Task Force on Depot Maintenance Management¹ to generate their statistics concerning the distribution of depot-level maintenance workloads between the public and private sectors. The Department recognized in this report

¹The Defense Science Board Task Force on Depot Maintenance Management was established to assess the overall performance and management of depot-level activities of the Department of Defense. The task force consisted of a large group of senior representatives from both industry and government. The Deputy Secretary of Defense submitted the task force report to Congress on April 7, 1994. The task force recommended eliminating the public-private competition program.

that a different baseline was used to develop workload allocation distributions than had been used in the past. For example, data portrayed in the report pertained to actual program execution rather than projected budget. Further, the data included costs associated with the performance of depot-level maintenance workload, regardless of the funding source (for example, operation and maintenance or procurement). The new "60-40" computation did not change the manner in which parts and material were captured. The cost of material and parts were included in the data pertaining to workload accomplished by DOD employees, even though those parts were procured from the private sector. At the same time, the purchase of reparable parts provided by the public sector (parts that were procured by the public sector from the private sector and furnished to maintenance contractors) were not included in the workload costs for the private sector.

We continue to believe there are alternative ways of collecting and reporting the depot maintenance workload data that would present a more valid workload comparison. For example, the cost of parts and materials could be excluded from the reported data for both the public and private sector. According to DOD officials, the cost of parts and material comprise about 30 percent of the total value of depot maintenance workload. Thus, including these costs as part of the data reported for public sector depot maintenance workload, while not including these same costs as part of the data reported for the private sector, distorts the public-private sector workload comparison. As we indicated in our April 12 testimony, if costs for reparable parts were excluded from the depot maintenance comparison in the Air Force, about 43 percent of the \$4.3 billion spent by the Air Force Material Command in fiscal year 1993 went to public sector depots while 57 percent went to the private sector.

The House version of the fiscal year 1995 Department of Defense Authorization Bill contains a provision which, if enacted, would direct DOD to change the way it computes and reports the percentage of depot maintenance funds provided to the public and private sectors. The change would require DOD to include in the private sector portion those funds used by public depots to purchase materials and parts. If this requirement were approved by the Congress and if the "60-40" public-private workload split continues to be a congressional requirement, the proportion of workload accomplished in public depots would have to be significantly increased to comply with the legislation.

Air Force officials told us that using the same methodology proposed by the House Armed Services Committee for calculating the public-private sector mix, the public sector's current share of Air Force depot maintenance workload would be about 33 percent versus the 64-percent share previously reported. Army officials said they have not made such a comparison. However, they agreed that, as we previously reported, about 58 percent of the Army's 1993 depot maintenance expenditures were spent in the private sector if purchases of parts and material are included in the private sector's share. Previously reported statistics indicated that in fiscal year 1993, about 31 percent of the Army's depot-level maintenance expenditures were spent in the private sector.

PUBLIC-PRIVATE COMPETITION AS A TOOL FOR
ALLOCATING DEPOT MAINTENANCE WORKLOAD

The industry group letter stated that our testimony suggested that public-private competition offers a solution to lowering maintenance outlays without significant reductions in overhead. On the contrary, our testimony fully recognized the need to reduce depot maintenance excess capacity. We stated that even after planned depot closures resulting from prior Base Closure and Realignment decisions, there will still be excess capacity in the public sector. We noted also that there is excess capacity in the private sector.

We stated that while we had concerns about program implementation and while the amount of competition savings is difficult to quantify, the public-private competition program has helped reduce depot maintenance costs. We also noted our agreement with some of the depot maintenance task force concerns about the department's implementation of public-private competition. On the other hand, while we recognize that improvements are needed in DOD's implementation of the public-private competition program, we do not believe there is sufficient evidence to support eliminating the option of competing depot maintenance workload between the public and private sectors.

Our point is that cost-effective decisions should be made when allocating available workload between the public and private sectors, and competition is one option that can help do this. Using some form of cost analysis as a basis for determining if it is more efficient to accomplish various government tasks or functions in government facilities or by contracting with the private sector has been a generally-accepted public policy for many years.

Based on results to date of our review of the public-private competition program, we continue to believe that the program has resulted in streamlining maintenance processes and procedures in the public depots and has reduced depot maintenance costs. Likewise, we found that as a result of competition with public depots, some private contractors reduced the price to the government for performing contract maintenance activities. For example, as a result of a public-private competition for a maintenance workload that had been contracted out for many years, a private contractor reduced its price about 55 percent below the price it had previously charged the government for the same work.

The industry letter noted that "no explanation [was] offered for why the Air Force was able to significantly underbid the Navy for stripping and painting F/A-18 aircraft, a weapon system and workload with which the Navy is, presumably, quite familiar." In reviewing the Air Force depot's F/A-18 proposal, we found that the number of hours proposed for this task was supported by historical data for similar fighter aircraft. According to Air Force officials, maintenance workers at this depot have stripped and painted about 1,000 fighter aircraft over the past 10 years.

Our analysis of the historical data corroborated the Air Force's position that the acquisition of robotic plastic media blast paint removal equipment had significantly reduced the time required to strip paint from an aircraft. We found that the chemical stripping procedure used by the Navy F/A-18 depot was a more labor intensive procedure. However, as noted in the industry group letter as well as in our testimony, an evaluation of any competition program is incomplete until performance data is available to determine if a winning public depot performs the work for the bid price. Limited performance data is currently available on which to assess the ability of the Air Force to accomplish this work for the number of hours proposed. However, records maintained by the performing work center indicate that paint removal for the first 10 aircraft was accomplished with about 6 percent fewer direct labor hours than estimated for this task in the Air Force proposal.

The industry group letter also noted that our testimony did not comment on whether Air Force competition bids appropriately account for productivity enhancing capital equipment, such as the plastic media blast equipment. In the past, GAO and the Air Force Audit Agency have reported that the Air Force did not completely and accurately account for capital costs. However, the Air Force Materiel Command has initiated action to improve the accuracy and

completeness of its reporting of capital costs. With regard to its accounting for capital assets in the Air Force depot's F/A-18 proposal, records indicate that the proposal included (1) depreciation expenses for most capital assets and (2) a cost comparability adjustment to account for depreciation expenses for assets that were not depreciated. We are continuing to monitor Air Force efforts to resolve previously reported problems in this area.

PUBLIC-PRIVATE COMPARABILITY ISSUES

The industry group letter stated that our testimony suggested that "public-private cost comparability issues related to depot maintenance competitions have been successfully addressed." Based on evidence we have observed to date, we believe that DOD has made progress in making public-private competitions fair.

As we have stated in the past, it would be difficult, if not impossible, to completely level the playing field between the public and private sectors. We have reached similar conclusions about conducting cost comparisons between the public and private sector for various commercial activities under Office of Management and Budget Circular A-76. The issue seems to be that if any consideration is to be given to cost in making workload allocation decisions between the public and private sectors, it is essential to decide if the methodology, procedures, systems, and data that must be used in the course of making these decisions are "fair enough." If not, initiatives would be needed to improve the process or a decision made not to use cost as a consideration in workload allocation decisions.

A May 4, 1994 Office of the Deputy Secretary of Defense memo on depot maintenance operations policy discontinued the public-private competition program. The memo stated that although vigorous attempts have been made to execute fair public-private cost competitions through the Cost Comparability Handbook, a level playing field is not achievable in the near term.

We have made no determination of whether the public-private competition program, as currently implemented, is fair enough, but have concluded that we have not seen sufficient evidence for terminating the program. DOD personnel responsible for acquiring depot repair capability need procurement options that will result in the most cost-effective depot maintenance program. When used appropriately, public-private competition could be a cost-effective option to assist DOD managers in making the best

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use of available depot maintenance dollars. Nonetheless, more attention is needed to assure that, if public-private competition is continued, required improvements are initiated to assure that the competition program is as fair as it can be for all parties involved.

If you or your staff have questions regarding issues addressed in our testimony or this letter, please contact me or Julia Denman at (202) 512-8412.

Sincerely yours,



Donna M. Heivilin
Director, Defense Management
and NASA Issues

Enclosure

AEROSPACE INDUSTRIES ASSOCIATION
AMERICAN DEFENSE PREPAREDNESS ASSOCIATION
AMERICAN ELECTRONICS ASSOCIATION
CONTRACT SERVICES ASSOCIATION
ELECTRONIC INDUSTRIES ASSOCIATION
NATIONAL SECURITY INDUSTRIAL ASSOCIATION
PROFESSIONAL SERVICES COUNCIL
SHIPBUILDERS COUNCIL OF AMERICA
U.S. CHAMBER OF COMMERCE

May 19, 1994

The Honorable Earl Hutto
Chairman
Subcommittee on Readiness
Committee on Armed Services
U.S. House of Representatives
2339 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

The undersigned associations want to thank you for providing us the opportunity to testify before your subcommittee on April 12, 1994, on depot maintenance issues. As you'll recall, our views were presented through the testimony of Don Fuqua, President of AIA.

We are concerned that the testimony of Donna Heivilin before your subcommittee contained a number of assertions that appear to be inconsistent with conclusions offered previously by GAO and others. Taken uncritically, the testimony suggested that:

- (a) The private sector is receiving more than its "share" of depot work, that is more than 50 percent of the funds, rather than the 30 percent of workload reported by DoD;
- (b) Public-private competition offers a solution to lowering maintenance outlays without significant reductions in government overhead; and
- (c) Public-private cost comparability issues related to depot maintenance competitions have been successfully addressed.

Drawing any conclusions of this nature from GAO's testimony would be an unfortunate outcome of the hearing. GAO's testimony reflected a puzzling skepticism toward the Depot Maintenance Task Force report and the intentions of its authors, as well as a remarkable lack of familiarity with many of its findings.

We fully support the Depot Maintenance Task Force's recommendations and encourage their full and expeditious implementation. We, therefore, feel it's important to clarify the erroneous statements made by GAO and offer our analysis of their testimony as it relates to the Task Force's findings and recommendations.

Sincerely,



Don Fuqua
Aerospace Industries
Association



Lawrence F. Skibbie
American Defense Preparedness
Association



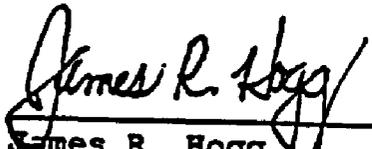
J. Richard Iverson
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Gary Engebretson
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Peter McCloskey
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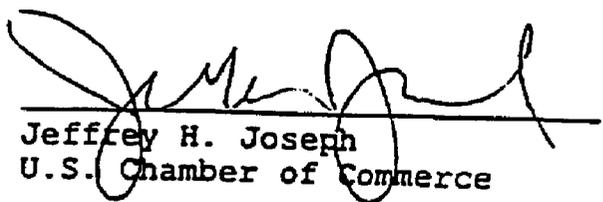
James R. Hogg
National Security Industrial
Association



Bert Concklin
Professional Services Council



John Stoker
Shipbuilders Council of America



Jeffrey H. Joseph
U.S. Chamber of Commerce

INDUSTRY'S REVIEW OF THE GENERAL ACCOUNTING OFFICE'S TESTIMONY ON *THE REPORT OF THE DEFENSE SCIENCE BOARD TASK FORCE ON DEPOT MAINTENANCE MANAGEMENT* BEFORE THE SUBCOMMITTEE ON READINESS OF THE HOUSE COMMITTEE ON ARMED SERVICES, APRIL 12, 1994.

The General Accounting Office testimony before the Readiness Subcommittee of the House Armed Services Committee contained a number of assertions that appear to be inconsistent with conclusions offered previously by GAO and others. Taken uncritically, the testimony suggests that:

- The private sector is receiving more than its "share" of depot work, that is, more than 50 percent of the funds, rather than the 30 percent of workload reported by DoD;
- Public-private competition offers a solution to lowering maintenance outlays without significant reductions in government overhead; and
- Public-private cost comparability issues related to depot maintenance competitions have been successfully addressed.

Drawing any conclusions of this nature from GAO's testimony would be an unfortunate outcome of the hearing.

Public-Private Workshares

From a broad perspective, GAO's use of spare parts and other non-service purchases in the calculation of market share should be questioned. By law, the Services have reported public-private workshares in terms of *direct labor hours*, not dollars. This allows for a reporting system that emphasizes workload. Spare parts purchases tend to be uneven as DoD seeks to augment or deplete inventories based on current requirements. Including these purchases with estimates of workload distorts what would otherwise be a consistent measure of industrial activity. Confusion arises when GAO attempts to count funds that are ultimately "pass through" to the private sector, rather than comparing only the first level of contracts issued (to the private sector) with the first-level allocation of depot maintenance funds to the government depots.

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The internal logic behind GAO's conclusion is also suspect. Citing the case of the Army, GAO indicated that 31 percent of its budget was paid to contractors for weapon system support-related activities while another 21 percent was used to purchase parts and supplies. Unfortunately, GAO does not indicate from whom these parts are purchased. The Army has significant capability for the fabrication of spare parts, and may use some of its supply funds to purchase material from itself or from inventory, neither of which necessarily generates current private sector industrial activity.

Public-Private Competition

GAO also concluded that public-private competition is an effective way to reduce costs and should be continued. Evidence supporting this conclusion was not presented, although GAO seemed particularly impressed with the Air Force competition program, claiming savings of \$108 million based on the difference between the AF and the lowest private bids. An AF explanation that its lower costs were a result of an investment program that has "contributed significantly to efficiency and productivity" was accepted by GAO without challenge¹. GAO also failed to take sufficient note of the fact that the AF figures were based on *projected* hours and hourly rates, not actual costs. It will be years, following the completion of the contracts, before any savings claims can be verified.

GAO noted that the primary cost advantage claimed by the AF is the number of labor hours projected to perform the work. Huge differences in the number of hours bid between

¹ It is worth noting that GAO did not comment on whether the AF was fully accounting for these productivity-enhancing capital improvements in its bids. According to data presented by the Services in the DSB Task Force Report, the AF has invested more than any other Service in its depots in the period from FY 1990-95. However, on the expense side AF capital depreciation is lower as a percentage of total depot costs than either the Army or the Navy. This suggests that either (1) AF capital investments have been mischaracterized in budget submissions or (2) the AF is not completely and accurately accounting for its capital costs in calculating its expenses.

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the AF and private sector to perform depot tasks are explained, in part, as a result of the AF's "better understanding" of what is actually required in depot work.² All of this is accepted without comment by GAO despite its own recent testimony indicating that:

- DoD has difficulty developing consistent and reliable data about the productivity of the ALC's work forces or the productivity improvements that the work forces have achieved;³ and
- Inadequate financial controls within the AF render its savings claims questionable and suggest that the AF does not know its true organic depot costs.⁴

This last point was reinforced by the AF Chief of Staff, General Merrill A. McPeak, in February 1994 when he said "It would be nice if we knew what actual costs were, but *our accounting systems often do not perform this simple and reasonable service*" (emphasis added).⁵ It is difficult to accept a conclusion that depot maintenance savings have been achieved when the public sector admits that it does not know its true costs.

² No explanation is offered for why the AF was also able to significantly underbid the Navy for stripping and painting F/A-18 aircraft, a weapon system and workload with which the Navy is, presumably, quite familiar.

³ United States General Accounting Office, *Air Logistics Center Indicators* GAO/NSIAD-93-146R, p. 3.

⁴ See United States General Accounting Office, *Air Force Depot Management: Improved Pricing and Financial Management Practices Needed*, GAO/AFMD-93-5, and also GAO decision in Heroux (File No. B-253278, September 3, 1993). GAO noted that labor rates in the AF depots are based on consistently unrealistic estimates of efficiency: "...DMIF managers repeatedly based...prices and the size of the workforce on productivity estimates that were not attained."

⁵ United States Air Force, *Airman*, February 1994, p. 9.

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The Level Playing Field

An additional GAO conclusion concerning the leveling of the playing field should also be challenged. GAO testified that the AF has raised its public-sector bid adjustments from 3.5 to 7.6 percent since the inception of the competition program, and this is offered as evidence that competitions are more fair now than at the start of the program. This conclusion assumes:

- The public bids include all relevant costs before the adjustment is made; and
- The cost adjustment factors address all relevant comparability issues.

Neither of these assumptions is intuitively obvious. In fact, unadjusted public and private sector hourly rates *are* converging as the private sector reduces overhead and the public bidders do attempt to include more relevant costs. As noted by GAO, however, the largest difference in the offers is attributable to hours bid, and the private sector remains unconvinced that the AF can perform many of these functions within the hours contained in their bids. GAO rightly suggests that post-award audits are in order.

Additional Comments

In their oral testimony, Donna Heivelin and Julia Denman made some additional misleading statements. Heivelin claimed that, among their functions, the depots must act as a "bidders of last resort" to guard against price gouging by contractors. This was offered as a partial justification for a public-private competition program. It should be noted that her statement ignores the enormous cost of maintaining excess depot capacity for that purpose. The Navy, among others, has concluded that any savings attributable to forcing bidders to "sharpen their pencils" against public competitors are dwarfed by the cost of excess infrastructure devoted to "above core" work. In fact, the Joint Chiefs of Staff report on depot consolidation issued last year indicated that overall maintenance costs remain high because the Services maintain 25-50 percent excess depot capacity. Savings can be achieved only if

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excess capacity is reduced. It is generally accepted within the depot community that the 25-50 percent figure is conservative.

There were other statements in GAO's oral testimony that should be challenged. Heivelin's assertion that the core methodology outlined in the Task Force report would not yield a quantitative measure of core was incorrect and left an erroneous impression on the Subcommittee. She also made an unsupported claim that private sector repair contracts uniformly exceed estimates while the public sector's do not. This latter claim ignores GAO's finding that, in the case of ship repair, the public yards build cost growth factors of 10 percent into their estimates, a privilege denied the private yards, and that "inadequate and late government furnished information and materials were among the major causes of contract cost growth and schedule overruns."⁶ GAO also noted that the private sector schedule performance was significantly better than that of the public sector. Furthermore, the Task Force report, using Service data on 55 different private contracts, concluded that *approximately 99 percent of the private sector cost increases were based on approved changes to the scope of work, not underpricing of tasks by contractors in their bids.*

In summary, GAO's testimony was inconsistent with many of its own previous conclusions on the depot maintenance issue, and did not appear to conform to conclusions drawn by the Army and the Navy, among others. This testimony reflected a puzzling skepticism toward the Task Force report and the intentions of its authors, as well as a remarkable lack of familiarity with many of its conclusions, suggesting that GAO may have based its remarks on an early draft of the Task Force report. GAO's implicit conclusion that significant defense savings can be achieved without major reductions in public infrastructure should be treated with equal skepticism.

⁶ U.S. General Accounting Office, *Navy Maintenance: Cost Growth and Schedule Problems Continue at the Shipyards*, GAO/NSIAD-90-144, July 1990, p. 17.