Audit Report

OFFICE OF THE INSPECTOR GENERAL

COST GROWTH IN COMMERCIAL ACTIVITY CONTRACTS

Report No. 95-162 March 31, 1995

Department of Defense

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Acronyms

CA	Commercial Activity
CAMIS	Commercial Activity Management Information System

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

Report No. 95-162 March 31, 1995

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION AND TECHNOLOGY
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
DIRECTOR, DEFENSE LOGISTICS AGENCY
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Audit of Cost Growth in Commercial Activity Contracts (Project No. 4CG-5066)

Introduction

We are providing this report for your information and use. The audit was required under the National Defense Authorization Act for FY 1995, section 364, "Review by Defense Inspector General of Cost Growth in Certain Contracts." The Act directed the Inspector General, DoD, to review a representative sample of existing commercial activity (CA) contracts that resulted from a cost comparison study conducted by DoD under Office of Management and Budget Circular No. A-76, "Performance of Commercial Activities," August 4, 1983 (the Circular). The review was to determine the extent of cost growth on CA contracts. A report containing the results of the review is to be submitted to the Senate Committee on Armed Services and the House Committee on National Security by April 1, 1995.

Audit Results

Review of 20 Army, Navy, and Air Force CA contracts, which were negotiated at $522 million, determined that the contracts had a net cost growth of $108 million. The contract cost growth resulted from $31 million in contractor wage increases and $111 million in increased within-scope work requirements, less $34 million in decreased work requirements (Enclosure 1).

Audit Objectives

The primary audit objective was to determine the extent to which the costs incurred on selected CA contracts exceeded the original negotiated contract price and the reasons for that growth. The audit also evaluated the effectiveness of internal controls applicable to the primary audit objective.

Scope and Methodology

Commercial Activity Management Information System Database. We obtained data on CA contracts from the Commercial Activity Management Information System (CAMIS) database. FY 1993 CAMIS data showed a total of 1,114 CA contracts, awarded at $4.5 billion, that resulted from a cost comparison study. The CAMIS database provided the following information on the CA contracts:

- CA function,
- contract award date,
- total contract bid price,
- contract bid price for each performance period, and
- actual cost for each performance period.

We determined that the FY 1993 CAMIS report contained incomplete data. It contained incomplete data for the Navy in the areas of performance period contract costs and actual period contract costs for many contracts. Similar CA data for the Army and the Air Force was more complete than for the Navy. We were unable to select a statistical sample of CA contracts because of the incomplete CAMIS database. However, the incomplete CAMIS database did not preclude us from identifying and judgmentally selecting CA contracts for review.

Judgmental Selection of CA Contracts. We judgmentally reviewed Air Force, Army, and Navy records related to 20 contracts negotiated from 1986 through 1992 that were valued at $522 million, including contract options. The judgmental sample of Army and Air Force contracts was selected from those contracts that had cost growth between the original contract price and the actual cost for the first three performance periods in the CAMIS database. We were unable to select Navy contracts based on cost growth because of the lack of cost data, therefore, we selected Navy contracts that resulted from cost comparison studies. Based on our review, we determined that all the Navy contracts contained cost growth. The Defense Logistics Agency and other defense agencies CA contracts were not reviewed because of their limited number. The selected Army, Navy, and Air Force CA contracts were for the performance of food service, custodial services, base operations support, transportation, public works, military clothing services, and aircraft maintenance.

Methodology. We obtained and reviewed the following contract documentation for each selected CA contract:

- contract award,
- performance work statement,

- cost comparison study, and
- contract modifications.

Review of Contracting Officer Representative Records. We interviewed the cognizant contracting officer representative for each CA contract reviewed. The contracting officer representatives were responsible for monitoring the CA contracts to verify that performance was satisfactory and cost-effective. We reviewed the contracting officer representative monthly and quarterly inspection reports and other relevant documentation.

Authoritative Guidance on Commercial Activity Contracts. We reviewed existing Office of Management and Budget, DoD, and Federal regulations governing CA contracts.

Audit Period and Standards. This economy and efficiency audit was performed from September 1994 through March 1995 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. Accordingly, we included such tests of internal controls as were considered necessary. We did not rely on any computer-processed data or statistical sampling procedures to perform the audit. Enclosure 2 lists the organizations visited or contacted during the audit.

Internal Management Control Program

We evaluated internal management controls associated with the CA program. No material internal control weaknesses were identified. Therefore, we did not review the implementation of the DoD Internal Management Control Program as it applied to the primary audit objective.

Prior Audit Coverage

Inspector General, DoD, Report No. 90-096, "Procedures for Monitoring Commercial Activities' (CA) Functions After Completion of A-76 Competitions," July 5, 1990. The report concluded that the Military Services were not effectively managing contractor work load after CA functions were converted from Government to contractor operations, and therefore, anticipated savings were not always realized. The audit estimated that the Services would obtain some savings on 37 of the 41 contracts reviewed. However, the Services would not realize the total $94.9 million anticipated savings to be achieved by contracting out. Rather, the Services would spend $63.4 million more than the estimated cost of retaining the functions in-house. The report recommended that the Assistant Secretary of Defense (Production and Logistics) revise DoD Instruction 4100.33, "Commercial Activities Program Procedures," September 9, 1985, to include written policies and procedures for managing the postaward phase of the commercial activities program; develop and periodically review performance work statements that clearly define contractor workload; and require the resolicitation of contracts when costs exceed DoD in-house cost estimates. The Principal Deputy Assistant Secretary of Defense (Production and

Logistics) nonconcurred with the need to revise DoD Instruction 4100.33 to include policies and procedures for managing the program for the Circular after CAs are converted from Government to contractor operations. In mediation, the Deputy Assistant Secretary of Defense (Installations) agreed to track cost escalation of contracts awarded as result of cost comparisons. Contracts with abnormal cost escalation would be referred to appropriate officials for evaluation and action.

Audit Background

Office of Management and Budget Circular No. A-76. The Circular establishes Federal policy regarding the performance of CAs. The supplement to the Circular sets forth procedures for determining whether CAs should be performed under contract with commercial sources or in-house using Government facilities and personnel. The Circular requires that, if a cost comparison determines that a Government function should remain in-house, the activity is required to perform a cost comparison every 5 years to determine whether remaining in-house is still the most economical means of performance. However, the Circular does not require that a review be performed every five years for contracted out functions. Rather, the Circular requires the contracted out function be continuously monitored and if costs become excessive, the function should be recompeted. Also, individual installation commanders retain sole authority to determine when a cost comparison will be performed.

Commercial Activity. A CA is operated by a Federal Executive Agency and provides a product or service that could be obtained from a commercial source. A CA is not an inherently governmental function. A CA also may be part of an organization or a type of work that is separable from other functions or activities and is suitable for performance by contract. Examples of CAs are audiovisual products and services; food services; custodial services; industrial shops and services; transportation; and maintenance, overhaul, repair, and testing.

Cost Comparison Study. A cost comparison is the process of developing an estimate of the in-house cost of Government performance of a CA and comparing it with the cost for contract performance of the CA function.

Discussion

We reviewed 20 CA contracts awarded as a result of cost comparisons performed under the Office of Management and Budget Circular A-76. The Circular requires that cost comparisons be performed to determine whether a current in-house governmental function could be economically performed by an outside contractor rather than with Government personnel. The primary reasons for cost growth were contractor wage increases and increased within-scope work requirements for the CA contracts reviewed. Additionally, as a result of accomplishing the primary audit objective, we observed the following:

- Government union and contractor concerns on the A-76 cost comparison process.

- Returning contracted functions to in-house is difficult.

- DoD was not fully supporting CA contracting under the Circular.

Reasons for Contract Cost Growth. The audit determined that the 20 CA contracts reviewed had contract cost growth when compared with the negotiated contract price amounts. The Army, Navy, and Air Force CA contracts, which were negotiated at $522 million, had a net contract cost growth of $108 million. The contract cost growth was caused by $31 million in mandated Department of Labor wage increases under the Service Contract and Davis-Bacon Acts and $111 million in increased within-scope work requirements, less $34 million in decreased within-scope work requirements (Enclosure 1). Increased within-scope work requirements of $111 million were added after the initial CA contract awards. In some cases, nonrecurring costs from Desert Shield and Desert Storm operations contributed to contract growth. The presence of increased contract requirements does not necessarily mean problems exist with the contract. The increased contract requirements would have affected in-house costs as well as contract costs; however, the increased contract requirements may render the original cost comparison invalid.

Government Union and Contractor Concerns on the A-76 Cost Comparison Process. Limitations and problems exist in the cost comparison process. For example, the application of the unsupported 10-percent conversion differential factor required by the Circular represented a potential problem in the cost comparison process. The conversion factor is added to the contract performance costs to compensate for transition costs of contracting out the Government function. Certain DoD contracting officials believed that the conversion differential factor was understated and could have resulted in contracting out in-house functions.

Government Union Concerns. Various Government union representatives expressed concerns that the following costs were not considered when preparing the cost comparisons:

- indefinite-quantity work orders;

- taxes paid on purchase of materials for direct contract use;

- adequate contract surveillance staff;

- administration of contract change orders;

- contract award fees; and

- Department of Labor Service Contract Act of 1965, Davis-Bacon Act wages, and collective bargaining agreements.

Contractor Concerns. Various industry organizations representing contractors have expressed concerns that Government in-house estimates in cost comparisons do not always include all of the in-house costs. Industry officials have protested that they are not competing on a fair playing field as the Government not only states the needs and the requirements, but also holds the competition and selects the eventual winners. Industry officials have stated that the cost comparison process is flawed for the following reasons:

- current work organization of the Government;

- the Government's accounting structure;

- cost comparisons promote a low-cost, low-bid mentality in contrast with the best value mentality; and

- the Government budgeting process does not fully allocate indirect costs.

Returning Contracted Functions In-House. When Government functions were contracted out, bringing those functions back in-house was extremely difficult. Commanding officers of the activities that had the 20 reviewed CA contracts stated that they preferred that most Government functions remain in-house; however, remaining in-house was not possible for various reasons. For example, certain commanding officers stated that they lacked sufficient personnel resources to determine whether contracted-out functions could more economically be performed in-house rather than continuing to be contracted out.

The Federal Workforce Restructuring Act of 1994 requires the Office of Management and Budget to reduce the total Federal workforce by 202,300 full-time equivalent positions by FY 1999. To comply with the Federal Workforce Restructuring Act of 1994 mandate, DoD anticipates reducing the DoD civilian workforce by 18 percent by the end of FY 1999. In that environment, there is little or no incentive for managers to revisit past decisions to privatize functions. Indeed, the goal of downsizing the Federal workforce is widely perceived as placing DoD in a position of having to contract for services regardless of what is more desirable and cost-effective. However, The Federal Workforce Restructuring Act of 1994 prohibits the conversion of work formerly performed by Federal employees to compensate for personnel reductions. The Act requires that a cost comparison be performed to convert a function from in-house to contracted.

DoD Support of CA Contracting Under the Circular. Several DoD officials stated that the CA program has not been fully supported because of the time involved in performing cost comparison studies and congressional language restricting cost comparison studies. However, senior Air Force personnel responsible for CA programs stated that the Air Force fully supports the CA program under the Circular. This audit did not analyze the timeliness of performing the cost comparison studies.

Several laws have impacted the ability of DoD to completely support CA cost comparison studies. The DoD Appropriation Act for 1991 (Public Law 101-511, November 5, 1990) restricted funding for current CA studies that exceeded 2 years in duration. DoD personnel involved in CA cost comparisons stated that, as a result of this law, a majority of cost comparison studies were canceled because the studies were either beyond the 2-year limit or ultimately reached the 2-year limit before study completion. Most recently, Public Law 102-484, section 312, October 23, 1992, and Public Law 103-160, section 313, November 30, 1993, established a moratorium that stopped the awarding of service contracts resulting from cost comparison studies under the Circular for 17 months.

During the moratorium period, Public Law 103-139, section 8022, November 11, 1993, restricted DoD from contracting out an in-house governmental function until an analysis had been completed to determine the most efficient and cost-effective organization.

Conclusions

The audit determined that the primary reasons for cost growth were mandated Department of Labor wage increases and increased within-scope work requirements for the 20 CA contracts reviewed. The audit also observed that the Circular cost comparison process has inherent limitations and that returning contracted functions in-house is difficult. In addition, the time involved in performing cost comparison studies and congressional language restricting cost comparison studies has caused incomplete implementation of the program in recent years.

Management Comments

We provided a draft of this report to management on March 6, 1995. Because this report contains no findings and recommendations, written comments were not required. On March 17, 1995, written comments were received from the Deputy Assistant Secretary of the Air Force for Communications, Computers and Support Systems. We considered the Air Force comments in preparing this report. A complete text of the Air Force comments is included in Enclosure 4.

The courtesies extended to the audit staff are appreciated. If you have questions on this audit, please contact Mr. Garold Stephenson, Audit Program Director, at (703) 604-9332 (DSN 664-9332) or Mr. Timothy Staehling, Audit Project Manager, at (703) 604-9256 (DSN 664-9256). The distribution of this report is listed in Enclosure 3. The audit team members are listed inside the back cover.

Robert J. Lieberman

Robert J. Lieberman
Assistant Inspector General
for Auditing

Enclosures

Cost Growth in Commercial Activity Contracts

Location and Function	Contract and Award Date	Negotiated Contract Price[1]	Actual Contract Cost[1]	Total Cost Growth	Reasons for Cost Growth: Wage Increases[2]	Reasons for Cost Growth: Increased Work Requirements[3]	Reasons for Cost Growth: Decreased Work Requirements[4]
Army							
Army Aviation Center Fort Rucker, Alabama, custodial services	DABT01-88-C-5000 August 29, 1988	$ 813,794	$ 972,892	$ 159,098	$ 6,458	$ 153,764	($ 1,124)
Army Aviation Center Fort Rucker, Alabama, food services	DABT01-91-D-0001 November 19, 1990	2,102,023	2,224,798	122,775	80,443	85,039	(42,707)
Army Aviation Center Fort Rucker, Alabama, visual information services	DABT01-91-C-0051 February 11, 1991	3,571,832	3,907,597	335,765	268,452	95,691	(28,378)
Army Field Artillery Center Fort Sill, Oklahoma, wearing apparel services	DABT39-92-C-3214 August 14, 1992	1,576,251	1,666,014	89,763	9,559	80,204	0
Army Field Artillery Center Fort Sill, Oklahoma, base operations support	DABT39-87-C-4040 October 1, 1988	53,955,003	64,112,576	10,157,573	805,000	12,790,744[5]	(3,438,171)
Army Armament Center Fort Knox, Kentucky, food services	DABT23-88-C-0804 September 30, 1988	39,915,801	36,147,360	(3,768,441)	380,380	5,474,846[5]	(9,623,667)
Headquarters, 4th Infantry Division Fort Carson, Colorado, public works services	DAKF06-88-C-0001 July 28, 1988	52,097,735	80,101,885	28,004,150	1,606,384	26,397,766[5]	0
Subtotal		**$154,032,439**	**$189,133,122**	**$35,100,683**	**$3,156,676**	**$45,078,054**	**($13,134,047)**
Navy							
Navy Support Activity New Orleans, Louisiana, housing and maintenance	N62467-85-D-7584[6] February 13, 1987	$ 2,890,880[7]	$ 3,472,634[7]	$ 581,754	$ 377,257	$ 224,816	($ 20,319)
Naval Air Facility El Centro, California, base operations	N62474-84-C-1712[6] February 14, 1986	23,886,015	33,705,984	9,819,969	2,480,894	7,339,075	0

See footnotes at the end of enclosure.

Cost Growth in Commercial Activity Contracts

Location and Function	Contract and Award Date	Negotiated Contract Price[1]	Actual Contract Cost[1]	Total Cost Growth	Reasons for Cost Growth: Wage Increases[2]	Reasons for Cost Growth: Increased Work Requirements[3]	Reasons for Cost Growth: Decreased Work Requirements[4]
Navy (cont'd)							
Naval Air Station Whidbey Island, Washington, base operations	N62474-83-R-3001[6] April 25, 1986	37,312,604	40,655,040	3,342,436	1,850,000	2,410,000	(917,564)
Naval Air Station Corpus Christi, Texas, aircraft maintenance	N68520-87-C-0015 July 8, 1987	60,811,612	95,713,174	34,901,562	13,669,107	22,661,432[8]	(1,428,977)
Naval Air Station Corpus Christi, Texas, aircraft maintenance	N68520-89-C-0017 March 17, 1989	81,032,269	82,141,709	1,109,440	2,387,767	0	(1,278,327)
Naval Air Station Fallon, Nevada, base operations	N62474-83-R-3131[6] April 17, 1987	61,896,464	72,881,158	10,984,694	3,542,819	9,267,802	(1,825,927)
Subtotal		**$267,829,844**	**$328,569,699**	**$60,739,855**	**$24,307,844**	**$41,903,125**	**($5,471,114)**
Air Force							
37th Training Wing Lackland Air Force Base, Texas, medical transcription	F41636-91-C-0001 November 7, 1990	$ 1,522,335	$ 1,784,840	$ 262,505	$ 74,669	$ 228,555	($ 40,719)
Air Intelligence Agency Kelly Air Force Base, Texas, custodial services	F41621-90-C-7000 July 18, 1990	1,133,378	1,356,577	223,199	69,847	169,297	(15,945)
Air Force Space Technology Center Kirtland Air Force Base, New Mexico, logistics materiel control	F29650-91-C-0001[9] August 16, 1990	1,740,332	1,831,432	91,100	90,000	1,100	0
914th Air Wing Niagara Falls, New York, base operations services	F30617-90-D-0002[10] July 15, 1989	5,803,785[11]	6,352,474[11]	548,689[11]	336,114	212,575	0
16th Special Operations Wing Hurlburt Field, Florida, engineering supply store	F08620-92-D-0002 December 15, 1991	3,423,441	5,818,084	2,394,643	0	2,394,643	0

See footnotes at the end of enclosure.

Location and Function	Contract Number and Award Date	Negotiated Contract Price[1]	Actual Contract Cost[1]	Total Cost Growth	Reasons for Cost Growth: Wage Increases[2]	Increased Work Requirements[3]	Decreased Work Requirements[4]
Air Force (cont'd)							
64th Flight Training Wing Reese Air Force Base, Texas, aircraft maintenance	F41689-90-C-0251[12] August 9, 1989	85,951,551	94,511,738	8,560,187	3,260,735	21,088,417	(15,788,965)
64th Flight Training Wing Reese Air Force Base, Texas, protective coating	F41620-91-D-0002 October 1, 1990	907,038	1,241,825	334,787	0	334,787	0
Subtotal		**$100,481,860**	**$112,896,970**	**$12,415,110**	**$3,831,365**	**$24,429,374**	**($15,845,629)**
Total		**$522,344,143**	**$630,599,791**	**$108,255,648**	**$31,295,885**	**$111,410,553**	**($34,450,790)**

[1]The negotiated contract price and actual contract cost amounts include only those contract performance periods that have been completed.

[2]Represents Department of Labor mandated wage increases in accordance with the Service Contract Act of 1965 or the Davis-Bacon Act.

[3]Represents increased within-scope work requirements.

[4]Represents decreased within-scope work requirements.

[5]Includes nonrecurring costs related to Desert Shield and Desert Storm operations.

[6]The date within the contract number represents the date when the cost comparison study was initiated.

[7]Includes fixed-price costs only because no records were maintained for indefinite-quantity work order costs.

[8]Includes about $8.2 million of work requirements (aircraft maintenance) transferred from Naval Air Station El Centro, California.

[9]The contract had an orientation period from August 17 through October 1, 1990.

[10]The contract had an orientation period from August 17 through September 30, 1989.

[11]Negotiated contract price, actual contract cost, and total cost growth amounts represent only the fixed-price portion of the contract.

[12]The contract effective date was October 1, 1989.

Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology, Washington, DC
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Deputy Under Secretary of Defense for Environmental Security, Washington, DC
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Defense Manpower Data Center, Arlington, VA

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Assistant Secretary of the Army (Financial Management), Washington, DC
Auditor General, Department of the Army, Washington, DC
Army Training and Doctrine Command, Fort Monroe, VA
  Army Aviation Center, Fort Rucker, AL
  Army Field Artillery Center, Fort Sill, OK
  Army Armament Center, Fort Knox, KY
Army Forces Command, Fort McPherson, GA
  Headquarters, 4th Infantry Division, Fort Carson, CO
Army Missile Command, Redstone Arsenal, AL

Department of the Navy

Assistant Secretary of the Navy (Financial Management), Washington, DC
Assistant Secretary of the Navy (Research, Development, and Acquisition), Washington, DC
Office of the Chief of Naval Operations, Installations Support Branch, Washington, DC
Naval Air Station, Whidbey Island, WA
Naval Air Station, Fallon, NV
Naval Air Force, El Centro, CA
Naval Support Activity, New Orleans, LA
Naval Air Station, Corpus Christi, TX

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller), Washington, DC
United States Air Force, Directorate of Programs and Evaluation, Washington, DC
Air Education and Training Command, Randoloph Air Force Base, TX
  37th Training Wing, Lackland Air Force Base, TX
  64th Flight Training Wing, Reese Air Force Base, TX
Air Intelligence Agency, Kelly Air Force Base, TX
Air Force Space Technology Center, Kirtland Air Force Base, NM

Department of the Air Force (cont'd)

914th Air Wing, Niagara Falls, NY
16th Special Operations Wing, Hurlburt Field, FL
Air Force Audit Agency, Western Audit Region, Randoloph Air Force Base, TX
Air Force Audit Agency, Area Audit Office, Cannon Air Force Base, NM

Other Defense Organizations

Defense Contract Audit Agency, Alexandria, VA
Defense Logistics Agency, Alexandria, VA

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- Senate Subcommittee on Defense, Committee on Appropriations
- Senate Committee on Armed Services
- Senate Committee on Governmental Affairs
- House Committee on Appropriations
- House Subcommittee on National Security, Committee on Appropriations
- House Committee on Government Reform and Oversight
- House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
- House Committee on National Security

Honorable Strom Thurmond, Chairman, Senate Armed Services Committee, U.S. Senate
Honorable Sam Nunn, Ranking Minority Member, Senate Armed Services Committee, U.S. Senate
Honorable Floyd Spence, Chairman, House National Security Committee, U.S. House of Representatives
Honorable Ronald V. Dellums, Ranking Minority Member, House National Security Committee, U.S. House of Representatives

Department of the Air Force Comments

Final Report Reference.

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC

OFFICE OF THE ASSISTANT SECRETARY

17 March 1995

MEMORANDUM FOR THE ASSISTANT INSPECTOR GENERAL FOR AUDITING,
OFFICE OF THE INSPECTOR GENERAL,
DEPARTMENT OF DEFENSE

FROM: SAF/AQK
1060 Air Force Pentagon
Washington DC 20330-1060

SUBJECT: Draft Report of Proposed Audit Report, Cost Growth in Commercial Activity Contracts, March 6, 1995 (Project No. 4CG-5066)

This is in reply to your request for Air Force comments on the subject report. The Air Force requests a formal briefing on the results of this audit.

The Air Force nonconcurs with several major aspects of this report. Our main concern is it contains allegations regarding Air Force management that was not researched completely and stereotypes the Air Force's program with the other services. The Air Force has had and continues to have the most aggressive Commercial Activities (CA) program in the federal government. Additionally, CA Program managers did not have an opportunity to confirm aspects of this audit relating to CA Program management within the Air Force.

An additional concern is that the language contained in the report does not meet with Congressionally directed audit objectives and, in fact, tends to mislead the reader. The current draft report contains excessive and unsupportable information. The danger of this extraneous and unsubstantiated data is that it can lead to further Congressional restrictions through legislation.

We strongly recommend the report be amended to limit it to the Congressional tasking and audit objectives: (1) To what extent has existing CA contracts exceeded the original negotiated contract price and (2) are internal controls being effectively performed? Our specific concerns are:

a. **Scope and Methodology**: The Air Force non-concurs with the statement that the Commercial Activities Management Information System (CAMIS) report was unreliable.

AIR FORCE COMMENT: Unreliable refers to erroneous entries or omissions. The Air Force data records provide explanations when information is missing or when entries deviate from the expected norm. This does not make the records unreliable.

AIR FORCE RECOMMENDATION: Change "unreliable" to "incomplete in some cases." Revised

b. **Internal Management Control Program**: The report indicates no material internal control weaknesses were identified. This statement indicates CA contracts are satisfactorily monitored for contract performance and costs.

Final Report Reference.

c. **Prior Audit Coverage:**

AIR FORCE COMMENT: Why are July 90 Report conclusions germane to the objectives of this audit and were these problems adequately investigated to determine if they still exist five years later? The implication is that these problems are directly attributable for contract cost increases. Conspicuously missing is the mention of any effort to determine if in-house operating costs would have similarly increased as requirements changed. The Air Force experience is that increases in work scope creates cost increases whether the workload is contracted or performed in-house. For example, we note the current report shows the Air Force increased operating costs at Reese AFB by $8,560,187 which is primarily due to the addition of a new T-1 aircraft mission. An in-house operation would have experienced a similar cost increase. (Many GAO Audits exist to support this statement.) Inclusion of these facts in this report is essential to Congressional understanding of the audit.

Revised

AIR FORCE RECOMMENDATION: Delete the section or change it to eliminate any reference to the July 90 Report because it does not comply with nor is it germane to the Congressional objectives of this audit.

d. **Discussion**:

(1) "The cost comparison process has inherent limitations."

AIR FORCE COMMENT: The report does not identify the specific limitations, their impact, or address potential solutions. We cannot correct a limitation to an unidentified problem. Is this issue germane to the objectives of this audit?

Revised

AIR FORCE RECOMMENDATION: Include specific limitations, impacts and potential solutions or delete the comment.

(2) "Returning contracted functions in-house is difficult."

AIR FORCE COMMENT: Recommend specific difficulties and potential solutions be identified. Based on Air Force experience, we cannot concur with this statement. Air Force policy has been and continues to stress cost effective operation of any CA. We have returned several contracted functions in-house based on cost comparisons. We currently have cost comparisons in-progress on contracted activities where the installation commander will submit an in-house bid. Additionally, this issue is not in-line with audit objectives.

Revised

AIR FORCE RECOMMENDATION: Delete this statement.

Final Report Reference.

(3) "The Military services are not actively pursuing CA contracting under OMB Circular A-76."

AIR FORCE COMMENT: The Air Force has maintained an active CA Program. Even under the recent prohibition, the Air Force continued with in-progress cost comparisons by delaying milestones when possible, while seeking legislative relief.

AIR FORCE RECOMMENDATION: Delete this statement. Revised

(4) Para on "All CA Contracts Reviewed Contained Contract Cost Growth."

AIR FORCE COMMENT: Contract cost growth due to increased requirements was not reviewed to determine if similar increases would have been incurred by an in-house operation.

AIR FORCE RECOMMENDATION: The audit should indicate that cost growth due to increased requirements will increase the cost of operating a function whether it is operated by a contractor or an in-house workforce. Revised

(5) Para on "OMB Circular No. A-76 Cost Comparison Process."

AIR FORCE COMMENTS: The report addresses various costing limitations and problems existing in the cost comparison process; however, the IG report does not reflect the impact nor propriety of these subjects on the cost comparison process. The current costing procedures recognize the absence of a uniform accounting system throughout the Federal Government and are intended to establish a practical level of consistency and uniformity to assure substantive factors are considered when making cost comparisons. As stated by OMB, these procedures are recognized by both the private and public sector as being fair, reasonable and consistent.

Additionally, union allegations should not be included as factual unless substantiated. If public sector labor unions were consulted for opinions regarding the cost comparison process, the private sector should have also been consulted for their assessment.

AIR FORCE RECOMMENDATION: All references to comments made by public sector labor unions should be deleted from this report. They are not germane and do not meet the objectives of the audit. Revised

(6) Para on "Returning Contracted Functions In-House."

AIR FORCE COMMENTS: Again, this section makes reference to a problem without any supporting evidence. Specific comments follow:

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- Regarding the Hurlburt Field example--This cost comparison (directed by the federal courts) determined that retaining the activity on contract was the most cost effective and efficient method of operation to the American taxpayer; therefore, we fail to see any fault with the decision to retain its contract performance. Contract costs have increased over the last few years due to increased mission requirements and materiel costs. An in-house operation would have experienced similar cost increases.

Deleted

AIR FORCE RECOMMENDATION: Exclude the erroneous information regarding the cost comparison decision as it is not germane to the objectives of this audit. Change the Hurlburt Field explanation to address the objective of the audit which is to explain why the contract costs have increased.

- Reference comments regarding the commanding officer's preference for in-house retention. While it is true that some commanders prefer the flexibility of an in-house operation, the Air Force (and all DoD) is facing severe end strength and budget decreases. Commanders at all levels cannot afford to operate a CA in-house if it is not cost effective for the sake of "flexibility" in today's environment.

Revised

AIR FORCE RECOMMENDATION: Delete comment. Not germane to the objectives of this audit.

- Reference "The goal of downsizing the Federal workforce has placed DoD in a position of having to contract for services regardless of what is more desirable and cost effective."--This is an inaccurate statement. In accordance with P.L. 103-116, para 5(g) and OMB Memo M-94-28, DoD and the Air Force cannot legally contract without demonstrating cost effectiveness.

Revised

AIR FORCE RECOMMENDATION: Change statement to accurately reflect the statutory and OMB language.

- Reference statement indicating a previously cost compared in-house function must be cost compared every five years. This statement is inaccurate. 10 USC, 2468, gives installation commanders sole authority to determine when a cost comparison will be performed.

Revised

AIR FORCE RECOMMENDATION: Change statement to accurately reflect the statutory language.

- Reference statement that OMB Circular (OMBC) A-76 does not require contracted functions to be reviewed every five years to determine cost effectiveness. This statement has no bearing on the issue. For your information, all service contracts (including contracts awarded via the A-76 process), are continuously monitored by the local contracting office and functional manager for satisfactory performance and cost effectiveness. When costs become excessive or performance unsatisfactory, a contracting officer is required to resolicit the contract. At

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that time, an installation commander may choose to compete in the solicitation by submitting an in-house bid via the cost comparison process. If the decision is in favor of in-house performance, the activity is returned in-house. The allegation throughout this report that it is impossible to convert such contracts to in-house performance is not true. The Air Force has and continues to convert contracts to in-house performance when supported by a cost comparison. Additionally, OMBC A-76 (Supplement, Part I, Chapter 1, Paragraph C.3.) outlines procedures for monitoring cost growth or unsatisfactory performance in contracted CAs.

AIR FORCE RECOMMENDATION: Change this paragraph to reflect the policy contained in OMBC A-76. Revised

(7) Para on "Implementation of OMB Circular No. A-76 CA Program in DoD."

AIR FORCE COMMENTS:

- Reference the statement that indicates the Military services have not actively pursued nor support the CA Program. The Air Force has and continues to have a very active CA Program. Of the 1,114 completed cost comparisons referenced in this audit report, the Air Force has completed 772 of them (about 70%) and continues to actively support and pursue the policies contained in OMBC A-76. For example, we have 35 initiatives in-progress impacting 5,898 full time equivalents (FTEs) and an additional 135 projected initiatives.

  AIR FORCE RECOMMENDATION: Change the paragraph to indicate the Air Force has an active CA Program.

- Reference the statement that the services are not actively pursing studies because of the time involved. Most of the time consumed in conducting a cost comparison is due to the acquisition process. A-76 specific actions (MEO development, MEO costing, Independent Review, comparing contract/in-house costs) take place concurrently with acquisition actions which must comply with the FAR.

  AIR FORCE RECOMMENDATION: Delete reference. It is not germane to the objectives of the audit. Revised

- Reference the statement made on the Congressionally mandated time limitations. While the Air Force did cancel some initiatives due to this restriction, the legislation does not pose a problem for the Air Force. Because installation commanders have both sole authority to nominate functions for cost comparison and responsibility to complete them within the legislated timeframe, the required level of effort is applied.

  AIR FORCE RECOMMENDATION: Revise to reflect the Air Force position or eliminate the reference completely as it is not germane to the objectives of the audit. Revised

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Revised

e. **Conclusions:**

AIR FORCE COMMENT: This audit should specify the limitations impacting the A-76 program so they can be reviewed and appropriate solutions developed. The vague and unsubstantiated statements contained in this report cannot be concurred upon by the Air Force and will grossly mislead Congress.

AIR FORCE RECOMMENDATION: Address service compliance individually and respond only to the objectives directed by Congress.

f. **Enclosure 1:**

AIR FORCE COMMENT: This report does not indicate how values were determined: Recommend inclusion of the methodology. We cannot validate the information reported in this Enclosure as most of the award dates or negotiated contract prices shown do not match our CAMIS data. The Air Force CAMIS data is reliable and is the only mechanism we have to validate the information in this Enclosure given the short suspense provided.

The Air Force continues to endorse and actively pursue the policies dictated by OMBC A-76. It is to the benefit of the Air Force, the Department of Defense and the American taxpayer. The DoD/IG as a member of the DoD team should ensure this report does not undermine ongoing OSD A-76 program efforts by including unrelated and unsubstantiated remarks in the audit. Instead the report should be limited to addressing the Congressional tasking and audit objectives.

LLOYD K. MOSEMANN II
Deputy Assistant Secretary, Communications, Computers and Support Systems

cc:
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