

October 1999

**DOD COMPETITIVE
SOURCING**

**Plan Needed to
Mitigate Risks in Army
Logistics
Modernization
Program**



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Abbreviations

AMC	Army Materiel Command
DOD	Department of Defense
CECOM	Communications and Electronics Command
OMB	Office of Management and Budget



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

**National Security and
International Affairs Division**

B-283303

October 4, 1999

The Honorable Floyd D. Spence
Chairman
The Honorable Ike Skelton
Ranking Minority Member
Committee on Armed Services
House of Representatives

The Honorable James M. Inhofe
Chairman, Subcommittee on Readiness
and Management Support
Committee on Armed Services
United States Senate

The Army is seeking to implement a Wholesale Logistics Modernization Program to reengineer its processes and modernize the aging computer information systems it uses to manage its inventories of equipment, parts, and supplies needed to support combat forces. To accomplish this modernization, the Army plans to contract with the private sector to reengineer its business processes and develop and operate a new system. Until the new system is operational, the contractor will operate the existing computer information system as well. The Army's goal is to accomplish these objectives with the same level of resources currently devoted to the existing system. The contractor selected to perform the work would be expected to make the capital investment needed to develop the new system, with the expectation that it would be able to recoup its investment through future operating efficiencies.

This report responds to the request of the Chairman of the Senate Subcommittee on Readiness and Management Support, Committee on Armed Services, that we review the Army's decision to contract for its wholesale logistics management information system. It also fulfills a requirement of the House National Security Committee's¹ report (Report No. 105-532) on the Strom Thurmond National Defense Authorization Act for Fiscal Year 1999, which directed us to analyze and determine whether the information provided by the Army supports this proposed action.

¹ Now known as the House Armed Services Committee.

Specifically, this report discusses (1) the Army's actions to comply with the requirements of 10 U.S.C. 2461, section 8014 of the Department of Defense Appropriations Act for Fiscal Year 1999 (P.L. 105-262), and Office of Management and Budget Circular A-76 and (2) cost uncertainties and other risks that could impact the future success of the modernization program.

Results in Brief

The Army's plans for implementing its Wholesale Logistics Modernization Program initiative by contracting with the private sector include actions to respond to the congressional notification requirements contained in legislation and the guidance contained in Office of Management and Budget Circular A-76. At the same time, significant uncertainties about the Army's abilities to execute its modernization program as planned, particularly within preset funding levels, exist. Specifically,

- In July 1998, the Army provided advance notification to the Congress, under 10 U.S.C. 2461, concerning its plans to consider contracting for the operation of its existing system and development of a modernized system. It subsequently notified the Congress in April 1999 concerning approval of a waiver of a detailed cost comparison between the public and private sector under Circular A-76. While the Army has not yet provided the Congress with cost information and certifications required under section 2461 and section 8014 of the Department of Defense Appropriations Act for Fiscal Year 1999 (P.L. 105-262), it expects to do so prior to entering into a contract for the modernization effort. To date, the Army has taken actions to comply with legislative and A-76 requirements for the plan to contract for the wholesale logistics modernization. However, affected employees have filed four appeals of the A-76 waiver with the Assistant Secretary of the Army for Installations and Environment which are currently pending.
- Because it was granted an A-76 waiver, the Army did not conduct a detailed cost comparison, but it did complete a business case analysis to assess prospective costs of various alternatives and as a basis for selecting its planned approach. However, various factors suggest that much uncertainty exists over the Army's ability to achieve its modernization objectives within preset funding levels and whether a new system would be put in place as quickly as initially anticipated to reduce operating costs. Thus, the Army could be faced with making future tradeoffs between Wholesale Logistics Modernization Program investment costs and its modernization objectives. Additionally, the Army faces uncertainties regarding the number of employees who may be willing to accept employment with the private sector to maintain the

existing system while a new system is being developed. Limited system documentation of the existing system increases the importance of existing employees to continue maintenance of the legacy system while a new system is being developed.

This report contains a recommendation to the Secretary of Defense concerning the need to mitigate the risks identified and to closely monitor this program as it progresses.

Background

In August 1997, in response to a tasking from the Army Materiel Command (AMC), the Communications and Electronics Command (CECOM) formed a special project team to gather information and market research to develop alternatives for modernizing its logistics information system processes. The approach the Army ultimately selected was to rely on the private sector to modernize and operate the wholesale² logistics management information system. This approach affects existing software design, development, and operations involving Army employees and contractors at Army facilities in St. Louis, Missouri, and Chambersburg, Pennsylvania. Under the plan, functions currently performed by government employees would be performed by contractor personnel in the future. Accordingly, the Army must consider legislative provisions and policy guidance that may be applicable.

Overview of the Modernization Plan

The Army's wholesale logistics management information system is currently sustained by the Logistics Systems Support Center in St. Louis, Missouri, and the Industrial Logistics Systems Center in Chambersburg, Pennsylvania. These centers report to the Communications and Electronics Command at Fort Monmouth, New Jersey, a major subordinate command of the Army Materiel Command. The two centers, referred to as Central Design Activities, design, develop, and maintain computer software systems and provide services that manage commodities, such as ammunition, avionics, communications and electronics, tanks, and missiles. The software systems integrate all wholesale logistics functions,

² The Army has a two-tiered, wholesale and retail logistics support system. The wholesale system is comprised of the four major commands subordinate to the Army Materiel Command; these subordinate commands procure supplies directly from vendors and hold inventories of stocks to meet the demands of retail customers. Retail customers are field-operating commands, which receive support from the wholesale level.

including cataloging the inventory of items, processing customer orders, computing requirements for items and ordering replenishment stocks, and handling the accounting processes. The budget for the two centers has been about \$40 million annually. The centers support numerous customers besides AMC, such as the Joint Chiefs of Staff, Defense Logistics Agency, and the Defense Finance and Accounting Service. In addition to the \$40 million used to sustain the software by the two centers, the Army also provides funding to have the current software processed by the Defense Information Systems Agency. This additional funding has been around \$60 million each year.³

The Wholesale Logistics Modernization Program⁴ is but one portion of a larger Army strategy for a future logistics system. The larger strategy, known as Global Combat Support System—Army, is to implement a single system to provide a seamless, integrated interactive communications and an automated information system for the Army’s retail and wholesale logistics support systems, and to support joint and allied operations. The retail logistics support system is currently undergoing a modernization effort similar to the wholesale modernization program. The retail modernization is structured so that federal employees continue to operate the current system while working with the contractor to develop a new system, which will be operated and maintained by the contractor.

The software programs associated with the Army’s wholesale logistics management information system are complex, were initially developed about 30 years ago, and widely recognized as being in need of modernization to avoid system failure in the future. To undertake such a modernization effort, the Army believes its wholesale logistics modernization program must include business process reengineering. The goal would be to eliminate non-value added activities and develop processes that expedite sound decision making. The change would apply both on the battlefield and at home, and create a system that will be flexible, adaptable, and responsive to both a peacetime and a wartime environment. Reduced operating and support costs and the elimination of data redundancy and inaccuracy are additional anticipated benefits.

³ This figure includes some costs for data processing that are outside the scope of the modernization effort.

⁴ This program is also referred to as logistics modernization, or LOGMOD.

To accomplish such dramatic change in the wholesale logistics process, while containing costs, the Army decided to leverage industry's investment in commercial logistics practices. CECOM considered the status quo and three alternatives to accomplish the modernization effort. Specifically, they included:

Status Quo: Maintain the current systems, supported by the Central Design Activities as currently staffed, organized, trained, and funded.

Alternative I: The Central Design Activities perform legacy sustainment, wholesale logistics modernization, and sustainment of the modernized system.

Alternative II: The Central Design Activities perform legacy sustainment; the contractor performs wholesale logistics modernization and sustainment of the modernized system.

Alternative III: The contractor performs legacy sustainment, wholesale logistics modernization, and sustainment of the modernized system. In addition, the contractor will employ displaced Central Design Activities workers.

The Army selected alternative III, which placed reliance on the private sector to operate the existing legacy system as it undertook the modernization effort and would be expected to operate the modernized system once it was in place. The alternative selected would have the potential to eliminate approximately 478 government civilian employees at the two center locations. AMC wanted to minimize the impact on these employees and help ensure continuity of operation of the legacy system and mission. To accomplish that goal, AMC decided to include as a key requirement in its request for proposals for the private-sector competition that the winning contractor offer displaced employees jobs with comparable pay and benefits, in the employees' current geographical location, for a minimum of 1 year. A chronology of key decisions associated with the evolution of this program is contained in appendix I.

Since 1955, federal agencies have been encouraged to obtain commercially available goods and services from the private sector if doing so is cost-effective. In 1966, OMB issued Circular A-76, which established federal policy for the government's performance of commercial activities and set forth the procedures for studying them for potential contracting. In 1979, OMB issued a supplemental handbook to the circular that included cost-comparison procedures for determining whether commercial activities should be performed in-house, by another federal agency through an interservice support agreement, or by the private sector. OMB updated this handbook in 1983 and again in March 1996.⁵ The March 1996 Revised Supplemental Handbook describes a wide range of options government officials must consider as they contemplate reinventing government operations. They include "the consolidation, restructuring or reengineering of activities, privatization options, make or buy decisions" and others. It also explains that the scope of the handbook is limited to conversion of recurring commercial activities to or from in-house, contract or interservice support agreement performances.⁶

Where A-76 cost-comparison procedures apply, the initial step is to develop a performance work statement describing what is needed to perform the activity, which is used as the technical performance section of a solicitation for private-sector offers. The government also develops a management plan that describes the most efficient organization for in-house performance of the activity described in the performance work statement. The cost of performance by the government in accordance with the most efficient organization is compared to the cost proposed by the private-sector source selected pursuant to the solicitation. The activity will be converted to performance by the private sector if the private sector's offer represents a cost differential of at least 10 percent of direct personnel costs or \$10 million over the performance period when compared to the government's in-house cost estimate.

The handbook also allows for direct conversions to contractor performance and cost comparison waivers. In the case of the Department of Defense (DOD), the authority to issue such a waiver may be delegated to the cognizant military service Assistant Secretary. A cost-comparison

⁵ The Handbook was revised again in June 1999 to issue guidance for implementing the Federal Activities Inventory Reform Act of 1998 (P.L. 105-270).

⁶ While A-76 addresses conversions in both directions, for purposes of this report, we will focus on conversion from performance by government employees to the private sector.

waiver must be accompanied by a detailed determination that the conversion meets at least one of the following requirements:

- the conversion will result in a significant financial or service quality improvement and a finding that the conversion will not serve to reduce significantly the level or quality of competition in the future award or performance of the work or
- the waiver will establish why in-house offers have no reasonable expectation of winning a competition conducted under the cost comparison procedures.

Cost-comparison waivers are subject to the administrative appeal procedures contained in the handbook. An appeal must be in writing and generally submitted within 20 calendar days of documentation being made publicly available concerning the outcome of the waiver. A final decision should be made within 30 days of receipt of the appeal.

In addition to Circular A-76, DOD must consider 10 U.S.C. 2461 and section 8014 of the Department of Defense Appropriations Act for Fiscal Year 1999 (P.L. 105-262). Both contain requirements for congressional notifications concerning the planned performance of functions by the private sector.

Section 2461, as amended by the Strom Thurmond National Defense Authorization Act for Fiscal Year 1999 (P.L. 105-261), requires that before any commercial or industrial type function that as of October 1, 1980, has been performed by DOD civilian employees is changed to private sector performance, DOD must report to the Congress, conduct an analysis showing that private-sector performance will result in a savings to the government over the life of the contract, and certify that analysis.⁷ Section 8014 of the 1999 Defense Appropriations Act requires that DOD certify its in-house estimate to congressional committees before converting any activity performed by more than 10 DOD civilian employees to contractor performance. While this provision is applicable to fiscal year 1999 actions only, we expect that next year's appropriation act will have this same provision as it has been included in recent years' appropriations acts.

⁷ The Army notified the Congress prior to the effective date for last year's amendments. The prior version of section 2461 contains similar notification, certification, and cost comparison requirements.

Army Plans Include Compliance With Circular A-76 and Legislative Reporting Requirements

The Army has provided notifications to the Congress under 10 U.S.C. 2461 concerning its intent to contract for its modernization effort. The Army plans to provide the Congress with relevant cost information and certifications required under section 2461 and the applicable appropriation act provision prior to awarding any contract for the program. Further, the Army has executed a waiver of the cost comparison provision under the terms of the supplemental handbook.

The Army's notification to the Congress in July 1998 stated that the Army was considering an initiative to rely on private industry to reengineer its wholesale logistics business processes and to provide information management support for these processes. The notification stated that the Army would provide the Congress a summary of its cost comparison and other reports and certifications pursuant to section 2461 prior to entering into a modernization contract.

At the time of its initial congressional notification, the Army believed that its planned action was not subject to OMB Circular A-76. Subsequently, the Army changed its view and decided that A-76 did apply. The Army concluded that in-house performance of the reengineering was not feasible or cost-effective, and Army officials decided to seek a waiver to A-76 cost-comparison requirements from the Assistant Secretary.

On April 27, 1999, the Army submitted a notification to the Congress that a waiver of the A-76 cost comparison process had been approved. The waiver was approved by the Assistant Secretary of the Army (Installations and Environment) pursuant to section E of chapter 1 of the supplemental handbook. Specifically, the waiver stated that the modernization initiative will result in significant service quality improvement beyond that which could be reasonably expected from a reorganization of the current approach, that the modernization effort will not serve to reduce significantly the level or quality of competition in the future award of work, and that the functions involved are not inherently governmental. However, pursuant to the waiver appeal process provided for in A-76, four appeals have been filed by affected employees with the Assistant Secretary of the Army for Installations and Environment and are currently pending. This latest congressional notification reiterated that section 2461 cost information would be provided prior to entering into a contract for the performance of the modernization effort. DOD likewise is expected to provide the 1999 Defense Appropriations Act certification prior to entering into a contract for the modernization project.

Cost and Personnel Uncertainties Could Adversely Impact Modernization Efforts

Because it was granted an A-76 waiver, the Army did not conduct a detailed cost comparison between the public and private sectors for its wholesale logistics modernization program. Nevertheless, it did complete a business case analysis in formulating its logistics modernization strategy. The Army's business case analysis outlined the modernization program alternatives being considered and analyzed each alternative's estimated costs, benefits, and risks. While numerous criteria were considered in developing alternative strategies, emphasis was placed on cost containment and a transition approach for affected government employees in selecting the preferred alternative. Table 1 summarizes the estimated cost and schedule for the three alternatives. (The Army determined that the status quo was not a viable option because it could not meet the design, implementation, and timeliness of future requirements. The Army concluded that the risk of doing nothing was unacceptable.)

Table 1: Estimated Cost and Schedule for Wholesale Logistics Modernization Alternatives

Current dollars in millions

Alternative	Estimated cost to government		Time to deploy new system
	Program cost over the 10-year period ^a	New system development cost ^b	
I (All work done in-house)	\$581.7	\$562.5	8 years
II (In-house/contractor mix of work)	425.2	329.8	6 years
III (All work done by contractor)	420.9	253.5	5 years

Note: We did not attempt to validate the figures in the table.

^aCost of performing the legacy sustainment and modernization to a common end-state over a 10-year period.

^bThis cost is included in the 10-year program cost. The cost of new system development includes sustaining the legacy system until the new system is deployed.

Source: The Business Case, Wholesale Logistics Modernization Program, February 12, 1999.

According to the Army, its analysis showed that alternative III, which called for contractor operation of the legacy system while developing the modernized system, was the alternative expected to require the least time to develop a new system, the smallest estimated investment costs, and the lowest estimated operational costs over a 10-year period. It was also considered the option most likely to be able to meet the Army's goal of a solution that was executable within the program's existing operating budget.⁸ However, available Army data show a range of uncertainty about the cost estimates that could make it difficult to achieve this objective. Also, uncertainties associated with the transfer of the work to the private sector could affect program stability during the transition period.

Cost Uncertainties

The Army's request for proposals provides for an expenditure limit on the planned contract, with certain exceptions,⁹ of under \$40 million a year, the approximate current funding level of the two centers. The request for proposals further provides that up to an additional \$30.5 million per contract year would be available for the data processing of the modernized services. The amount allowed for processing is to be based directly on the percentage of data processing performed by the contractor, with the Defense Information Systems Agency performing the residual processing. However, various factors suggest much uncertainty as to whether the modernized system may be achievable within the projected funding level.

First, as part of its economic analysis, AMC performed a limited sensitivity analysis on alternative III¹⁰ by assessing how underlying assumptions could affect cost estimates. The analysis showed that for this alternative, developmental costs, an element of investment cost, ranged from a low of \$107.3 million to a high of \$232.7 million. For purposes of its comparison of alternatives, the Army adopted an estimate at the mid-point of this range; nevertheless, the analysis underscored the uncertainty associated with development cost estimates. Further, concerning the issue of additional

⁸ The Army's approach is predicated on the assumption that a contractor will be willing to provide a sizable investment in the first few years with the anticipation that those costs, and a profit, will be forthcoming in the later years of the contract.

⁹ Exceptions include additional functionality and in-processing changes, data processing for transferred systems, data processing for modernized services, related logistics services, and expanded services.

¹⁰ Documentation of the Army's economic analysis states that a sensitivity analysis was conducted only for alternative III because it was the most favorable option.

requirements in the future, the economic analysis states that “the cost of system growth, adding new functions during the ten year contract, has not been addressed by the estimate and could be a significant area of cost considering the number of related logistic process improvement plans.” Underestimating the effects of changing requirements can significantly affect software development schedule and costs. History shows that the average project experiences about a 25-percent increase in requirements over its lifetime. Such a change can produce at least a 25-percent addition to the software schedule and increase cost. Also, projects that skimp on initial system development activities, such as requirement definition, must have the same work performed later at anywhere from 10 to 100 times the cost of doing it properly in the first place.

Second, cost uncertainties also exist because of the uncertain nature of the requirements. The request for proposals¹¹ provides for a contract that contains a requirements portion and indefinite delivery portion. The work is to be performed pursuant to task orders issued on both a firm fixed price and time and materials basis. The cost of the work is not known in advance for any of the task orders. The cost estimates of those task orders to be issued on a time and materials basis are particularly uncertain, even though the hourly rates would be fixed in the contract, because the number of labor hours and the cost of materials are not.

A third risk area that could affect costs relates to the Army’s tentative plans for developing and implementing a modernized information system under an incremental approach. Under the incremental approach, changes affecting the legacy system would be made on a graduated basis. This would allow a gradual transition from the legacy system to the modernized system, requiring less sustainment of the legacy system as the functions are transferred from the old to the new systems. Should this prove feasible, the government would likely begin to realize the benefits of a modernized system sooner, and the contractor might be able to achieve operating efficiencies much sooner—and realize additional revenues by assuming responsibilities for processing the new software code as it comes online. Until that occurs, the processing of the existing software will continue to be performed by the Defense Information Systems Agency. However, an Office of Secretary of Defense official providing oversight for the modernization effort has expressed concern that a modular, incremental

¹¹ The Army issued its request for proposals on April 29, 1999; contractor proposals were submitted June 28, 1999.

approach of transferring functions from the legacy system to a new, modernized system will not work. He indicated that since the new system is expected to be predicated upon reengineered processes, and new software code tied to the new processes, this would likely preclude a one-for-one modular replacement between old and new systems. An Army official responsible for oversight of information systems issues agreed that such an incremental approach is likely not to be feasible.

Fourth, known problems with DOD data—particularly “cost” data—undermine confidence in the reliability of the cost estimates. DOD has acknowledged fundamental problems with its ability to accumulate reliable cost information. Continuing problems in this area were confirmed by our most recent audit of the federal government’s 1998 consolidated financial statements.¹² For example, we reported that DOD is unable to provide data on the costs associated with functions to be considered for A-76 outsourcing competitions. Our audit also revealed a material deficiency in DOD’s ability to report budget information. Given the severity of these deficiencies, the estimated cost of the modernization effort must be considered uncertain.

Each of the above factors has the potential to affect the timing and costs associated with developing and implementing the Army’s modernized wholesale logistics information management system. This could put the Army in the difficult position of having to revisit issues of cost, timing, or making tradeoffs in terms of modernization objectives. Close program monitoring against specific program objectives and milestones will be important to ensuring the program meets the requirements of relevant legislation and policy guidance, including the Clinger-Cohen Act of 1996, which requires federal agencies to have processes and information to help ensure that technology projects (1) are implemented at acceptable costs, within reasonable and expected time frames and (2) contribute to tangible, observable improvements in mission performance. Such monitoring or tracking of progress should be facilitated by the use of a performance plan establishing specific goals and indicators to measure performance as provided for in the Government Performance and Results Act of 1993. Without performance measures, managers often have great difficulty getting results from information systems because they cannot define their needs precisely.

¹² *Financial Audit: 1998 Financial Report of the United States Government* (GAO/AIMD-99-130, Mar. 31, 1999.)

Uncertainty Over Employees' Receptivity to "Soft-Landing" Package

As the Army contemplates relying upon a contractor to operate the legacy system while developing a modernized system, uncertainties exist regarding the extent to which government employees will be willing to accept the "soft-landing" approach of employment with the winning contractor. Given the limited amount of documentation on the legacy system, the continued support of the existing workforce could be important to continuing maintenance of the system during the transition period. While experience in other DOD cases suggests that significant numbers of government employees in other circumstances have accepted similar employment opportunities with the private sector, the large number of center employees nearing retirement eligibility under the Civil Service Retirement System could limit the number of acceptances depending on the availability of opportunities for other government positions.

An important feature of the Army's approach to the modernization program is a so-called soft landing for displaced government employees,¹³ ensuring them of employment with the winning contractor. The Army believes such an approach also has important benefits to both the government and the contractor since these employees may be essential to maintaining the Army's existing legacy system as a modernized system is being developed. The current system, as it has evolved over time, consists of over 560 program applications, 3,000 major subordinate command bridging programs, 260 databases, and over 20 million lines of computer software code. Available information suggests that the institutional knowledge of the current employees may be essential to maintaining the system given extensive system modifications that have been made over the years, but with limited documentation. Based on analyses of the Central Design Activities completed in 1994 and 1997, employing criteria developed by the Software Engineering Institute, both centers ranked very low in written technical documentation needed to replicate operation and maintenance of their systems.¹⁴ This means that much of the institutional knowledge

¹³ Specifically, the "soft landing" requires the contractor to offer displaced employees jobs with comparable pay and benefits, in the employees' current geographical location, for a minimum of 1 year. Displaced employees are those who are on the Central Design Activities' rolls on the date immediately preceding the transfer and who are involuntarily separated from federal service as a result of the contracting action.

¹⁴ The Industrial Logistics Systems Center was determined to be level 2 by the Software Production Consortium in October 1997 and the Logistics System Support Center was ranked as level 1 by itself and the Software Engineering Institute in 1994. The scale goes from 1 to 5, with 1 being the lowest ranking.

concerning the existing system resides with the individual employees who have been responsible for maintaining and modifying the system over time.

The Army currently plans for the wholesale logistics modernization program contractor to assume operation and maintenance of the existing legacy system about 90 days after contract award. The contractor is expected to maintain and operate the legacy system, in full or in part, until the modernized system becomes fully operational in an estimated 5 years. Whether a contractor can sustain a system as complex as the Army's without adequate documentation and staff experienced with that system remains uncertain. In its business case analysis, the Army acknowledged the potential for "interruption of wholesale logistics services to the war fighter due to the transfer of expertise, workload, software, and documentation of its legacy system to the contractor." The mitigation proposed by the Army, however, does not fully address the risk. The Army's mitigation strategy was that "the government would retain control of the wholesale logistics processing at the Defense Information Systems Agency Megacenters." However, the risk is in the contractor's ability to sustain the legacy software, not process it.

While the Army's request for proposals requires that displaced government employees be given positions with the winning contractor for a period of at least 1 year, the number of employees who would be willing to accept such positions, if offered, is unknown. About 85 percent of the current center employees are participants in the government's Civil Service Retirement System, and 83 percent will be eligible for either regular or early retirement within 5 years¹⁵—reportedly making them reluctant to leave Federal service before becoming eligible for retirement.

The number of persons willing to accept the soft-landing package could be significantly affected by the availability of other federal opportunities for employment. During on-site interviews, staff indicated to us that they would prefer to continue working for the federal government rather than join the contractor. A 1997 study sponsored by the Office of the Secretary of Defense and conducted in RAND's National Defense Research Institute, *Outsourcing of DOD Commercial Activities: Impacts on Civil Service*

¹⁵ Regular voluntary retirement occurs when an employee wants to retire and meets the full age and service eligibility requirements. Early voluntary retirement occurs when an employee meets lesser age and/or service requirements than for regular voluntary retirement. Authority to grant early voluntary retirement must be approved by the Office of Personnel Management.

Employees, addresses this issue. The report states, “Civil service workers are averse to leaving civil service and accepting employment with private-sector contractors. Reasons cited are nonportability of some federal retirement benefits, better civil service wages and benefits, and better job security.”

Officials from CECOM’s personnel office told us that the current employees expressed an overwhelming preference to remain in government service. CECOM does not plan to conduct a formal survey to determine the number of staff by functionality that would actually go to work for the winning contractor, since many staff do not make decisions until the action is imminent.

At the same time, we found that some employees are already beginning to seek other federal employment and that existing shortages of information technology personnel within the government could provide other options for the affected employees. As of May 31, 1999, the CECOM personnel office told us its estimate of displaced employees who would be required to be offered jobs by the contractor has been reduced from 350 to 335. However, it believes the number may be further reduced since there already has been more attrition than expected because of uncertainty about the program’s future. An official in the Office of Secretary of Defense has expressed concern that continuing program uncertainties could endanger the capability of the Army to maintain its existing wholesale logistics functionality.

Conclusions

To date, the Army has taken actions to comply with legislative and A-76 requirements for the plan to contract for the wholesale logistics modernization. While we agree that there is a need to modernize and improve operating efficiencies, we believe the modernization initiative has significant uncertainties and risks. We expect some of these uncertainties will be addressed during the contract negotiation process. Even then, the uncertainties over cost and implementation schedule for the modernized system are likely to remain for some time. Also, performance measures have not been established for measuring whether the modernization program is achieving observed results.

Recommendation

We recommend that the Secretary of Defense require the Secretary of the Army to develop a transition plan based on an assessment of the

quantitative and qualitative risks associated with this project and what actions are planned to mitigate those risks. We also recommend that the Secretary of Defense require the Secretary of the Army provide for sufficient oversight with quantifiable performance measures to track the success of the modernization program.

Agency Comments and Our Evaluation

The Deputy Under Secretary of Defense (Logistics) provided written comments on a draft of this report. The Department of Defense concurred with the report's recommendations to develop a strategy to ensure actions are in place to mitigate the risks associated with the Wholesale Logistics Modernization Program. It indicated the Army will develop a transition plan that will be put in place before contract award. The department also stated that the Army plans to negotiate performance metrics as part of the contract award. We are encouraged that DOD is starting to address the risks and uncertainties that have been identified for this major modernization effort. However, as we previously noted, we expect that the uncertainties over cost and implementation schedule for the modernized system will continue for some time and, as indicated in our recommendation, will require high level oversight to track the success of the modernization program.

DOD also provided technical comments, which have been incorporated as appropriate. The department's written comments on a draft of this report are included in appendix II.

Scope and Methodology

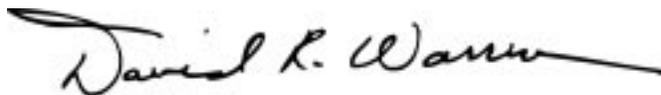
To determine if the Army's actions complied with the requirements of applicable legislation and policy guidance, we reviewed Circular A-76 and relevant legislation; the Army's programming and implementation plans; and the A-76 waiver package, including the business case and economic analysis, although we did not establish the reliability of the data. We interviewed senior officials at the Logistics Systems Support Center, St. Louis, Missouri; the Industrial Logistics Systems Center, Chambersburg, Pennsylvania; CECOM, Fort Monmouth, New Jersey; and AMC, the Army's Office of General Counsel, and the Office of Management and Budget, Washington, D.C. We met and talked with many of the employees of both Central Design Activities in St. Louis and Chambersburg. We also made use of our prior work regarding A-76 issues.

To assess the risks associated with this proposal, we reviewed the A-76 waiver package, which included the business case, economic analysis, and risk analysis of proposed alternatives, although we did not independently verify the data. We also reviewed the request for proposals and the solicitation package. We interviewed officials at the Office of the Assistant Secretary of Defense, Command, Control, Communications, and Intelligence and the Army Office of the Director of Information Systems for Command, Control, Communication, and Computers charged with monitoring the program and officials at AMC, CECOM, the Central Design Activities, and the Defense Information Systems Agency. We also made use of our prior work in the outsourcing area.

We conducted our review from May 1998 through August 1999 in accordance with generally accepted government auditing standards.

We are providing copies of this report to the Honorable Charles S. Robb, Ranking Minority Member of the Subcommittee on Readiness and Management Support, Senate Armed Services Committee; the Honorable Ted Stevens, Chairman of the Senate Committee on Appropriations; the Honorable Robert C. Byrd, Ranking Minority Member of the Senate Committee on Appropriations; the Honorable C.W. Bill Young, Chairman of the House Committee on Appropriations; the Honorable David R. Obey, Ranking Minority Member of the House Committee on Appropriations; the Honorable James M. Talent, House Armed Services Committee; the Honorable William S. Cohen, Secretary of Defense; the Honorable Louis Caldera, Secretary of the Army; and the Honorable Jacob J. Lew, Director of OMB. We will make copies available to others upon request.

If you have any questions regarding this report, please contact me on (202) 512-8412. Other GAO contacts and other key contributors to this assignment are listed in appendix III.



David R. Warren, Director
Defense Management Issue

Chronology of the Modernization Initiative

August 1997	In response to tasking from the Army Materiel Command (AMC), the Communications and Electronics Command formed a Special Project Team to gather information and market research to develop alternatives for modernizing its logistics processes.
October 1997	Contractors were invited to present their approach to performing the function.
February 1998	AMC approved the team's approach, which proposed to contract for development and sustainment of the wholesale logistics system, provide a "soft landing" for affected government employees, and provide for contractor operation of legacy systems until total implementation of a modernized system could be completed.
April 28, 1998	Concerned that the proposed approach would place "national security at risk" by contracting for "mission essential support to the warfighter," the Chairman of the Military Readiness Subcommittee, House Committee on National Security, requested that the Office of the Assistant Secretary of the Army (Manpower and Reserve Affairs) and the Army Audit Agency answer specific questions about the proposed action. The Army considered its planned action was not subject to A-76 requirements.
July 15, 1998	Pursuant to 10 U.S.C. 2461, the Army notified the Congress of its intent to rely on private industry to modernize its information management system for wholesale logistics. The notification stated the Army would provide the Congress a summary of its cost comparison and other reports and certification required under 2461 prior to contract award.
August 17, 1998	The Army Audit Agency published its report.
October 22, 1998	Because the Army changed its view and decided that A-76 should apply, the Commander of AMC sent an A-76 waiver package to the Assistant Secretary of the Army for Installations, Logistics and Environment, ^a recommending that a cost-comparison waiver be granted. AMC recommended an alternative that would transfer responsibility of software support services to a private contractor, reengineer the business processes and recommend changes, and replace the legacy system with commercial software applications.
March 3, 1999	The original waiver package was revised, based on input from cognizant Army organizations, and resubmitted to the Assistant Secretary. This package included a revised business case analysis, an economic analysis, an acquisition strategy, a logistics integration agency study, background research of industry's achievements in supply chain management, and a risk analysis of proposed alternatives. A draft request for proposals was also sent forward. The memorandum supporting the waiver request emphasized the need to modernize the Army's logistics support system and proposed to leverage industry's investments and technology in the logistics field. The basis for the waiver request was threefold: (1) the conversion would result in significant service quality improvement, (2) the conversion would not serve to reduce significantly the level or quality of competition in the future award or performance of work, and (3) the functions to be converted are not inherently governmental.
April 20, 1999	The Assistant Secretary approved the A-76 waiver request—the first A-76 waiver approved by the Army.
April 27, 1999	The Army informed the Congress that it had approved a waiver of the cost comparison requirements of A-76. The notice also reconfirmed the Army's intent to provide a detailed summary of its cost comparison and other reports and certifications pursuant to section 2461 prior to entering into any contract for wholesale logistics modernization.
April 29, 1999	Employees and union are officially notified. Final request for proposals is issued.
May 13-28, 1999	A total of four appeals are filed with the Assistant Secretary of the Army for Installations and Environment by both the Industrial Logistics Systems Center and the Logistics System Support Center and are currently pending. The appeals are from individuals, a group of individuals, and the Local 1763 union, representing employees at the St. Louis Central Design Activity.
June 17, 1999	Appellants are notified that the Secretary of the Army will resolve the appeals after he has received a recommendation from an independent panel of senior civilian officials after July 30, 1999.

^aNow known as the Assistant Secretary of the Army (Installations and Environment).

Comments From the Department of Defense



ACQUISITION AND
TECHNOLOGY

OFFICE OF THE UNDER SECRETARY OF DEFENSE

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SEP 14 1999

(L/LSM)

Mr. David Warren
Director, Defense Management Issues
National Security and International Affairs Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Warren:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "DOD COMPETITIVE SOURCING: Army Logistics Modernization: A-76 Waived but Risks Remain" Dated August 4, 1999 (GAO Code 709391/OSD Case 1871). The Department concurs with the recommendations in the draft report.

The Department's detailed comments to the recommendations are enclosed. The Department appreciates the opportunity to comment on the draft report.

Sincerely,


for Roger W. Kallock
Deputy Under Secretary
of Defense (Logistics)

Enclosure



GAO DRAFT REPORT - DATED AUGUST 4, 1999
(GAO CODE 709391) OSD CASE 1871

**“DOD COMPETITIVE SOURCING: ARMY LOGISTICS MODERNIZATION :
A-76 WAIVED BUT RISKS REMAIN”**

DEPARTMENT OF DEFENSE COMMENTS TO THE RECOMMENDATIONS

RECOMMENDATION: GAO recommended that the Secretary of Defense require the Secretary of the Army to:

(1) develop a transition plan based on an assessment of the quantitative and qualitative risks associated with the project and what actions are planned to mitigate those risks; and

DOD RESPONSE: Concur. The Army will develop a transition plan. A Risk Management Plan is available now and will be revised as needed. The final plan will be in place prior to contract award. Detailed comments addressing the actions implemented to date and those to be initiated in the future have been provided directly to the GAO staff.

(2) provide for sufficient oversight with quantifiable performance measures to track the success of the modernization program.

DOD RESPONSE: Concur with the recommendation to provide sufficient oversight with quantifiable measures to track the success. The Army plans to negotiate service performance metrics as part of the contract award. A more detailed discussion of proposed metrics has been provided directly to the GAO staff.

GAO Contacts and Staff Acknowledgments

GAO Contacts

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Acknowledgments

In addition to those named above, John Brosnan, Stephanie May, J. T. "Mickey" McDermott, Debra McKinney, and Bonita Page made key contributions to this report.

Appendix III
GAO Contacts and Staff Acknowledgments

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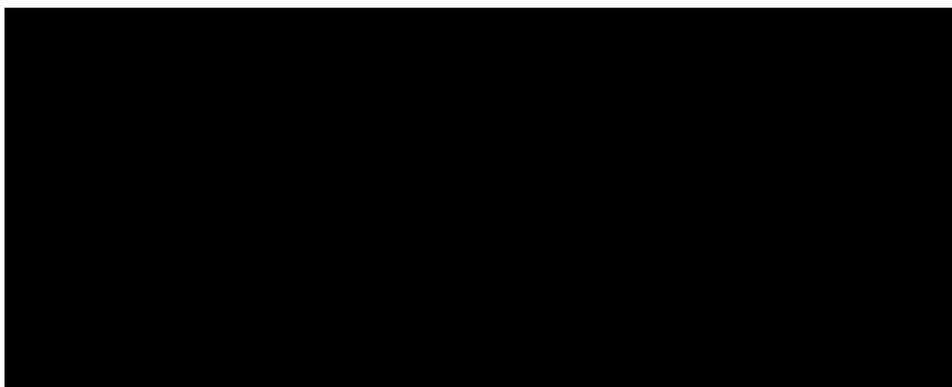
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**Table 1: Estimated Cost and Schedule for Wholesale Logistics
Modernization Alternatives**

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