DECISION

THE COMPTROLLER GENERAL
OF THE UNITED STATES
WASHINGTON, D.C. 20548

FILE: B-218166 **DATE:** June 11, 1985

MATTER OF: Nero and Associates, Inc.

DIGEST:

Protest against agency appeal board decision, affirming agency decision to perform services in-house following an OMB Circular A-76 cost comparison, is sustained where agency failed to comply with procedures for conducting cost comparison identified in the request for proposals.

Nero and Associates, Inc. (Nero), protests an Army Administrative Appeals Board (Board) determination of January 15, 1985, that the Army should continue in-house performance at the Yuma Proving Ground (Yuma), Arizona, of various installation support functions (facilities engineering and logistics) included in request for proposals (RFP) No. DAAD10-83-R-0001, because it is more economical than contracting with Nero.

A decision whether or not to contract work involves a cost comparison analysis prepared in accordance with Office of Management and Budget (OMB) Circular No. A-76 (Circular). In accordance with the Circular, the Army compared the sum of (1) total costs associated with the acceptance of Nero's offer and (2) an OMB-imposed 10-percent (of in-house personnel costs) conversion differential reflecting assorted unpredictable risks encountered any time a conversion is made to contract (loss of production, decreased efficiency, retained pay, etc.) with the Army's estimate of the total costs of continuing in-house performance following reorganization into the most efficient organization. The cost comparison, as adjusted by the Board, reads:

	TOTAL CONTRACT COSTS	$11,158,890
+	CONVERSION DIFFERENTIAL	1,215,840
	COST TO GOVERNMENT OF CONTRACTING	$12,374,730
-	TOTAL IN-HOUSE COSTS	$12,328,713
	AMOUNT SAVED BY REMAINING IN-HOUSE	$ 46,017

In deciding Nero's appeal, the Board found in Nero's favor on two issues and adjusted the cost comparison accordingly; however, the adjustments did not change the decision to continue the work in-house. Nero now contends that additional adjustments which the Board refused to make are required by applicable cost comparison procedures and that these adjustments would change the cost comparison outcome and require an award to Nero.

We sustain the protest.

Nero raises numerous issues in its protest of the Board's determination; however, we need only consider the issue of one-time labor-related expenses (specifically, severance pay) since it is dispositive of the protest. Nero argues that the cost for one-time labor-related expenses (an element of one-time conversion costs) was improperly determined. One-time conversion costs are the one-time costs the government incurs when it discontinues an in-house activity in order to convert to contract. These costs cover both material and labor. One-time labor-related expenses cover costs associated with the adjustment of the government's labor force to accommodate the conversion to contract and includes separation/displacement costs such as the cost of severance pay, homeowner assistance, relocation and retraining. These costs are usually developed after consultation with the agency's personnel office. If Nero is correct that the one-time labor costs and, thus, one-time conversion costs, are overestimated, then the total cost of contracting out, which includes the one-time conversion costs, is too high.

Specifically, Nero objects to the Army using a mock reduction in force (RIF) to develop the costs ($349,064) associated with one-time labor-related expenses. Nero urges that the costs should have been based on 2 percent of the base year personnel cost of $1,800,058. This results in one-time labor-related expenses of $36,001, which would reduce total contract costs by $313,063 and eliminate the $46,017 difference between contracting and in-house performance. Although not affecting our conclusion, Nero's calculations concerning the amount the one-time labor conversion

costs are overstated are not precisely correct because the 2-percent factor used in the calculation of all one-time labor-related expenses is only applicable to the calculation of severance pay. However, in any event, the use of the 2-percent factor to calculate severance costs only shows that total contract costs would be reduced by $70,773, and the use of this figure would change the outcome of the cost comparison analysis by eliminating the $46,017 difference in favor of the in-house estimate and would require an award to Nero.

As a general rule, we do not review matters of executive branch policy such as the decision to either perform work in-house or by contract. Crown Laundry and Dry Cleaners Inc., B-194505, July 18, 1979, 79-2 C.P.D. ¶ 38. We make an exception, however, where an agency uses the procurement system to aid in its decisionmaking, spelling out the circumstances under which a contract will or will not be awarded. In such cases, we review the matter to ascertain whether the procedures identified in, or applicable to, the solicitation were followed, particularly in comparing in-house and contract costs. Serv-Air, Inc.; AVCO, 60 Comp. Gen. 44 (1980), 80-2 C.P.D. ¶ 317. However, in deciding whether the procedures were followed, we only look to see that the comparison is not faulty or misleading. Support Services, Inc., B-214793, Oct. 22, 1984, 84-2 C.P.D. ¶ 428.

On September 30, 1983, the instant RFP was issued. It provided that the cost comparison would be accomplished using "the procedures contained in current applicable regulations." Amendment 10 to the RFP established May 31, 1984, as the extended closing date for receipt of offers.

The methodology used in the cost comparison analysis (in-house performance vs. contracting) is outlined in the Circular. The Circular, in turn, is implemented by agency guidance in various forms (regulations, circulars, instructions, and letters) and by the solicitation itself. In February 1983, the Army issued guidance on the subject of the methodology to be used in estimating separation costs. Estimating Separation Cost for Government Personnel--CA Letter Number 83-2, Feb. 1, 1983 (Letter). The Letter furnished a methodology and an example. The example was computed using estimates based on installation averages and certain assumptions (percentage of married vs. single employees, number of dependents, percentage of employees who are homeowners, the average selling price of a home ($65,000)). The Letter warned that the assumptions were for

"illustrative purposes only." The Letter is consistent with a preceding Circular revision issued on January 26, 1982, in attachment "A" to Transmittal Memorandum No. 6 (TM-6), which, in addition to allowing consideration of historical data, requires agencies to make an estimate of the number of employees who will retire, separate, be downgraded, or relocate as a result of a decision to contract out. Mercury Consolidate, Inc., B-213350, Jun. 11, 1984, 84-1 C.P.D. ¶ 612 at p. 2.

On August 4, 1983, the Circular was completely revised (hereafter, Revised Circular). The section treating severance pay now reads, in part, as follows:

"3. Labor-Related Costs

"a. A conversion will also normally result in certain one-time labor-related expenses. These include severance pay, homeowner assistance, relocation and retraining expenses. The amount of these expenses should be computed in consultation with the personnel office. Care must be taken that only those expenses which can reasonably be expected to be paid out are entered on the CCF [cost comparison form].

"b. Government experience indicates that only a small fraction of the total number of employees affected in conversion actions are actually separated from Government service. Therefore, it would be inappropriate to enter on the CCF an amount for severance pay that assumes every employee eligible for severance pay would actually receive severance pay. Past conversion experience indicates that only four percent of the total number of employees assigned to the function under study are separated and receive severance pay. Based on this separation rate and the average Federal employee's severance pay entitlements, a two-percent severance pay factor is appropriate for use in most cost studies. The variations to consider when computing severance pay are discussed in the following paragraph.

"c. For most studies, where the in-house staffing estimate is equal to or lower than the number of assigned Federal employees, the two-percent factor is multiplied by the annual basic pay from the Personnel Cost Worksheet, Column F, Total (Illustration 2-1). There are two exceptions to this procedure.

"(1) . . . . .

"(2) In cost studies for which a nigher or lower separation rate than four percent can be anticipated, other estimates of severance pay may be used, provided the alternate assumptions can be fully documented."

On March 20, 1984, the Assistant Secretary of Defense, Installations and Logistics, issued guidance to the entire Department of Defense (DOD guidance) (the Army reissued it on April 3, 1984), concerning the changes in the Revised Circular. The guidance stated that the alternative cost comparison procedures could not be used if contract offers would be received and cost comparisons made on or after April 30, 1984 (the instant RFP closed on May 31, 1984). Where the alternative cost comparison procedures could not be applied, the Revised Circular and the guidance were to be followed "even if it entails an amendment to the solicitation." The guidance provided, in part:

"(2) Labor-Related Separation Costs. The logic applicable to the computation of severance pay is contained in the . . . [Revised Circular]. The use of the two percent factor, in accordance with the . . . [Revised Circular] direction is strongly encouraged. However, it is recognized that unique circumstances may prevail where a strict application of this guidance may result in a substantial overstatement or understatement of this cost. On those occasions an alternative methodology may be employed. The reason for the deviation from this standard and the supporting alternative computation and documentation shall be provided to the appropriate Service/Defense Agency policy office for advance approval."

On May 11, 1984, the Army issued additional guidance for units seeking a deviation from the "Severance Pay Factor (formula using 2 percent)." It required submission of a formal request for prior approval to deviate which included a detailed justification containing: (1) a narrative justification, (2) supporting calculations ("matrices"); and (3) the results of a mock RIF. It made reference to the Letter for more details, presumably on how to set out the calculations.

On June 20, 1984 (3 weeks after the RFP closing date), the Army issued amendment No. 12, which changed the basis of the cost comparison from one accomplished using "the procedures contained in current applicable regulations" to one accomplished using "the alternative cost comparison study method described in . . . [TM-6] or currently applicable guidance." We note that use of TM-6 is contrary to the DOD guidance referred to above. This would leave only "currently applicable guidance" as the basis for the cost comparison.

On September 4, 1984, the Army further supplemented its previous guidance on severance pay directing that personnel costs be adjusted to include all pay raises likely to fall between the base year calculations and actual severance of the employee prior to application of the 2-percent factor. It concluded:

> "3. THEREFORE, EFFECTIVE IMMEDIATELY, SEVERANCE PAY WILL BE BASED ON THE 2 PERCENT OF THE AMOUNT SHOWN ON THE PERSONNEL COST WORKSHEET, COLUMN F, TOTAL, OR A PREVIOUSLY APPROVED AMOUNT (IAW REF B [the Army's May 11, 1984, guidance]), ADJUSTED FOR ALL PROPOSED PAY RAISES BETWEEN THE BASE YEAR CALCULATIONS AND THE ANTICIPATED SEVERANCE DATE."

Nero contends that the foregoing provides a sufficient basis for concluding that the 2-percent factor should have been applied to the calculation of severance pay during the cost comparison.

The Army admits that it was aware of the Revised Circular, the DOD guidance and Army guidance and its applicability to this procurement. The Army reports that nonuse of the 2-percent formula is proper because this case falls

within the Revised Circular's exception for cost studies where a higher than normal separation rate can be anticipated and the alternate assumptions underlying the anticipation can be fully documented. However, it is clear that as early as April 3, 1984, the Army guidance specifically advised that use of the claimed exception would require advance approval of a request which stated "the reason for the deviation from this standard" and provided "supporting alternative computation and documentation." The record also shows that Yuma did not initially have a reason for anticipating an abnormal separation rate and prepared cost comparison worksheets using the 2-percent formula. It appears that nonuse of the 2-percent formula grew out of the following situation which occurred in November 1983:

> ". . . the audit team strongly suggested that . . . [Yuma Proving Ground] utilize 'actual' costs developed through a mock-RIF process . . . to estimate one-time personnel costs associated with a conversion to contractor operation. It was explained that the auditors were more comfortable with 'actual' figures as opposed to the use of an arbitrary formula."

Yuma thereupon abandoned use of the 2-percent formula and relied instead on a previously conducted mock RIF as the basis for calculation of severance pay.

Although we have held that the mock-RIF procedure is a proper and recognized method to calculate severance pay and that estimates of severance pay involve complex and somewhat subjective judgments which we will not second-guess, Support Services, Inc., B-214793, supra, at 5, we find the Army's nonuse of the 2-percent formula improper. The RFP bound the Army to follow currently applicable guidance. In order for Yuma to deviate from the 2-percent formula, the applicable guidance required both a reason for anticipating unusual separation rates based on assumptions which could be fully documented and submission of a request for advanced approval of a deviation from the 2-percent formula stating a reason and providing supporting computations and documentation. Here, the record indicates that a formal request was never received by the Army approving authority and the Army never provided a reason and appropriate supporting documentation for nonuse of the 2-percent formula other than the fact that the procedure followed was favored by the auditors.

We note in this connection that the Board denied this appeal issue on the ground that the cognizant Army approving authority would have approved a request to deviate had it received the request and such request was fully documented as required by the Army directives. This assumption on the Board's part does not justify the Army's clear failure to follow the cost comparison guidance.

We further note that, while the Board indicates that the mock-RIF used here was more accurate than the 2-percent factor, we do not find that this record supports this view. As indicated above, in our discussion of the Letter, mock-RIF calculations contain numerous assumptions the validity of which may vary widely according to time and place to which they are applied. The record indicates that a number of the Army mock-RIF calculations were based upon the same assumptions made in the example in the Letter. On the other hand, the 2-percent formula is based on the government's actual past conversion experience.

We conclude on this record that the cost comparison was defective because the Army failed to adhere to the procedure set out in the RFP (that is, use of "currently applicable guidance") in establishing that deviation from the 2-percent formula required by "currently applicable guidance" was necessary. As indicated above, the Army has never provided a reason and appropriate supporting documentation for nonuse of the 2-percent formula and the nonuse has never been approved by the Army approving authority.

We recommend that the Army evaluate the conversion costs consistent with this decision.

Milton J. Socolar

for Comptroller General
of the United States