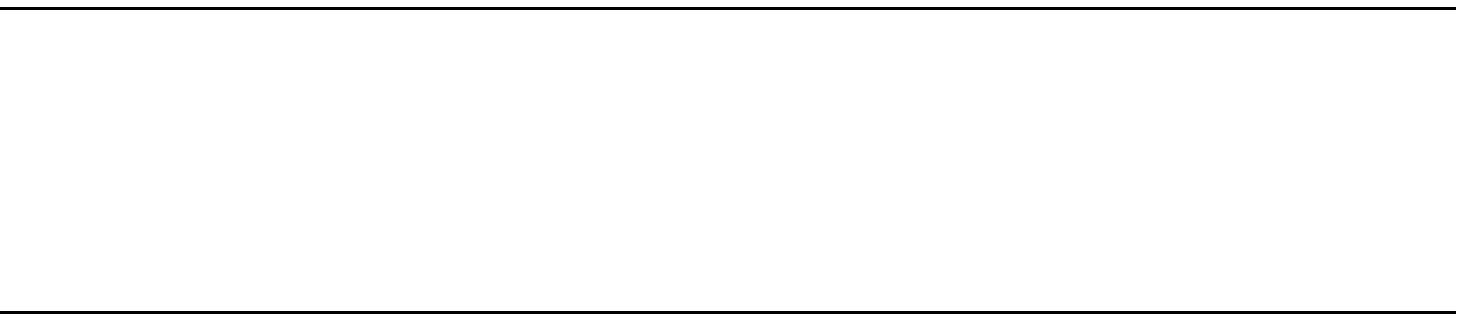

February 1999

FUTURE YEARS DEFENSE PROGRAM

How Savings From Reform Initiatives Affect DOD's 1999-2003 Program





National Security and
International Affairs Division

B-281980

February 25, 1999

The Honorable Floyd D. Spence
Chairman
The Honorable Ike Skelton
Ranking Minority Member
Committee on Armed Services
House of Representatives

In its report on the National Defense Authorization Act for Fiscal Year 1999, the House Committee on Armed Services¹ noted that prior Department of Defense (DOD) reform initiatives had not generated the anticipated savings and had created difficulties because of premature budget reductions.² Accordingly, the report directed that we provide answers to a series of questions pertaining to the support for savings and personnel reductions contained in DOD's fiscal year 1999 budget request and out-year budget plans. This report addresses the following questions:

- What savings in DOD's fiscal years 1999-2003 Future Years Defense Program (FYDP)³ were the result of the Department's Defense Reform Initiatives (DRI)?
- To what extent were the savings and personnel reductions from competitive sourcing⁴ in the 1999-2003 FYDP based on ongoing or planned studies of functions specifically identified under Office of Management and Budget (OMB) Circular A-76, and what percentage of the current costs of performing those functions were included from the projected savings from these studies?
- Did Defense components outsource activities that included inherently governmental functions, without allowing civilian employees to

¹Formerly the House National Security Committee.

²House Report 105-532, May 12, 1998.

³The FYDP is an authoritative record of current and projected force structure, costs, and personnel levels approved by the Secretary of Defense. In its annual FYDP documents, which in accordance with 10 U.S.C. 221 have been provided to the Congress since 1988, DOD presents its estimated expenditures and appropriations needs for the budget year for which funds are being requested, for the previous 2 years, and for at least the following 4 years. The fiscal year 1999 FYDP supports the President's fiscal year 1999 budget request.

⁴While the phrase outsourcing is sometimes used, we chose to use competitive sourcing to reflect competition between the public and private sector.

compete under Circular A-76 procedures, or without following the study and notification requirements of 10 U.S.C. 2461?

Results in Brief

DOD expects savings from individual Defense Reform Initiatives, but has not incorporated specific savings in the 1999-2003 FYDP from these initiatives, except in the areas of competitive sourcing and estimates relating to future base realignment and closure (BRAC) decisions. DOD's 1999-2003 FYDP incorporated \$6.2 billion of estimated savings from competitive sourcing between fiscal year 1997 and 2003, but these estimated savings do not fully account for up-front investment costs, which could reduce the amount of actual savings in the short term. The FYDP does provide a fuller estimate of the impact of investment costs associated with BRACs. For example, the 1999-2003 FYDP offsets estimated BRAC savings with implementation costs and comes up with net costs of \$832 million for fiscal year 2002 and \$1.45 billion for fiscal year 2003. While DOD has requested additional BRAC rounds, the Congress has not authorized them.⁵ The Office of the Secretary of Defense expects its DRIs to reduce personnel requirements but has not required the services to link specific reductions with individual initiatives. Some services, however, have linked projected personnel reductions with their competitive sourcing studies.

Savings from competitive sourcing reflected in the 1999 FYDP were not linked to specific functions under study or targeted for future studies. In addition, DOD does not yet have the systems in place that can provide reliable cost information needed to precisely identify savings. Consequently, it is not feasible to accurately identify current costs of functions to be studied or the potential savings as a percentage of these costs. According to DOD, savings estimates incorporated in the FYDP represented broad projections based on the numbers of positions expected to be studied and historic savings data.⁶ Our work has shown that historic savings estimates may have important limitations and may not accurately

⁵DOD included an estimate of the net of future BRAC costs and savings in its 1999-2003 FYDP, as it was seeking authority from the Congress for additional BRAC rounds.

⁶The number of positions has generally increased over time, but appears to have fluctuated much more than the projected savings. For example, the projected cumulative savings of approximately \$6 billion has remained in that range for the past 2 years, while the number of positions expected to be studied has ranged from a low of about 171,000 to a high of 237,000 and was only recently changed to 229,000 by fiscal year 2005.

indicate likely current and future savings. Study plans of most Defense components have evolved over time, but in many cases they have not linked positions to be studied to specific functions and locations. Firm savings estimates probably will not be possible until individual studies are completed. Even then, these estimates would be subject to change.

Procurement and commercial activities data systems do not identify the extent to which Defense components may be outsourcing functions without complying with Circular A-76 procedures or 10 U.S.C. 2461 congressional reporting requirements. Currently, such cases can be identified only when they are specifically raised by affected parties.

Background

In May 1997, DOD completed a comprehensive review of national security threats, risks, and opportunities facing the United States to 2015. This review, known as the Quadrennial Defense Review (QDR), was intended to examine America's defense needs and provide a blueprint for a strategy-based, balanced, and affordable defense program. The QDR noted that DOD had reduced active duty personnel by 32 percent between 1989 and 1997 while reducing personnel performing infrastructure functions by only 28 percent. The report called for additional reductions in both military and civilian personnel. Our July 1998 report on the 1999-2003 FYDP noted that the services planned to reduce military and civilian personnel by 175,000 and save \$3.7 billion by 2003. Our recent reviews of planned Defense personnel reductions resulting from the QDR and the 1999-2003 FYDP raised questions about DOD's ability to achieve some of these reductions and savings.⁷

The changes in military strategy and capabilities enunciated in the QDR and other reports have often been referred to as a revolution in military affairs. However, the QDR also recognized that DOD must undergo a similar revolution in its business affairs. To that end, the Secretary of Defense chartered a study effort that resulted in the November 1997 DRI report. The report emphasized the need to reduce excess Cold War infrastructure to free up resources for modernization. The report identified numerous initiatives to reengineer business practices, consolidate organizations, eliminate unneeded infrastructure through additional base

⁷Quadrennial Defense Review: Some Personnel Cuts and Associated Savings May Not Be Achieved (GAO/NSIAD-98-100, Apr. 30, 1998) and Future Years Defense Program: Substantial Risks Remain in DOD's 1999-2003 Plan (GAO/NSIAD-98-204, July 31, 1998).

closures, and conduct public/private competitive sourcing studies for commercial activities. Most of the potential savings identified in the report were expected to result from BRACs and competitive sourcing studies. Future BRAC actions were contingent on the Congress enacting legislation authorizing additional closures, while competitive sourcing studies were to be completed under the policy guidance of OMB.

The concept of competitive sourcing is not new. Through the 1980s, DOD encouraged the services and Defense agencies to conduct competitions between the public and private sectors to determine who would be responsible for performing selected functions that were being provided by in-house staff. These competitions were to be done under OMB Circular A-76. Although DOD's use of Circular A-76 was limited from the early to mid-1990s, in 1995 DOD reestablished the competition program in the hope of obtaining significant savings that could be used to fund modernization and other priority needs.

Circular A-76 and its supplemental handbook specify a process to develop a statement that defines the work to be done and a comparison of in-house costs with contractor costs to determine who should perform the work. Circular A-76 is limited to competitions for the conversion of recurring commercial activities. The handbook identifies circumstances under which detailed cost studies may not be required, such as for the conversion from performance by military personnel to contractor performance or if the number of affected civilian positions is below a specific threshold. It also indicates instances in which Circular A-76 may not apply, such as for restructured or reengineered functions. Appendix I contains a more detailed description of the A-76 process.

In addition, several laws affect competitive sourcing. Some, such as 10 U.S.C. 2461 and 2462, affect the process of transferring work currently being performed by civilian government employees to the private sector. Section 2461, as amended by the National Defense Authorization Act for Fiscal Year 1999 (P.L. 105-261), requires an analysis of the activity and a comparison of the costs of having the activity performed by DOD civilian employees and by a contractor to determine whether changing to contractor performance will save money. It also requires that DOD notify the Congress of this analysis and provide other information before making

a change in performance.⁸ Section 2462 requires the Secretary of Defense to obtain needed supplies or services from the private sector, if a private-sector source can provide the supply or service at less cost, and establishes criteria for conducting the cost comparison.

FYDP Shows Partial Costs and Savings Estimates From BRAC and Competitive Sourcing

DOD expects savings from individual DRIs but has not incorporated specific savings from these initiatives in the FYDP, except in the areas of potential BRAC and competitive sourcing. Both have significant up-front investment costs that can limit net savings in the short term. The 1999-2003 FYDP shows a more complete accounting of these investment costs for potential BRACs than it does for competitive sourcing, but the latter provides the majority of DRI savings incorporated in the FYDP. While personnel reductions are programmed in the 1999-2003 FYDP and are expected to represent a portion of savings from DRIs, DOD has not required the services to link specific personnel reductions to individual initiatives. Some services, however, have projected personnel reductions in conjunction with competitive sourcing studies.

FYDP Shows Net Costs for Early Years of Implementing Any New BRAC Rounds

We previously reported that BRAC actions can provide the basis for significant savings in infrastructure costs.⁹ However, while savings can begin to accrue even as costs are being incurred to implement BRAC decisions, it can take several years for net savings to begin accruing on an annual recurring basis. The 1999-2003 FYDP reflects this situation, showing a net cost for projected BRAC decisions between fiscal year 1999 and 2003.

The 1999-2003 FYDP incorporated some savings from future BRAC rounds, but these savings were offset by implementation costs, resulting in net costs of \$832 million for fiscal year 2002 and \$1.45 billion for fiscal year 2003. DOD showed these net costs in the FYDP as a Department-level contingency account but did not allocate them to individual services. Beyond the FYDP period, DOD expects the two additional rounds of base

⁸Section 8014 of the DOD Appropriations Act for Fiscal Year 1999 (P.L. 105-262) requires that DOD certify its in-house estimate to congressional committees before converting any activity performed by more than 10 DOD civilian employees to contractor performance.

⁹Military Bases: Review of DOD's 1998 Report on Base Realignment and Closure (GAO/NSIAD-99-17, Nov. 13, 1998) and Military Bases: Status of Prior Base Realignment and Closure Rounds (GAO/NSIAD-99-36, Dec. 11, 1998).

closures to result in about \$3.4 billion in annual savings after the closures are completed and implementation costs have been offset.¹⁰

We reported in November that DOD's method of estimating costs and savings for future BRAC rounds was limited, principally because it assumed that savings from future base closures would closely resemble savings from the 1993 and 1995 BRAC rounds, adjusted for inflation. While DOD's estimate may be appropriate for planning purposes, its precision is limited because the costs of future BRAC rounds might not parallel those of the prior two rounds. Previous base closures frequently involved facilities that were of low military value and were the least costly to implement. Often those closures required the shortest time for savings to offset implementation costs. Generally, DOD did not choose to close facilities that required higher implementation costs or longer periods to recover savings. More precise cost estimates will probably not be available until DOD actually studies implementation scenarios for specific BRAC actions and puts in place more reliable cost accounting systems. However, BRAC history suggests that future implementation costs could be greater than those in previous rounds and the closures could thus take longer to produce net recurring savings.

Projected Competitive Sourcing Savings Are Significant but Do Not Fully Account for Investment Costs

DOD's 1999-2003 FYDP projected \$6.2 billion in savings from competitive sourcing between fiscal year 1997 and 2003. However, as we previously reported, the projected savings do not fully account for the up-front investment costs associated with completing the studies and implementing the results. Though recurring savings from competitive sourcing could be substantial in the long term, it will take longer to begin achieving these savings than DOD has projected, and net savings during the 1999-2003 period will be less than projected.

In formulating their fiscal year 1999 budget, Defense components identified over 200,000 positions that would be subjected to competitive sourcing studies between 1997 and 2003. Table 1 shows the projected savings and the number of positions to be studied by fiscal year as summarized in documents supporting the President's fiscal year 1999 budget submission.

¹⁰Future BRAC savings are expressed in fiscal year 1999 dollars and represent savings expected to recur annually for fiscal year 2012 and beyond, when the two proposed future rounds are projected to be completed. DOD estimated future savings on the assumption that future costs and savings will be similar to those of the 1993 and 1995 rounds.

Table 1: Programmed Savings and Positions to be Studied for Competitive Sourcing, Fiscal Years 1997-2003

Dollars in millions

	Fiscal year						Total	
	1997	1998	1999	2000	2001	2002		
Projected savings	\$24	\$59	\$205	\$532	\$1,184	\$1,831	\$2,320	\$6,155 ^a
Positions to be studied	26,200	55,300	59,600	45,400	25,400	1,100	1,100	214,100 ^b

^aIncludes savings for individual services and Defense agencies.^bThe President's Fiscal Year 2000 budget request adjusted the number of positions to be studied to 229,000 and extended the years of study out to 2005.

Source: DOD

Our February 1999 report on competitive sourcing goals noted that, like BRACs, competitive sourcing studies and implementing actions require up-front investments that should be considered when estimating net savings.¹¹ We also reported that the estimates of competition savings provided to the Congress in 1998 had limitations and that several factors were likely to reduce savings in the short term. We further noted that DOD had not fully identified the resources associated with the studies or the personnel separation costs likely to be needed for implementation. The Navy was the only component that had deducted some estimated investment costs when calculating the savings presented to the Congress in DOD's April 1998 report on competitive sourcing.

Linkage of Specific Personnel Reductions With Individual Defense Reform Initiatives Is Limited

Personnel reductions are programmed in the 1999-2003 FYDP and are expected to represent a portion of savings from DRIs. DOD officials told us that they had not required the services to target specific personnel reductions to individual initiatives.

The Army programmed a reduction of 9,600 civilian staff on the assumption that 20 percent of the positions studied would be eliminated. The Army programmed the 20-percent reduction based on the assumption that the 20-percent savings would result whether the government or a contractor won the A-76 competitions. Army officials said they made this assumption because they did not want to be seen as preselecting the winner. The Army recognizes, however, that it will likely separate more personnel based on

¹¹DOD Competitive Sourcing: Questions About Goals, Pace, and Risks of Key Reform Initiative (GAO/NSIAD-99-46, Feb. 22, 1999).

the historical trends of contractors winning about 50 percent of the competitions. The Army did not program any reductions in military positions as a result of competitive sourcing and planned to make up for military personnel shortages elsewhere by transferring the military personnel from positions competed to other military duties.

The Navy and the Marine Corps did not program any potential military or civilian personnel cuts as a result of competitive sourcing. According to Navy officials, the Navy's overall objective is to achieve savings through competition, and personnel savings are a consequence and not a goal of the program. Further, Navy officials said they believed that establishing a goal for personnel reductions would send a negative message to staff and would affect morale.

The Air Force was more aggressive in identifying personnel reductions from competitive sourcing and programmed about 26,000 military and 19,300 civilian position reductions between fiscal year 1997 and 2003, according to its final budget submission. The Air Force's programmed reduction of all military positions to be competed was based on the belief that if a position could be competed, it did not have to be staffed by military personnel. Generally, the Air Force programmed reductions in civilian positions on the assumption that private contractors would win 60 percent of the competitions and that the competitions would last 2 years.

Officials at the Office of the Secretary of Defense (OSD) were aware that the services used different methods to show the effects of competitive sourcing on personnel and funding and that the fiscal year 1999 FYDP reflects these different approaches. The Deputy Under Secretary for Industrial Affairs and Installations established a task force to ensure that consistent and comparable approaches are used to estimate personnel and dollar savings in future budget submissions. Subsequently, the Acting Director of the Office of the Secretary of Defense's Program Analysis and Evaluation Office issued guidance incorporating the task force's recommendations, which required Defense components to program both dollar savings and personnel reductions for the 2000-2005 FYDP. Further, the DOD Comptroller required Defense components to specifically identify investment and transition costs and report both gross and net savings in their fiscal year 2000 budget submissions.

Competitive Sourcing Savings Were Projected Using Historic Experience But Were Not Linked to Specific Study Plans

Savings from ongoing and future competitive sourcing studies as projected in the 1999 FYDP were the result of broad-based estimates drawn from previous experience. When the FYDP was being prepared, the projections were not linked to specific functions then under study or planned for future study. Consequently, it is not feasible to link projected savings with the current cost of individual functions. In previous reports, we urged caution in the use of historical savings assumptions in the absence of any efforts to adjust these assumptions for changes that can occur over time and that may reduce savings. The 1999-2003 FYDP was not based on detailed competitive sourcing plans developed by the services and other Defense components. These plans continue to evolve, and specific functions to be studied by location are mostly yet to be determined.

Historic Data Used to Project Future Savings

The estimated competitive sourcing savings included in the 1999-2003 FYDP were largely based on numbers of positions expected to be studied, average personnel costs per position, and average savings rates estimated by using historical data from prior competitions. Savings rates varied among the services. Our previous work has already shown that there are important limitations to using historical savings estimates because they may not provide an accurate indication of likely future savings.

The services' cost savings estimates ranged between 20 and 30 percent; the Navy projected savings of more than 30 percent where functions performed by military personnel would be competed. These estimates, as shown in table 2, represented what the services believed to be conservative achievable savings based on historical experience.

Table 2: Comparison of Programmed Savings Rates Used by the Services in the 1999-2003 FYDP

Service	Programmed rate of cost savings (percent)
Air Force	25
Army	20
Marine Corps	
• Contractor wins	30
• Remains in-house	20
Navy	31 ^a

^aThe Navy's programmed savings rate is a composite rate based on the projection that competing functions currently performed by civilian personnel would yield 25-percent savings and competing functions currently performed by military personnel would yield 50-percent savings.

Sources: Military services' data.

While we believe that competitive sourcing competitions are likely to produce savings, we have previously urged caution when estimating the amount of savings likely to be achieved.¹² The estimates used in the FYDP are based on savings estimates calculated at the end of competitive sourcing competitions. These estimates can change over time because of changes in the scope of the work or mandated wage increases. We previously noted that continuing budget and personnel reductions could make it difficult to sustain the levels of previously projected savings. We also recognized that larger savings are likely to occur when positions filled by military personnel are converted to civilian or contractor performance.

Finally, we previously noted limitations in DOD's efforts and capabilities to track changes in program costs and savings after the results of competitions are implemented. Actual savings data has not been captured. Our February 1999 report noted the need for improvements in the databases used to record the results of competitive sourcing competitions.¹³

¹²Base Operations: Challenges Confronting DOD as It Renews Emphasis on Outsourcing (GAO/NSIAD-97-86, Mar. 11, 1997), Defense Outsourcing: Challenges Facing DOD as It Attempts to Save Billions in Infrastructure Costs (GAO/T-NSIAD-97-110, Mar. 12, 1997), and Defense Management: Challenges Facing DOD in Implementing Defense Reform Initiatives (GAO/T-NSIAD/AIMD-98-122, Mar. 13, 1998).

¹³DOD Competitive Sourcing: Results of Recent Competitions (GAO/NSIAD-99-44, Feb. 23, 1999).

Specific Study Plans Continue to Evolve

Study plans of most Defense components linking the number of positions to be studied with specific functions and locations are still evolving, and estimated savings will not be known until the studies are completed. Consequently, it is not feasible to identify the current costs of functions to be studied and their potential savings rates. In our February 1999 report, we concluded that clearer indications of actual savings will require that Defense components develop mechanisms to track actual savings over time in order to validate continuing savings from completed competitions.

None of the services based fiscal year 1999 budgets or 1999-2003 FYDP submissions on a completed multiyear study plan for their competitive sourcing program, although the Air Force was furthest along. Our February 1999 report on competitive sourcing goals noted that most Defense components lacked detailed plans identifying the numbers of positions by function expected to be studied over the next few years. Detailed planning to implement the program has been largely delegated to components and field activities. These activities are responsible for determining which specific functions are suitable candidates for competitions and whether there are sufficient positions to meet overall competition goals. In addition, according to service officials, some or all of the major commands were given numbers of positions to compete and savings goals, and it is up to them to determine how best to meet the goals.

OSD on December 9, 1998, directed each component to develop multiyear competition plans consistent with and presented at the same time as their fiscal year 2001-2005 Program Objective Memorandum. OSD directed that these plans should include, by fiscal year, the functions and numbers of positions to be competed.

Perceived Efforts to Bypass Circular A-76 and Related Legislation Difficult to Identify

The Committee questioned whether Defense components may have outsourced some activities, possibly even some involving inherently governmental functions, without following the procedures of OMB Circular A-76 or meeting the 10 U.S.C. 2461 requirements for congressional notification. Other than specific cases brought to our attention, procurement and commercial activities data systems do not identify the extent to which Defense components may be outsourcing functions without complying with these procedures or requirements.

Circular A-76 does not apply to inherently governmental activities. Defense components are currently reviewing to what extent the functions

performed by DOD personnel are inherently governmental or otherwise exempted from A-76 competitive sourcing. DOD expects to report the results to the Congress early this year, but the results were not available for our review when we completed our work.

We have been asked to review two reengineering cases, one in the Army and one in the Air Force, in which affected parties expressed the belief that Circular A-76 procedures and 10 U.S.C. 2461 requirements should have been followed. We are currently studying these cases and expect to report on them in the near future.

Conclusions

The costs and savings associated with Defense Reform Initiatives incorporated in DOD's 1999-2003 FYDP include partial costs and savings from competitive sourcing and additional BRAC initiatives. While savings are expected from other initiatives, DOD has not required the services to calculate the specific savings to be obtained from them. Likewise, while personnel reductions are included in the FYDP and some are expected to result from DRIs, DOD has not required the components to link any personnel reductions with specific DRI elements. Also, questions exist about the precision of savings expected from BRAC and competitive sourcing. DOD assumed there would be additional base closures; however, the required legislative authorization has not been given. Further, the BRAC savings estimate, should future rounds occur, has limitations in terms of projecting short-term savings that might be realized. Competitive sourcing savings incorporated in the 1999-2003 FYDP were determined using broad estimates based on prior competitive sourcing experience, but they were not linked to specific positions and functions currently under study or planned for study at specific locations.

There is no systematic way to identify whether components outsource functions without following the requirements of OMB Circular A-76 or the procedures of 10 U.S.C. 2461. Such cases can be identified only when they are specifically raised.

We are currently reviewing two such allegations and expect to report on them individually in the near future.

We recently recommended that the Secretary of Defense require Defense components to assess whether available resources are sufficient to execute the numbers of planned competitions within the envisioned time frames and make the adjustments needed to ensure adequate program execution.

We also recommended that the Secretary require Defense components to reexamine and adjust competitive sourcing study targets, milestones, expected net short-term savings, and planned operating budget reductions as necessary. Accordingly, we are not making additional recommendations in this report.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from the Secretary of Defense. On February 4, 1999, Department and service representatives from their respective competitive sourcing offices provided us with the following comments on the draft.

The representatives generally concurred with the information presented in the report. DOD officials reiterated their previously stated position that they have developed an aggressive competitive sourcing program by planning to compete nearly 229,000 positions by fiscal year 2005. They acknowledged that their program has met a number of challenges; however, they believe none of these challenges are insurmountable. They stated that through the program and budget review process, the Department reviews the competitive sourcing study targets, milestones, and objectives of the program to measure advancement toward its goals and that adjustments are made to the program as necessary. Further, they stated that several important improvement and oversight tools are being worked into the competitive sourcing program during calendar year 1999 that will address our concerns. More specifically, according to these officials, the DOD Competitive Sourcing Master Plan will, among other things, identify by fiscal year the functions and number of component positions to be competed by fiscal year 2005. Also, they stated each component is undertaking a series of program improvement initiatives that includes (1) identifying best practices, (2) assisting installation/activity execution, (3) developing internal communications and training, and (4) improving management information systems. DOD officials also stated that the components have not completed enough studies, thus far, to establish a baseline that would necessitate the reevaluation of their milestones and objectives and that as more studies are conducted, they will be able to better refine and adjust their study savings objectives.

While we support DOD's efforts to institute more comprehensive oversight tools and program improvement initiatives, we did not review any of these efforts because they have not yet been fully implemented, and we are therefore not in a position to comment on them. However, as we previously reported, we continue to believe that DOD needs to reassess the

competitive sourcing study targets, milestones, expected short-term savings, and planned operating budget reductions now. The issues involve more than the number of competitions completed; they also involve the extent the planned announcements of competitions have been made and whether there are sufficient resources to complete them. This is of concern especially because of the large number of studies planned for announcement in fiscal years 1998 and 1999 and the delays encountered in getting the fiscal year 1998 studies under way. If similar delays are encountered in fiscal year 1999, they could seriously affect future program execution and DOD's ability to achieve results in a timely manner.

In addition, officials reiterated the Department's disagreement with our statement that the precision of its future base closure costs was limited and that average net costs of future BRAC rounds will be higher than DOD estimated by using the cost experience of previous rounds. As we previously reported, our intent was to suggest that there are reasons to expect greater costs to close bases during any future implementation period than during the previous BRAC rounds because many bases with lower implementation costs and quicker offsets of closure costs have already been realigned or closed. Thus, the higher costs likely to be incurred in the future could reduce the net savings achieved during the implementation period. Nevertheless, we believe that future BRAC rounds can still result in significant savings.

DOD also provided technical comments on our report, which we have incorporated as appropriate.

Scope and Methodology

To determine the savings included in the 1999-2003 FYDP that were the result of DRIs, we reviewed budget documents and discussed the issue with representatives from the DOD Comptroller's office and the Army, the Navy, and the Air Force. We also drew on other work that we had underway or completed relating to competitive sourcing and the DRI.

To determine the basis used to project competitive sourcing savings and personnel reductions in the 1999-2003 FYDP and whether they were based on studies of specific functions, we reviewed competitive sourcing budget submissions and the assumptions underlying the savings calculations. We also held discussions with service officials responsible for budget formulation and competitive sourcing program management. Further, we drew on work we had previously performed to evaluate DOD's competitive

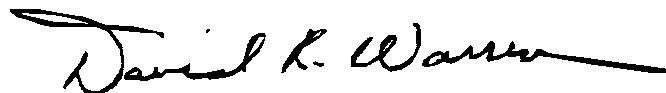
sourcing plans and programs, and to review the results of recently completed competitions.

To determine whether Defense components outsourced inherently governmental functions without allowing civilian employees to compete or did not meet the requirements of 10 U.S.C. 2461, we reviewed pertinent laws and other directives and discussed the issue with cognizant service officials.

We conducted our review from November 1998 to January 1999 in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Chairmen of the Senate Committees on Armed Services and on Appropriations and the House Committee on Appropriations; the Secretaries of Defense, the Army, the Navy, and the Air Force; the Commandant of the Marine Corps; the Director, Office of Management and Budget; and other interested congressional committees. Copies will be made available to others upon request.

Please contact me at (202) 512-8412 if you or your staff have any questions concerning this report. Major contributors to this report are listed in appendix II.



David R. Warren, Director
Defense Management Issues

Contents

Letter

1

Appendix I The A-76 Process

18

Appendix II Major Contributors to This Report

22

Tables

Table 1: Programmed Savings and Positions to be Studied for
Competitive Sourcing, Fiscal Years 1997-2003

7

Table 2: Comparison of Programmed Savings Rates Used by the
Services in the 1999-2003 FYDP

10

Figures

Figure I.1: Overview of the A-76 Process

19

Abbreviations

BRAC	Base Realignment and Closure
DOD	Department of Defense
DRI	Defense Reform Initiative
FYDP	Future Years Defense Program
OMB	Office of Management and Budget
OSD	Office of the Secretary of Defense
QDR	Quadrennial Defense Review

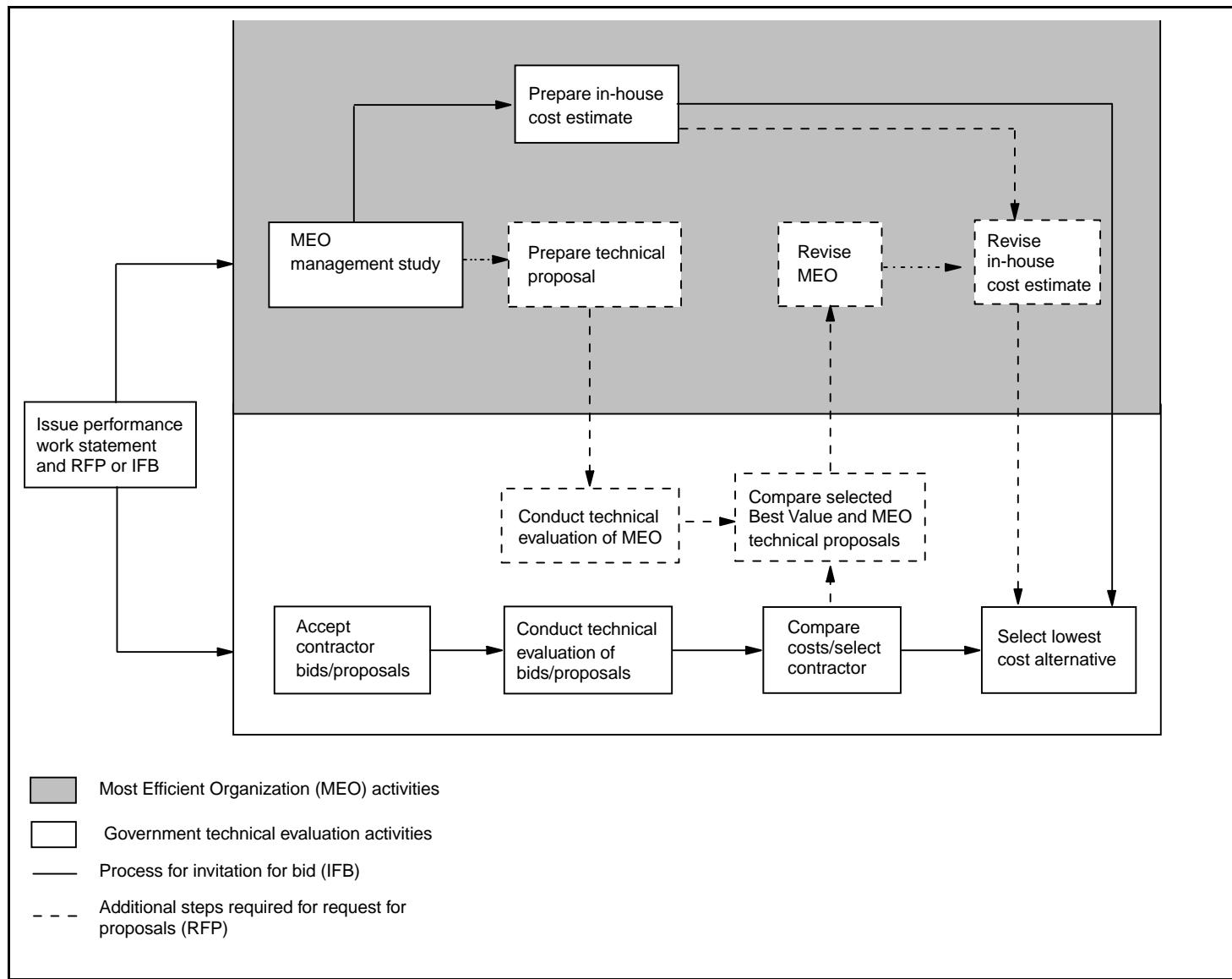
The A-76 Process

In general, the A-76 process consists of six key activities: (1) developing a performance work statement and quality assurance surveillance plan; (2) conducting a management study to determine the government's most efficient organization (MEO); (3) developing an in-house government cost estimate for the MEO; (4) issuing a Request for Proposals or Invitation for Bids; (5) evaluating the proposals or bids and comparing the in-house estimate with a private-sector offer or interservice support agreement and selecting the winner of the cost comparison; and (6) addressing any appeals submitted under the administrative appeals process, which is designed to ensure that all costs are fair, accurate, and calculated in the manner prescribed by the A-76 handbook.

Figure I.1 shows an overview of the process. The solid lines indicate the process used when the government issues an Invitation for Bids, requesting firm bids on the cost of performing a commercial activity. This type of process is normally used for more routine commercial activities, such as grass-cutting or cafeteria operations, where the work process and requirements are well defined. The dotted lines indicate the additional steps that take place when the government wants to pursue a negotiated, "best value" procurement. While it may not be appropriate for use in all cases, this type of process is often used when the commercial activity involves high levels of complexity, expertise, and risk.

Appendix I
The A-76 Process

Figure I.1: Overview of the A-76 Process



Source: Air Force Air Education and Training Command documents.

The circular requires the government to develop a performance work statement. This statement, which is incorporated into either the Invitation for Bids or Request for Proposals, serves as the basis for both government estimates and private sector offers. If the Invitation for Bids process is used, each private sector company develops and submits a bid, giving its firm price for performing the commercial activity. While this process is taking place, the government activity performs a management study to determine the most efficient and effective way of performing the activity with in-house staff. Based on this "most efficient organization," the government develops a cost estimate and submits it to the selecting authority. The selecting authority concurrently opens the government's estimate along with the bids of all private sector firms.

According to the Office of Management and Budget's (OMB) A-76 guidance, the government's in-house estimate wins the competition unless the private sector's offer meets a threshold of savings that is at least 10 percent of direct personnel costs or \$10 million over the performance period. This minimum cost differential was established by OMB to ensure that the government would not contract out for marginal estimated savings.

If the Request for Proposals–best value process—is used, the Federal Procurement Regulation and the A-76 supplemental handbook require several additional steps. The private sector offerors submit proposals that often include a technical performance proposal and a price. The government prepares an in-house management plan and cost estimate based strictly on the performance work statement. On the other hand, private sector proposals can offer a higher level of performance or service.

The government's selection authority reviews the private sector proposals to determine which one represents the best overall value to the government based on such considerations as (1) higher performance levels, (2) lower proposal risk, (3) better past performance, and (4) cost to do the work. After the completion of this analysis, the selection authority prepares a written justification supporting its decision. This includes the basis for selecting a contractor other than the one that offered the lowest price to the government. Next, the authority evaluates the government's offer and determines whether it can achieve the same level of performance and quality as the selected private sector proposal. If not, the government must then make changes to meet the performance standards accepted by the authority. This ensures that the in-house cost estimate is based upon the same scope of work and performance levels as the best value private sector offer. After determining that the offers are based on the same level of

performance, the cost estimates are compared. As with the Invitation for Bids process, the work will remain in-house unless the private offer is (1) 10 percent less in direct personnel costs or (2) \$10 million less over the performance period.

Participants in the process--for either the Invitation for Bids or Request for Proposals process--may appeal the selection authority's decision if they believe the costs submitted by one or more of the participants were not fair, accurate, or calculated in the manner prescribed by the A-76 handbook.

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