

146-1910



Comptroller General  
of the United States  
Washington, D.C. 20548

## Decision

**Matter of:** PRC, Inc.  
**File:** B-247036  
**Date:** April 27, 1992

William L. Walsh, Jr., Esq., J. Scott Hommer, III, Esq., and William Craig Dubishar, Esq., Venable, Baetjer and Howard, and Ronald L. Shingler, Esq., PRC, Inc., for the protester. Joel R. Feidelman, Esq., James M. Weitzel, Jr., Esq., and Jordan S. Fried, Esq., Fried, Frank, Harris, Shriver & Jacobson, for Science Applications International Corporation, an interested party. Eric Lile, Esq., and Bernard T. Decker, Esq., Department of the Navy, for the agency. Guy R. Pietrovito, Esq., and James A. Spangenberg, Esq., Office of the General Counsel, GAO, participated in the preparation of the decision.

### DIGEST

In a negotiated procurement for the award of a cost reimbursement contract, the procuring agency's cost realism determination of the awardee's proposed subcontractor costs was unreasonable where the agency normalized the amount of subcontractor hours proposed upward to the level of the government's independent estimate but used the awardee's estimated subcontractors' labor rates, which the agency had previously and properly determined to be unrealistically low, in calculating the awardee's total adjusted subcontractors' cost.

### DECISION

PRC, Inc. protests the award of a contract to Science Applications International Corporation (SAIC) under request for proposals (RFP) No. N61339-91-R-0027, issued by the Naval Training Systems Center, Department of the Navy, for a logistics training simulator and related supplies and services for the Department of the Army.<sup>1</sup> PRC protests that the award to SAIC is improper because the Navy failed to evaluate proposals in accordance with the stated

<sup>1</sup>The training simulator system is being purchased by the Navy for the U.S. Army Combined Arms Support Command at Fort Lee, Virginia.

evaluation scheme, performed an unreasonable cost realism analysis, and made an unreasonable cost/technical tradeoff.

We sustain the protest.<sup>2</sup>

The RFP contemplated the award of a cost-plus-incentive-fee contract for a fully operational, prototype Combat Services Support Training Simulator System (CSSTSS), which is a computer driven training device that will provide a simulated battlefield environment on which to teach combat support functions. In essence, the CSSTSS is an integrated system of computer and input/output devices that will interface with software developed by the contractor to provide the necessary training for a range of specified combat support activities, including medical, transportation, personnel, grave registration, maintenance, petroleum, ammunition, and supply services. The RFP provided a detailed statement of work. Besides the hardware requirements, the contractor was required to develop and provide all software, application programs, operating systems, and diagnostic software necessary to the operate the CSSTSS.

The RFP stated that award would be made to "the offeror whose proposal is evaluated as offering the optimum, or 'best value,' approach for attainment of program objectives considering not only cost, but also the other evaluation criteria . . ." Detailed requirements for the preparation of technical and cost proposals were provided, which informed offerors of the information required for each evaluation factor and subfactor. The following were stated to be the evaluation factors:

1. Technical
  - a. System Design
  - b. Integrated Logistics Support (ILS)
  - c. Management
2. Cost

Technical considerations, collectively, were stated to be more important than cost, but no single technical evaluation factor was more important than cost. The RFP also provided that system design was significantly more important than the other two technical evaluation factors, which were equal in weight. Subfactors were listed for each of the technical

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<sup>2</sup>Portions of the protest record are subject to a General Accounting Office protective order to which counsel for PRC and SAIC have been admitted. Our decision, which is based upon protected, confidential information, is necessarily general.

evaluation factors and their relative importance was provided. Some of the subfactors were designated as "primary," or of greatest importance, although some primary subfactors were stated to be of more importance than other primary subfactors. Offerors were also informed that the realism of costs would be evaluated and that:

"The cost proposal must be commensurate with the proposed effort. Offerors are cautioned to submit realistic pricing since an offeror's ability to project costs which are reasonable for the effort proposed relates to its understanding of the nature and scope of work to be performed and thus may affect the technical proposal evaluation. Proposals unrealistic in terms of technical or schedule commitments or unrealistically low in cost or price will be deemed to reflect an inherent lack of technical competence or indicative of failure to comprehend the complexity and risks of the contract requirements and may be grounds for rejection of the proposal."

The Navy received three proposals, including offers from PRC and SAIC. The proposals were evaluated by the source selection evaluation board (SSEB) in accordance with an adjectival rating scheme set out in the agency's proposal evaluation plan.<sup>3</sup> All three offers were found to be in the competitive range. Written discussions were conducted, through the issuance of two rounds of deficiency notices and proposal clarification requests. Upon completion of discussions, the Navy requested and received best and final offers (BAFO).

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<sup>3</sup>Proposals were evaluated as either "exceptional," which was defined as exceeding the specified performance in a beneficial way; "acceptable," which was defined as meeting specified performance with good probability of success and no significant weaknesses; "marginal," which was defined as containing no more than minor deficiencies and the proposal failed to provide sufficient information to conclusively determine that requirements had met and/or there were contradictions in the proposal; and "unacceptable," which was defined as failing to meet the requirements of the solicitation and major modification or rewrite of the proposal would be required. Differentiations in ratings were provided through the use of (+) which indicated a rating at the top of the scale and (-) which indicated a rating at the bottom of the scale.

The final evaluation results were as follows:<sup>4</sup>

	System Design	ILS	Management
PRC	A+	M+	A
SAIC	A	A+	A
Offeror A	A	A+	A

The SSEB determined that PRC was slightly higher rated overall than SAIC and Offeror A, but that no offeror was significantly superior overall.

The source selection authority (SSA) found that all of the offerors' proposed costs were substantially below the government's baseline cost estimate and were unrealistically low." Hearing Transcript (Tr.) at 257, 340.<sup>5</sup> In performing its cost realism analysis, the agency used two different cost analysis methodologies. Under method I, the agency accepted the man-hours proposed by each offeror, but, with assistance from the Defense Contract Audit Agency (DCAA), analyzed, and adjusted where appropriate, the offerors' labor and indirect cost rates. Certain other adjustments were also made under this method to account for SAIC's and Offeror A's failure to propose all subcontractor costs. Under method II, since the agency determined that all of the offerors proposed fewer man-hours than those determined by the agency in its undisclosed IGME, the Navy adjusted all the offerors' proposed manning levels and associated costs upwards based upon the IGME. The offerors' proposed and evaluated costs are as follows:

	<u>Proposed</u>	<u>Method I</u> (in millions of dollars)	<u>Method II</u>
SAIC	\$11.2	\$17.1	\$23.2
PRC	18.5	18.4	25.2
Offeror A	18.5	19.7	29.9

The source selection advisory council (SSAC) adopted the technical recommendation of the SSEB that the offerors were essentially equal and recommended award to SAIC on the basis

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<sup>4</sup>The letters under the technical rating represent the following: "A" for acceptable and "M" for marginal.

<sup>5</sup>A hearing was conducted, pursuant to 4 C.F.R. § 21.5 (1992), to receive testimony concerning the agency's independent government man-loading estimate, the evaluation of offerors' proposed manning and labor skill mix, and the agency's normalization of offerors' proposed levels of effort to that of the undisclosed independent government man-loading estimate (IGME).

of its lower evaluated costs. The SSA likewise adopted the SSAC's recommendation, as follows:

"With the technical rankings being so close, I have determined that my award decision will be based on cost . . . In evaluating the cost proposals the immediate aberration is that of the SAIC costs. A large amount of the SAIC difference in cost can be attributed to their making reductions on their subcontractors' cost proposals. This technique was also used by [Offeror A]. SAIC also included uncompensated overtime. Pricing in uncompensated overtime along with subcontractors' costs as proposed, SAIC is still the low offeror by almost \$1.4 [million]. In an additional effort to ensure that the volume of the scope of work was adequately evaluated, the [g]overnment estimate for man-years of effort required was priced in at the rates offeror's proposed. As a result of this analysis, SAIC was still the low offeror by almost \$2 [million].

"Based upon the foregoing, I have determined that SAIC offers significant cost savings no matter which evaluation method was used. Since there are no significant technical differences, I determine that the SAIC proposal represents the best value to the [g]overnment."

Award was made to SAIC on November 22, 1991, and this protest followed on December 13. Performance of SAIC's contract was not required to be suspended because the protest was filed more than 10 calendar days after award, and contract performance has continued.

As an initial matter, the Navy and SAIC argue that PRC's protest allegations contesting the agency's cost realism analysis and evaluation of SAIC's proposal are untimely since PRC's protest was not filed within 10 working days of the date it learned of the award to SAIC and the award amount.<sup>6</sup> We disagree. PRC promptly requested and received debriefings, on December 3 and 10, to obtain the agency's explanation for its evaluation and award selection. From its debriefings, PRC first learned the basis for its protest allegations concerning the Navy's evaluation of PRC's and SAIC's proposals, the Navy's cost realism determinations, and the award selection. Since PRC protested within

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<sup>6</sup>The agency and SAIC do not challenge as untimely PRC's protest allegations concerning the evaluation of its own proposal and whether the agency conducted meaningful discussions with PRC.

10 working days after its December 3 debriefing, the protest is timely. 4 C.F.R. § 21.2(a)(2); S-Cubed, a Div. of Maxwell Laboratories, Inc., B-242871, June 17, 1991, 91-1 CPD ¶ 571.

The crux of PRC's protest is its challenge to the agency's technical evaluation and cost realism determination that found SAIC's proposal technically equal to PRC's proposal with a lower evaluated cost, despite the fact that SAIC offered more than 50 percent fewer man-hours than PRC. As described below, we find that the agency's cost realism analysis was defective and that, in a proper cost realism analysis, PRC's evaluated cost would be more than \$7.6 million less than SAIC's.

Where, as here, an agency evaluates proposals for the award of a cost reimbursement contract, an offeror's proposed estimated costs of contract performance are not dispositive, because, regardless of the costs proposed, the government is bound to pay the contractor its actual and allowable costs. Federal Acquisition Regulation (FAR) § 15.605(d); Amtec Corp., B-240647, Dec. 12, 1990, 90-2 CPD ¶ 482. Consequently, a cost realism analysis must be performed by the agency to determine the extent to which an offeror's proposed costs represent what the contract should cost, assuming reasonable economy and efficiency. CACI, Inc.- Fed., 64 Comp. Gen. 71 (1984), 84-2 CPD ¶ 542. Because the contracting agency is in the best position to make this cost realism determination, our review is limited to determining whether the agency's cost realism analysis is reasonably based and not arbitrary. General Research Corp., 70 Comp. Gen. 279 (1991), 91-1 CPD ¶ 183, aff'd, American Mgmt. Sys., Inc.; Dept. of the Army--Recon., 70 Comp. Gen. 510 (1991), 91-1 CPD ¶ 492; Grey Advertising, Inc., 55 Comp. Gen. 1111 (1976), 76-1 CPD ¶ 325.

As explained above, the Navy's technical evaluators and the SSA determined that all of the offerors' proposals were technically acceptable and essentially equal, and that award should be made to the offeror with the lowest evaluated cost. The Navy conducted a cost realism analysis of the firms' cost proposals, using two different cost methodologies, and made a number of adjustments to the offerors' proposed costs.

Under the method I cost realism analysis, the agency, with assistance from DCAA, adjusted the firms' proposed labor and indirect cost rates, uncompensated overtime costs, and escalation factors. No adjustments were made under this first methodology for the firms' low estimated man-hour levels of effort. SAIC's proposed prime labor costs were

adjusted upward to cost its use of uncompensated overtime,<sup>7</sup> and their proposed subcontractor costs were significantly adjusted upward to reflect costs proposed by the firm's subcontractors that were not included in SAIC's proposed costs.<sup>8</sup> Tr. at 358.

Specifically, the Navy found that SAIC, in its BAFO, had made substantial unilateral reductions in the loaded labor burden rates proposed by 2 of its 3 subcontractors (representing nearly 90 percent of the subcontract work) in the subcontractor's cost and pricing data.<sup>9</sup> The Navy concluded that the labor burden rates contained in the subcontractors' cost and pricing data were more accurate indicators of the subcontract costs that the government ultimately would have to pay, inasmuch as these rates, as confirmed by DCAA, represented the subcontractors' audited or forward pricing rates.<sup>10</sup> The application of SAIC's actual subcontractor's labor rates resulted in SAIC's evaluated subcontract costs being more than doubled.

The Navy's total cost realism adjustments under method I resulted in SAIC's proposed costs of \$11,204,966 being adjusted upward to \$17,063,932. The Navy found PRC's proposed costs realistic under this methodology, with only minor adjustments for the firms' proposed subcontract costs (for an addition error), material overhead, G&A expenses, cost of money, and fee. PRC's proposed costs of \$18,473,013 were adjusted downward to \$18,443,173.

Under the method II cost realism analysis, the agency adjusted all of the offerors' proposed costs based upon the agency's undisclosed man-hour estimate. As noted above, the

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<sup>7</sup>PRC protested that SAIC offered an unreasonable amount of uncompensated overtime. The record indicates that the amount of uncompensated overtime proposed by SAIC was not significant.

<sup>8</sup>Other proposed costs of SAIC were adjusted under this method, i.e., its General & Administrative (G&A) expenses.

<sup>9</sup>The RFP incorporated FAR § 52.215-24 (FAC 90-3) that required the submission of cost and pricing data for any subcontract expected to exceed \$100,000, unless the subcontract price was based upon adequate price competition, established catalog or market prices of commercial items, or set by law or regulation.

<sup>10</sup>Forward pricing rates are rates that the government and contractor have agreed will be available for a specified period of time for use in pricing contracts or modifications. FAR § 15.801.

Navy concluded that the offerors' estimated man-hour levels of effort were unrealistically low. The IGME was 239.8 man-years of effort, while PRC proposed 158.3 man-years and SAIC proposed 101.4 man-years. Accordingly, the agency normalized the offerors' proposed levels of effort to that of the IGME. This was accomplished by adding prime and subcontract labor hours, in the ratio proposed by each offeror, to bring each offeror's total level of effort up to that contemplated by the IGME.

The offerors' proposed costs were then adjusted upward under the method II cost analysis to reflect the increased evaluated level of effort. The Navy sought to do this by calculating average labor rates for the firms' prime contractor costs and for the firms' subcontractor costs. These rates were then multiplied against the respective, additional prime contractor and subcontractor hours (as adjusted to the IGME level of effort) to determine additional labor costs. These additional labor costs were then added to each firm's proposed prime contractor and subcontractor labor costs to determine the total adjusted prime and subcontractor labor costs. The Navy's normalization of the level of effort, with associated cost adjustments, resulted in an upward adjustment in SAIC's cost proposal to \$23,236,361 and in PRC's cost proposal to \$25,202,315.

The Navy appears to argue that the two cost methodologies are separate and distinct and that SAIC appears to be the lowest evaluated cost offeror under either cost analysis methodology. In our view, both methodologies, together, are necessary to properly determine the probable costs that the government will be required to pay. That is, under method I, the offerors' rates were to be adjusted to reflect the agency's judgment as to what rates it would ultimately be required to pay, while under method II a realistic level of effort, as reflected in the IGME, was used to determine the offerors' probable costs of performance. These two methodologies must be combined to determine the true probable costs of the offerors.

We find that the Navy failed to combine the two methodologies when, in its method II analysis, it determined SAIC's subcontractors' average labor rate using SAIC's estimated subcontractor costs before the method I cost adjustment.<sup>11</sup> In other words, the Navy used SAIC's estimated subcontractor costs, which it had found were less

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<sup>11</sup>The Navy, on the other hand, properly calculated PRC's method II adjusted costs using the adjusted subcontractor costs it had determined for PRC under the method I analysis. PRC's prime labor costs were not adjusted in the agency's method I cost analysis.

than half the actual costs that the subcontractors would incur, as a basis for making the method II subcontractor labor cost adjustment.

The reason that such a massive method I adjustment had to be made by the Navy to SAIC's proposed subcontractor costs was that SAIC, in its BAFO, reduced subcontractor costs by unilaterally and substantially reducing its subcontractors' estimated labor burden rates. This resulted in a substantial decrease in the amount of subcontractors' costs included in SAIC's estimate of its costs of contract performance. Although SAIC's initial proposal stated that the subcontractor rates were "based upon government audited rates or approved forwarded pricing rate structures" (emphasis added), SAIC, in its BAFO, determined that the burden rates of its major subcontractors were not comparable to SAIC's rate structure and proposed a significant cost reduction based on the assumption that the subcontractor rates could be reduced to SAIC's level. Specifically, SAIC stated in its BAFO that it "is encouraging our major subcontractors to achieve this comparable rate through the use of co-locations and/or engineering service company participation." (Emphasis added.) However, there is no commitment in these cost reimbursement subcontracts to "cap" these rates at, or otherwise not charge the government for rates beyond, the amounts SAIC "believed" were reasonable.

As explained above, the Navy did not accept SAIC's subcontractor cost adjustments in its method I cost analysis, but instead calculated a probable subcontractor cost from the subcontractors' cost and pricing data. The SSA's source selection decision expressly recognized this discrepancy in SAIC's subcontract costs and did not accept these costs as adjusted by SAIC. Indeed, the SSA testified that he believed that further discussions with SAIC were necessary because of SAIC's "reductions that [SAIC] had taken on the cost figures proposed by their subcontractors."<sup>12</sup> Tr. at 358. Inexplicably, this discrepancy was not recognized in the method II cost analysis, although other method I cost results were appropriately used in the method II analysis. For example, in determining SAIC's method II prime labor costs, the Navy properly used the adjusted prime labor costs, as determined for SAIC under method I, and not SAIC's proposed costs.

We see no rational basis for the agency's failure in the method II cost analysis to use the subcontractor costs that were determined to be reasonable by the agency under its method I cost analysis. In this regard, as noted above, SAIC's proposal did not offer to cap these rates at the

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<sup>12</sup>No further discussions were conducted.

amounts SAIC "believed" were reasonable. Moreover, the DCAA rate information in the record supports the subcontractors' labor burden rates contained in SAIC's subcontractors' cost and pricing data. Finally, SAIC reaped the benefit of its use of these subcontractors in the technical evaluation and that the proposal of these subcontractors was incorporated into the contract.

Given the Navy's recognition in the method I cost analysis that SAIC's proposed subcontractors' costs were unreasonably low because SAIC had unjustifiably reduced its subcontractors' estimated labor burden rates, we find unreasonable the agency's subsequent use in the method II cost analysis of SAIC's proposed subcontractor costs that were based upon these artificially reduced labor burden rates. The Navy's erroneous cost realism adjustment resulted in SAIC's method II subcontractor costs being greatly understated. This is so because the method II cost adjustments associated with the massive increase in SAIC's subcontractor labor hours is significantly exacerbated by the proper application of SAIC's subcontractors' substantially higher rates than those actually used by the Navy in its method II adjustment.<sup>13</sup>

We calculate that SAIC's subcontract costs under the second methodology should be more than \$9.6 million higher than those calculated by the Navy.<sup>14</sup> Using the Navy's own cost realism methodologies, PRC's evaluated costs are \$25.2 million while SAIC's evaluated costs are \$32.8 million. Thus, PRC offered the lowest evaluated cost by more than \$7.6 million.<sup>15</sup>

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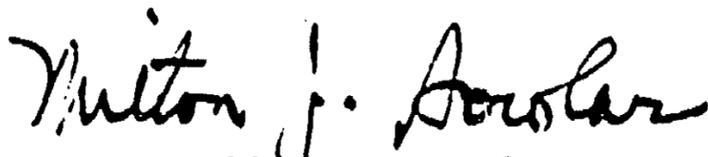
<sup>13</sup>As noted above, SAIC's actual average subcontractor labor rates, as based upon the DCAA audited rates, were more than double that proposed by SAIC or the other offerors.

<sup>14</sup>We calculated SAIC's subcontractors' realistic average labor rate by dividing SAIC's method I subcontractor costs by the number of subcontractor hours proposed. This subcontractor labor rate was multiplied by the subcontractor hours that were added to raise the offeror's subcontractor level of effort to the IGME level. This sum was then added to the method I subcontractor costs to determine the total probable method II subcontractor cost.

<sup>15</sup>Since we find that the agency's cost realism analysis was defective and that under a proper cost realism analysis PRC is entitled to award, we need not address PRC's other cost realism issues, including whether the offerors' proposed levels of effort should have been normalized to the IGME.

Since the Navy concluded that the offerors' were essentially technically equal, the basis for award should be the firm's evaluated costs, See General Research Corp., supra. Based on the foregoing, we find that PRC's proposal should have been selected for award because it offered the lowest evaluated cost.<sup>16</sup> We recommend that the Navy terminate SAIC's contract for the convenience of the government and make award to PRC. We also find that PRC is entitled to its costs of filing and pursuing the protest, including reasonable attorneys' fees, 4 C.F.R. § 21.6(d)(1). PRC should submit its certified claim for its protest costs directly to the agency within 60 working days of receipt of this decision. 4 C.F.R. § 21.6(f)(1).

The protest is sustained.



Comptroller General  
of the United States

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<sup>16</sup>Since we have sustained PRC's protest of the agency's cost realism analysis and find that PRC is entitled to award as the lowest evaluated cost offeror, we need not address PRC's other allegations concerning the Navy's evaluation of PRC's and SAIC's proposals.