
**CONCERNS WITH SAVINGS CALCULATIONS IN A-76
COMPETITIONS**

In the course of this analysis, we have identified several limitations in the process used to estimate cost savings in the A-76 competition. We describe these concerns here.

ACTUAL COST MAY DIFFER FROM THE EXPECTED COST

One concern is that the personnel cost estimates are not based on the actual personnel costs associated with the individuals occupying a particular position. Civilian personnel cost estimates include the salary of a GS employee at step five or the annual full-time pay for a step-four FWS worker plus a fringe rate as stipulated in OMB circular A-76. This rate has varied over time and was 32.45 percent in 1996. The baseline estimates we examined did not include other pay,¹ even when other pay was included in the MEO cost estimates. For military personnel, the baseline costs are generally derived from the military standard composite rate for the service in question. This rate includes grade-weighted basic pay, entitlements, and an additional cost for other benefits. The way in which these baseline costs are calculated raises some concerns, but it is not clear that the procedures would lead to an overall overestimate or underestimate of the actual baseline personnel costs. For example, if the workforce has been in place a long time and there is little turnover, the average local step is likely to be above five for GS workers or four for FWS

¹Other pay is compensation to which fringe benefits are not applied. Examples of other pay include overtime pay, night differential, bonuses, and uniform allowances.

workers. In such a situation, the estimates based on wage rates at steps five or four underestimate the actual wage and salary costs. On the other hand, the baseline cost estimates might overestimate actual wage and salary in a function with high turnover where the average step is low. The exclusion of other pay from the calculation will push the estimates down as well, whereas the tendency of installations to include the costs of authorized positions that are not filled will push costs up.

CIVILIANIZATION MAY GENERATE ILLUSORY SAVINGS

Whenever civilianization of military positions is used to reduce the size of the workforce, we believe some of the assumed savings may be illusory. Several managers responsible for developing MEOs told us that they substituted fewer civilian workers (often significantly fewer), for a given number of military workers because military members are often unavailable at their primary duty activity due to training, local details, or deployments. If the training, details, and deployments meet valid and continuing defense requirements, the burden of supporting them is not eliminated by civilianization; rather, it is shifted to other activities with military workforces. However, in A-76 cost calculations, savings that an *activity* realizes by off-loading this burden are not offset by increased costs in other activities to which the burden is shifted.

A different concern is that although military personnel may be removed from the function, the overall number of military authorizations in that service may not decline. In other words, the military authorizations that are deleted from the function are put to use in another activity. Indeed, GAO (NSIAD-99-46, p. 12) reports that although the Army plans to compete about 8000 military positions, it has no plans to reduce military end strength. Instead, it plans to use those personnel to meet other priorities.²

²This redeployment of military labor may be a good thing for the Army. We simply note the global cost implications of the policy.

MANDATED 12 PERCENT IN-HOUSE OVERHEAD RATE MAY OVERSTATE OVERHEAD COSTS

We note GAO's concern that one factor in the MEO cost calculation, the overhead rate of 12 percent of direct labor costs specified in Circular A-76,³ lacks an analytical basis and may be overstating or understating the overhead costs associated with in-house performance.⁴ According to the GAO, OMB offered DoD and other agencies the opportunity to develop and use another rate, but DoD and the services declined to do so. The 12 percent rate is reportedly a compromise between private-sector interests, which argued for government overhead rates ranging from 15 percent to 30 percent, and rates used in earlier A-76 competitions, which generally ranged from 0 to 3 percent.⁵

This overhead rate is intended to cover two types of overhead. The first is *operations overhead*, defined as those costs that are not 100 percent attributable to the activity, but are generally associated with recurring management and support of the activity. The second is *general and administrative overhead*, including salaries, equipment, space and other activities related to headquarters management, accounting, personnel, legal support, data processing management, and similar common services performed outside the activity.⁶

Although tracing the overhead costs of the activities we studied was beyond the scope of our research, we see indications that the 12 percent rate can misstate the marginal cost of overhead support for in-house performance. In the activities we examined, the cost comparisons were focused on relatively straightforward frontline labor services. Higher-level management services were being retained in-house and were not subject to the MEO or contractor bid. Operations overhead appeared to be undiminished by outsourcing. Outsourcing did not reduce command, executive, and functional

³U.S. Office of Management and Budget, *Circular No. A-76, Revised Supplemental Handbook*, Mar. 1996, p. 23.

⁴GAO, *Defense Outsourcing: Better Data Needed to Support Overhead Rates for A-76 Studies*, GAO/NSIAD-98-62, Feb. 1998, p. 12.

⁵GAO, 1998, pp. 4-6.

⁶OMB, p. 23.

oversight responsibilities at higher organizational levels (installation, major command, or service headquarters). Further, because contractors occupied government-furnished facilities and used government-furnished equipment and parts, large pieces of general and administrative overhead were also common to in-house and contractor performance. The only significant overhead costs we believe were saved through these competitions are those associated with personnel and payroll support of the displaced civil service workforce (due to a reduction in MEO staffing or outsourcing).

We do not know what the appropriate overhead rate might be for these six competitions. However, we note that personnel-related occupations occupy only 1.75 percent of the DoD workforce.⁷ The salaries of the staffs of local and regional civilian personnel offices and headquarters functions probably constitute the largest element of the overhead rate. As a proportion of direct labor cost of an activity, the average overhead cost is unlikely to be much greater than the ratio of personnel specialists to personnel. The marginal rate would be less than the average rate. As a result, we believe it likely that MEO costs were substantially overstated in the competitions we examined. If true, this overstatement resulted in inflated costs for the MEOs and inflated savings estimates (relative to the MEO) for those activities that were outsourced.

The 12 percent rule might also understate the overhead cost savings, particularly in cases where the PWS requires the contractor or MEO to assume a substantial amount of work management, facilities management, supply functions, discretion over work processes, and broad accountability for program outcomes. If the DoD outsources larger and more complex activities and concurrently reduces its management and oversight of production processes, then greater overhead cost savings may be attainable.

Currently, what the overhead personnel costs should capture is not well understood, and it is likely that the potential incremental overhead cost savings in the event of outsourcing or a more streamlined MEO vary dramatically by competition. Before the introduction of

⁷Data derived from U.S. Office of Personnel Management, *Federal Civilian Workforce Statistics: Occupations of Federal White-Collar and Blue-Collar Workers as of September 30, 1997*, OMSOE-OWI-56-25, September 1998.

the 12 percent rule, most DoD competitions did not include any such overhead cost in the in-house bid. Clearly, some overhead cost should be applied to the in-house bid. However, we believe that the imposition of an arbitrary 12 percent rate does not appropriately capture the costs and therefore reduces the credibility of the cost-comparison process. Therefore, we believe this issue warrants further study.