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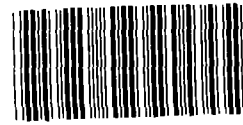
GAO

Briefing Report to Congressional Requesters

October 1987

# NAVY CONTRACTING

## Award of a Contract at Whidbey Island Naval Air Station



134151

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National Security and  
International Affairs Division

B-226840

October 7, 1987

The Honorable William D. Ford  
Chairman, Committee on Post Office  
and Civil Service  
House of Representatives

The Honorable Gary L. Ackerman  
Chairman, Subcommittee on  
Compensation and Employee Benefits  
Committee on Post Office and Civil  
Service  
House of Representatives

As requested in your letters of July 31 and August 1, 1986, we reviewed the award of a 5-year base operating support contract at Whidbey Island Naval Air Station, Oak Harbor, Washington, to Del-Jen, Incorporated. We examined the procedures followed by the Navy as they related to specific concerns raised by the American Federation of Government Employees (AFGE), Local 1513. These concerns included the

- calculation of specific cost comparison items, such as contract administration cost;
- amount of indefinite quantity work and related labor hours;
- qualifications of the contractor as a small business; and
- conflict of interest.

We found that the procedures followed in awarding this contract were not inconsistent with Office of Management and Budget (OMB) or Navy guidance. Specifically, the Navy followed either its own or OMB guidance in (1) comparing the in-house versus contractor performance costs and (2) determining the amount of indefinite quantity work. As to the contractor qualifying as a small business, we found that the successful bidder was not a subsidiary of or in partnership with one of the other firms bidding on this contract as had been claimed.

The allegation concerning the conflict of interest in the award of the contract was investigated by the Navy and, as agreed with your offices, we performed limited work on this issue. We basically determined what the Navy had done to resolve the matter. The Navy Judge Advocate General investigated this matter and concluded that there was no violation of the conflict of interest regulations. However, he recommended that if the contractor was asked to bid on a new contract, then the Navy's contracting office should determine if a potential conflict of interest exists and, if so, either bar the contractor from bidding or contract with appropriate restraints. The Navy's contracting office subsequently requested the Naval Investigative Service to review the case and based on the information in the Investigative Service's and the Judge Advocate General's reports, its Office of General Counsel concluded that the contractor should not be barred from competing for future business.

The results of our work on the specific concerns raised by AFGE are discussed in appendixes I through III. Our objective, scope, and methodology are described in appendix IV.

We discussed the information presented in the appendixes with Navy officials and AFGE representatives at Whidbey Island. As you requested, we did not obtain official Department of Defense comments.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 7 days from the date of issuance. At that time, we will send copies to interested parties and make copies available to others upon request.

If you have any questions, please call me on 275-6504.

Sincerely yours,

  
John Landicho  
Senior Associate Director

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ABBREVIATIONS

AFGE	American Federation of Government Employees
CINPACFLT	Commander-in-Chief, United States Pacific Fleet
COMNAVAIRPAC	Commander, Naval Air Force, Pacific Fleet
GAO	General Accounting Office
OMB	Office of Management and Budget
PCS	permanent change of station

THE WHIDBEY ISLAND NAVAL AIR STATION'S CONTRACT

The Whidbey Island Naval Air Station's base operating support contract was awarded under the provisions of OMB Circular A-76, which directs government agencies to rely on the private sector to perform commercial functions when it is more economical than using in-house facilities and personnel. In most situations, the circular requires a comparison of the costs of the two approaches as a basis for determining which one will be used to perform the work. In making such comparisons, agencies are to add estimated conversion costs to contractors' bids, such as relocating displaced government employees and paying the salaries and benefits of a contract administration staff.

The 5-year contract awarded in August 1986 to Del-Jen, Incorporated, covers 11 functions such as transportation operations and family housing maintenance. The Navy had considered contracting for these types of functions as early as 1982. Del-Jen's winning bid, which was submitted in October 1985, was \$37,312,604, or \$2,711,880 less than the Navy's estimate of doing the work in-house.

The contract, which was reserved for small business competition, was a negotiated procurement composed of two parts. The first part covered work of a known extent--that is, work for which the number of hours could be accurately estimated. The contractor submitted a firm fixed-price bid for that portion of the contract. The Station used its own historical work load data to develop a cost estimate for doing the same work in-house.

The second part consisted of indefinite quantity work, unexpected maintenance activities that cannot be estimated accurately. The Station identified a probable quantity of work in the request for proposals for this part and asked prospective contractors to provide a firm fixed-price bid in terms of a "price per unit" or a "price per craft hour."

Officials at the Offices of the Commander, Naval Air Force, Pacific Fleet (COMNAVAIRPAC), and the Commander-in-Chief, United States Pacific Fleet (CINCPACFLT), helped develop and endorsed the request for proposal and the in-house cost estimate. CINCPACFLT is the principal agent for the Chief of Naval Operations, which establishes the Navy's commercial activity policy and approves commercial activities' cost comparison decisions recommended by subordinate commands. The Western Division Naval Facilities Engineering Command, as the contracting office, served as an

advisor in the development of the request for proposal and oversaw the contractor selection process.

COMPARING THE COST OF CONTRACTOR  
VERSUS IN-HOUSE PERFORMANCE

AFGE was concerned that the Navy's cost comparison of the private contractor's bid and the projected cost of doing the work in-house was incorrect because the contractor's costs did not include some conversion costs that the Navy would incur if the contractor won the bid. These costs related to administering the contract, relocating displaced government employees, and transferring inventories of materials and supplies to the contractor. AFGE was also concerned that the estimate for doing the work in-house was overstated because the Navy had inappropriately increased the fringe benefit rate for in-house labor. Our review showed that the Navy's cost comparison was not inconsistent with the provisions of OMB Circular A-76 and its own guidance in developing cost estimates for each of these items.

Procedures used for determining  
contract administration costs

AFGE alleged that the Navy did not adequately consider the cost to the government of overseeing a contract of this magnitude and complexity when evaluating the cost comparisons.

OMB Circular A-76 defines contract administration costs as those incurred by the government in assuring that a contract is faithfully executed by both the government and the contractor. Costs used in determining whether to perform the work in-house or to contract out include the costs of reviewing the contractor's performance and compliance with the terms of the contract, processing contract payments, negotiating change orders, and monitoring the closeout of contract operations.

The circular sets limits on the number of contract administration personnel that may be included in an A-76 cost comparison. It states that if the functions under study are so technically specific or geographically dispersed that the limits would be exceeded, the appropriate agency official may grant a waiver. In this instance, the various Navy commands agreed that the circular's suggested staffing level of nine was insufficient, but they disagreed on what an appropriate staffing level should be.

The Station originally estimated that 18 contract administration personnel would be needed and that this would cost \$3,313,613. This estimate was based on the size of the contract, the variety

of technical specialties represented, and the amount of indefinite quantity work included.

However, the commercial activity staffs at COMNAVAIRPAC and CINCPACFLT believed that 18 contract administrators were too many. Accordingly, the Station reduced its estimate to 15, which the COMNAVAIRPAC staff endorsed as being appropriate. The estimated costs for 15 staff would be \$2,781,611.

CINCPACFLT Headquarters staff, however, believed 15 personnel were still too many and insisted on limiting the number of contract administration staff for cost comparison purposes to 11. The two commands were unable to resolve their disagreement, and the Chief of Naval Operations subsequently set the estimate at 13. Costs for 13 personnel were estimated at \$2,389,709, a reduction of about \$924,000 from the original estimate.

Procedures used for determining  
permanent change of station costs

AFGE alleged that, in comparing cost estimates, the Navy underestimated the number of displaced government employees that would make permanent change of station (PCS) moves.

Circular A-76 guidance is vague with respect to estimating the costs associated with relocating displaced employees. It basically says that such costs can be expected as a result of contracting out and that, based upon past experience, a relatively small percentage of the total employees affected will actually separate from government service.

The Navy's A-76 implementing instructions were also vague on this point. Consequently, in August 1985 the Chief of Naval Operations issued clarifying instructions that specified that PCS costs cannot be included for more than 10 percent of the affected employees without prior approval. The instructions also specified the type of information the activities had to submit to obtain this approval.

The Station initially estimated that 41 of the total 212 affected employees, about 20 percent, would eventually relocate at a cost of \$773,670. That estimate was based in part on a "mock reduction in force" questionnaire filled out by the employees and partly on projections that the number of affected employees would be higher than usual because the activity is relatively remote from other government installations.



The Chief of Naval Operations initially approved including PCS costs for nine employees in the cost comparison, but later agreed to allow costs for 22 PCS moves, which is consistent with its guidance that 10 percent of the total number of employees affected would likely move. This reduced the PCS cost estimate to \$415,140, a decrease of \$358,530.

Procedures used for estimating  
inventory costs

AFGE alleged that the Navy underestimated the cost to contract out because the estimate did not include the costs associated with a one-time, inventory of consumable supplies and materials in data entry, supply operations, and public works; the cost of a "wall-to-wall" inventory of the main supply warehouse; and the cost of reconciling the government's books with the results of the inventory.

OMB Circular A-76 specifies that when the government discontinues an in-house activity to obtain commercial service by contract, one-time in-house costs are usually involved. According to the circular, the government can add the costs associated with transferring material to a contractor, such as taking a physical inventory, to the contractor's bid price.

The Chief of Naval Operations issued clarifying instructions in August 1985 that stated that Navy policy and good management practice dictate that inventories of parts, materials, and equipment should be reasonably current. The instructions further specified that higher levels of command must approve the inclusion of such costs in the cost comparison. The COMNAVAIRPAC interpreted this to mean that costs to reconcile the government's inventory records with the actual count of material should not be added to the contractor's bid price.

The Station initially estimated inventory costs based upon the assumption that much of the work would require paying overtime. In addition, the Station assumed that a 100-percent count of the main supply warehouse inventory would be done and that a physical inventory of consumable supplies and materials in data entry, supply operations, public works transportation, and public works maintenance/utilities would be taken. Estimated costs were \$30,511.

The CINCPACFLT determined that the Station should do the work during regular business hours and should not add costs to the contractor's bid for inventorying consumable supplies and material in data entry, supply operations, public works transportation, and

public works maintenance/utilities. It also determined that the Station should count only 25 percent of the supply warehouse inventory, using random sampling techniques. It based this decision on the Navy's policy that activities are to maintain reasonably current inventory records of parts, materials, and equipment. The costs were estimated at \$8,776, a decrease of about \$22,000 from the original estimate.

Procedures used for  
fringe benefits

AFGE alleged that the Navy unjustifiably increased the in-house estimate for government employee fringe benefits.

Circular A-76 requires that an activity making a cost comparison multiply federal employees' basic pay by standard fringe benefit factors. OMB, as part of its annual update of these factors, increased the retirement factor by 7.5 percent in August 1985 and increased the other fringe benefit factors a total of 0.95 percent. The Navy appropriately used these revised fringe benefit factors in its cost study.

INDEFINITE QUANTITY WORK AND  
CALCULATION OF DAVIS-BACON HOURS

The contract included provisions for indefinite quantity work. This type of work usually consists of one-time efforts involving more than 80 hours of work, but the exact magnitude of effort can not be specifically defined. AFGE alleged that the contract exceeded the Navy's limits for the amount of indefinite quantity work that could be included. AFGE also stated that the contractor understated the amount of work subject to the Davis-Bacon Act.<sup>1</sup>

PROCEDURES FOR DETERMINING THE AMOUNT OF  
INDEFINITE QUANTITY WORK

AFGE cited a 1983 message from the Chief of Naval Operations that established a limit on the amount of indefinite quantity work allowed in a base operating support contract. AFGE stated that the amount of indefinite quantity work in the Whidbey contract exceeded this limitation.

We found that the 1983 message had been canceled by a 1984 message that did not limit the amount of indefinite quantity work allowed in the contract, but instead gave guidance on calculating indefinite quantity work. The Station followed the 1984 guidance in determining the amount of indefinite quantity work in the contract. Specifically, the Station used historical work load data from 1982 to determine the type of indefinite quantity work expected and established either a unit price for this work or a price per craft hour.

Procedures for calculating  
Davis-Bacon hours

AFGE alleged that the Navy miscalculated the amount of Davis-Bacon work to be performed under the contract. AFGE cited a 1983 memorandum discussing a projection of 23,000 hours of Davis-Bacon work for the contract. AFGE believed that the contractor had included only 6,600 Davis-Bacon hours in its bid.

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<sup>1</sup>This act provides for the payment of the prevailing wage rates, including fringe benefits to laborers and mechanics engaged in construction activity under contracts entered into by the United States.

The contractor's bid for indefinite quantity work subject to the Davis-Bacon Act was actually based on 25,020 hours. We discussed this point with AFGE representatives who agreed that the basis for their belief was inaccurate.

CONTRACTOR'S SMALL BUSINESS QUALIFICATIONS

Navy policy is to reserve some of its contract work for small business firms. The Small Business Administration defines a small business as one whose average annual gross revenues during the past 3 fiscal years did not exceed \$13.5 million. The business cannot be affiliated with another firm if their combined revenues exceed this amount.

To reserve contracts for small businesses, the Navy must have a reasonable expectation that two qualified small businesses exist to bid on a potential contract. The contracting officer determines this by advertising potential work in the Commerce Business Daily and evaluating any businesses that respond. The evaluation is based on factors such as prior work experience, existing and expected work load, and performance bonding capacity.

PROCEDURES USED IN SETTING ASIDE THE WHIDBEY CONTRACT FOR SMALL BUSINESS

AFGE raised concerns regarding the contractor's qualifications as a small business. AFGE questioned whether the firm was a subsidiary of or in partnership with another firm that expressed an interest in the contract.

The Navy initially attempted to set aside the Whidbey contract for a small business award in 1983. At that time, the Station estimated that the contract's cost would range from \$60 million to \$75 million, or \$12 million to \$15 million annually over a 5-year period. However, the contracting officer was unable to locate two potential small business bidders that he believed were qualified to perform a contract that large.

In 1983 the Defense Acquisition Regulations defined a small business as one whose average annual receipts during the past 3 years did not exceed \$7.5 million. However, this definition was revised in February 1984 by the Small Business Administration to include businesses with gross revenues of up to \$13.5 million. The Navy then decided to readvertise the contract to determine if two small businesses would meet this new definition.

In 1983 Del-Jen, Incorporated, submitted a work history to the Western Division Naval Facilities Engineering Command as a small business interested in bidding on the proposed contract. The work history cited experience during the 1960s under the name of another firm. The Engineering Command did not use this earlier experience in its evaluation because it was unable to contact the sources

cited as references. On the basis of the more recent work experience cited, it judged the contractor as unqualified to perform the estimated \$60 million to \$75 million contract.

When the request for proposal was readvertised in 1984 as a small business set-aside, Del-Jen provided a general description of its work experience that did not list the 1960's work experience. Between the first and second advertisements, Del-Jen reported that its annual work load had increased from \$4 million to \$6 million. The Engineering Command determined Del-Jen to be a potentially qualified small business on the basis of this reported work load increase and the expectation that the value of the contract would range from \$8 million to \$10 million annually.

A firm with a name similar to that cited in the work history that Del-Jen had submitted in 1983 also submitted a work history for the second advertisement. The Engineering Command did not recommend that firm for further consideration because the information submitted was not sufficient to determine its qualifications as a potential bidder. The contracting officer stated that there was no indication Del-Jen was affiliated with that firm.

To determine whether Del-Jen was affiliated with this firm, we reviewed the corporate renewal license for both companies and found no indication that these companies were in partnership with or a subsidiary of each other. In addition, the Navy's technical evaluation board report contained no evidence that Del-Jen was a subsidiary of or in partnership with the other firm.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to review the procedures used by the Navy as they related to several allegations on the award of a base operating support contract at Whidbey Island Naval Air Station, Oak Harbor, Washington. These allegations, raised by AFGE, Local 1513, concerned the

- calculation of specific cost comparison items,
- amount of indefinite quantity work and related labor hours,
- conflict of interest, and
- small business qualification of the contractor.

We interviewed AFGE representatives at the Station to determine their major concerns about the contract award. Also, we reviewed the documentation they provided in support of their allegations, most of which were naval messages that had been issued between August 1983 and February 1984.

We reviewed the procedures used by the Navy in each of AFGE's areas of concern. To do so, we reviewed A-76 guidance, including OMB's A-76 handbook; the Navy's implementing instructions for A-76; laws and regulations related to conflict of interest; and the available supporting documentation at the locations visited. In addition, we interviewed officials from the Station; the offices of COMNAVAIRPAC, CINCPACFLT, the Chief of Naval Operations, the Engineering Command; the Naval Audit Service; and the Naval Investigative Service to determine the procedures that were followed in developing the cost comparison. We discussed the procedures for determining the increases and decreases in estimated costs to determine the appropriateness and reasonableness of the changes. As agreed with the requesters, we performed limited work on the alleged conflict of interest issue since the Navy had conducted its review of this matter.

We discussed the results of our work with Station officials and with AFGE representatives. Our work was conducted in accordance with generally accepted government auditing standards.

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