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U.S. Department of Energy
Office of Inspector General

August 1991



Report on

Audit of the Cost Effectiveness of Contracting for Headquarters Support Services

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THE SECRETARY OF ENERGY
WASHINGTON, D.C. 20585

DOE/IG--0297

September 5, 1991

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The Honorable John C. Layton
Inspector General
U.S. Department of Energy
1000 Independence Ave., S.W.
Washington, D.C. 20585

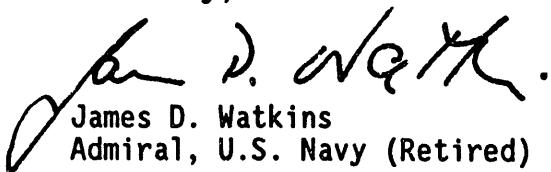
Dear Mr. Layton:

I have reviewed your report on the "Audit of the Cost Effectiveness of Contracting for Headquarters Support Services".

On my behalf, the Director of Administration and Human Resource Management has begun efforts to strengthen Headquarters support service contracting activities. Discussions have been initiated with the Office of Management and Budget in an effort to provide for sufficient interim Federal positions when contractor conversions are justified, and we have refined the budget process for justifying and accounting for additional positions needed for these conversions. Additionally, DOE's support service contracting policy is being revised to incorporate the requirement to conduct cost comparison analyses as part of the review and approval process for requesting contractor support services.

Thank you for your continuing efforts to ensure the Department's accountability.

Sincerely,


James D. Watkins
Admiral, U.S. Navy (Retired)

MASTER



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memorandum

DATE: August 30, 1991

REPLY TO
ATTN OF: IG-1

SUBJECT: INFORMATION: Report on "Audit of the Cost Effectiveness of Contracting for Headquarters Support Services"

TO: The Secretary

BACKGROUND:

The attached report is provided to inform you of our finding and recommendations on our audit of contractor costs for support services at Department of Energy (DOE) Headquarters. Our objective was to determine whether the Office of Management and Budget (OMB) Circular A-76 requirement for new and existing support services contracts was properly implemented. DOE spends about \$229 million on support services annually.

DISCUSSION:

OMB Circular A-76 requires a comparison of in-house and contractor costs to identify the most cost effective means of acquiring needed services. The audit found that, on average, the costs to perform the work in-house were 40 percent less than contractor costs. The contracted activities were nevertheless continued because DOE policy did not require a cost comparison analyses as part of the program office request for support services. In addition, program officials were reluctant to perform cost comparisons because of concerns about the time required to complete the cost analysis and the availability of additional Federal positions needed for conversion to in-house performance. For the contracts reviewed, DOE could have saved \$16.3 million by performing these services in-house rather than by contract.

Our recommendations include revising the review and approval process for support service requests to include a cost comparison that follows the principles of OMB Circular A-76 and establishing a systematic process for coordinating with OMB to ensure that sufficient interim Federal positions will be available to staff the support service function. Management generally agreed with the finding and recommendations.


for John C. Layton
Inspector General

Attachment

cc: Deputy Secretary
Under Secretary
Director, Office of Administration and Human Resource Management

AUDIT OF THE COST EFFECTIVENESS
OF CONTRACTING FOR HEADQUARTERS SUPPORT SERVICES

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U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL
OFFICE OF AUDITS

AUDIT OF THE COST EFFECTIVENESS
OF CONTRACTING FOR HEADQUARTERS SUPPORT SERVICES

Audit Report Number: DOE/IG-0297

SUMMARY

Department of Energy (DOE) Headquarters uses support service contractors to perform specific activities and functions required to meet mission assignments. Annually, DOE Headquarters spends about \$229 million on support service activities. The Office of Administration and Human Resource Management sets the policy on the use of support service contracts and reviews each support service request from the program office.

We reviewed and evaluated selected Headquarters awards to determine if DOE properly implemented cost comparison analyses for new and existing support service contracts. The Office of Management and Budget (OMB) Circular A-76 requires a comparison of in-house and contractor costs to identify the most cost effective means of acquiring needed services.

The audit found that, on average, the costs to perform the work in-house were 40 percent less than contractor costs. The contracted activities were nevertheless continued because DOE policy did not require a cost comparison analysis as part of the program office request for support services. In addition, program officials were reluctant to perform cost comparisons because of concerns about the time required to complete the cost analysis. Notwithstanding the time factor, program officials observed that there is no guarantee of Federal staffing resources being available once the decision is made to convert to an in-house staff. We recognize the validity of this concern and, therefore have recommended that the Department seek OMB's assistance in assuring that the necessary resources will be available to effect these conversions. For the contracts reviewed, DOE could have saved \$16.3 million by performing these services in-house rather than by contract.

Our recommendations include revising the review and approval process for support service requests to include a cost comparison that follows the principles of OMB Circular A-76 and establishing a systematic process for coordinating with OMB to ensure that sufficient interim Federal positions will be available to staff the support service function. The Office of Administration and Human Resource Management generally agreed with the finding and recommendations.

Office of Inspector General

PART I

APPROACH AND OVERVIEW

PURPOSE AND OBJECTIVE

Department of Energy Headquarters uses support service contractors to perform specific activities and functions required to meet mission assignments. The objective of our audit was to determine whether the Department properly implemented OMB Circular A-76 requirements for new and existing support service contracts. Specifically, the Circular requires comparison of in-house and contractor costs to identify the most cost-effective means of acquiring needed services.

SCOPE AND METHODOLOGY

We reviewed selected Headquarters support service contracts listed as active in the Procurement and Assistance Data System as of November 1989. The system listed 138 Headquarters contracts totaling \$619 million. Of the 138 contracts listed, 54 contracts worth \$564 million had an average annual award amount over \$1 million or required at least 10 full-time equivalents (FTEs) and were subject to OMB cost comparison requirements.

We selected 7 of the 54 contracts for detailed review. They had total award values of \$40.8 million and covered a broad range of support service activities and Headquarters program offices. The individual award values of the seven contracts ranged from \$2.4 million to \$10.8 million.

We used OMB guidelines in comparing the contractor costs to estimated costs of performing the same work with Federal employees. For each sample contract, actual costs incurred by the contractor were identified from vouchers submitted to DOE for the months of January, February, and March 1990. We used the contractor's organizational structure in developing the in-house cost estimate. Comparable Government positions were identified with the assistance of a personnel classifier using the same personnel skill levels as the current contractor staff. Other in-house expenditures were based on costs stipulated by OMB Circular A-76 or actual Headquarters cost experience.

We held meetings with personnel from the Office of Organization and Management Systems to discuss our cost comparison techniques. We identified any problems with the cost estimating procedures and determined acceptable methods for estimating individual cost elements. We also held discussions with program officials responsible for monitoring the contractors' work.

The audit was made in accordance with generally accepted Government auditing standards for performance audits. We assessed the significant internal controls with respect to review and approval of requests for support service contracts. This included tests of internal controls and compliance with laws and regulations to the extent necessary to satisfy the objective of the audit. Because our review was limited, it would not have necessarily

disclosed all internal control deficiencies that may exist. The audit was performed between April and November 1990.

The Office of Administration and Human Resource Management waived an exit conference.

BACKGROUND

Program offices in DOE Headquarters use support service contractors with various skills and abilities to assist in the development and execution of their assigned missions. Support services may include performance of specific commercial activities as well as advisory and assistance functions. Annually, DOE Headquarters spends about \$229 million on support service activities.

Before a contract award can be made, program managers must prepare and submit a detailed request for the services required. The Office of Administration and Human Resource Management sets policy on the use of support service contracts and reviews each support service request from the program office. In cooperation with the program manager, this Office is responsible for performing periodic reviews of support service activities within DOE organizations to assess compliance with Departmental policy and other applicable Governmentwide regulations. The program manager makes the final determination on whether to perform the activity in-house with Government personnel or to contract it out.

OBSERVATIONS AND CONCLUSIONS

It is the policy of the Department not to enter into or maintain a support service contract when services are more economically available within DOE. Departmental procedures require program offices to prepare a detailed justification for performing work with a contractor. However, program officials were not performing cost comparisons to determine if the use of support service contractors was cost effective.

Our review of seven active support service contracts showed that, on average, costs to perform the work in-house were 40 percent less than contractor costs. Cost comparisons were not done because DOE procedures did not require them as part of the support service request. For the seven contracts, we estimate that DOE could have saved \$16.3 million by performing these services in-house rather than by contract.

In addition to policy implementation problems, staff availability concerns also contributed to program officials' reluctance to perform cost comparisons. Program officials were concerned about the time required to complete a cost analysis and were apprehensive about the availability of additional Federal positions if a cost comparison supported conversion to in-house performance. We recognize that the availability of the necessary approved positions presents a significant barrier to DOE on in-house performance.

Thus, we recommended that where the cost comparison supports conversion to Federal service, DOE establish a systematic process for coordinating with the Office of Management and Budget to ensure that sufficient Federal positions will be available to appropriately staff the support service function. We also recommended that DOE develop a revised process for the review and approval of requests for contractor support services that would include a cost comparison analysis of Federal and contractor costs. The cost comparison should follow the principles established in OMB Circular A-76. The Office of Administration and Human Resource Management generally agreed with the finding and recommendations.

Our finding relating to cost effective use of support service contracts disclosed material internal control weaknesses which management should consider when preparing its yearend assurance memorandum on internal controls.

PART II
FINDING AND RECOMMENDATIONS

Cost Effective Use of Support Service Contracts

FINDING

OMB Circular A-76 states that Government performance of a commercial activity is authorized when a cost comparison shows that the activity can be operated at a lower estimated cost. Our review of seven active support service contracts showed that, on average, in-house costs were 40 percent less than contractor costs. The contracted activities were nevertheless continued because DOE procedures did not require cost comparisons for new and existing contracts as part of the program office request for support services. Since these comparisons were not made, additional staffing needed to support conversion to in-house performance was not included in the annual budget request. For the seven contracts reviewed, we estimate that DOE could have saved \$16.3 million by performing these services in-house rather than by contract.

RECOMMENDATIONS

We recommend that the Director, Office of Administration and Human Resource Management:

1. Develop a revised process for the review and approval of requests for contractor support services that would include a cost comparison analysis of Federal versus contractor costs. The cost comparison should follow the principles established in OMB Circular A-76.
2. Where the cost comparison supports conversion of the activity to Federal service, establish a systematic process for coordinating with OMB to ensure that sufficient interim Federal positions will be available to appropriately staff the support service function. Adjust the Department's personnel base through the annual budget request to include the additional positions.

MANAGEMENT REACTION

Management generally agreed with the finding and recommendations. Management and auditor comments are in Part III of this report.

DETAILS OF FINDING

REQUIREMENTS FOR REASONABLE COST DETERMINATIONS

OMB Cost Comparison Requirements

OMB Circular A-76 establishes the Federal policy regarding performance of commercial activities. It states that Government performance of a commercial activity is authorized if a cost comparison demonstrates that the Government can operate the activity on an ongoing basis at an estimated cost lower than the cost of a qualified commercial source. A supplement to the Circular sets forth procedures for determining whether commercial activities should be performed under contract or in-house using Government facilities and personnel.

The supplement establishes procedures for performing cost comparisons for both existing and new contracts. According to the supplement, existing contracts should be continually monitored to ensure that performance is satisfactory and cost effective. When contract costs become unreasonable, a cost comparison of the contracted activity should be performed if re-competition does not result in reasonable prices and if in-house performance is feasible. For new contracts, a cost comparison is required if there is reason to believe that commercial prices may be unreasonable.

According to Circular A-76, contracts that are not cost effective will be allowed to expire (options will not be exercised) once in-house capability is established. If required Federal personnel cannot be accommodated within the agency's personnel ceiling, a request for adjustment will be submitted to OMB in conjunction with the annual budget review. In addition, Government agencies are required to ensure that the impact of cost comparison decisions are reflected in budget estimates and should be timed to conform with the budget process.

DOE Policy

In addition to the OMB Circular, DOE has established internal policy, procedures, and responsibilities for the management of support service contracts. According to DOE Order 4200.3B, it is Departmental policy not to enter into or maintain a support service contract when "services are more economically available within DOE." The Order provides for specific review requirements which must be met before a request for a support service contract can be approved.

CONTRACTING OUT FOR SUPPORT SERVICES

Cost Considerations

Our review indicated that contracting for support services was more costly than performing the work in-house for each of the seven contracts examined. The cost difference ranged from 26 to 53 percent. On average, the cost of contracting for the support service activity was 40 percent higher, as shown in the following illustration.

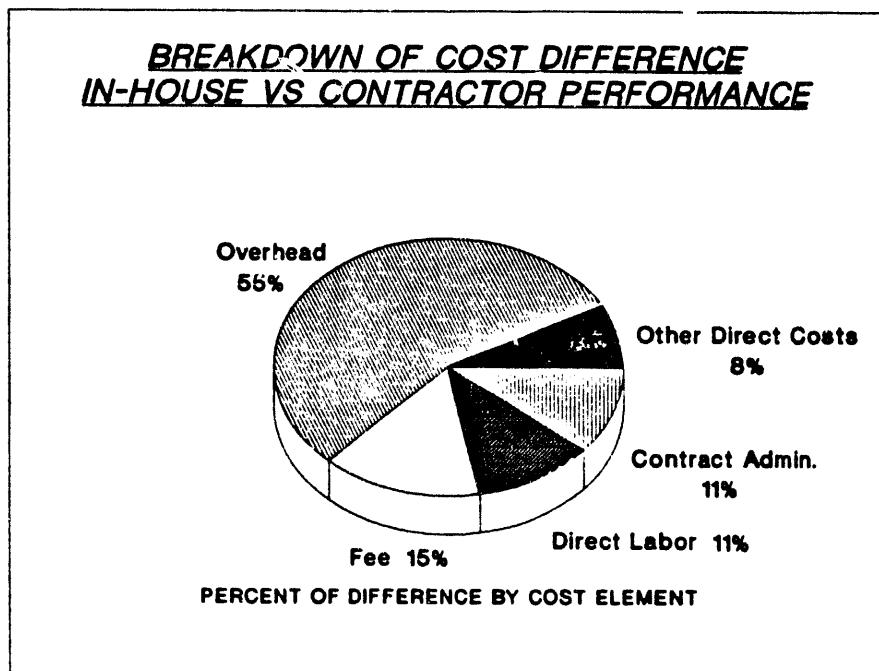
HEADQUARTERS SUPPORT SERVICES COST COMPARISONS BY CONTRACT

Contract	Contractor Cost	In-house Cost	Cost Difference	Percentage Difference 1/
A	\$424,162	\$315,107	\$109,055	26
B	\$533,880	\$367,404	\$166,476	31
C	\$378,262	\$251,657	\$126,605	33
D	\$766,546	\$497,620	\$268,926	35
E	\$478,525	\$295,983	\$182,542	38
F	\$195,282	\$117,425	\$77,857	40
G	\$1,422,479	\$672,879	\$749,600	53
 Totals	\$4,199,136	\$2,518,075	\$1,681,061	40
	=====	=====	=====	=====

1/ Generally, OMB Circular A-76 stipulates that the cost differential must exceed 10 percent in order to convert from contractor to in-house performance.

Contributing Cost Elements

To evaluate in-house versus contractor performance, OMB Circular A-76 identifies specific cost elements for inclusion in the cost comparison. Our review found differences in several of these cost elements that contributed significantly to the higher cost for each of the contracts reviewed. These elements included overhead, direct labor, fee (profit), contract administration, and other direct costs. The following illustration shows the percentage that each cost element contributed to the total estimated cost difference.



Analysis of Cost Factors

We found various reasons for the differences between each in-house and contractor cost element. For example, contract overhead costs were higher due to the difference in overhead rates. The Government rate used for in-house cost calculations was 49.25 percent. The contractors' overhead rates ranged from 51 to 130 percent with a median rate of 92 percent.

Fee represents the contractor's profit as a percentage of total contract charges. This cost, which in our sample was a median of 7 percent, would be eliminated when the activity was performed by a DOE work force.

Total contract labor costs were 17 percent higher than Federal labor costs. The higher contract costs resulted from differences in Federal and contractor wage rates, since comparable Federal positions were almost always paid below contractor wage rates. To perform the functions described in each

contract, an in-house staff was created using the current contractor work force and actual hours worked.

Contract administration costs are incurred by DOE procurement and program offices to ensure that contracts are faithfully executed. When contract work is converted to in-house performance, the contract administration personnel stipulated in the Circular would be eliminated. This represents a direct cost savings to DOE. Other direct costs consisted of items such as travel, computer usage, subcontractor costs, material and supplies. The cost difference resulted from a comparison of contractor and in-house costs for each of these items.

In addition, two other cost elements actually reduced the difference between contractor and in-house costs by 4 percent. The first is the loss of Federal income taxes generated by the contractor when the work is converted to in-house. The second is the one-time conversion cost of recruiting and relocating new Federal employees. Despite these factors, our analysis showed that the cost to perform work in-house was 40 percent less than when performed by a contractor.

Feasibility of In-house Performance

In addition to cost considerations, in-house performance must also be feasible. The work performed under the seven selected contracts consisted of administrative, management and technical support. Contractors provided administrative support by conducting studies or performing required research assignments; preparing draft reports, procedures, or recommendations on program related documentation and assisting in briefing and seminar preparations. Management support was provided through assistance in identifying, developing and analyzing program issues, objectives, missions, strategies and options. Technical services included contractor scientific and engineering support for safeguard and security activities, nuclear energy decommissioning projects, defense waste and transportation management and courier/messenger services.

According to some program officials, the support work currently being performed by their contractors could be done by Government employees. One program office would prefer an in-house staff. To enhance their hiring capabilities, several program offices have been able to fill specific staffing requirements through special programs approved by the DOE Office of Personnel. Although lower Federal wage rates have caused employment difficulties, special hiring programs, as well as former contractor staff, provide program offices with the necessary resources to establish an in-house performance capability.

REASONS FOR USING HIGHER COST CONTRACTORS

Policy Implementation and Compliance

OMB Circular A-76 cost comparison studies for existing contracts and new requirements were not performed because DOE policy and procedures did not require them as part of the requests for support services. DOE Order 4510.1A establishes the procedures for implementing Circular requirements and defines the responsibilities of program officials. It stipulates that program

officials use the detailed instructions in DOE Order 4200.3B for preparation and approval of their support service requests.

DOE Order 4200.3B requires program offices to provide specific documentation in their support service requests including appropriate program office signatures, the contract statement of work, the proposed contractor (if known), and an analysis of the proposed work. Program officials must also provide a brief justification for performing the work with a contractor, including a statement on alternatives to contractor performance. This statement discusses the use of in-house resources and resources from other agencies and why each one of these alternatives is not recommended by the program officials.

This Order, however, has no specific requirement for cost comparison data. The statements from program offices do not contain any information or discussion on cost justifications for contractor performance. The information required by the Order addresses only non-cost related factors or alternatives to using contractors. For example, justifications often used by program officials in their support service requests included the unavailability of in-house personnel with the necessary technical skills, the relatively short period of time these personnel will be needed, and the quick-reaction requirement associated with the project.

According to Office of Organization and Management Systems (OM) officials, program offices have been notified that DOE is required to comply with Circular A-76. Furthermore, procedures for contracting out for support services are set forth in DOE Order 4200.3B. Even though the Order had not previously identified cost as a review element in support service requests, OM officials agreed that a change to the Order could be made to require that a cost comparison be included in the request package for new contracts. They also agreed that costs should be considered before re-competition of existing contracts.

Staff Availability

Staffing problems contributed to the reluctance of program offices to perform cost comparisons. Program officials were concerned about the time required to complete the cost analysis and were apprehensive about the availability of additional Federal positions if the cost comparisons justified conversion to in-house performance.

Program officials have not evaluated the cost effectiveness of their contractors because of current staffing problems. They contend that the cost studies are time consuming and that managers do not have the staff available to complete the necessary work, which may include updating the performance work statement, developing an organizational structure, and completing the cost study.

In addition, program offices are reluctant to dedicate already limited resources to performing a cost study when in-house performance is not feasible without additional positions. It is much easier to contract out the function than to consider in-house performance, especially if the function is already under contract and a follow-on contract is proposed. OM officials also pointed

out that, although a cost comparison should be made by program offices, conversion to in-house performance depends mainly on the availability of approved personnel positions.

The President's Council on Management Improvement (PCMI) confirmed in a recent report the problems the Department of Energy and other Government agencies have in acquiring additional personnel positions. Their report concludes that the unavailability of necessary approved positions presents a significant barrier to these agencies on in-house performance. Currently, there is no guarantee of Federal positions being available once the decision is made to convert to an in-house staff. To resolve this problem, the PCMI recommended that interim positions be provided until the agency base is adjusted through its budget process. DOE officials supported the recommendations but stated that in order for the process to work smoothly they would need a commitment from OMB.

EFFECT OF MORE COSTLY SUPPORT SERVICES

For the seven support service contracts with total award values of \$40.8 million, we estimate the Department could save \$16.3 million by performing the work with in-house staff, which represents an annual savings of \$5.5 million.

Our estimated cost savings is limited to the sample contracts; however, we believe that similar cost savings could be realized with other Headquarters support service contracts. Contracts for engineering services, technical assistance and other administrative support work represent the majority (52 percent) of support service contracts awarded by DOE Headquarters. As of September 1990, there were 35 active contracts worth \$200 million awarded for such services. Based on an average estimated cost savings of 40 percent, the total cost savings could approach \$80 million if in-house conversion is determined feasible. The annual savings would be about \$30 million. We believe these types of contracts should be included in any initial effort to perform Circular A-76 cost studies since the type of personnel skills required are readily available to DOE.

PART III
MANAGEMENT AND AUDITOR COMMENTS

In responding to our draft report, the Director, Office of Administration and Human Resource Management generally agreed with the finding and recommendations. A summary of management's comments and our response follows.

Management Comments. Management partially concurred with Recommendation 1 and stated that a cost comparison that follows the principles of OMB Circular A-76 should be included in requests for contractor support services. However, management believes that a revised process for review and approval of requests for contractor support services should also document, as appropriate, factors other than cost (e.g., eclectic mix of technical skills, short term tasks, intermittent nature of some of the work, new requirements that have funding but no manpower allocation, etc.) that create mitigating circumstances for permitting contracting when the cost comparison shows savings projected for in-house operation. Without considering these factors, the Department may not be able to contract out work even though it may be in the best interests of the Department.

Management also stated that while they have not yet conducted a detailed analysis of the workpapers supporting the cost comparison for each of the seven contracts covered in the audit, it appears that the in-house costs were understated resulting in an overstatement of the projected savings. Management believes the savings would be less than the 40 percent quoted in the draft report. However, since our cost comparison included some costs for in-house cost elements, management agrees that significant savings could apparently be achieved by conversion from contract to in-house operation.

Auditor Comments. The primary concern of this report is to ensure that the process for review and approval of support service contracts is revised to include the results of a cost comparison using OMB Circular A-76 principles. In this respect, management's comments are responsive to the recommendation. We recognize that other factors can be part of the contract justification and have been used by program officials to document their support service requests. However, such mitigating circumstances should be the exception and not the rule. Cost remains the most important factor to consider during the review and approval process.

The estimated cost savings of 40 percent was calculated using OMB Circular A-76 guidelines and in-house cost estimates. Our review was performed in accordance with generally accepted Government auditing standards that require findings be correctly portrayed and conclusions be supported by competent and relevant evidence in the working papers. Our projected savings amounts were independently verified and accurately reflect the results of our audit.

Management Comments. Management concurred with Recommendation 2. Concurrence was based upon the assumption that a process can be developed and

approved by OMB to establish a pool or other interim supply of Federal employee positions to staff the support function until the Department's personnel base can be adjusted through the annual budget process.

Auditor Comments. Management's comments are responsive to the recommendation. Management should actively pursue establishing a systematic process with OMB to ensure the necessary Federal positions will be available.

END

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12/16/91

