DEPARTMENT OF DEFENSE

AUDIT REPORT

PROCEDURES FOR MONITORING COMMERCIAL ACTIVITIES' FUNCTIONS AFTER COMPLETION OF A-76 COMPETITIONS

No. 90-096

July 5, 1990

Office of the Inspector General

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
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MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE (PRODUCTION AND LOGISTICS)
ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Report on the Audit of Procedures for Monitoring Commercial Activities' Functions After Completion of A-76 Competitions (Report No. 90-096)

This is our final report on the Audit of Procedures for Monitoring Commercial Activities' Functions After Completion of A-76 Competitions for your information and use. Management comments on a draft of this report were considered in preparing this final report. The audit was performed from October 1988 through September 1989 and included an analysis of commercial activity contracts awarded by the Services during FY's 1985 through 1987. The overall audit objective was to evaluate the adequacy of DoD's procedures and the effectiveness of the internal controls over contractors' work load and performance of commercial activities. Also, we determined if the Services had implemented Executive order 12615, "Performance of Commercial Activities," and Section 1111 of the Defense Authorization Act for FY 1988 and FY 1989. From FY's 1985 through 1987 the Military Departments and the Defense agencies awarded 243 commercial activities' contracts, valued at about $1.1 billion.

The Services will realize some savings by contracting versus in-house operation on most of the contracts reviewed. However, overall the Services will spend $158.3 million more than they anticipated when the comparisons to in-house operation were made because the Services were not effectively managing contractor work load after the contracts were awarded. Also, the Services' quality assurance surveillance programs on commercial activities' contracts were not adequate to ensure that contractors were meeting contract performance requirements. The Services generally complied with Section 1111 of the Defense Authorization Act for FY 1988 and FY 1989 (the Nichols Amendment). For the 28 installations visited, all 28 installation commanders complied with the Nichols Amendment by deciding which commercial

activities would be studied. The results of the audit are summarized in the following paragraphs, and the details, audit recommendations, and management comments are in Part II of this report.

Based on our review of 41 commercial activities' contracts valued at $425.6 million, the Services were not effectively managing contractor work load; therefore, anticipated savings were not always realized. We estimate the Services will obtain some savings on 37 of the 41 contracts reviewed. Overall, however, the Services will not realize the $94.9 million savings anticipated to be achieved by contracting out. Rather, they will spend an additional $63.4 million more than the estimated cost of retaining the functions in house. We recommended that the Assistant Secretary of Defense (Production and Logistics) revise DoD Instruction 4100.33 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 work load, and require the resolicitation of contracts when costs exceed DoD in-house cost estimates. We also made recommendations to the Military Departments on specific issues (page 5).

The Services did not ensure that contractor performance was meeting contract requirements. For the 41 commercial activities' contracts reviewed, quality assurance surveillance plans were not fully implemented on 20 contracts valued at $332.3 million. We recommended that the Assistant Secretary of Defense (Production and Logistics) revise DoD Instruction 4100.33 to require contracting officers to periodically certify that quality assurance surveillance plans are fully implemented, to establish procedures on when contracting officers are to take deductions when quality assurance representatives document poor contractor performance, and to ensure that contracts provide for use of extrapolation to calculate deductions for poor contractor performance (page 15).

Although the Services were making progress in completing their commercial activities' studies, they were not in compliance with Executive order 12615, which required Government Agencies to study a minimum of 3 percent of their civilian population annually until all identified potential commercial activities have been studied. We recommended that the Secretaries of the Military Departments comply with the Executive order by studying 3 percent of their total civilian populations annually (page 23).

The audit identified internal control deficiencies as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. The Services did not have adequate internal controls to ensure that contractor work load and quality assurance plans were accomplished. Recommendations A.1. and B.1. in this report will correct the

weaknesses. The monetary benefits associated with these recommendations could not be determined because we could not determine the direct costs of these inadequate procedures. A copy of this report is being provided to the senior officials responsible for internal controls within the Office of the Secretary of Defense and each Service.

A draft of this report was provided to the Assistant Secretary of Defense (Production and Logistics), the Assistant Secretaries of the Army and Navy (Financial Management), and the Assistant Secretary of the Air Force (Financial Management and Comptroller) on March 5, 1990. The Principal Deputy Assistant Secretary of Defense (Production and Logistics) provided comments on May 16, 1990. The Director of Management, Office of Assistant Secretary of the Army (Installations, Logistics and Environment), provided comments on April 27, 1990. The Assistant Secretary of the Navy (Installations and Environment) provided comments on May 3, 1990. The Deputy Assistant Secretary of the Air Force (Logistics) provided comments on May 11, 1990. The complete texts of management comments are included in Appendixes E through H. An extract of management comments on the findings and our responses is included as Appendix I.

The Principal Deputy Assistant Secretary of Defense (Production and Logistics) nonconcurred with Recommendations A.1. and B.1. on the need to revise DoD Instruction 4100.33 to include policies and procedures for managing the A-76 program after commercial activities are converted from Government to contractor operations. Based on the comments received, we further clarified Recommendations A.1. and B.1. concerning contractor work load and quality assurance of commercial activities. Therefore, we request that the Assistant Secretary of Defense (Production and Logistics) provide final comments on Recommendations A.1. and B.1., including proposed corrective actions and completion dates. We also ask that comments indicate concurrence or nonconcurrence with the internal control weaknesses described above.

The Deputy Assistant Secretary of the Air Force (Logistics) nonconcurred with Recommendation A.2. to reduce authorized funding on contract line items for logistics and transportation by $2.3 million for the remaining fiscal years on the Precision Acquisition Vehicle Entry Phased Array Warning System (PAVE PAWS) contracts. We feel the recommendation is still valid, and our reasons are discussed in Part II of this report.

The Army did not provide comments to Recommendation C. The Navy concurred with our Recommendation C. that the Secretaries of the Military Departments comply with the President's Executive order, but did not provide any actions taken or dates when the Navy plans to comply with the Executive order. The Air Force nonconcurred on the need to comply with our recommendation. We

recognized that the Secretary of Defense and Military Departments had taken actions to study their civilian populations performing commercial activities. However, the Military Departments were not in compliance and were not planning to comply with the Executive order at the installations visited. Therefore, we continue to feel the recommendation is valid, and our reasons are further discussed in Part II of this report. We request that the Secretary of the Army provide comments to this report; the Secretary of the Navy provide the actions to be taken and the date when his office will implement Recommendation C.; and the Secretary of the Air Force reconsider his office's nonconcurrence and provide additional comments to this final report.

As a result of the Principal Deputy's concerns about the poor execution of the A-76 program after commercial activities' contracts were awarded and the Services' lack of planned actions to correct the problems, we have added Recommendations A.3. and B.2. to the Secretaries of the Military Departments to correct the deficiencies found on the 41 contracts reviewed. We request that the Assistant Secretaries of the Military Departments provide final comments on Recommendations A.3. and B.2. If you concur, describe the corrective actions taken or planned, the completion dates for actions already taken, and the estimated dates for completion of planned actions. If you nonconcur, please state your specific reasons. If appropriate, you may propose alternative methods for accomplishing desired improvements.

Monetary benefits of $2.3 million are associated with the reduction of costs for contract line items under the Air Force's PAVE PAWS contracts. In responding to the draft report, the Air Force nonconcurred with the monetary benefits. We believe the monetary benefits are valid for the reasons discussed in Part II of this report. We ask that the Air Force provide final comments on the estimated monetary benefits. The monetary benefits are subject to mediation in the event the Air Force nonconcurs or fails to comment on them.

DoD Directive 7650.3 requires that all audit recommendations be resolved within 6 months of the date of the final report. Accordingly, final comments on the unresolved issues in this report must be provided within 60 days of the date of this report.

The courtesies and cooperation extended to the audit staff are appreciated. If you have any questions about this final report, please contact Mr. John S. Gebka at (202) 694-6206 (AUTOVON 224-6206) or Mr. Darrell Eminhizer at (202) 694-6220 (AUTOVON 224-6220). A list of the audit team members is in Appendix L. Final report distribution is shown in Appendix M.

Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Enclosure

cc:
Secretary of the Army
Secretary of the Navy
Secretary of the Air Force
Commandant of the Marine Corps

REPORT ON THE AUDIT OF PROCEDURES FOR MONITORING COMMERCIAL ACTIVITIES' FUNCTIONS AFTER COMPLETION OF A-76 COMPETITIONS

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Prepared by:
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REPORT ON THE AUDIT OF PROCEDURES FOR MONITORING COMMERCIAL ACTIVITIES' FUNCTIONS AFTER COMPLETION OF A-76 COMPETITIONS

PART I - INTRODUCTION

Background

The Office of Management and Budget (OMB) issued Circular A-76 in 1966 on the performance of commercial activities. The latest revision to the Circular was made in 1983. The Circular requires that all Government Agencies prepare an inventory of commercial activities, conduct cost comparison studies, determine if commercial activities' functions should be performed in-house or by contract, and determine if commercial activities are inherently Government functions for in-house performance. Supplement 2 of Circular A-76 outlines procedures for development of the Performance Work Statement and quality assurance surveillance plans.

Circular A-76 establishes Federal policy regarding the performance of commercial activities with emphasis on management efficiency. The Circular and its Supplement set forth procedures for determining whether or not commercial activities should be performed in-house using Government facilities and personnel or by commercial contractors. The intent of the Circular is to provide a disciplined approach to managing Government commercial activities by improving accountability through the use of performance standards and a formal performance measurement system.

The audit began as part of a Government-wide audit by the President's Council on Integrity and Efficiency's (PCIE) of Procedures for Monitoring Commercial Activity Functions After Completion of A-76 Competitions. However, the PCIE audit was canceled due to the lack of participation by Federal Agencies. Since DoD encompassed about 60 percent of commercial activities' functions and reported about 83 percent of dollar savings from completed studies for FY's 1984 through 1987, we decided to continue the DoD portion of the audit.

DoD engages in many activities that are similar to those performed by commercial contractors, such as custodial services, grounds maintenance, transportation, etc. The Government may realize savings if it obtains products or services from commercial contractors. DoD converted 243 commercial activities to contract with a value of about $1.1 billion during FY's 1985 through 1987. In FY 1988, DoD reported to OMB over $178.8 million in estimated savings that would be realized by converting in-house commercial activities to contract.

Objectives and Scope

The overall audit objective was to evaluate the adequacy of DoD's procedures and the effectiveness of the internal controls over contractor work load and performance of commercial activities after A-76 competitions. Specifically, we determined the adequacy and effectiveness of the Services' procedures for monitoring contractor work load and performance of commercial activities. Also, we determined if the Services had implemented Executive order 12615, "Performance of Commercial Activities," and Section 1111 of the Defense Authorization Act for FY 1988 and FY 1989 (the Nichols Amendment).

We identified a universe of 243 commercial activities' contracts, valued at about $1.1 billion, that were awarded during FY's 1985 through 1987 under the A-76 program. We selected a sample of 41 commercial activities' contracts valued at $425.6 million awarded during FY's 1985 through 1987 by the Services under the A-76 program. The contracts were categorized by Service and geographic region of the commercial activities studied. The specific details of our sampling procedure are included as Appendix A. Our review of these commercial activity contracts included analyses of the Performance Work Statements, quality assurance surveillance plans, contract modifications, contract costs, workload data, and contractor performance.

This program audit was made from October 1988 through September 1989 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and accordingly included such tests of internal controls as were considered necessary. A list of the activities visited or contracted during the audit is included as Appendix K.

Internal Controls

We evaluated internal control procedures over monitoring contractor work load and performance of commercial activities after A-76 competitions. Specifically, we reviewed internal controls to ensure workload requirements are properly defined, contractors performed the work load at an acceptable quality level, and unsatisfactory contractor performance is identified. We determined that internal controls were not sufficient to adequately monitor contractor work load or performance. These internal control deficiencies are discussed in detail in Part II of this report. We recommended that internal controls be improved to upgrade Performance Work Statements, to measure contractor work load, and to obtain compensation for inadequate contractor performance.

Prior Audit Coverage

The Assistant Inspector General for Auditing, the Military Departments' audit organizations, and the General Accounting Office had issued 31 audit reports concerning DoD's A-76 program from FY 1988 through the second quarter of FY 1990. The reports identified such problems as inadequate monitoring of contractors' operations, poorly defined Performance Work Statements, inadequate cost comparisons, lack of accountability over Government furnished property, and inadequate quality assurance surveillance over contractor performance. A list of these audit reports is included as Appendix B.

The Office of the Assistant Inspector General for Auditing issued Report No. 90-009, "Defense Logistics Agency Commercial Activities Program," on November 7, 1989. The report identified problems associated with Defense Logistics Agency (DLA) commercial activities' studies. DLA had not made a concerted effort to perform the commercial activities' studies required by OMB Circular A-76. As a result, DLA did not meet the 3-percent study goal set forth in Executive order 12615, "Performance of Commercial Activities," November 19, 1987. Consequently, DLA lost the opportunity to achieve an estimated savings of about $61.5 million during a 5-year period. The report recommended that the Director, DLA, comply with the requirements of the Executive order and the Nichols Amendment. At a minimum, DLA should issue a commercial activities regulation that includes policies, procedures, and guidance for computing DLA's commercial activities inventory and that allows the installation commanders to prioritize the scheduling and studying of all functions in their commercial activities inventory.

The General Accounting Office (GAO) issued Report No. GGD-90-58, "DoD's Reported Savings Figures Are Incomplete and Inaccurate," on March 15, 1990. GAO reported that DoD estimates of expected cost savings from A-76 studies are inaccurate. GAO found that DoD estimated expected cost savings from individual studies on the basis of standardized assumptions, not on the best available cost data; DoD did not routinely collect and analyze cost information to monitor actual operations after a cost study has been made; and DoD's automated system did not contain reliable information on the cost of implementing DoD's A-76 program, including the cost of doing the studies.

To improve DoD's oversight of the A-76 program and the reliability of A-76 program savings reported by DoD, the GAO report recommended that the Secretary of Defense take several actions to include requiring DoD Components to use standardized budgetary and actual cost information, rather than using a formula; and requiring DoD's A-76 office to collect information on reasons for contract cost changes that occur after cost studies are completed. DoD did not provide written comments to

the GAO report. However, GAO reported that DoD views at the exit conference and as reflected in the report were that the responsibility of DoD's A-76 office ends with a cost study's completion and does not involve gathering additional information.

Other Matters of Interest

One of our objectives was to determine if the Services were complying with the Nichols Amendment. The Nichols Amendment states that the commander of each military installation shall have the authority and the responsibility to decide which commercial activities shall be reviewed under the provisions of OMB Circular A-76. At the 28 military installations visited, the Services were in compliance with the Nichols Amendment. The installation commanders decided which commercial activities were to be studied under the A-76 program and established the priority of the commercial activities to be studied.

PART II - FINDINGS AND RECOMMENDATIONS

A. Contractor Work Load

FINDING

The Services were not effectively managing work load after commercial activities' functions were converted from Government to contractor operations. This occurred because Performance Work Statements in contracts did not accurately describe the work to be done by contractors, the Services were not determining if the amount of work reportedly done by contractors was appropriate, and contracts were not resolicited when contractor's costs exceeded DoD's estimated in-house costs. As a result, DoD activities did not effectively control cost increases on some contracts awarded for commercial activities' functions and savings anticipated from having contractors perform the functions were not always realized. Of 41 contracts reviewed valued at $425.6 million, we estimated that 7 contracts will achieve savings greater than anticipated from contracting out the commercial activities; 30 contracts will achieve savings, but the savings will be less than anticipated; and 4 contracts will cost more by contracting out than if the commercial activities had remained in-house. Overall, on these 41 contracts, we estimated that DoD will not realize the anticipated savings of $94.9 million by contracting out these functions. Rather, the Department as a whole will spend an additional $63.4 million more to accomplish the commercial activities than the estimated cost of retaining these functions in house.

DISCUSSION OF DETAILS

Background. The Commercial Activities program, also known as the A-76 program, is based on the policy that the Government will rely on commercial contractors for its goods and services when it is proper and economical to do so. Commercial activities are functions that can be performed by either the Government or commercial contractors. The Bureau of the Budget first implemented the policy in 1955, and Congress and the Office of Management and Budget (OMB) have continued to support it. The A-76 program was established to have commercial contractors compete for commercial type work that was being performed by Government employees, to reduce the Government's cost for these activities. Implementing guidance within DoD of the A-76 program is DoD Instruction 4100.33.

Under the A-76 program, the Government estimates savings by comparing the cost of performing a function in-house with Government employees to the cost of having a contractor perform the same function. Government in-house costs are determined by a cost study, while contractor operating costs are determined by soliciting bids from potential contractors. A figure equal to

10 percent of in-house personnel costs is added to the contractor bid as a decision threshold for purposes of the cost comparison. There is no actual outlay of funds. This amount is added to compensate for the loss of production, the temporary decrease in efficiency and effectiveness, the temporary operation of facilities at reduced capacity, and the other unpredictable risks that result when a contract conversion is made. The Government compares the cost of the most efficient in-house operation to the cost of the contractor operation and selects the least costly method to perform the commercial activity. Any savings are recorded in the Commercial Activities Management Information System. OSD officials use this System to monitor implementation and results of the A-76 program in DoD.

OMB Circular A-76 requires that Government and contractor costs be based on the same scope of work and level of performance. The Circular also requires accurate work statements with performance standards that can be measured. A Performance Work Statement (PWS) is a workload document that the Government prepares and incorporates into contract solicitations. Contractors use the PWS's to prepare proposals for performing commercial activities' work. The Circular further requires that the contracted commercial activity be continually monitored to ensure that the operation is cost-effective and performance is satisfactory. Office of Federal Procurement Policy Pamphlet Number 4 provides guidance for developing PWS's that accurately describe the items, materials, and services needed to accomplish commercial activities. PWS's become part of the contract and contractually bind both the contractor and the Government. PWS's written by Government personnel need to define the work load sufficiently to avoid misinterpretation of contractual requirements and to allow the Government to effectively manage the work performed by the contractors.

Defining Work Load. The Services were not effectively defining the work load to be performed by the contractors for the commercial activities, as required by OMB Circular A-76. The Circular also requires that the PWS be sufficiently comprehensive to ensure that either in-house or contract performance will satisfy DoD requirements. The PWS should clearly define what is to be done without describing how it is to be done. The PWS should also describe the output requirements of the commercial activity function, including all contractor responsibilities, and the requirements for facilities, equipment, and material. In evaluating 41 commercial activities' contracts valued at $425.6 million, we found 15 contracts valued at $316.2 million where PWS's developed during the cost study process were inadequate. Because workload requirements were not accurately defined in the original PWS, numerous contract modifications had to be made after contractors started work, and the Services could not evaluate the amount of contractor work done. The following table summarizes by Service the number and value of these 15 contracts.

Service	Number of Contracts: Audit Sample	Number of Contracts: Inadequate PWS	Contract Dollar Value: Audit Sample	Contract Dollar Value: Inadequate PWS
Army	14	9	$272,850,661	$223,957,496
Navy	10	3	101,823,685	86,494,982
Air Force	14	3	48,444,696	5,728,030
Marine Corps	3	0	2,507,255	0
Total	41	15 *	$425,626,297	$316,180,508

* The 15 contracts with inadequate PWS's are shown in Appendix C (footnote 2).

The following examples illustrate the problems that occur when the PWS is inadequate. The PWS was inadequate because either timely historical data were not used in the preparation of the PWS or measurable and verifiable work load was not used in the preparation of the PWS.

The PWS for the installation support services contract at Redstone Arsenal, Alabama, was based on workload data that were 4 years old at the time the contractor started work. As a result, the contract required substantial modification to incorporate workload changes, which resulted in a first year contract cost of about $47.6 million, $20 million (72.5 percent) more than the original $27.6 million contractor bid.

At Fort Huachuca, Arizona, the Army awarded a $12.9 million contract for facility engineering services. The PWS for this contract included 15 different functional areas including ground maintenance, woodworking, and plumbing and an estimated 1,700 different task codes, with each task code having been assigned a work unit value. The contract stated that for each work order the Army would furnish the contractor with the task code that best described the work to be performed and the estimated number of work units required to accomplish the work. Because the Army was unable to define the work to be performed on a given work order, it let the contractor assign the task code that best described the work and determine the number of work units to be charged. Army personnel were not verifying the volume of work units charged or the accuracy of task codes assigned by the contractor. The contract cost increased by 74 percent from an original estimate of about $3.5 million per year to an actual cost of over $6.1 million per year. At other activities, we identified PWS's for similar functional areas where standards for the work load were clearly identified.

Managing Work Load. DoD Instruction 4100.33, "Commercial Activities Program Procedures," September 1985, contains detailed procedures and requirements for cost comparison studies and implementing the preaward phase of the A-76 program. However, it does not establish criteria to monitor the cost-effectiveness of contractor performance of the work load identified in the PWS.

Frequently, contractor workload data were not tracked or, if they were, were not analyzed against contract requirements and costs. Because workload data were not tracked or analyzed, the Services' personnel had no means of assessing the efficiency of contractor operations or determining if contract costs were reasonable. Moreover, the Services' contracting officers were not equipped to effectively negotiate price increases or decreases for significant workload changes. Our review of the 41 commercial activities' contracts found that on 13 contracts valued at $184 million, contracting personnel placed limited emphasis on tracking and analyzing the amount of work contractors performed. These data are summarized in the following table.

	Number of Contracts		Contract Dollar Value	
Service	Audit Sample	Work Load Was Not Tracked	Audit Sample	Work Load Was Not Tracked
Army	14	2	$272,850,661	$67,407,000
Navy	10	3	101,823,685	86,494,982
Air Force	14	7	48,444,696	28,977,631
Marine Corps	3	1	2,507,255	886,449
Total	41	13 *	$425,626,297	$183,766,062

* The 13 contracts where work load was not tracked are shown in Appendix C (footnote 3).

On these 13 contracts, data were not available to determine the reasonableness of contractors' billings for work performed. Some specific examples of the problems that occur by not tracking work load along with examples of where tracking work load permitted the Services to avoid contract cost increases are discussed below.

On the Navy's base operating support contract to include telephone services for $61.3 million at Naval Air Station, Fallon, Nevada, workload data were maintained for only 8 of 16 functions included in the PWS after the contract was awarded. Therefore, the installation commander was unable to ensure that work load billed by the contractor was reasonable.

Although the daily volume of toll telephone calls in the last 6 months of FY 1988 increased by 17,805 (5,250 percent), AUTOVON calls increased by 27,113 (2,950 percent), and local calls increased by 12,030 (770 percent) over PWS estimates, Navy personnel did not determine why these increases had occurred.

In a refuse collection contract at Hill Air Force Base, Utah, PWS work load was defined in terms of tonnage, but payment was based on the number of containers collected. The refuse collection contract at Hill Air Force Base had an overall net increase of $1.1 million. Although 47 percent ($524,000) of the cost increase may have been caused by increased disposal costs to meet environmental laws, the overall cost increased significantly above the original contract price of $2.3 million. This cost increase occurred even though a comparison of actual work load to the historical work load showed a 4-percent decrease in tonnage from July 1988 through June 1989.

A review of documentation relating to contractor work load showed that military installations did not negotiate contract price adjustments when work load decreased. At Beale Air Force Base, California, the PWS in the Air Force's transient aircraft maintenance contract for $270,000 provided for reevaluation of the contract price in the event of a 5-percent variation in work load. However, the Air Force did not reevaluate the contract price even though work load decreased 38 percent from a total of 1,065 aircraft in the PWS to 655 aircraft actually maintained for the year ended June 1989.

The Air Force Space Command's contract for the Precision Acquisition Vehicle Entry Phased Array Warning System (PAVE PAWS) contained $600,000 per year in cost reimbursable contract line items for logistics and transportation at Beale Air Force Base, California, and Cape Cod Air Station, Massachusetts; and $440,000 per year for Robins Air Force Base, Georgia, and Eldorado Air Station, Texas. The average yearly expenditures for logistics and transportation have been $235,000 and $124,000, respectively. A review of the contractors' work load and the yearly expenditures should have resulted in a reevaluation of the contracts and a reduction of about $2.3 million for these line items on the contracts. However, no contract modifications had been initiated on either contract to reduce the logistics and transportation line items for the remainder of the contract period.

The Supplement to OMB Circular A-76 states that contracted commercial activities should be continually monitored to ensure performance is satisfactory and the activities are cost-effective. Where the military installation commanders were monitoring contractor workload changes, contracting officers were able to successfully negotiate price adjustments with contractors concerning the contract PWS. Thus, it is essential for DoD's

instructions to require that contractor work load be continually monitored as part of the internal controls established for the A-76 program. The internal controls should include the need for collection, periodic review, and analysis of workload data against contractual workload estimates.

On the Army's transportation motor pool contract at Fort Lewis, Washington, and the Navy's data processing support contract at Navy International Logistics Control Office, Philadelphia, Pennsylvania, the contracting officers involved successfully rebutted contractor claims for $260,000 and $746,000, respectively, for alleged workload increases. Also, on the Marine Corps' unimproved and semi-improved ground maintenance contract at Marine Corps Air Station, El Toro, California, personnel observed and reported reductions in acreage maintained by the contractor to the contracting officer, which resulted in a contract price reduction of $20,000.

Cost Increases. The Services anticipated savings on all 41 commercial activities' contracts reviewed. For seven contracts valued at $13.9 million, we estimate that the Services will realize savings greater than anticipated by the time work on these contracts is completed. These contracts will produce a savings of $5.9 million, which is $1.6 million more than the original estimate of $4.3 million. For 30 contracts, the Services' anticipated $73.3 million in savings at the time of the cost comparison. Based on our review of these contracts, we project that actual savings of about $45.9 million will be realized by the time these contracts are completed. For the remaining four contracts, instead of projected savings of $17.3 million, we estimate cost increases of $132.5 million. As a result, by the time these contracts are completed, they will cost the Services about $115.2 million more than originally projected. Overall, on these 41 contracts, we estimate that DoD will not realize the anticipated savings of $94.9 million, but will spend an additional $63.4 million to accomplish the commercial activities. The following table summarizes contract costs and estimated savings for the 41 commercial activities' contracts reviewed.

	Contract Costs (Millions)				Savings (Additional Costs) (Millions)	
	Number of Contracts	Award	Projected to Completion	Increase (Decrease)	Anticipated at Time of Award	Projected by Audit
Greater Savings Realized	7	$ 13.9	$ 12.3	$ (1.6)	$ 4.3	$ 5.9
Savings Realized, But Less Than Anticipated	30	236.2	263.6	27.4	73.3	45.9
Savings Not Realized	4	175.5	308.0	132.5	17.3	(115.2)
Total	41	$425.6	$583.9	$158.3	$94.9	$(63.4)

Of the 41 commercial activities' contracts reviewed, 37 indicated that the A-76 program can achieve savings. However, six of these contracts (three Army, two Air Force, and one Marine Corps) valued at $29.5 million were experiencing cost growth ranging from 33 to 73 percent. For the remaining four commercial activities' contracts reviewed, conversion from in-house to contractor operations was not cost-effective. These four contracts (three Army and one Navy) valued at $175.5 million exceeded the estimated cost of performing the work in house by $103.5 million and exceeded the estimated contract cost by $132.5 million.

DoD Instruction 4100.33 does not provide criteria on when commercial activities' contracts are to be resolicited when contract costs exceed in-house cost estimates or contract cost increases become unreasonable. As a result, the Services had taken virtually no action to resolicit contracts with significant cost escalation. We found one instance where resolicitation had occurred. The Marine Corps had resolicited a small custodial services contract for $900,000 that had experienced cost growth of 62 percent. To ensure cost-effective contractor operations, the Services need criteria on when contracts are to be resolicited.

RECOMMENDATIONS FOR CORRECTIVE ACTION

1. We recommend that the Assistant Secretary of Defense (Production and Logistics) revise DoD Instruction 4100.33 to include policies and procedures for managing the A-76 program that require the Services to:

a. Prepare Performance Work Statements that are based on accurate and timely historical or projected workload data and that provide measurable and verifiable performance standards.

b. Evaluate contractor work load against estimated work load in the Performance Work Statements, determine the reasons for significant variances, and modify the contract if warranted.

c. Resolicit contracts when costs exceed DoD in-house cost estimates.

2. We recommend that the Assistant Secretary of the Air Force (Manpower, Reserve Affairs, Installations and Logistics) reduce authorized funding on contract line items for logistics and transportation by $2.3 million for the remaining fiscal years on the Precision Acquisition Vehicle Entry Phased Array Warning System contracts.

3. We recommend that the Secretaries of the Military Departments require the installation commanders to:

a. Revise the Performance Work Statements for the 15 contracts, identified in Appendix C (footnote 2), with inadequate statements of work to clearly define the work load to be performed.

b. Track contractor work load data for the 13 contracts, identified in Appendix C (footnote 3), where work load was not tracked to effectively evaluate contractor performance.

MANAGEMENT COMMENTS

The Assistant Secretary of Defense (Production and Logistics) and the Services provided comments to draft findings and recommendations. Office of the Secretary of Defense (OSD) comments to Recommendation A.1. and Air Force comments to Recommendation A.2. are discussed below. OSD and the Services' comments to the Finding and our response are in Appendix I.

The Principal Deputy Assistant Secretary of Defense (Production and Logistics) nonconcurred with Recommendation A.1. Although he recognized that opportunities exist for improving contract monitoring and partially concurred with the need to do a better job of gathering workload data after commercial activities' contracts are awarded, he stated that the problems lie in execution of the contracted commercial activities, not in DoD instructions. Special procurement procedures are not needed in DoD Instruction 4100.33. The Federal Acquisition Regulation is the proper vehicle to transmit procurement policies and procedures. He stated that DoD Instruction 4100.33 adequately covers the preparation of PWS's and the resolicitation of

contracts. He also stated that much of the cost growth for commercial activities would have increased the cost to DoD regardless of whether the commercial activity was retained in-house or performed by a contractor.

The Deputy Assistant Secretary of the Air Force (Logistics) nonconcurred with Recommendation A.2. to reduce authorized funding on contract line items for logistics and transportation by $2.3 million for the remaining fiscal years on the PAVE PAWS contracts. The Air Force stated that the Air Force Space Command established Government estimates for each year based on historical expenditures and anticipated costs. If it becomes apparent that there are excess funds on a contract, the excess funds are deobligated by the administrative contracting officer and returned to the command's budget.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

The Principal Deputy's comments to Recommendation A.1. did not address the issue raised in the Finding. The issue is the lack of control within DoD over commercial activities contracted out under the A-76 program, not DoD's contracting procedures. His response does not address the deficiencies we found concerning inadequate PWS's and contractor work load, but addresses contracting officers' responsibility in executing and monitoring contractor performance. The Principal Deputy states that DoD Instruction 4100.33 does not need to be revised, but does not provide any proposed solutions or actions being taken to solve the problems concerning contractor work load. We would have no objections to the Assistant Secretary processing changes to the DoD FAR Supplement, as a means of supplementing DoD Instruction 4100.33.

Commercial activities do not cease at the point a cost comparison is performed under the A-76 program. The Supplement to OMB Circular A-76 states that contracted commercial activities are to be continually monitored to ensure they are cost-effective. Therefore, DoD Instruction 4100.33 should not be limited to the cost comparison process, but should include management of commercial activities in DoD whether performed in-house by Federal employees or under contract by contractors. In reviewing DoD Instruction 4100.33 concerning PWS's, managing contractor work load, and resoliciting contracts, we found that the Instruction did not have adequate provisions to ensure that PWS's were based on accurate and timely historical workload data that provided measurable and verifiable performance standards, did not include provisions on how commercial activities' work load is to be managed if contracted out, and did not define unreasonable contract costs or unsatisfactory performance for resolicitation of commercial activities' contracts. These shortfalls have contributed to the contractor work load deficiencies discussed in the finding. Based on comments received, we modified the

Recommendation A.1.a. to require that PWS's be based on historical or projected work load, recognizing that projected work load may be more pertinent due to planned organizational changes. We request the Assistant Secretary of Defense (Production and Logistics) reconsider his nonconcurrence with Recommendation A.1., and provide comments on the modified recommendation when responding to this final report.

The Air Force's comments were not responsive to Recommendation A.2. Our analysis of historical expenditures showed that the costs for logistics and transportation services remain relatively constant. The contracting officer ought to reduce the price of these contract line items to more accurately represent actual costs. The Air Force continues to obligate about $1,040,000 yearly for logistics and transportation contract line items or about 290 percent more than the $359,000 in average yearly expenditures for logistics and transportation. We see no advantage in the Air Force continuing to overfund these contract line items and reprogramming these funds when they are not used on the PAVE PAWS contracts. We therefore request that the Assistant Secretary of the Air Force (Manpower, Reserve Affairs, Installations and Logistics) reconsider his position on Recommendation A.2. and provide final comments on this report.

Further, we believe that the Services have a responsibility to prepare adequate PWS's and to effectively monitor contractor work load on commercial activities contracts. Based on the Principal Deputy's concerns about the poor execution of contracted commercial activities, and the Services' lack of action concerning the problems identified in Finding A., we have added Recommendation A.3. to this final report. We request that the Secretaries of the Military Departments provide comments on Recommendation A.3. when responding to this final report.

B. Contractor Performance

FINDING

The Services were not effectively evaluating contractor performance to ensure that contractors were meeting contract requirements. Also, the Services were not obtaining adequate compensation for substandard performance. These conditions occurred because quality assurance surveillance plans were not fully implemented on all commercial activities' contracts, and deductions for poor contractor performance were not properly processed or computed. Of the 41 commercial activities' contracts reviewed valued at $425.6 million, quality assurance surveillance plans were not effectively implemented on 20 contracts valued at $332.3 million, which prevented the Services from evaluating the quality of contractor work. Where plans were implemented, the Services recovered $783,000 (61 percent) of the $1.3 million that quality assurance representatives recommended for recovery. Army contracting officers only recovered $224,000 (31 percent) of the $721,000 in deductions recommended by quality assurance representatives for inadequate contractor performance, whereas Navy, Air Force, and Marine Corps contracting officers recovered $559,000 (98 percent) of $571,000 in recommended deductions.

DISCUSSION OF DETAILS

Background. The Federal Acquisition Regulation (FAR), part 46, subpart 46.101, defines Government contract quality assurance as various functions performed by the Government . . . "to determine if a contractor has fulfilled the contract obligations pertaining to quality and quantity." FAR, subpart 46.401, states that Government contract quality assurance shall be performed at such times and places as may be necessary to determine that the services conform to contract requirements. FAR, subpart 46.104, requires contract administration offices to develop procedures for the Government to follow in performing quality assurance actions to verify that services received under contract conform to contract quality requirements and to document quality assurance actions performed. According to the FAR, subpart 46.407, an equitable price reduction may be made to compensate the Government for substandard contractor performance.

DoD Instruction 4100.33, "Commercial Activities Program Procedures," September 1985, requires that a quality assurance surveillance plan be prepared in accordance with Office of Federal Procurement Policy Pamphlet Number 4, "Writing and Administering Performance Work Statements." The Pamphlet describes a systematic means of developing statements of work and quality assurance surveillance plans. However, the Pamphlet does not require the full implementation and periodic review of quality assurance surveillance plans and does not require PWS's

to prescribe the use of extrapolation (projection of the sample results to the universe) in calculating deductions for poor contractor performance. OMB Circular A-76 includes as an example the calculation of contract deductions by the use of extrapolation. DoD Instruction 4100.33 makes no reference to the use of extrapolation.

The FAR, subpart 46.1, assigns responsibilities for quality assurance personnel involved in surveillance of contractor performance including the contracting officer, the contracting officer's representative, and the quality assurance representative. The contracting officer is an official appointed in writing by the head of the contracting activity, with the authority to enter into, administer, and/or terminate contracts. The contracting officer's representative is an individual designated in writing by the contracting officer to act as an authorized representative and is limited to the authority specified in the letter of appointment. The quality assurance representative is a technical representative of the contracting officer's representative who is responsible for monitoring and evaluating the contractor's performance of required services as specified in the contract's statement of work.

When contractor performance falls below the acceptable levels in the contract's provisions, the contract may provide for deductions in payments to the contractor for work performed. The quality assurance representatives provide their evaluations to the contracting officers who are responsible for taking the deductions by reducing payments to the contractor.

Quality Assurance Surveillance Plans. The quality assurance surveillance plan is a guide used to evaluate and document contractor performance. In evaluating 41 commercial activities' contracts valued at $425.6 million, we found 20 contracts valued at $332.3 million where quality assurance representatives had not fully implemented quality assurance surveillance plans. The Services' internal controls were not adequate to ensure contractors were complying with contract requirements. To determine the extent to which the surveillance plans were implemented, we discussed quality assurance processes and problems with quality assurance representatives and contracting officers. We then compared documented quality assurance efforts with the requirements outlined in the surveillance plans. The Services were not completing required tests, were not complying with the documentation requirements prescribed by the surveillance plans, and were not maintaining oversight over quality assurance efforts. The following table summarizes the number and value of contracts for which quality assurance plans were not fully implemented.

Service	Number of Contracts		Contract Dollar Value	
	Number of Contracts Reviewed	Quality Assurance Plans Not Fully Implemented	Dollar Value of Contracts Reviewed	Quality Assurance Plans Not Fully Implemented
Army	14	10	$272,850,661	$217,485,167
Navy	10	4	101,823,685	87,260,608
Air Force	14	6	48,444,696	27,531,736
Marine Corps	3	0	2,507,255	0
Total	41	20*	$425,626,297	$332,277,511

* Contracts on which the 20 quality assurance plans were not fully implemented are shown in Appendix C (footnote 1).

The following examples illustrate the Services' difficulties in implementing the quality assurance surveillance plans.

At the Army Aviation Systems Command, St. Louis, Missouri, a staff of nine quality assurance representatives was assigned other duties in addition to regular quality assurance surveillance functions on the $12 million installation support contract. The representatives performed only 326 of the 602 tests prescribed by the surveillance plan. The quality assurance representatives issued five contract discrepancy reports between January 1987 and July 1989, but the contracting officer did not determine the value of the discrepancies and made no contract deductions for poor contractor performance.

At the Naval Air Station, Fallon, Nevada, the staff of nine quality assurance representatives had conducted 139 of 220 tests required by the quality assurance surveillance plan on a $61 million base operating support contract. Based on the quality assurance tests performed, the quality assurance representatives recommended $74,600 in deductions for poor contractor performance, of which the contracting officer recovered $68,100.

The Services' contracting personnel did not provide necessary oversight to quality assurance representatives to ensure an effective quality control program. At Patrick Air Force Base, Florida, no quality assurance tests were performed on an $868,600 administrative switchboard contract. Contract performance files showed no evidence of oversight by the quality assurance representatives. Internal controls were not adequate

to ensure quality assurance representatives understood their surveillance responsibilities for switchboard operations on the contract and to ensure that contractor performance was being adequately reviewed.

Contractor Deductions. When quality assurance representatives documented substandard contractor performance and recommended deductions, Army contracting officers were not taking the deductions at the same rate as the other Services. However, none of the Services were effectively using extrapolation to compute the amount of the deductions. DoD Instruction 4100.33 does not address procedures for deductions when contractor performance is substandard in the postaward phase of commercial activities' contracts. Overall, the Services' contracting officers recovered $783,000 (61 percent) of $1.3 million recommended by quality assurance representatives for poor contractor performance on the 41 commercial activities' contracts reviewed. The following table shows the number of deductions recommended by quality assurance personnel and the number of recommended deductions taken by contracting officers.

Service	Deductions Recommended by Quality Assurance Personnel	Deductions Taken by Contracting Officers	Deductions Taken as a Percent of Deductions Recommended
Army	$ 721,215	$223,845	31
Navy	465,794	459,306	99
Air Force	78,425	76,011	97
Marine Corps	26,488	23,711	90
Total	$1,291,922	$782,873	61

A summary of the deductions recommended by quality assurance representatives and taken by contracting officers for the commercial activities' contracts reviewed is provided in Appendix D.

Army contracting officers often did not take the recommended deductions. Of eight Army contracts with recommended deductions, contracting officers took full deductions on three contracts, partial deductions on two contracts, and no deductions on three contracts. For example, records of the Rock Island Arsenal quality assurance representative indicated that 40 contract discrepancy reports had been prepared as of August 1989 on the Army's $55.3 million installation support contract. However, the contracting officer's representative's records indicated that

only 20 contract discrepancy reports had been sent to the contracting officer for review. Deductions valued at about $23,000 were recovered on four of these discrepancies. On four additional discrepancy reports, on which quality assurance representatives recommended deductions of about $43,000, the contracting officer had not taken any deductions. The contracting officer was reluctant to take the deductions on these four reports because the reports were not written in a timely manner, even though the contract allowed the Army to take deductions at any time while the contract was active.

Even when deductions were taken, they may have been understated because the Services were not effectively using extrapolation to compute the deductions. To illustrate, the sample tests were not projected to the sample universe to calculate the deductions. Although OMB Circular A-76 provides for the use of extrapolation when contract deductions are calculated, the Services were not consistently using extrapolation to compute deductions on commercial activities' contracts.

For the 41 contracts reviewed, none of the Services used extrapolation on all the contracts on which the contracting officers had taken deductions. Of the $783,000 in deductions taken by contracting officers on the contracts reviewed, only $342,000 (44 percent) in deductions was computed using extrapolation. The following table summarizes by Service the dollar value of deductions taken using extrapolation.

Service	Total Deductions Taken	Deductions Based on Extrapolation	
		Dollar Value	Percent of Deductions Taken
Army	$223,845	$138,265	62
Navy	459,306	139,188	30
Air Force	76,011	60,870	80
Marine Corps	23,711	3,551	15
Total	$782,873	$341,874	44

By not using extrapolation to compute deductions for inadequate contractor performance, the Services may not have been recovering all that they could for inadequate contractor performance. A summary of the 21 contracts with deductions is provided in Appendix D.

RECOMMENDATIONS FOR CORRECTIVE ACTION

1. We recommend that the Assistant Secretary of Defense (Production and Logistics) revise DoD Instruction 4100.33 to:

a. Require contracting officers to annually certify to the appropriate commercial activity manager that quality assurance surveillance plans are fully implemented.

b. Establish procedures on when contracting officers are to take deductions for inadequate contractor performance documented by quality assurance representatives.

c. Require that all commercial activities' contracts provide for the use of extrapolation of quality assurance samples if less than 100 percent of the commercial activities are inspected to calculate deductions for inadequate contractor performance.

2. We recommend that the Secretaries of the Military Departments fully implement the quality assurance surveillance plans on the 20 contracts, listed in Appendix C (footnote 1), with incomplete quality assurance surveillance.

MANAGEMENT COMMENTS

The Principal Deputy Assistant Secretary of Defense (Production and Logistics) nonconcurred with Recommendation B.1. The Principal Deputy stated that our recommendation is inappropriate because most of the procurement related recommendations already exist in the FAR or Office of Procurement Policy Pamphlet Number 4. In addition, adequate guidance on procedures for deductions from the contractor is provided in DoD Instruction 4100.33, Enclosure 5, which refers to Pamphlet Number 4. The Principal Deputy stated that the problem lies in execution of the Commercial Activities' Program, not in policy or procedures.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

The Principal Deputy Assistant Secretary of Defense's comments to Recommendations B.1. are incomplete. DoD Instruction 4100.33 and Pamphlet Number 4 do not address the need for contracting officers to certify to the appropriate commercial activity manager that quality assurance surveillance plans had been fully implemented. They do reference the need for such plans, and Pamphlet Number 4 describes the major contents of a surveillance plan. However, the Instruction does not address what actions are to be taken if the surveillance plans are not implemented. As shown in this final report, 20 of 41 commercial activities' contracts reviewed were not fully implemented. Since the Supplement to OMB Circular A-76 states that contracted commercial

activities should be monitored to ensure performance is satisfactory and cost-effective, we believe that the Instruction should be revised to incorporate the need to ensure quality assurance surveillance plans are fully implemented.

Also, DoD Instruction 4100.33 does not address contractor deductions. The Instruction merely states that in the cost comparison process, quality assurance plans are to be prepared in accordance with Enclosure 5, which refers to Pamphlet Number 4. The Pamphlet does indicate some general steps to be taken by contract administration officials when the quality assurance evaluator reports deficiencies in contract performance, but the Pamphlet states that these are not hard-and-fast rules. As discussed in this final report, deductions taken by the Services ranged from 31 to 99 percent on the commercial activities' contracts reviewed. We believe DoD needs to establish procedures on when contracting officers are to take deductions for inadequate contractor performance on commercial activities' contracts.

The Principal Deputy's comments on the benefits of extrapolation in calculating deductions for non-performance do not address the issue, which is the need for the requirement that commercial activity contracts provide for the use of extrapolation of quality assurance samples to calculate deductions for inadequate contractor performance. One of the reasons for not using extrapolation was that the contract did not contain provisions for extrapolation. This need is evidenced by the fact that only $342,000 (44 percent) of $783,000 of deductions identified were computed using extrapolation. Pamphlet Number 4, cited by the Principal Deputy, suggests extrapolation be applied in calculating deductions for non-performance. The Pamphlet does not require that contracts provide for the use of extrapolation of quality assurance samples to calculate deductions for inadequate contractor performance. Further, the FAR does not specifically address the methods to be used to calculate deductions for inadequate contractor performance. We maintain that such a provision would enhance DoD's ability to maintain an effective quality assurance program by ensuring that deductions for non-performance fairly represent the extent of work not performed. Based on comments, we modified Recommendation B.1.c. to recognize that extrapolation of quality assurance samples would not be necessary if 100 percent of the function were inspected. We request that the Assistant Secretary of Defense (Production and Logistics) reconsider his position on Recommendation B.1., as modified, and provide additional comments to the final report.

We believe that the Services have a responsibility to ensure that quality assurance of contractor performance is effectively completed on commercial activities' contracts. Based on the Principal Deputy's concerns about the poor execution of quality

assurance surveillance on commercial activities' contracts, and the Services' lack of action concerning the problems identified in Finding B., we have added Recommendation B.2. to this final report. Therefore, we request comments from the Secretaries of the Military Departments on Recommendation B.2. to the final report.

C. Implementation of A-76 Program

FINDING

The Services did not plan to complete commercial activities' studies for 3 percent of their total civilian populations annually, as required by Executive order 12615. At the 28 military installations visited, the Services had plans to study an average of about 1 percent of their total civilian populations from FY's 1989 through 1993. However, after the total civilian populations were reduced by exemptions authorized by OMB Circular A-76 and Congress, the Services planned to study 22 percent of the remaining civilian positions from FY's 1989 through 1993. By not studying 3 percent of their total civilian populations, the Services will not be in overall technical compliance with the Executive order, but will make reasonable progress in implementing the A-76 program for civilian positions that qualify for possible conversion to contractor operations.

DISCUSSION OF DETAILS

Background. Executive order 12615, "Performance of Commercial Activities," November 19, 1987, states that the head of each executive department or agency shall meet the study goal for FY 1988, and thereafter will conduct annual studies of not less than 3 percent of the department's or agency's total civilian population until all identified potential commercial activities have been studied. Under Executive order 12615, the total DoD study goal for FY 1989 was 31,000 full-time equivalent positions.

However, OMB Circular A-76 provides various exemptions from study, thereby reducing departments' and agencies' civilian populations available for study. Also, permanent congressional moratoriums of some commercial activities further reduce the civilian populations actually available for study by departments and agencies.

To determine the degree that the 28 military installations visited implemented Executive order 12615, we determined 3 percent of the total civilian population and identified potential commercial activities at the installations. We then compared 3 percent to the actual number of full-time equivalent positions studied and scheduled for study.

A-76 Studies. Executive order 12615 requires departments and agencies to conduct annual studies of not less than 3 percent of their total civilian population under the A-76 program. The Services had a total civilian population of 81,627 at the 28 audited installations. Three percent of the total civilian population was 2,448. Except for the Navy, the Services will not

meet the FY 1989 study goal of 3 percent of their total civilian population at the installations visited. The following table shows the number of full-time equivalent positions that have been, and were to be, studied in FY 1989 at the audited installations.

Service	Total Civilian Population	3% of Total Civilian Population	Positions Studied or Planned for Study	Compliance With Executive Order
Army	49,575	1,487	684	No
Navy	7,395	222	338	Yes
Air Force	21,109	633	64	No
Marine Corps	3,548	106	34	No
Total	81,627	2,448	1,120	

Based on the number of full-time equivalent positions scheduled for study from FY's 1990 through 1993 at the audited installations, the Services will not technically meet the study goal of 3 percent per year required by the Executive order for the next 4 fiscal years. These military installations plan to study only about 1 percent of their civilian populations per year. The following table summarizes the full-time equivalent positions that the audited installations plan to study from FY's 1989 through 1993.

Service	Positions Studied or Planned for Study	Required Positions for Compliance	Compliance With Executive Order
Army	5,615	7,435	No
Navy	404	1,110	No
Air Force	432	3,165	No
Marine Corps	34	530	No
Total	6,485	12,240	

Exemptions. Although the Services were not technically complying with the Executive order, they had made significant efforts to study the civilian populations actually available for study. Large numbers of their civilian populations were exempt,

deferred, or under moratorium from commercial activities' studies based on OMB and congressional guidance. OMB Circular A-76 exempts certain commercial activities from study when research and development are concerned, when direct patient care is involved, when no commercial source is available, and when the function is inherently governmental. Permanent congressional moratoriums on commercial activities' functions also include fire and guard services in the commercial activities available to be studied.

When the installation commanders applied the various exemptions and moratoriums to their civilian populations, a significant number of full-time equivalent positions became unavailable for study. At the installations visited, the Services had identified 30,020 of their 81,627 civilian positions as available for study. The military installation commanders planned to study 6,485 (22 percent) of their 30,020 available civilian positions from FY's 1989 through 1993.

As a result of the various exemptions, some military installations had exhausted the civilian populations available for study. For example, Hill Air Force Base, Utah; Naval Air Facility El Centro, California; Naval Air Station, Nevada; and Fort Huachuca, Arizona, have studied all of their civilian populations that were not under moratorium or exemption. Overall, at the 28 installations visited, reasonable progress had been made to implement the A-76 program for civilian positions that qualified for possible conversion to contractor operations. This progress was made even though the installations technically were not complying with Executive order 12615.

RECOMMENDATION FOR CORRECTIVE ACTION

We recommend that the Secretaries of the Military Departments comply with Executive order 12615 by increasing the civilian population to be studied annually to 3 percent of the total civilian population.

MANAGEMENT COMMENTS

The Principal Deputy Assistant Secretary of Defense (Production and Logistics) concurred that none of the DoD Components have been able to achieve the study goal set forth in Executive order 12615. The Army did not provide any comments on the recommendation. The Navy concurred with the recommendation stating that the Department of the Navy will continue to strive to meet this ambitious goal, but the Navy anticipates continued difficulties in meeting the goal. The Air Force nonconcurred with the recommendation stating that the Secretary of Defense gave the Air Force a study goal, but the Air Force elected not to further allocate its goal to the major commands or installations. The Air Force's position is that each installation is different and the availability of commercial

activities for study is a function of the mission and wartime commitment of that installation. The Air Force was also concerned that allocation of its goal to the major commands and installations would be construed as a violation of the Nichols Amendment.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

We recognized that the Secretary of Defense and each of the Military Departments have taken actions to meet the ambitious goal established in Executive order 12615. As noted in our report, permanent congressional moratoriums on studying various commercial activities have hampered the Military Departments' efforts to meet the study requirements. However, the Military Departments were not in technical compliance with Executive order 12615. The Military Departments also did not plan to comply with the Executive order for the next 4 years at the audited installations. We disagree with the Air Force's position that compliance with the Executive order may violate the Nichols Amendment. The Nichols Amendment states that the commanders of the military installations have the authority and responsibility to inventory their commercial activities and prioritize the study of the commercial activities. The Nichols Amendment does not preclude the Air Force or its installation commanders from studying 3 percent of their civilian population. We continue to believe that the Military Departments should comply with Executive order 12615. We request that the Secretary of the Army provide comments to this final report; the Secretary of the Navy provide the actions to be taken and the date when his office will implement the recommendation; and the Secretary of the Air Force reconsider his office's nonconcurrence and provide additional comments to this final report.

SAMPLING PROCEDURE

We identified a universe of 243 commercial activities' contracts that were awarded from FY's 1985 through 1987. These contracts had a value of about $1.1 billion.

We stratified the 243 contracts into 3 strata according to dollar value, as follows.

Stratum	Number of Contracts
Stratum 1 (total contracts greater than $10 million)	20
Stratum 2 (total contracts between $1 million and $10 million)	102
Stratum 3 (total contracts less than $1 million)	121
Total	243

We categorized the contracts by Service and geographic region of the commercial activities studied. We then selected a statistical sample of 41 contracts valued at $425.6 million.

Services	Sample Size
Army	14
Navy	10
Air Force	14
Marine Corps	3
Total	41

The review of the sample included analyses of Performance Work Statements, workload data, quality assurance surveillance plans, contractor performance, contract modifications, and contract costs.

AUDIT COVERAGE OF THE A-76 PROGRAM FROM FY 1988 TO FY 1990

DoD

Inspector General

Report No. 88-099, "The Defense Logistics Agency Decision to Retain Industrial Plant Equipment Operations In-house," March 10, 1988.

Report No. 90-009, "DLA Implementation of the Commercial Activities Program," November 7, 1989.

Army Audit Agency

Report No. NE 88-200, "Contractor Operations of Commercial Activities -- Military Traffic Management Command, Eastern Area, Bayonne, New Jersey," October 15, 1987.

Report No. SW 88-200, "Contractor Operations of Commercial Activities -- Custodial and Maintenance Services -- U.S. Army Medical Department Activity, Fort Carson, Colorado," October 16, 1987.

Report No. WE 88-201, "Contractor Operations of Commercial Activities, Fort Huachuca, Arizona," October 29, 1987.

Report No. NE 88-202, "Contractor Operations of Commercial Activities -- U.S. Army Training Center and Fort Dix, Fort Dix, New Jersey," December 29, 1987.

Report No. NE 88-204, "Contractor Operations of Commercial Activities Philadelphia Maintenance Activity Fort George Meade, Maryland," February 4, 1988.

Report No. SO 88-300, "Contractor Operations of Commercial Activities -- Administrative Telephone Services, Southeast Region -- U.S. Army 7th Signal Command, Fort Ritchie, Maryland," February 11, 1988.

Report No. MW 88-201, "Contractor Operations of Commercial Activities -- Transportation Motor Pool -- 101st Airborne Division (Air Assault) and Fort Campbell, Fort Campbell, Kentucky," February 26, 1988.

Report No. MW 88-205, "Contractor Operations of Commercial Activities Administrative and Installation Support Activity -- U.S. Army Aviation Systems Command, St. Louis, Missouri," May 9, 1988.

Report No. EC 88-202, "Contractor Operations of Commercial Activities -- U.S. Army Engineer Center and Fort Belvoir, Fort Belvoir, Virginia," June 1, 1988.

Report No. SO 88-203, "Contractor Operations of Commercial Activities Base Support Services -- U.S. Army Missile Command, Redstone Arsenal, Alabama," June 16, 1988.

Report No. EC 89-205, "Contractor Operations of Commercial Activities," June 9, 1989.

Naval Audit Service

Report No. 014-W-88, "Commercial Activity Post-Decision Review of Facilities Maintenance (Groups II) at Marine Corps Air Station, Kaneohe Bay, Hawaii," October 30, 1987.

Report No. 018-S-88, "Commercial Activity Post-Decision Review of Storage and Warehousing at Polaris Missile Facility, Atlantic, Charleston, South Carolina," November 9, 1987.

Report No. 030-5-88, "Commercial Activity Post-Decision Review of Laundry and Dry Cleaning of Marine Corps Recruit Depot, Parris Island, South Carolina," December 9, 1987.

Report No. 058-N-88, "Commercial Activity Post-Decision Review of Storage and Warehousing at Naval Weapons Support Center, Crane, Indiana," January 5, 1988.

Report No. 054-S-88," "Post-Decision Commercial Activity Review of Bus, Trucking, and Snow Removal Operations at Navy Public Works Center, Norfolk, Virginia," January 11, 1988.

Report No. 060-S-88, "Post-Decision Commercial Activity Evaluation of T-2C Aircraft Organizational Maintenance Function at Chief of Naval Air Station, Corpus Christi, Texas," January 11, 1988.

Report No. 070-5-88, "Post-Decision Review of Transportation Maintenance at Navy Public Works Center, Norfolk, Virginia," February 9, 1988.

Report No. 127-W-88, "Commercial Activity Post-Decision Review of Maintenance and Report of Buildings and Structures (other) at Camp H.M. Smith, Hawaii," July 13, 1988.

Report No. 017-W-89, "Commercial Activity Post-Decision Review of the Base Operating Support Functions performed by contract at Naval Air Facility, El Centro, California," December 6, 1988.

AUDIT COVERAGE OF THE A-76 PROGRAM FROM FY 1988 TO FY 1990
(Continued)

Air Force Audit Agency

Report No. 6305110, "Major Command Independent Reviews of Commercial Activity Decisions," December 15, 1987.

GAO

Report No. GAO/GGD-88-63FS, "Federal Productivity: DoD Functions With Savings Potential from Private Sector Cost Comparisons," April 1988.

Report No. GAO/NSIAD-88-175BR, "Navy Contracting: Contract Administration Staffing Requirements for Navy A-76 Studies," July 1988.

Report No. GAO/NSIAD-89-25, "Army Procurement: No Savings From Contracting Support Services at Fort Eustis, Virginia," October 1988.

Report No. GAO/GGD-89-6, "Federal Productivity: DoD's Experience in Contracting Out Commercially Available Activities," November 28, 1988.

Report No. GAO/NSIAD-89-46, "Army Procurement: Allegations of Unfair Treatment at Fort Lee, Virginia, Found to Be Unmerited," December 1988

Report No. GAO/NSIAD-89-90, "Army Procurement: Fort Benjamin Harrison's Commercial Activity Study Should Be Redone or Updated," February 1989.

Report No. GAO/GGD-89-65, "Managing the Government: Revised Approach Could Improve OMB's Effectiveness," May 4, 1989.

Report No. GAO/GGD-90-58, "DoD's Reported Savings Figures Are Incomplete and Inaccurate," March 1990.

COST GROWTH ON COMMERCIAL ACTIVITIES' CONTRACTS REVIEWED

Military Installation	Commercial Activity	Anticipated Savings at Time of Award	Projected Cost Growth (Savings)	Audit Estimated Savings (Additional Cost)
Army				
Greater Savings Realized				
Fort Meade, MD	Aircraft Refueling [1]	$ 197,517	$(3,000)	$ 200,517
Fort Lewis, WA	Transportation and Motor Pool [1]	1,264,559	(252)	1,264,811
Subtotal		$1,462,076	$(3,252)	$1,465,328
Savings Realized, But Less Than Anticipated				
Aviation Systems Command, St. Louis, MO	Installation Support [1] [2] [3]	$7,888,221	$3,962,440	$3,925,781
Defense Metropolitan Area Telephone Systems, St. Louis, MO	Administrative Phone Services	142,948	35,058	107,890
Fort Dix, NJ	Administrative Phone Services	466,183	161,961	304,222
Fort Dix, NJ	Food Services	10,193,899	2,517,142	7,676,757
Fort Bliss, TX	Commissary Shelf Stocking [1] [2]	1,356,255	333,892	1,022,363
Fort Bliss, TX	Laundry and Dry Cleaning [1] [2]	1,967,423	315,417	1,652,006
Fort Hood, TX	Commissary Shelf Stocking [1] [2]	963,577	365,494	598,083
Fort Huachuca, AZ	Commissary Shelf Stocking [1] [2]	423,400	351,131	72,269
Rock Island Arsenal, IL	Installation Support [1] [2] [3]	20,848,720	7,156,000	13,692,720
Subtotal		$44,250,626	$15,198,535	$29,052,091

See footnotes on last page of appendix.

COST GROWTH ON COMMERCIAL ACTIVITIES' CONTRACTS REVIEWED (Continued)

Military Installation	Commercial Activity	Anticipated Savings at Time of Award	Projected Cost Growth (Savings)	Audit Estimated Savings (Additional Cost)
Savings Not Realized				
Redstone Arsenal, AL	Commissary Shelf Stocking 1/ 2/	$ 423,280	$ 801,491	$ (378,211)
Redstone Arsenal, AL	Installation Support 1/ 2/	7,816,158	116,303,472	(108,487,314)
Fort Huachuca, AZ	Facility Engineering Services 2/	4,834,864	9,365,856	(4,530,992)
Subtotal		$13,074,302	$126,470,819	$(113,396,517)
Total		$58,787,004	$141,666,102	$ (82,879,098)

See footnotes on last page of appendix.

COST GROWTH ON COMMERCIAL ACTIVITIES' CONTRACTS REVIEWED (Continued)

Military Installation	Commercial Activity	Anticipated Savings at Time of Award	Projected Cost Growth (Savings)	Audit Estimated Savings (Additional Cost)
Navy				
Greater Savings Realized				
U.S. Naval Academy, Annapolis, MD	Base Supply Operations 2/	$ 377,406	$ (28,034)	$ 405,440
Naval Air Station, Patuxent River, MD	Transportation	1,155,834	(1,121,077)	2,276,911
Naval Shipyard, Norfolk, VA	Word Processing Services	105,827	(220,076)	325,903
Subtotal		$1,639,067	$(1,369,187)	$3,008,254
Savings Realized, But Less Than Anticipated				
Naval Air Station, Patrol Wing 11, Jacksonville, FL	Training/Simulators	$1,549,781	$943,195	$606,586
U.S. Naval Academy, Annapolis, MD	Audiovisual 1/ 3/	171,453	107,178	64,275
Naval Air Station, Patuxent River, MD	Storage and Warehousing	641,501	132,441	509,060
Naval Air Engineering Center, Lakehurst, NJ	Administrative Services 1/	210,053	78,108	131,945
Naval Air Station, Fallon, NV	Base Operating Support 1/ 2/ 3/	6,430,118	880,554	5,549,564

See footnotes on last page of appendix.

COST GROWTH ON COMMERCIAL ACTIVITIES' CONTRACTS REVIEWED (Continued)

Military Installation	Commercial Activity	Anticipated Savings at Time of Award	Projected Cost Growth (Savings)	Audit Estimated Savings (Additional Cost)
Navy International Logistics Control Office, Philadelphia, PA	Word Processing Support	755,525	93,694	661,831
Subtotal		$9,758,431	$2,235,170	$7,523,261
Savings Not Realized				
Naval Air Facility, El Centro, CA	Base Operating Support 1/ 2/ 3/	$ 4,172,655	$5,943,106	$(1,770,451)
Subtotal		$ 4,172,655	$5,943,106	$(1,770,451)
Total		$15,570,153	$6,809,089	$8,761,064

See footnotes on last page of appendix.

COST GROWTH ON COMMERCIAL ACTIVITIES' CONTRACTS REVIEWED (Continued)

Military Installation	Commercial Activity	Anticipated Savings at Time of Award	Projected Cost Growth (Savings)	Audit Estimated Savings (Additional Cost)
Air Force				
Greater Savings Realized				
McGuire AFB, 4/ NJ	Ground Maintenance	$804,901	$(25,661)	$830,562
Subtotal		$804,901	$(25,661)	$830,562
Savings Realized, But Less Than Anticipated				
Beale AFB, CA	Transient Aircraft Maintenance 3/	$ 38,318	$ 9,690	$ 28,628
Patrick AFB, FL	Vehicle Operation and Maintenance	2,623,738	856,776	1,766,962
Patrick AFB, FL	Administrative Switchboard 1/ 3/	496,912	143,454	353,458
Patrick AFB, FL	Audiovisual	114,992	16,902	98,090
Patrick AFB, FL	Publication Distribution	112,117	7,453	104,664
Robins AFB, GA	Vehicle Operation and Maintenance	2,408,931	1,957,678	451,253
Cape Cod Air Station, MA	PAVE PAWS 5/ Support 1/ 3/	4,736,464	4,420,287	316,177
McGuire AFB, NJ	Protective Coating 1/ 3/	423,031	309,942	113,089
Hill AFB, UT	Occupational Medicine 1/ 2/ 3/	778,137	308,480	469,657
Griffiss AFB, NY	Transient Aircraft Maintenance	459,774	17,239	442,535

See footnotes on last page of appendix.

COST GROWTH ON COMMERCIAL ACTIVITIES' CONTRACTS REVIEWED (Continued)

Military Installation	Commercial Activity	Anticipated Savings at Time of Award	Projected Cost Growth (Savings)	Audit Estimated Savings (Additional Cost)
Dyess AFB, TX	Protective Coating	447,748	245,156	202,592
Dyess AFB, TX	Ground Maintenance 1/ 2/ 3/	2,232,782	6,246	2,226,536
Hill AFB, UT	Refuse Collection 1/ 2/ 3/	2,550,357	1,117,800	1,432,557
Subtotal		$17,423,301	$9,417,103	$8,006,198
Total		$18,228,202	$9,391,442	$8,836,760

See footnotes on last page of appendix.

COST GROWTH ON COMMERCIAL ACTIVITIES' CONTRACTS REVIEWED (Continued)

Military Installation	Commercial Activity	Anticipated Savings at Time of Award	Projected Cost Growth (Savings)	Audit Estimated Savings (Additional Cost)
Marine Corps				
Greater Savings Realized				
Marine Corps Air Station, El Toro, CA	Ground Maintenance	$439,470	$(157,570)	$597,040
Subtotal		$439,470	$(157,570)	$597,040
Savings Realized, But Less Than Anticipated				
Marine Corps Logistics Base, Albany, GA	Custodial Services 3/	$1,475,223	$552,111	$ 923,112
Marine Corps Base, Quantico, VA	Pest Control	401,802	47,864	353,938
Subtotal		$1,877,025	$599,975	$1,277,050
Total		$2,316,495	$442,405	$1,874,090
Grand total		$94,901,854	$158,309,038	($63,407,184)

Factors contributing to cost growth and poor contractor performance

1/ Quality assurance surveillance plans not fully implemented

2/ Poorly defined Performance Work Statement

3/ Insufficient monitoring of contractor work load

Abbreviation

4/ Air Force Base

5/ Precision Acquisition Vehicle Entry Phased Array Warning System

SUMMARY OF DEDUCTIONS RECOMMENDED AND TAKEN

Service/ Installation	Commercial Activity	Deductions Recommended	Deductions Taken	Deductions Taken Using Extrapolation	Deductions Not Taken
Army					
Redstone Arsenal, AL	Base Support Services	$545,887	$96,147	$96,147	$449,740
Fort Huachuca, AZ	Facilities Engineer	5,785	5,785	5,785	0
Fort Huachuca, AZ	Commissary Shelf Stock	13,203	13,203	13,203	0
Fort Lewis, WA	Transport Motor Pool	4,501	0	0	4,501
Rock Island Arsenal, IL	Base Support Services	66,259	23,130	23,130	43,129
Fort Bliss, TX	Commissary Shelf Stock	Not Computed 1/	0	0	0
Fort Hood, TX	Commissary Shelf Stock	Not Computed 1/	0	0	0
Fort Dix, NJ	Food Service	85,580	85,580	0	0
Subtotal		$721,215	$223,845	$138,265	$497,370
Navy					
NAVILCO 2/, PA	Processing Support	$97,326	$97,326	$97,326	$ 0
U.S. Naval Academy, MD	Base Supply Operations	29,428	29,428	29,428	0
NAEC 3/ Lakehurst, NJ	Administrative Services	9,582	9,582	9,582	0
NAS 4/ Patuxent River, MD	Transportation	2,120	2,120	2,120	0
NAF 5/ El Centro, CA	Base Operating Support	252,015	252,015	0	0
NAS Fallon, NV	Base Operating Support	74,591	68,103	0	6,488
NAS Patrol Wing II, FL	Simulator Operation and Maintenance	732	732	732	0
Subtotal		$465,794	$459,306	$139,188	$6,488

See footnotes on last page of appendix.

SUMMARY OF DEDUCTIONS RECOMMENDED AND TAKEN (Continued)

Service/ Installation	Commercial Activity	Deductions Recommended	Deductions Taken	Deductions Taken Using Extrapolation	Deductions Not Taken
Air Force					
Patrick AFB 6/, FL	Audiovisual	$4,287	$1,873	$1,873	$2,414
Patrick AFB, FL	Vehicle Operation and Maintenance	45,420	45,420	45,420	0
McGuire AFB, NJ	Ground Maintenance	4,463	4,463	4,463	0
Dyess AFB, TX	Ground Maintenance	7,094	7,094	7,094	0
Beale/Cape Cod, MA	PAVE PAWS 7/	15,141	15,141	0	0
Hill AFB, NJ	Occupational Medicine	2,020	2,020	2,020	0
Subtotal		$78,425	$76,011	$60,870	$2,414
Marine Corps					
Quantico, VA	Pest Control	$3,552	$3,552	$3,552	$ 0
MCLB 8/ Albany, GA	Custodial Services	14,470	14,470	0	0
MCAS 9/ El Toro, CA	Ground Maintenance	8,466	5,689	0	2,777
Subtotal		$26,488	$23,711	$3,552	$2,777
Total All Services		$1,291,922	$782,873	$341,875	$509,049

See footnotes on last page of appendix.

1/ The contracting officers and quality assurance representatives did not compute the deductions for poor contractor performance.

2/ Navy International Logistics Control Office

3/ Naval Air Engineering Center

4/ Naval Air Station

5/ Naval Air Facility

6/ Air Force Base

7/ Precision Acquisition Vehicle Entry Phased Array Warning System

8/ Marine Corps Logistics Base

9/ Marine Corps Air Station

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D C 20301-8000

PRODUCTION AND
LOGISTICS

May 16, 1990

MEMORANDUM FOR DOD INSPECTOR GENERAL

SUBJECT: Response to Draft Report on the Audit of Procedures for Monitoring Commercial Activities' Functions after Completion of A-76 Competitions (Project No. 9SC-0005)

I recognize that opportunities always exist for improving contract monitoring, both inside and outside of the Commercial Activities Program. I do not agree that special procurement procedures are needed in the DoDI 4100.33. The Federal Acquisition Regulation is the proper vehicle to transmit procurement policies and procedures. Also, as the DoDIG stated in several findings, the problem lies in execution, not lack of regulations.

While I welcome any objective review of the A-76 program, I strongly object to the fact that information necessary to present a balanced report was often omitted. The finding relating to cost increases is especially slanted. Without a comparison of cost increases that would have affected a government work force, the DoDIG cannot support the finding of a $63.4 million cost increase over in-house performance. The report also pointed to a $1.1 million cost increase while ignoring the fact that it was caused by newly enacted federal environmental laws.

The detailed comments on the report findings and recommendations are provided in the enclosure. I appreciate the opportunity to comment on the draft.

David J. Berteau
Principal Deputy

Enclosure

**OIG DRAFT REPORT - DATED MARCH 5, 1990
(PROJECT NO. 9SC-0005)**

"AUDIT OF PROCEDURES FOR MONITORING COMMERCIAL ACTIVITIES' FUNCTIONS AFTER COMPLETION OF A-76 COMPETITIONS"

ASSISTANT SECRETARY OF DEFENSE (P&L) COMMENTS

* * * * *

FINDINGS

o FINDING A.3. Managing Work Load. DoD Instruction 4100.33, "Commercial Activities Program Procedures," September 1985 contains detailed procedures and requirements for cost comparison studies and implementing the preaward phase of the commercial activities' program. However, it does not establish criteria to monitor the cost-effectiveness of contractor performance of the work load identified in the PWS.

Frequently, contractor workload data were not tracked or, if they were collected, were not analyzed against contract requirements and costs. Because workload data were not tracked or analyzed, the Services' personnel had no means of assessing the efficiency of contractor operations or determining if contract costs were reasonable. Moreover, the Services' contracting officers were not equipped to effectively negotiate price increases or decreases for significant workload changes. The OIG review of the 41 commercial activities' contracts found that on 13 contracts valued at $184 million, contracting personnel placed limited emphasis on tracking and analyzing the amount of work contractors performed.

Where the military installation commanders were monitoring contractor workload changes, contracting officers were able to successfully negotiate price adjustments with contractors concerning the contract PWS. Thus, it is essential for DoD's instructions to require that contractor work load be continually monitored as part of the internal controls established for the Commercial Activities Program. The internal controls should include the need for collection, periodic review, and analysis of workload data against contractual work load estimates. 8
(pp. 12-16/OIG Draft Report)

DoD Response: Partially Concur. It is correct that we do not always do a good job of gathering workload data after a contract is awarded. However, contracts awarded under the Office of Management and Budget Circular A-76, as well as other contracts administered at an installation, are reviewed by the installation contracting officer, their Major Command/Claimant and Service/Agency headquarters, as the current option period nears expiration. Based on a review of the contractor's performance and the reasonableness of the contract price in the current marketplace, a determination is made to either exercise the contract option or re-solicit. Thus, cost growth and poor performance is identified and corrected, if necessary, at the installation. The DoDIG already pointed out that this is done in some instances, therefore it is not a problem of "instruction", but one of "execution".

- **FINDING A.4.** Cost Increases. The Services anticipated savings on all 41 commercial activities' contracts reviewed. For seven contracts valued at $13.9 million, the OIG estimate that the Services will realize savings greater than anticipated by the time work on these contracts is completed. These contracts will produce a savings of $5.9 million, which is $1.6 million more than the original estimate of $4.3 million. For 30 contracts, the Services' anticipated $73.3 million in savings at the time of the cost comparison. Based on the OIG review of these contracts, the OIG project that actual savings of about $45.9 million will be realized by the time these contracts are completed. For the remaining four contracts, instead of projected savings of $17.3 million, the OIG estimate cost increases of $132.5 million. As a result, these contracts will cost the Services about $115.2 million more than originally projected by the time they are completed. Overall, on these 41 contracts, the OIG estimate that DoD will not realize the anticipated savings of $94.9 million, but will spend about an additional $63.4 million to accomplish the commercial activities.

  Of the 41 commercial activities' contracts reviewed, 37 indicated that the Commercial Activities Program can achieve savings. However, six of these contracts, valued at $29.5 million, were experiencing cost growth ranging from 33 to 73 percent. For the remaining four commercial activities' contracts reviewed, conversion from in-house to contractor operations was not cost-effective. These

four contracts, valued at $175.5 million, exceeded in-house cost estimates by $103.5 million.

DoD Instruction 4100.33 does not provide criteria on when commercial activities' contracts are to be resolicited when contract costs exceed in-house cost estimates or contract cost increases become unreasonable. As a result, the Services had taken virtually no action to resolicit contracts with significant cost escalation. To ensure cost-effective contractor operations, the Services need criteria on when contracts are to be resolicited. (pp. 17-19/OIG Draft Report) 10

DoD Response: Nonconcur. In reviewing the 41 contracts the DoDIG seems to have labored under the assumption that contract costs never change. This is rarely so. Previous reports have pointed to increased DOL wage rates and increases in the scope of work as two of the more significant sources of cost escalation. The DoDIG failed to recognize that most cost escalations would have increased the cost to the government for the particular goods or services regardless of who performed the function. For example, the DoDIG's claim that one contract at Hill Air Force Base, Utah had a cost increase of $1.1 million made no mention of the fact that the increase was due to new federal environmental laws concerning refuse disposal. Report Revised

The DoDIG's finding that the Department will not realize the anticipated $94.9 million savings on the 41 contracts it reviewed, but will actually spend an additional $63.4 million is inaccurate and misleading. See App. I

First; since the DoDIG did not provide an estimate of what it would cost an in-house workforce to provide theses goods and services under similar circumstances (i.e., wage and salary increases, increased scope of work) there is no basis on which an accurate comparison could be made. The $63.4 million increase was derived in a vacuum.

Second; the DoDIG fails to point out that one contract of the 41 reviewed accounted for more than $108 million of the alleged increased costs. The other 40 contracts will realize a savings of over $45 million. Stated as it was, the DoDIG finding presents a totally misleading and unfair representation of the Department's performance under OMB Circular A-76.

The DoD Instruction 4100.33 does address recompetition due to unreasonable costs or performance. The Department objects to the recommendations that procurement policy be either expressed or modified in DoDI 4100.33. The Federal Acquisition Regulations (FAR) and Service/Agency supplements provide detailed guidance for resolicitation of contracts. The FAR is the proper document for such change. DoD publications cannot supersede the FAR, nor do contracting officers look to the DoDI in lieu of the FAR.

o **FINDING B.3.** Contractor Deductions. When quality assurance representatives documented substandard contractor performance and recommended deductions, some contracting officers within a service were not taking the deductions at the same rate as the other Services. However, none of the Services were effectively using extrapolation to compute the amount of the deductions. DoD Instruction 4100.33 does not address procedures for deductions when contractor performance is substandard in the postaward phase of commercial activities' contracts. Overall, the Services' contracting officers recovered $783,000 (61 percent) of $1.3 million recommended by quality assurance representatives for poor contractor performance on the 41 commercial activities' contracts reviewed.

For the 41 contracts reviewed, none of the Services used extrapolation on all the contracts on which the contracting officers had taken deductions. Of the $783,000 in deductions taken by contracting officers on the contracts reviewed, only $342,000 (44 percent) in deductions was computed using extrapolation.

By not using extrapolation to compute deductions for inadequate contractor performance, the Services may not be recovering all that they can for inadequate contractor performance. (pp. 26-29/OIG Draft Report) 18

DoD Response: Nonconcur. Guidance is provided in DoD Instruction 4100.33 on procedures for deductions from the contractor in enclosure 5, "Writing and Administering Performance Work Statements", Office of Federal Procurement Policy Pamphlet Number 4.

- **FINDING C.** Implementation of A-76 Program. The Services did not plan to complete commercial activities studies for 3 percent of their total civilian populations annually, as required be Executive Order 12615. At the 28 military installations visited, the Services had plans to study an average of about 1 percent of their total civilian populations from FY's 1989 through 1993. However, after the total civilian populations were reduced by exemptions authorized by OMB Circular and Congress, the Services planned to study 22 percent of the remaining civilian positions from FY's 1989 through 1993. By not studying 3 percent of their total civilian populations, the Services will not be in overall technical compliance with the Executive Order, but will make reasonable progress in implementing the A-76 program for civilian positions that qualify for possible conversion to contractor operations.

DoD Response: Concur. None of the DoD components have been able to achieve the study goal set forth in Executive Order 12615.

The IG report fails to point out however that the goal is a threefold increase in the Department's average annual performance and that the Department has expressed its concern over the magnitude of this goal to OMB and before Congress. The IG report also fails to note that OMB has admitted that the 3 percent goal is an arbitrary figure not based on historical performance or reasonable expectations.

* * * *

RECOMMENDATIONS

- **RECOMMENDATION A.3/4.** The OIG recommends that the Assistant Secretary of Defense (Production and Logistics) revise DoD Instruction 4100.33 to include policies and procedures for managing the Commercial Activities Program that require the Services to:

  - Prepare Performance Work Statements that are based on accurate and timely historical workload data and that provide measurable and verifiable performance standards.

  - Evaluate contractor work load against estimated work load in the Performance Work Statements, determine the reasons for significant variances, and modify the contract if warranted.

  - Resolicit contracts when costs exceed DoD in-house cost estimates. (pp. 19/OIG Draft Report) 11

  DoD Response: Nonconcur. DoDI 4100.33 adequately covers the preparation of performance work statements and the resolicitation of contracts. The evaluation of contractor performance is a process performed on a continuing basis by the installation contracting officers. Any changes to that process would be more properly addressed in the Federal Acquisition Regulations.

- **RECOMMENDATION B.3.** OIG recommends that the Assistant Secretary of Defense (Production and Logistics) revise DoD Instruction 4100.33 to:

  - Require contracting officers to annually certify to the appropriate commercial activity manager that quality assurance surveillance plans are fully implemented.

  - Establish procedures on when contracting officers are to take deductions for inadequate contractor performance documented by quality assurance representatives.

- Require that all commercial activities' contracts provide for the use of extrapolation of quality assurance samples to calculate deductions for inadequate contractor performance. (pp. 30/OIG Draft Report) 20

DOD RESPONSE: Nonconcur. None of the DoDIG's recommendations are appropriate for this audit. Most of the procurement related recommendations already exist in the FAR or in OFPP Pamphlet No. 4. As the DoDIG points out by its own admission, the problem lies in the execution. Furthermore, special procurement instructions in DoDI 4100.33 would conflict with the Defense Management Review which calls for the removal of redundancies in the procurement system.

- **RECOMMENDATION C:** We recommend that the Secretaries of the Military Departments comply with Executive Order 12615 by increasing the civilian population to be studied annually to 3 percent of the total civilian population.

DOD RESPONSE: Nonconcur. This recommendation duplicates existing direction provided by the Secretary and the Military Departments. The Department has failed to meet the goal because it is a threefold increase in our average annual performance and is not based on historical performance or reasonable expectations.

DEPARTMENT OF THE ARMY
OFFICE OF THE CHIEF OF STAFF
WASHINGTON, DC 20310-0200

CSCM-SP

27 APR 199[illegible]

MEMORANDUM THRU

DIRECTOR OF THE ARMY STAFF

ASSISTANT SECRETARY FOR INSTALLATIONS, LOGISTICS, AND ENVIRONMENT

ROBERT W WHITTON
Colonel, General Staff
Acting Deputy for Programs
and Installation Assistance
OASA (I, L&E)

FOR OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE,
400 ARMY NAVY DRIVE, ARLINGTON, VA 22202-2884

SUBJECT: Draft Report on the Audit of Procedures for Monitoring Commercial Activities Functions After Completion of A-76 Competitions (Project No. 9SC-0005)

1. We have reviewed subject report and provide the following comments:

a. Finding A - Contractor Work Load.

(1) Part of the rationale supporting this finding is that the Services were not effectively managing workload because contracts were not resolicited when contractor's costs exceeded DOD's estimated in-house cost. The directives governing the CA Program do not require that contracts be resolicited when costs exceed the government estimate. Before such a decision is made, an analysis should be made as to why the costs increased. This usually falls into three categories: (1) wage rate increases, (2) inaccurate PWSs, or (3) work outside the scope of the original PWS. In most, if not all of these cases, the in-house costs would have increased commensurate with the contract increases. The finding states that 30 contracts will achieve less savings than anticipated and that 4 will actually cost more; however, it is unclear whether the comparisons were based on the original in-house estimate, or whether allowances were made for increases that would also have occurred had the function(s) remained in-house. See App. I

(2) The report states that DOD will not realize the anticipated savings of $94.9 million, but will in fact spend an additional $63.4 million to accomplish the work. How was this determined? Is the $63.4 million above that of the cost to perform the work before CA studies were done, or over the originally estimated contract costs? or over the MEO costs? If the latter, what was the basis for estimating the in-house costs? Again, the original in-house bid should not be used in See App. I

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such a determination without a thorough analysis of whether similar increases would have occurred under in-house operations.

(3) The Background paragraph in the discussion of the first finding states that "contractor bids are increased by a factor equal to 10 percent of in-house personnel costs". This implies that we pay the contractor an additional amount of money, which is not a true representation of the process. The bids themselves are not increased. A figure equal to 10 percent of in-house personnel costs is added to the total cost of contracting as a decision threshold for purpose of the cost comparison only. There is no actual outlay of funds. Report Revised

(4) The paragraph entitled "Defining Work Load" states that the auditors found 15 contracts where PWSs were inadequate. However, the report fails to describe how the PWSs were inadequate or give examples. We are unable to respond to this unsubstantiated claim. This paragraph further states that the Services could not evaluate the amount of contractor work done. Normally, when a contractor presents his invoice for payment it includes some statement of the work performed to earn that payment. If this is not being done, what are contract payments being based on? How can installations justify payment without some report of the work done by the contractor? Report Revised

(5) The table on top of page 11 states that the 15 contracts with inadequate PWSs are shown in Appendix C. For the Army the table indicates nine contracts. However, Appendix C only lists eight contracts with the footnote for inadequate PWSs. 7 Report Revised

(6) The paragraph on page 13 states that "because workload data were not tracked...Services' personnel had no means of assessing the efficiency of contractor operations or determining if contract costs were reasonable. Tracking contractor workload data is not the sole, or even the primary means of assessing the efficiency of contractor operations. The CA Program requires continual surveillance of contractor operations through established surveillance plans, and additional positions are established to perform this work. Assessments of efficiency are derived from evaluation of the surveillance reports. The contracting personnel do not drive the amount of emphasis placed on tracking and analyzing contractor performance as stated in this report. 8

(7) The table on top of page 14 states that the 13 contracts in which workload was not tracked are shown in 8

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Appendix C. For the Army the table indicates two contracts. However, Appendix C lists nine contracts with the footnote for workload not tracked. Report Revised

(8) The paragraph entitled "Cost Increases" discusses cost increases of $132.5 million. According to the data in Appendix C, the Redstone Arsenal installation support contract accounts for $108.5 million of the total increase. The Redstone Arsenal study is an anomaly for several reasons: (1) timing - 1980-1984 workload lag, (2) size of the study (3) complexity of the functions under study, and (4) the rate of change which has occurred. It would seem that including a study that is recognized as abnormal in the CA world would skew the data and the resultant decisions. See App. I

(9) The same paragraph later mentions three Army contracts with a cost growth ranging from 33 to 73 percent (page 18). Without the cause of the cost growth, it is not prudent to assume the worst. A blanket statement that contracts should be resolicited solely because the cost exceeds the in-house estimate is not valid. In-house cost (MEO) is not a reliable indicator of cost reasonableness over time. Further, there is considerable cost involved in resoliciting any contract. If the contract is operating satisfactorily and the cost growth is reasonable in the scope of the increases, a resolicitation simply because costs had exceeded an untested figure for an MEO from a given point in time would be unjustified. 11 See App. I

(10) Although the recommendations are not directed at this Service, we do not feel that they are directed at the root causes of the problems. The guidance for surveillance, including evaluation of contractor workload, and for resolicitations contained in the supplement to OMB Circular A-76 and in the DODI and AR 5-20 are adequate. The root cause of the problems discussed in this finding appears to be in the way surveillance is managed at the installations. Recommend your recommendations relate to this facet of the problem.

b. Finding B - Contractor Performance:

(1) The finding states that quality assurance surveillance plans were not fully implemented. Further paragraphs state that the Services were failing to complete required tests and were not complying with documentation requirements prescribed by the surveillance plan. However, there is little discussion as to why the plans are not fully

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implemented. In order to resolve program problems, we need to clearly understand what those problems are.

(2) The second part of the finding states that deductions for poor performance were not properly processed. Specifically, Army contracting officers only recovered 31 percent of the deductions recommended by quality assurance representatives. However, there is no discussion of why the deductions were not taken.

(3) Background for this finding states that OFPP #4 does not require PWSs to prescribe the use of extrapolation in calculating deductions for poor performance (pages 22-23). The purpose of the performance work statements is to describe the work required by the contractor, not to prescribe how the government will calculate deductions. See App. I

(4) The background also states that when contractor performance falls below the acceptable levels the contract may provide for payment deductions. The deduct mechanism applies only to Firm Fixed Price contracts. Many of the CA contracts are Cost Plus contracts, which provide a different method for incentivizing contractor performance. The report is written as though all contracts audited were Firm Fixed Price. While this may have been the case, it is not clearly stated. The assumption of all Firm Fixed Price contracts invalidates the data. See App. I

(5) This section also states that "The quality assurance representatives evaluate the contracting officers who are responsible for taking the deductions by reducing payments to the contractor." The QA representatives sole responsibility is to evaluate contractor performance. Report Revised

(6) The table at the top of page 25 states that the 20 contracts on which quality assurance plans were not fully implemented are shown in Appendix C. For the Army the table indicates ten contracts. However, Appendix C only lists three contracts with the footnote for QA plan implementation. 17 Report Revised

(7) While the recommendations are not directed at this Service, we do not concur that the information cited in recommendations 2 and 3 belongs in DODI 4100.33. These issues which should be addressed in acquisition directives.

2. The sampling procedure at Appendix A indicates a sample of 41 CA contracts from a universe of 243 contracts awarded during the

period FY 85 thru FY 87. The report is making generalities and broad conclusions based on a sample of only 17 percent of CA contracts for a two year period. This is of special concern with Redstone Arsenal included in the data. For the Army, the 14 contracts audited represent less than 6 percent of all CA contracts. The discussion of sampling procedures does not address how the individual contracts were selected for audit.

3. The draft report as currently written presents numerous unsubstantiated claims. Assertions need to be fully explained and documented before we can determine the validity of the perceived problems and the appropriate actions to resolve the problems. My point of contact for this action is Dian Deal, 746-6168.

FOR THE CHIEF OF STAFF:

WILLIAM A. STOFFT
Brigadier General, GS
Director of Management

DEPARTMENT OF THE NAVY

OFFICE OF THE ASSISTANT SECRETARY
(INSTALLATIONS AND ENVIRONMENT)
WASHINGTON, D.C. 20360-5000

3 MAY 1990

MEMORANDUM FOR THE ASSISTANT INSPECTOR GENERAL FOR AUDITING
(AIG(A)), DEPARTMENT OF DEFENSE

Subj: DRAFT REPORT ON THE AUDIT OF PROCEDURES FOR MONITORING COMMERCIAL ACTIVITIES' FUNCTIONS AFTER COMPLETION OF A-76 COMPETITIONS (PROJECT NO. 9SC-0005) - ACTION MEMORANDUM

Encl: (1) Department of the Navy Comments

This memorandum responds to your request for comments on the subject draft report of 5 March 1990. Because service contracts awarded under an A-76 competition do not differ in terms of contract administration requirements from service contracts awarded outside an A-76 context, we do not concur with Recommendation A.1. that DoD Instruction 4100.33 should be revised to include additional policies and procedures for preparing performance work statements, for evaluating contractor workload, and for resoliciting contracts exceeding DoD in-house estimates.

Similarly, we do not concur with Recommendations B.1-B.3. to require special procedures in DoD Instruction 4100.33 for certifying the implementation of quality assurance plans, for taking deductions for inadequate performance, and for extrapolating samples to calculate deductions for inadequate performance. These proposals concern generic contracting issues that are not unique to the A-76 program and that are already satisfactorily addressed in the Federal Acquisition Regulation (FAR) and in its DoD and Service supplements. Including such generic contracting guidance a second time in DoD Instruction 4100.33 clearly runs counter to the Secretary of Defense's expressed intent to reduce redundancy in DoD regulations.

Navy and Marine Corps will continue to try to comply with Executive Order 12615's requirement that the Services study annually three percent of their total civilian population per Recommendation C. Because of the complexities of the A-76 process and the time required to complete each A-76 competition, the Services have historically been able to achieve only one-third of this very ambitious goal.

Subj: DRAFT REPORT ON THE AUDIT OF PROCEDURES FOR MONITORING COMMERCIAL ACTIVITIES' FUNCTIONS AFTER COMPLETION OF A-76 COMPETITIONS (PROJECT NO. 9SC-0005) - ACTION MEMORANDUM

Additional Department of the Navy comments are provided in enclosure (1).

Jacqueline E. Schafer

JACQUELINE E. SCHAFER
ASSISTANT SECRETARY OF THE NAVY
(INSTALLATIONS & ENVIRONMENT)

Copy to:
NAVINSGEN
NAVCOMPT (NCB-53)

Department of the Navy Comments

Summary of Finding A

DoD commercial activities converted to contract were not as cost effective as anticipated because the Services were not effectively managing contractor workload after the contracts were awarded.

Recommendation A.1., page 19 - We recommend that the Assistant Secretary of Defense (Production and Logistics) revise DoD Instruction 4100.33 to include policies and procedures for managing the Commercial Activities Program that require the services to: 11

a. Prepare performance work statements that are based on accurate and timely historical workload data and that provide measurable and verifiable performance standards.

DON Response: Defer to ASD(P&L) but we do not concur. The requirement for preparing performance work statements is already adequately detailed in Part II of the Supplement to OMB Circular A-76, which in turn is referenced in paragraph E.3.b. of DoD Instruction 4100.33. Circular A-76, however, places the use of historical data in the broader context of job analysis, using it as one of many data points in the development of the performance work statement. Strict reliance on historical workload data as the sole or primary consideration is not appropriate in all cases, particularly where changing requirements may result in major deviations from historical workload. In addition, strict reliance on historical data in developing requirements may tend to conflict with OMB policy, which as the DoDIG notes on page 10, is to define what must be done in the future, not how it was done in the past. We would not want to lose the flexibility to change our methods or to permit the contractor to introduce new methods or techniques, which such a requirement to rely principally on historical data might imply. Rec.A.1.a Revised

b. Evaluate contractor workload against estimated workload in the performance work statements, determine the reasons for significant variations, and modify the contract if warranted.

DON Response: Defer to ASD(P&L) but concur that such procedures would be a necessary part of the administration of most service contracts. Do not concur that there is a special applicability to A-76 contracts.

c. Resolicit when costs exceed DoD in-house estimates.

DON Response: Defer to ASD(P&L) but do not concur. Generally, contracts are to be resolicited when they expire. Options are not to be exercised unless prices are reasonable. No special guidance is needed for A-76 contracts unless the intent is to require a study to convert back to in-house performance, in which case satisfactory OMB and DoD policy already exists.

Summary of Finding B

The Services' quality assurance surveillance programs on commercial activities contracts were not adequate to ensure that contractors were meeting contract performance requirements.

Recommendation B., page 30 - We recommend that the Assistant Secretary of Defense (Production and Logistics) revise DoD Instruction 4100.33 to: 20

1. Require contracting officers to certify annually to the appropriate commercial activity manager that quality assurance surveillance plans are fully implemented.

DON Response: Defer to ASD(P&L) but do not concur. The contracting officer does not have the responsibility to implement QA plans. The report's discussion of quality assurance indicates a misunderstanding of the respective roles of the quality assurance representatives and the contracting officer. For example, it states that "the quality assurance representatives evaluate the contracting officers who are responsible for taking the deductions [in the contract price due to below satisfactory performance] by reducing payments to the contractor." The FAR, Part 46.104, however, indicates that quality assurance representatives take action necessary to ensure that supplies and services conform to the quality requirements and make recommendations to the contracting officer for changes to the contract or specifications. They do not evaluate the contracting officer. The contracting officer's failure to adopt all such recommendations does not, as the report implies, necessarily represent a deficiency in monitoring performance. It may in fact represent a sound business decision. If implementing the quality assurance plans were a contracting officer responsibility, it would still be pointless to require certification that he had done his job, since a supervisory chain and personnel procedures perform this function more effectively. Report Revised See App. I

2. Establish procedures on when contracting officers are to take deductions for inadequate contractor performance documented by quality assurance representatives.

DON Response: Defer to ASD(P&L) but do not concur. The procedure will be in the contract. The contracting officer should enforce the contract. The IG report states that Navy contracting officers took 99% of recommended deductions, implying that existing procedures are adequate when enforced.

3. Require that all commercial activity contracts provide for the use of extrapolation of quality assurance samples to calculate deductions for inadequate contractor performance.

DON Response: Defer to ASD(P&L) but do not concur. Agree that when the contract provides for extrapolation, it should be enforced. Also agree that extrapolation should be used where appropriate, but do not agree that it is appropriate in all cases. Do not agree that existing guidance on when to use extrapolation is inadequate. Rec.B.1.c Revised

Summary of Finding C

The Services are technically not complying with Executive Order 12615, which requires Government agencies to study a minimum of three percent of their civilian population annually until all identified potential commercial activities have been studied.

Recommendation C, page 35 - We recommend that the Secretaries of the Military Departments comply with Executive Order 12615 by increasing the civilian population to be studied annually to three percent of the total civilian population. 25

DON Response: Concur. The DON will continue to strive to meet this ambitious goal. Because of the complexities of the A-76 process, the Department's historical annual completion rate for A-76 studies has equaled only one-third of the Executive Order's goal. Given these circumstances, we anticipate continued difficulties in meeting this very ambitious goal.

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC 20330-1000

OFFICE OF THE ASSISTANT SECRETARY

11 MAY

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

SUBJECT: Draft Report on the Audit of Procedures for Monitoring Commercial Activities Functions After Completion of A-76 Competitions (Project No. 9SC-0005) (DOD(IG) Memo, March 5, 1990) - INFORMATION MEMORANDUM

This is in reply to your memorandum for Assistant Secretary of the Air Force (Financial Management and Comptroller) requesting comments on the findings and recommendations made in subject Draft Report.

Our overall concern with the report is that it does not reflect the in-depth understanding of the Commercial Activities Program on which a detailed audit should be based. We do not agree that DOD Directive 4100.33 needs to be revised to correct inadequacies cited since they are adequately covered there or in appropriate Air Force directives or Federal Acquisition Regulations. There is no acknowledgment of the conflict between Executive Order 12615 and Section 1111 of the National Defense Authorization Act for FY 1988 and FY 1989 (the Nichols Amendment) with respect to the total civilian population to be cost compared. These and other issues are addressed in the attached comments.

We believe as you do that programs involving the expenditure of large amounts of public funds require particularly close and constant scrutiny. We appreciate your working with us as we constantly strive to make the Commercial Activities Program as fair and beneficial as possible for all parties concerned. We look forward to working with you on your Final Report.

LLOYD K. MOSEMAN, II
Deputy Assistant Secretary
(Logistics)

1 Atch
Management Comments

MANAGEMENT COMMENTS

DRAFT REPORT ON THE AUDIT OF PROCEDURES FOR MONITORING COMMERCIAL ACTIVITIES FUNCTIONS AFTER COMPLETION OF A-76 COMPETITIONS (PROJECT NO. 9SC-0005)

PART II - FINDINGS AND RECOMMENDATIONS

A. Contractor Workload

FINDING (pg 7): The services were not effectively managing workload after commercial activities' functions were converted from Government to contractor operations. 7

RECOMMENDATIONS (pp 19-20):

1. That the ASD(P&L) revise DODI 4100.33 to include policies and procedures for managing the CA Program that require the Services to: 11

a. Prepare PWSs that are based on accurate and timely historical workload data and that provide measurable and verifiable performance standards.

b. Evaluate contractor work load against estimated work load in the PWSs, determine the reasons for significant variances, and modify the contract if warranted.

c. Resolicit contracts when costs exceed DOD in-house cost estimates.

2. That the Commander, AF Space Command, reduce authorized funding on contract line items for logistics and transportation by $2.3 million for the remaining fiscal years on the Precision Acquisition Vehicle Entry Phased Array Warning System (PAVE PAWS) contracts.

DISCUSSION:

1. We do not concur with the finding nor with the recommendation that DODI 4100.33 be revised to add more policies and procedures concerning preparation of performance work statements (PWSs), for evaluating contractor workload, and for resoliciting contracts that exceed in-house estimates.

a. Reference the section on Defining Workload, page 12. We disagree that the refuse collection contract at Hill AFB, Utah, is an example of inadequate PWSs where workload is not properly defined. The initial solicitation for that contract addressed both estimated tonnage and number of containers of refuse to be collected and dumped at landfills. Payments have always been based on both counts. However, changes to federal and state environmental regulations since contract award now require refuse disposal by a burn facility versus dumping in a 8 Report Revised

landfill. Associated fees have increased drastically from a previous rate of $5.00/ton to $35.00/ton now, with a further increase to $50.00/ton expected this year. Through the life of the contract there have also been labor rate increases implemented by the U.S. Department of Labor. These factors have driven up contract costs in spite of a decrease in refuse tonnage due to recycling initiatives implemented at Hill AFB. Due to the lack of specific examples, we are unable to address the other two contracts indicated on page 11 and in Appendix C as having inadequate PWSs. 7

b. Reference the discussion on Managing Workload, page 15. The implication of this portion of the audit is that there is a requirement for the government to track and analyze contractor workload, which is not the case. Only those contractual items where the contract payment is determined by the actual workload require monitoring by the government. For the majority of contracted services, the contract payment is based upon a monthly price for performance of all contract requirements regardless of the occurrence of any one task. Additionally, we disagree with citing the transient aircraft maintenance contract at Beale AFB, California, as an example of failure to negotiate contract price changes. The variation in workload provision of the contract provides for the possibility of a change in contract price, not the certainty. The determination to change the contract price must be based upon the complexity, difficulty and cost of the total work requirements with any resultant price change based upon the net of all increases or decreases in the estimated workload. Since the types of aircraft to be serviced vary greatly in the work required and, therefore, the cost to perform, a 10% variation from workload may not result in a price change. Also, the contractor must maintain the minimum staffing required to service all possible aircraft regardless of the actual workload. In consideration of these factors, the contracting officer must determine whether or not a price change is warranted for workload variations. Although the workload variation at Beale AFB was sufficient to warrant consideration of a price change, a change was not warranted due to the types of aircraft actually serviced and the minimum staffing requirements of the contract. Due to the lack of specific examples, we are unable to address the other six contracts, indicated on page 14 and in Appendix C, for which workload was allegedly not tracked. 8 See App. I

c. The FINDING on page 7 of the draft report includes the statement, "...and contracts were not resolicited when contractor's costs exceeded DOD's estimated in-house costs." While this may be factual, it does not necessarily mean that there is a problem. The in-house cost estimate is based upon the PWS as awarded and would not include any costs associated with changes to that PWS after contract award. If the contract costs exceeded the DOD's estimated in-house costs because of changes made to the PWS after award, there should not necessarily be a resolicitation of the contract. Each change made to the contract will be negotiated based upon a government estimate for the 5 See App. I

change; therefore, it may be appropriate to state that the contract should be resolicited if the contract costs exceed the estimated in-house cost inclusive of all government estimates for changes.

d. Reference the last sentence of this FINDING, which reads, "Overall, on these 41 contracts, we estimated that DOD will not realize the anticipated savings of $94.9 million by contracting out these functions, but will spend an additional $63.4 million to accomplish the commercial activities." This purports to provide an estimate for the actual savings versus the projected savings from the cost comparison conversions. These savings projections appear to be based upon a simple comparison of the existing contract price to the original estimated in-house costs, a comparison which is, very likely, inaccurate. Any changes made to the contract which resulted from changes to the contract requirements, and hence increased contract costs, would have been made to the in-house performance requirements and its attendant costs as well. Any determination or estimate of actual savings must consider changed requirements for both the contract and the in-house estimate. See App. I

2. We do not concur with Recommendation A2, concerning the PAVE PAWS contracts. Air Force Space Command established government estimates for cost reimbursable logistics and transportation support at its PAVE PAWS sites. These estimates were based on anticipated supplies, equipment, spare parts, and transportation necessary to ensure that support may be provided when required to continue near 100% missile warning coverage. If the funds are not used on the PAVE PAWS requirements, they are deobligated. However, reducing the cost estimates to a level of prior year expenditure could jeopardize the mission. Reducing the estimated costs of these contract line items would not be a true "cost avoidance" since only incurred costs are reimbursed. The Command reviews historical expenditures and anticipated costs to establish the government estimate for each year. Further, as a performance period progresses and it becomes apparent that there are excess funds on a contract, the excess funds are deobligated by the Administrative Contracting Officer and returned to the Command budget.

B. Contractor Performance

FINDING (pg 21): The Services were not effectively evaluating contractor performance to ensure that contractors were meeting contract requirements, and they were not obtaining adequate compensation for substandard performance. These conditions occurred because quality assurance surveillance plans were not fully implemented on all commercial activities' contracts, and deductions for poor contractor performance were not properly processed or computed. 15

RECOMMENDATION (pg 30): That the ASD(P&L) revise DODI 4100.33 to: 20

1. Require contracting officers to annually certify to the appropriate commercial activity manager that quality assurance surveillance plans are fully implemented.

2. Establish procedures on when contracting officers are to take deductions for inadequate contractor performance documented by quality assurance representatives.

3. Require that all commercial activities' contracts provide for the use of extrapolation of quality assurance samples to calculate deductions for inadequate contractor performance.

DISCUSSION:

1. Nonconcur with the entire finding and all recommendations. In the general discussion under FINDING, the broad, general allegations detract from the point(s) the report is attempting to make. For example, "Of the 41 commercial activities' contracts reviewed valued at $425.6 million, quality assurance surveillance plans were not effectively implemented on 20 contracts valued at $332.3 million, which prevented the Services from evaluating the quality of contractor work." This says that quality assurance surveillance plans (QASPs) of 48.8% of the contracts representing 78.1% of the total cost of the contracts were not effectively managed. There is no direct correlation between the cost of a contract and whether a QASP is effectively used. Rather, in 20 of 41 contracts, the quality assurance evaluator (QAE) recommended deductions which the contracting officer, for whatever reason, may or may not have taken all, or part, of the recommended amount. Also, the report seems to tie "success" in implementing the QASP with the amount recovered (Navy, Air Force, and Marine Corps contracting officers recovered 98% in recommended deductions). Due to lack of specific detail, we are unable to address the six contracts cited on page 25 and in Appendix C as not having quality assurance plans fully implemented. 17

2. Whether a contracting officer takes a deduction from a contractor based on performance is purely the contracting officer's decision made in coordination with the functional representative-the QAE's supervisor-and the commander of the installation. A contracting officer would not normally act purely on the report of a QAE. In any case, the QAE does not "evaluate the contracting officers" (p.24, lines 4-5). Also, it is difficult to determine from the report whether the QAEs were performing their jobs partially or not at all, were not ensuring deducts were taken (not their job) or were not following up with the proper paperwork. The Draft Report states that contract performance files showed no evidence of oversight by the QA representatives. Report Revised 16

3. In calculating deductions, the Air Force uses either the random sampling or 100% inspection technique. The majority of contracts resulting from cost comparison fall under the purview Rec.B.1.c. Revised

of AFR 400-28, Base Level Service Contracts. It requires the use of random sampling, which is a statistically reliable technique, whenever possible. Each contract written and administered under AFR 400-28 includes specific deduction procedures appropriate for that individual contract.

C. Implementation of the A-76 Program

FINDING (pg 31): The Services did not plan to complete commercial activities' studies for 3% of their total civilian populations annually, as required by Executive Order 12615. At the 28 military installations visited, the Services had plans to study an average of about 1% of their total civilian populations from FY 1989 through FY 1993. 25

RECOMMENDATION (pg 35): That the Secretaries of the Military Departments comply with Executive Order 12615 by increasing the civilian population to be studied annually to 3% of the total civilian population. 25

DISCUSSION:

1. We nonconcur with the Recommendation. On 29 February 1988, Secretary Carlucci issued guidance in accordance with Section 1111 of the National Defense Authorization Act for FY 1988/1989 (Nichols Amendment) and Executive Order (EO) 12615. In his letter, the SECDEF gave each Service a goal and guidance "to do your best to achieve the (following) FY 1988 A-76 study goals." Each service was to submit their management plan to meet the study goals. The Air Force further disseminated the guidance by letter on 1 May 1988 to its Major Commands.

2. The Air Force was given the goal by DOD and elected not to further allocate these goals to the MAJCOMs or installations since, at the time of the implementation of the EO, the Air Force had already scheduled a sufficient number of studies to fulfill the requirement of the EO. The EO represented a two-fold increase in the level of activity at the time. Also, the Air Force was concerned that the allocation of goals to MAJCOMs or installations could be construed to be a violation of law (the Nichols Amendment).

3. The installations were not given goals, nor should they be. Each installation is different and the availability of commercial activities for study is a function of the mission/wartime commitment on that installation. Given the Congressional interest on the rapid completion of studies and their interest in the installation commanders' involvement in the CA program, the Air Force will continue to make steady, deliberate progress toward fulfilling our wartime commitments while meeting peacetime budget constraints.

AGENCY COMMENTS ON THE FINDINGS AND AUDIT RESPONSE

This appendix includes extracts from DoD, Army, Navy, and Air Force comments on the findings as presented in a draft of this report. It also includes our response to management comments. Management comments on the recommendations and potential monetary benefits are addressed in Part II of this report. The complete texts of management comments are included as Appendixes E through H.

Finding A. Contractor Workload

DoD Comment

The finding that DoD will not realize the anticipated $94.9 million savings on the 41 contracts it reviewed, but will actually spend an additional $63.4 million is inaccurate and misleading. The DoD-IG did not provide an estimate of what it would cost an in-house workforce to provide these goods and services under similar circumstances (i.e., wage and salary increases, increased scope of work). There is no basis on which an accurate comparison could be made.

Army Comment

How was it determined that DoD will not realize the anticipated savings of $94.9 million, but will in fact spend an additional $63.4 million to accomplish the work?

Air Force Comment

The savings projections appear to be based upon a simple comparison of the existing contract price to the original estimated in-house costs, a comparison which is, very likely, inaccurate.

Audit Response

We do not believe that the finding is inaccurate or misleading. The A-76 program guidance provides detailed procedures for the cost comparison between the Most Efficient Organization (in-house organization) and the contractors' bids for a given commercial activity to include anticipated changes in labor costs and scope of work over the period covered in the comparison. We evaluated actual contract cost growth from the baseline contracts, which were awarded based on the cost comparison process and then estimated the contracts' total cost by the time they are completed. DoD reported the estimated savings under the A-76 program to OMB, but did not update its estimates to reflect actual costs incurred.

Army Comment

Directives governing the Commercial Activities program do not require that contracts be resolicited when costs exceed the Government estimate. Before such a decision is made, an analysis should be made as to why the costs increased.

Audit Response

We agree that analyses should be made as to why commercial activities' contracts have increased in cost. We believe these analyses should be part of any contract resolicitation. We recommend DoD establish specific criteria on when commercial activities' contracts be resolicited.

DoD Comment

The DoD-IG did not point out that one contract accounted for $108 million of the alleged increased cost.

Army Comment

According to data in Appendix C, the Redstone Arsenal installation support contract accounts for $108.5 million of the total cost increase. It would seem that including a study that is recognized as abnormal in the commercial activities world would skew the data and resultant decisions.

Audit Response

As discussed in Appendix A, we stratified the universe of commercial activities' contracts and selected a statistical sample of 41 contracts from the universe. The Redstone Arsenal contract was just part of the sample and should be representative of the total universe.

Army Comment

A blanket statement that contracts should be resolicited solely because the costs exceed the in-house estimate is not valid. In-house cost is not a reliable indication of cost reasonableness over time.

Air Force Comment

If contract costs exceed DoD's estimated in-house costs because of changes made to the Performance Work Statement (PWS) after award, there should not necessarily be a resolicitation of the contract.

Audit Response

Under A-76 program guidance, the cost comparison process includes evaluation of contractor and in-house proposals for the same work load over the same time period. Since the decision to award the commercial activity contract is based on that comparison and the resulting savings by no longer performing the workload in-house, the in-house cost estimate ought to be an excellent indicator to evaluate contractor costs to accomplish the work load identified in the PWS.

Air Force Comment

Although the workload variation at Beale Air Force Base was sufficient to warrant consideration of a price change, a change was not warranted due to the types of aircraft actually serviced and the minimum staffing requirements of the contract.

Audit Response

The intent of our recommendation was to get the Military Departments to track contractor work load in order to effectively evaluate contractor performance. In the case of the Beale Air Force contract, the Air Force has taken those steps necessary to review contractor workload data and evaluate the contractor's performance, which meets the intent of our recommendation.

Finding B. Contractor Performance

Army Comment

The purpose of PWS's is to describe the work required by the contractor, not to prescribe how the Government will calculate deductions.

Audit Response

We do not agree. It is our opinion that extrapolation for calculating deductions is needed to provide a full disclosure in the PWS to alert the contractor of actions that will be taken for poor performance of work.

Army Comment

The deduct mechanism applies to firm-fixed-price contracts. Many of the commercial activities' contracts are cost-plus contracts, which provide a different method of incentivizing contractor performance. The report is written as though all contracts were firm-fixed-price.

Audit Response

Not all Army contracts reviewed were firm-fixed-price contracts. For example, a contract for food services at Fort Dix, New Jersey, was a cost-plus-award-fee contract. Even though the contract was not a firm-fixed-price contract, deductions were taken for poor contractor performance.

Navy Comment

If implementing the quality assurance plans were a contracting officer's responsibility, it would still be pointless to require certification that he had done his job, since a supervisory chain and personnel procedures perform this function more effectively.

Audit Response

Quality assurance plans are a surveillance tool used in contract administration of commercial activities' contracts to ensure that contractors are performing contract requirements. Since these plans are a surveillance tool, the Military Departments should be using them to the fullest extent possible. An annual certification that the quality assurance plan has been implemented would provide increased credibility to the monitoring process and strengthen internal controls over commercial activities' contracts. Since 20 of 41 contracts had not been fully implemented, we question the effectiveness of current supervisory review and personnel procedures to ensure plans are fully implemented.

SUMMARY OF POTENTIAL MONETARY AND OTHER BENEFITS RESULTING FROM AUDIT

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
A.1.	Internal Control - Revise DoDI 1/ 4100.33 to implement procedures to correct inadequate Performance Work Statements (PWS's) and to measure contractor's work load.	Cost Avoidance. Overall monetary benefits cannot be quantified. This is an internal control measure that could be used to improve DoD's A-76 Program.
A.2.	Economy and Efficiency - Reduce Air Force funding for logistics and transportation cost line items on the PAVE PAWS 2/ contracts.	Cost Avoidance. A one-time cost avoidance of $2.3 million could be achieved if the Air Force Space Command reduces cost reimbursable contract line items for logistics and transportation for FY's 1990 through 1994 on the PAVE PAWS contracts.
A.3.	Compliance - Revise the PWSs and track contractor workload data on commercial activities' contracts reviewed.	Cost Avoidance. Overall monetary benefits cannot be quantified. The Services will realize the savings associated with clearly defining work to be done and tracking contractors' performance of the work load.

1/ Department of Defense Instruction

2/ Precision Acquisition Vehicle Entry Phased Array Warning System

SUMMARY OF POTENTIAL MONETARY AND OTHER BENEFITS RESULTING FROM AUDIT (Continued)

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
B.1.	Internal Control - Revise DoDI 4100.33 to provide guidance on the preparation of quality assurance plans and the application of consistent treatment for contractors that perform poorly.	Cost Avoidance. Overall monetary benefits cannot be quantified. This is an internal control measure that could be used to improve DoD's A-76 Program.
B.2.	Compliance - Fully implement quality assurance surveillance plans on commercial activities' contracts reviewed.	Cost Avoidance. Overall monetary benefits cannot be quantified. By fully implementing quality assurance surveillance plans, the Services will realize the savings associated with effectively evaluating contractors' performance.
C.	Compliance - Implement procedures for Services to comply with Executive order 12615 by studying 3 percent of the civilian population.	Cost Avoidance. Overall monetary benefits cannot be quantified. By studying 3 percent of their civilian populations, the Services will realize savings associated with implementing most efficient organizations or contracting out.

ACTIVITIES VISITED OR CONTACTED

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Department of the Army

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Deputy Chief of Naval Operations (Logistics), Washington, DC
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