

Donelson

LABOR RELATIONS



May 16, 1997

Certified P 150 850 586

Mr. Moe Biller
President
American Postal Workers Union,
AFL-CIO
1300 L Street, N.W.
Washington, DC 20005-4128

Dear Moe:

Enclosed, for your information is a copy of management's July 15, 1996, Guidelines for the Preparation of Cost Data for Comparison with Contracting Out Proposals. This replaces the June 1990, version.

If there are any questions concerning this matter, you may contact Donna M. Gill of my staff at (202)268-2373.

Sincerely,

A handwritten signature in black ink, appearing to read "P. A. Sgro".

Peter A. Sgro
Acting Manager
Contract Administration APWU/NPMHU

Enclosure

MAY 1997
RECEIVED
OFFICE OF
POSTAL
COUNSEL

GUIDELINES FOR THE PREPARATION OF COST DATA FOR COMPARISON WITH CONTRACTING OUT PROPOSALS

A. Purpose

1. This instruction establishes Guidelines for evaluating the potential for servicewide contracting out of work currently being performed, or which could be performed, in-house. These studies must be fair, reasonable and consistent in their evaluation methods, and consider all the major substantive factors in making cost comparisons. These Guidelines will be used when conducting a comparative analysis of in-house versus contractor costs.

2. To ensure that services are being provided most economically, comparative analyses should be performed to evaluate in-house versus contractor costs for related services. Each project will provide a different set of challenges that may need to be evaluated differently. Management and staff involved should interpret the intent of these Guidelines using prudent business judgment to arrive at solutions that support the goals of the USPS. Exceptions should be reviewed, and can be approved, by the Vice President/Controller.

These Guidelines provide general (but not all-inclusive) procedures for determining in-house costs, estimating contractor costs, and comparing in-house costs to contractor estimates and bids. They deal only with the cost component of the decision-making analysis for contracting out initiatives. The highlights of this process are outlined on Attachment I, a flowchart. Attachment II is a suggested (but not necessarily all-inclusive) itemized cash flow format for completing a comparative analysis.

3. When a capital investment, or an expense investment with a significant capital component, is being considered, a Decision Analysis Report (DAR) must be prepared, validated and approved. If a DAR is required, the comparative analysis discussed herein should be incorporated within the DAR and be based upon the same Description of Work (DOW), or its equivalent, in the DAR. When no DAR is required, the comparative analysis is prepared as a stand-alone document and proceeds through the validation process discussed in these Guidelines.

B. Procedures

1. Prior to the cost comparison analysis, a DOW, or statement within the DAR, describing the work to be done must be prepared. It should address all performance requirements to satisfy Postal Service needs. It should describe the output requirements of the in-house operation, including responsibilities, equipment, material and qualifications of employees.

2. **The sponsor of the contracting out proposal is responsible for developing the cost estimates.** The sponsor should review the work to be performed to determine the current performance of the work by the Postal Service, or potential performance if the operation currently does not exist. The current or anticipated work force, material, equipment, facilities and procedures are to be analyzed. If it is determined during this review that major savings can be realized through operational adjustments, they should be implemented if they can be accomplished in a cost-feasible and timely fashion, to reduce the cost of in-house operations prior to outsourcing. Such adjustments should be explained and documented. The DOW and results of the review are used to prepare the in-house estimate. If major operational changes cannot be implemented initially, the in-house

baseline for the cost comparison should include the sponsor's best cost and savings estimates of identified improvements from the proposed change, for a valid comparison with the contract-out alternative.

3. The in-house estimate is to be based on the same work specified in the contract solicitation. The estimate should be developed with the assumption that costs which would continue at the same level regardless of the method of performance (in-house or contract), will not be considered in the analysis since they will offset each other. For example, if a contractor is to be provided equipment by the Postal Service for the performance of the contract and this equipment would have been used by USPS if the work was done in-house, the cost of this equipment should be excluded from the analysis. (However, the analysis should acknowledge the need for this equipment in the operation, regardless of whether in-house or contracted out.)

4. After development of the in-house estimate, contractor costs are estimated based on the same work. These estimates may be developed using several methods, such as:

- Actual experience in similar contract operations conducted by the Postal Service or through information provided by other companies and/or agencies.
- Market Research.
- Data provided in government or industry reports for costs of similar services.
- A pricing model may be used to build a price from the original cost elements, with all appropriate loading calculations included.

While these estimates may not be the same as those in a potential contract, they will provide a general cost basis for comparison with in-house costs, to determine if contracting out is economically viable.

5. Separate cash flows must be developed and compared to formalize the comparative analysis. Net Present Value (NPV) is the most significant factor on the issue of cost when comparing the in-house vs. contracting out alternatives. The discount rate utilized will be the most recent cost of capital specified by the Vice President/Controller.

6. After costs for in-house and contractor performance have been estimated, if it is determined that contracting out may be advisable, the sponsor will submit a comparative analysis to the Vice President/Controller for validation (or include the cost data as alternatives in the DAR, if applicable). If significant discrepancies are noted during the validation, they will be reported to the sponsor for recommended correction and resubmission. After validation, if the sponsor and Vice President, Labor Relations decide in favor of pursuing contracting out, all data, documentation, and a validation letter will be forwarded to the Vice President, Strategic Initiative Action Group, who will be responsible for concurring in whether or not a contract solicitation should be pursued. The Vice President, Purchasing and Materials, should be consulted during the preparation of the comparative analysis, to ensure that all potential contracting issues are addressed.

7. The confidentiality of all cost data should be maintained to ensure that in-house costs and final contract cost bids are completely independent.

8. If a contract solicitation option is pursued, it will be developed based on the current procurement guidelines. Once the successful bidder is identified, the comparative analysis will be revised to determine if the bidders' proposals indicate that contracting out will still be the more cost effective alternative. The results of the cost analysis will supplement the additional specified factors considered in evaluating possible contracting out, i.e., public interest, efficiency, availability of equipment and qualification of employees.

9. The final decision on whether to contract out is made by an approval board consisting of the Chief Operating Officer, Chief Financial Officer, and VP, Labor Relations.

C. Method To Develop Cost Data For In-House Performance

1. The in-house performance cost will be based on the same level of performance and DOW as identified to the potential contractor. The in-house methodology may differ from contractor methodology; however, the projected end product must be identical, and all costs to attain the end product will be considered in-house costs. Estimated costs of the function under study should include the following:

- Personnel Costs (see C.5.)
- Overhead Costs (see C.6.)
 - Operations Overhead
 - General Administrative Overhead
- Non Personnel Costs (see C.7. and C.8.)
 - Material and Supply Costs
 - Rent
 - Maintenance and Repair
 - Insurance
 - Utilities
 - Travel
- Additional Costs (see C.9.)

Cost comparison studies will consider all significant costs and will be based on a DOW to be accomplished. However, costs that would be the same for both the in-house and contract operation should not be computed (e.g., if the equipment used in the proposed process is to be supplied by the Postal Service, the cost is the same in the contract out scenario as in the Postal operated environment; these costs are not computed in the comparative analysis, but need to be referred to in the narrative to provide full disclosure of all costs). This should not in any way discourage contractors from proposing alternative arrangements to reduce costs by means not usable directly by the Postal Service such as, for example, processes to reduce the necessary quantity of raw materials.

2. Documentation

The comparative analysis should document the entries for each line of the cash flow in the cost analysis, as well as the calculation of each specific cost. Generally, the documentation should support the cost study without further explanation. The documentation will support all cash flow entries and will support the development of a DAR, if one is required to gain approval of an investment recommendation. Note that DARs are not always required. Contact Capital and Program Evaluation for information on current DAR requirements.

3. Inflation

These studies will use the established escalation factors for DAR development, which are updated semi-annually by the Vice President/Controller.

4. Length of Analysis

The length of the analysis period will be the anticipated duration of the service requirement plus renewal options, up to ten years.

5. Personnel Cost

a. This line includes the personnel costs required to accomplish the work, and includes salaries, wages and fringe benefits. To determine personnel costs, two steps are required:

- Development of an in-house staffing estimate. The staffing estimate describes the current operation minus any major cost savings that could be implemented and still accomplish the required work. If the operation does not currently exist, a staffing estimate will be made based on the best information available. These estimates will specify the number of employees required to accomplish the work in the most efficient and economical manner. Normally, the work requirements should be expressed in terms of productive work hours.
- Determination of personnel costs based on the in-house staffing estimate. If applicable, an estimate should be made of the cost of retaining employees at current pay and grade.

b. Full-time positions (FTP) will be converted into productive work hours using a national average work-year factor for bargaining unit positions and for non-bargaining unit positions. These factors are updated annually by the Vice President/Controller. Part-time positions will be based on the average number of hours worked during the year. Once the number of hours to be worked is established, they are converted to dollars using the applicable rates provided by the Vice President/ Controller, and escalated to the proper year. Allowances should be included for any overtime and shift differential payments.

When the dollar rate has been determined, it will be multiplied by a factor to increase the rate to compensate for service-wide personnel costs not included in the work hour rate. This factor is available from the Vice President/Controller.

6. Overhead

a. Costs incurred in support of the function under study, but not solely attributable to that function, will be classified as overhead.

b. Overhead normally is captured in two major categories.

- The first overhead category is operations overhead, defined as those costs incurred by the first supervisory level above and in support of the function under study. If the function currently exists in-house, compute operations overhead for the first supervisory level above and in support of the function. Determine if at least one position would be eliminated as a result of the potential conversion from in-house to contract operation. If the function does not exist, compute the costs for added positions. If there is no change from the baseline positions, operations overhead would be zero. If positions would be added or eliminated, compute personnel costs as previously addressed in section C.5. Also, compute other costs in support of positions to be added or eliminated using the same methodology.
- The second overhead category is general and administrative overhead (G & A), defined as all support costs other than operations overhead, incurred in support of the function under study. First, list all activities internal to the installation that provided definable support to the function, excluding operations overhead. Next, list those activities external to the installation, which provide general and administrative support not available to the installation, but which are essential to the operation of the function under study. Within each of these activities determine if at least one position or overtime workhours could be eliminated as a result of conversion to contract. If not, G&A overhead is zero. If positions or overtime workhours would be

added or eliminated, compute per-sonnel costs and other costs solely in support of those positions using the methodology outlined previously in these guidelines. The scope of analysis on general and administrative overhead support costs should include support costs which would be added if the work is done in-house or eliminated in the event the function is contracted.

7. Non Personnel Costs

a. **Material and Supply costs** - Material and supply costs are calculated for all items used solely in the in-house operation and not provided to the contractor, otherwise, they are common costs.

b. **Rent** - This cost is incurred for the use of non-Postal Service assets (land, buildings and equipment) by the function under study. Compute rental costs not expected to continue if the activity is contracted out. Include any future rent increases provided for in the lease(s).

c. **Maintenance and Repair** - Incurred to keep buildings and equipment in normal operating condition. Maintenance and repair does not include capital improvements which add value to an asset; such improvements would be included in the investment. Compute maintenance and repair costs of those assets needed for in-house performance and that are not furnished to the contractor.

d. **Insurance** - Include a provision for insurance costs only if they are anticipated to amount to ½ % or more of the proposed asset cost, if any.

e. **Utilities** - This includes charges for fuel, water, electricity, telephone and other communications, waste and sewage services that would not continue in the event of contract performance or that would increase for in-house operations. The amount of such costs applicable to the function under study will be determined either on a metered or consumption-allocated basis.

f. **Travel and Training**- This covers the expected costs of travel and training that would be added or discontinued.

8. Attributable Cost Factor

It may not be possible to estimate material and supply costs or other attributable costs, using the methods outlined above. In such cases an attributable cost factor developed by the Vice President/Controller may be used to estimate these costs and the servicewide personnel costs outlined in Section C.5. This factor is based on the relationship of direct labor attributable cost to total attributable cost, and the cost data contained in the Cost Segment and Components Report published by Cost Analysis in Product Finance.

To estimate costs using this factor, the analysis would calculate personnel costs as in Section C.5., excluding service-wide costs. In lieu of using the servicewide cost factor, the attributable cost factor will be used to increase or decrease personnel costs to compensate for service-wide costs, material and supply costs, and other attributable costs.

9. Additional Costs or Savings

This cost category encompasses any Postal Service costs or savings which are not classified appropriately in the other categories. These should be supported by justification for their inclusion in the cost study, an explanation of the computations used, and a listing of the specific cost components comprising the total amount. Reasonable cost estimates should be made for disruption resulting from a temporary loss in productivity or decrease in efficiency and effectiveness. If these cannot be quantified and are deemed to present more than nominal risk, the comparative analysis should state this. Include only those

costs or savings to be incurred as a result of an in-house operation being initiated or terminated. Exclude costs for unusual or special circumstances if they are expected to occur in both scenarios (although their existence should be mentioned).

D. Method To Estimate Cost Data for Contract Operation Prior To Request For Proposal.

1. Estimating Contract Price

a. An estimate of contract pricing could be calculated by any of several methods.

- Estimates using actual costs experienced for similar contract operations conducted by USPS or through information provided by other companies.
- Market Research.
- Estimates could be made using data outlining costs of similar services.
- Modeling, including raw materials costs, loaded rates, taxes, benefits, transportation, training, etc.

While it is understood that these estimates may not be the same as those experienced in a potential contract, they will provide a general cost basis for comparison with in-house costs, including the escalation factor as in C.3., to determine if contracting out may be economically viable.

2. Contract Administration

a. Contract administration costs are those incurred by the Postal Service in assuring that a contract is faithfully executed by both USPS and the contractor. They include the costs of reviewing contractor performance and compliance with the terms of the contract, processing contract payments, negotiating change orders, and monitoring the close-out of contract operations.

b. The contract administration costs should be based on the sponsor's estimate of the positions needed to accomplish the task outlined in D.2.a. above. This should be calculated in consultation with Purchasing, and should be backed by Purchasing's written concurrence. These position costs are computed based on instructions for determining personnel costs previously outlined in these guidelines.

3. Additional Costs

a. These include any additional costs to the Postal Service, such as transportation or purchased services, resulting from unusual or special circumstances which may be encountered. Include reasonable cost estimates for disruption resulting from a temporary loss in productivity or a decrease in efficiency and effectiveness. If these costs cannot be quantified and are deemed to present more than nominal risk, the comparative analysis should explicitly state this. Include only the costs that will be incurred as a result of a contract-out operation. Exclude costs for unusual or special circumstances if they are expected to occur in both scenarios (but they need to be mentioned in the narrative).

b. The total additional costs must be supported by a definition of the type of cost reported, justification for inclusion, methods of computation, and, if applicable, a detailed listing of the cost components.

4. Personnel costs

These costs include savings associated with positions eliminated when an in-house activity is converted to contract-out (See C.5., C.6.).

5. One-Time Conversion Costs

by When USPS discontinues an in-house activity to obtain a commercial product or service contract, there may be one-time in-house costs associated with the conversion.

a. Material Related Cost

1. A conversion will normally result in excess material (expendables) or material redeployable in-house or to the contractor. It may be possible to transfer material to the contractor providing the product or service in the future. Only the one-time costs associated with transferring material to a contractor will be included (physical inventory, packing, transportation, etc.).
2. When material is disposed of, the benefit is equal to the estimated recovery less the cost of disposal.
3. When material is transferred to another Postal facility, the benefit is equal to the recovery cost (now a savings) less the cost of transfer.
4. When a benefit (savings) is determined, it will be used as a reduction to the remainder of one-time conversion costs.
5. When cost of disposal or transfer is greater than the recovery of savings, it is treated as a one-time conversion cost.

b. Labor-Related Costs

1. A conversion may result in certain one-time, labor-related expenses. These include severance pay, grievances, homeowner assistance, relocation and retraining expenses. Human Resources should be asked to provide written estimates of these expenses. Care should be taken to include only those expenses which are reasonably expected to occur.

2. Other Costs

A conversion may require the Postal Service to take certain actions that would not be necessary if the activity continued in-house. For example, it may not be possible to terminate a rent/lease agreement without incurring a penalty fee. Penalty fees are to be included as conversion costs.

3. One-Time Cost Computation

Supporting documentation should clearly state the type of cost anticipated, justification for inclusion and methods of computation. The total of these one-time costs should be allocated to each performance period in which the costs occur. The cost entry will be determined by dividing the total one-time costs by the number of periods in the cost conversion.

6. Gain Or Loss On Disposal/Transfer Of Assets

- a. This section deals with the gain or loss on those capital assets to be disposed of if a decision is made to contract for the product or service. When switching from in-house to contract out, the need for all or some portion of these assets may disappear. If quantifiable, the value attributable to the reduced need for these assets should be included

as a consideration in the cost comparison. If not quantifiable, explanation should be included for this unquantifiable but positive attribute.

b. The estimated disposal value, minus the estimated cost of disposal or transfer, is considered to be either revenue or an outflow of funds. The disposal value of an asset is the original value of the asset minus depreciation.

From the disposal value, subtract an estimated cost of disposal. Enter this entire amount, the net disposal value, in the first year of the analysis. If the cost of disposal is less than the disposal value, the gain is a reduction in the cost of contracting. If the cost of disposal exceeds the disposal value, the cost is an addition to the cost of contracting.

c. Normally, a gain or loss on the disposal of assets will occur during the first year of the analysis. However, there may be cases where the contractor will be furnished with Postal Service equipment beyond the first year, and, therefore, the disposal or transfer would occur later in the analysis.

E. Cost Comparison Decision Prior To Request For Proposal

1. A comparison, outlining the costs and benefits for both in-house and contract performance, is made to determine which is the more cost-effective method. An evaluation is made to determine if the contract out initiative should go forward for consideration, as provided in section B.5. and B.6. above.

2. If a DAR is required, the most advantageous alternative, in-house or contract out, is used as a comparison against the baseline scenario to determine a return on investment for an investment decision.

F. Method To Develop Cost Data For Contract Operation After Receipt of Requests For Proposal

1. Contract Price

a. The contract price should be supported by a firm bid or proposal. The contractor's bid or proposal should be based on the same description of work utilized in preparing the in-house estimates. The solicitation for bids or proposals should notify the bidders that a comparison will be made between the cost of contracting and the cost of the in-house performance, and that a contract may not result.

b. In determining the amount to be recorded as the contract price, consider the type of contract. The following guidance is provided:

1. In the case of a firm fixed price contract, the price submitted by the selected offeror will be entered. If a firm fixed price contract is to be negotiated, the negotiated price will be entered.

2. When fixed-price contracts with flexible pricing arrangements are contemplated (e.g. fixed-price incentive), the target price will be entered.

3. If a cost reimbursement-type contract is proposed, the low negotiated estimated cost plus the fee to be earned if the contractor provides the minimum acceptable performance will be entered.

4. If a contract with an award fee is proposed, the minimum fee plus the contract costs of the most advantageous offer to USPS will be entered.

5. If a time and material or labor-hour contract is proposed, the estimated total cost of performance will be entered. Alternatively, comparable estimates may be developed for the Postal Service. The comparison may be made on the basis of productive workhour labor rates rather than total cost.

2. Other Costs

a. Other costs will be handled as previously outlined in Section D.

G. Cost Comparison Decision After Solicitation

1. Once the cash flows have been updated to reflect the latest costs and benefits for in-house and firm contract prices, the cost comparison is analyzed to determine which method is the most cost-effective.

2. If the sponsor decides to pursue contracting out, and significant changes in the data have developed, the comparative analysis should be resubmitted to the Vice President/Controller for validation.

3. The final decision to award a contract may be based on reasons other than, or in addition to, cost.

4. If a DAR is required, the most advantageous alternative, in-house or contract out, is used as a comparison against the baseline scenario to determine a return on investment for an investment decision. Upon receipt of actual bids, the DAR will be updated to reflect the revised costs. Then the DAR will flow through the normal review and approval process.

5. Refer to Section B.9 concerning final decision on outsourcing.