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STATEMENT OF SEYMOUR EFROS
ASSOCIATE GENERAL COUNSEL - PROCUREMENT

BEFORE THE
SUBCOMMITTEE ON MONETARY & FISCAL POLICY
JOINT ECONOMIC COMMITTEE

ON THE
PROTEST FILED BY
HOLMES & NARVER SERVICES, INC.
AND
MORRISON-KNUDSEN COMPANY, INC.
(B-212191 AND B-212191.2),
UNDER REQUEST FOR PROPOSALS
NOS. DAAHO-82-R-0002 AND DAAHO3-82-R-0033



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Mr. Chairman and Members of the Subcommittee:

We have been asked to appear today to discuss GAO's decisions concerning the protest of Holmes & Narver Services, Inc., and Morrison-Knudsen Company, Inc., a joint venture. The protests involve solicitations issued by Redstone Arsenal, United States Army Missile Command. The solicitations were issued to determine whether base operations and maintenance services should continue to be performed at Redstone Arsenal by federal employees in-house or by a contractor. I would like to submit for the record our decisions of November 17, 1983, and April 17, 1984, on the matter and briefly summarize them.

The solicitations were issued in February 1982. Initial proposals were submitted August 1982. Final proposals were submitted February 1983. The period of performance was for 4 years, 10 months, starting October 1, 1983.

Army's cost comparison was conducted pursuant to Office of Management and Budget (OMB) Circular No. A-76. It indicated that contracting out with the low offeror, Holmes & Narver, would cost about \$1 million less than in-house performance. (The estimated costs involved almost \$350 million for the entire contract period.)

The federal employees' union appealed this finding to an Army administrative appeals board, which determined that the in-house performance costs were lower than Holmes &

Narver's costs by about \$100,000. Both Holmes & Narver and a federal employee then appealed to the board. As a result of those appeals, the board ruled on June 10, 1983, that the cost of in-house performance was actually less than contracting out by approximately \$2 million. On June 23, 1983, Holmes & Narver protested this determination to GAO.

The protester challenged the Army's cost comparison in several areas. On November 17, 1983, we sustained the protest in some of the areas. We concluded that Army had failed to include certain in-house labor costs in the cost comparison and had not updated the information provided to offerors in one respect. Most importantly, we concluded that the cost comparison should be conducted in accordance with a February 1982 amendment of OMB Circular No. A-76 (OMB Transmittal Memorandum (TM) No. 6). The Army had argued that because its in-house cost estimate had been completed by February 1982, TM-6 did not have to be applied for these procurements. We disagreed, and concluded that TM-6 was applicable.

TM-6 provided, in essence, that base personnel costs that are incurred regardless of whether the solicitation services are performed in-house or by contract should no longer be charged to the costs of contracting out in a cost

comparison. In total, these costs (so-called underutilized personnel costs) amount to \$15.9 million.

After our November 17, 1983 decision was issued, the Army asked for clarification. It pointed out that when TM-6 was issued, the Department of Defense also issued instructions to the military departments that they were free to use an alternate cost method whereby these personnel costs were excluded from both in-house and contracting-out cost estimates. It was reported to us that OMB had approved use of the alternate approach, and that in July 1982, Army had directed its activities to use the alternate method only. The question Army raised with us was whether it could use the alternate approach consistent with our November 17 decision.

The Army Audit Agency stated as follows:

"The use of Memorandum 6 can significantly understate contract costs. . . . These costs have already been charged against the in-house activity and consequently, they properly reflect a cost of contract operations. By eliminating personnel related costs from line 24, Memorandum 6 unfairly reduces the cost of contract operations. The original Redstone study included costs of \$31.6 million on line 24. Applying the guidance in Memorandum 6 would reduce this amount by \$15.9 million. Use of Memorandum 6 would eliminate from the

comparison costs which are properly related to contract operations and which could significantly affect the results of the study. Since the difference in the total in-house estimate was only \$1.9 million less than the contract estimate, use of Memorandum 6 would not only reverse the difference but would reverse it by \$14 million in favor of the contractor.

"We find that conflicting guidance existed during the time of this study. Both the alternative method and Memorandum 6 were approved by DOD. The Army implemented the alternative method only. It may be significant that when OMB revised their Circular A-76, Performance of Commercial Activities, on 4 August 1983 they used a method similar to the alternative method for including overhead costs. As we have shown, Memorandum 6 will give significantly different results than a study done using the alternative method. In their revisions Redstone converted their study to the alternative method. Does this action by Redstone satisfy your requirements or should the revisions incorporate Memorandum 6?"

On April 17, 1984, we modified our earlier decision. We held that those costs that are not eliminated when the

operation is contracted out are not required to be charged to the in-house operation. We stated that:

"We review an agency determination under A-76 only when the agency utilizes the procurement process to aid in its policy decision-making under A-76. We review the process solely to assure that a determination to perform in-house, rather than to award a contract, is not the result of a faulty or misleading cost comparison. Crown Laundry and Dry Cleaners, Inc., B-194505, July 18, 1979, 79-2 CPD 38. Our prior decision was based on the premise that because TM-6 was in effect when offers were submitted for these procurements, it should be applied in order to assure a proper and fair cost comparison. Because it is now clear to us that use of TM-6 will have the opposite result, we think the Army should be permitted to use the alternate cost comparison method for these procurements in order to avoid an erroneous cost comparison."

Mr. Chairman, this concludes my prepared statement. I will be happy to respond to any questions.