

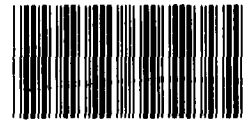
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Multiyear Contracting



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Statement of

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before the

Subcommittee on Research and Development HSE 00505

Defense Industrial Base Panel

House Committee on Armed Services HSE 00500

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Mr. Chairman, I am pleased to appear before the Defense Industrial Base Panel to discuss, as you requested, the important issue of multiyear contracting. I believe that this is a very timely issue due to the impact inflation is having on the costs of Government contractors and contracts. I hope that our testimony will clear up any misconceptions that may exist regarding multiyear contracting, and possibly provide some impetus to expand the use of multiyear contracting throughout the Government.

Before I discuss some of the historical background, our position, and other matters related to multiyear contracting, I would like to briefly explain what a multiyear contract is and discuss some of the different terms related to this contract method.

Multiyear Contracting Terms Defined

A multiyear contract is a commitment by the Government to purchase services or supplies from a contractor for a period extending beyond the fiscal year in which the contract is made. It is generally competitively awarded and a long-term arrangement where the parties are released from their mutual obligations only upon termination of the contract.

Before proceeding, I would like to try and distinguish between some of the terms which seem to lend themselves to confusion or misunderstanding. These are the differences between multiyear contracting versus multiyear funding,

and contract termination for the convenience of the Government versus cancellation of a multiyear contract.

In the first case, we believe there is no clearcut distinction that can be drawn between multiyear funding and multiyear contracting unless the question is one of whether full funding, in the form of multiyear appropriations, is always a necessary prerequisite for multiyear contracting. In other words, does the Congress have to agree to fund the the entire bill for a multiyear contract at its inception?

We believe that this is not the case where Congress has granted specific authority for multiyear contracting. A case in point is where Congress has given agencies authority to use annual appropriations in some multiyear procurements. Here, funds are obligated to cover the program requirements for the fiscal year in which the multiyear contract is made, however, each successive program year is subject to the availability of funds to cover the requirement for that program year. If funds were not made available to continue the multiyear contract, cancellation provisions would be invoked to allow the contractor to recover the balance of his unamortized non-recurring costs. In this instance, it is not necessary to fully fund the contract.

Where express multiyear contracting authority is not specifically granted multiyear contracting can still be

used when no-year or multiple-year funds are available. However, we believe that such appropriations and current apportionments would have to be adequate to cover the amount to be expended over the entire period of the multiyear contract for it to be proper and lawful. Full funding covering all of the program years' requirements in the contract would appear necessary under these circumstances.

The differences between termination for convenience versus contract cancellation as they relate to multiyear contracting may be somewhat easier to discern. A termination for convenience may come into play when the Government orders the contractor to discontinue the performance of the contract prior to completion even though funds are available to continue the performance of the contract. As used in multiyear contracting, "Cancellation" refers to the cancellation of the total requirements of all remaining program years. In this sense, the contract is cancelled if the contracting officer notifies the contractor that funds for continued performance for any subsequent program year are not available or if he fails to advise him that funds for continued performance in the succeeding program year will be available.

An example may best illustrate when each would come into play in a multiyear contract. Let's say that the Army ACC0020 has a multiyear contract to buy 100 missiles a year on a

4 year contract. At the beginning of the third program year, funds are not available. This would result in the cancellation clause being invoked. However, let's assume that the funds are available for the third program year but after the first 25 missiles are produced the Army decides that it does not need any additional missiles and thus stops performance. This is when the termination for convenience of the Government clause would be used.

Under each situation the contractor can make a claim for reimbursement of costs. When the termination for convenience is involved the contractor gets paid his allowable costs and profits up to the time of termination. The cancellation clause results in the contractor recovering any pre-production or other non-recurring costs that were spread out over the remaining program years of the multi-year contract that were terminated. Thus, the cancellation charges would decline for each succeeding program year in that these costs must exclude all amounts allocable to items included in the prior year program requirements.

We cannot say that in every situation a termination for convenience would cost more than a cancellation, or vice versa. Any comparison of this kind would be very difficult.

One thing that can be mentioned, however, is the fact that on DOD's multiyear contracts a statutory cancellation ceiling limitation of \$5 million exists, unless otherwise authorized by Congress. Each multiyear contract contains its own cancellation ceiling up to that amount. The termination for convenience,

however, is only limited by the total contract price after taking into consideration any prior payments made to the contractor for performance up to the point of termination. It is conceivable, therefore, that the payments to a contractor, when the contract is terminated for convenience, could exceed the \$5 million maximum cancellation charges in a multiyear contract.

Procurement Commission Recommendation A-8

As you have indicated, Mr. Chairman, the Commission on Government Procurement was established in November 1969 to study and recommend to Congress methods "to promote the economy, efficiency and effectiveness" of procurement by the executive branch of the Federal Government. One of its extensive studies concerned multiyear contracting.

(The study group assigned this task dealt with two basic issues. First, whether multiyear procurement was a beneficial tool for both the Government and the contractor. Secondly, whether Congress should legislate to provide general multiyear contracting authority. The Commission study group concluded that the advantages were greater than the disadvantages.) They also identified about \$56 million dollars in savings over a 5 year period where multiyear contracting was being employed by various DOD commands. (The Commission's findings and conclusions led to Recommendation A-8 which requested the Congress to enact legislation to authorize all executive agencies to enter into multiyear contracts for supplies and services with annual

appropriations. Further, the recommendation required such contracts to be based on clearly specified requirements and not exceed a five-year duration unless otherwise authorized by statute.)

The recommendation to permit multiyear contracting using annual appropriations was deemed necessary because most appropriations were annual, and there are statutes that prohibit agencies from entering into contracts for needs which extend beyond the current fiscal year when monies to be used for the contract are one-year appropriations. This prohibition and intent on the part of Congress was affirmed by the Comptroller General as being provided for in the Anti-Deficiency Act, Surplus-Fund-Certified Claims Act of 1949, and The Adequacy of Appropriations Act.

As you know, the GAO was tasked with tracking progress in implementing the recommendations made by the Commission on Government Procurement. In our last report on the status of these recommendations (PSAD-79-80; May 31, 1979), we reported that A-8 had been accepted and was embodied in a pending piece of legislation (Senate bill S.5.) Section 504 of the proposed bill provided that "an agency may make contracts for acquisition of property or services for periods not in excess of five years, when - (1) appropriations are available and adequate for payment for the first fiscal year"; and (2) the agency head determines that other specific conditions are met. This bill

was introduced on January 15, 1979, as the Federal Acquisition Reform Act. It was not enacted. Also, inclusion of the recommendation is being considered by the Office of Federal Procurement Policy in its Uniform Procurement System, legislation which is to be proposed by October 1981.

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Historical Position of GAO

At this point, I would now like to provide the Subcommittee with a brief summary of the historical position of the General Accounting Office relative to multiyear contracting. Several Comptroller General decisions and actions in the 1960's provide some insight into GAO's early position.

The Comptroller General has held that several statutes prohibit the use of annual funds for multiyear procurement. In a decision issued November 30, 1962, (42 Comp Gen 272) involving a 3-year Air Force contract for services and supplies at Wake Island, the Comptroller General expounded the proposition that "contracts entered into under fiscal year appropriations purporting to bind the Government beyond the fiscal year involved must be construed as binding upon the Government only to the end of the fiscal year..." Additionally, the decision held that contracts executed and supported under authority of annual appropriations must concern a bona fide need arising within the year of the appropriation's availability.

A Decision issued on April 3, 1964, (43 Comp Gen 657) repeated our position on this issue. In this case, the Comptroller

General affirmed the legality of the Armed Services Procurement Regulation dealing with multiyear procurement and held that multiyear contracts in which no-year funds are used do not violate statutory restrictions on fund obligations, nor provide impediments for contracting with small business.)

In our 1962 decision we recognized that the statutory restrictions imposed on contracts entered into under authority of annual appropriations may intensify procurement problems. We also noted that the making of multiyear contracts in some areas could produce more favorable bid prices to the Government. Around this time legislation was introduced which would provide an exception to the restrictive statutes. The legislation was an amendment to 10 U.S.C. 2306 in the form of a new subsection (g). The subsection allowed DOD to enter into contracts for periods of not more than five years for certain types of services and related supplies for which appropriations would normally be available for obligation only within the fiscal year for which appropriated, provided that certain conditions were met. The views of the General Accounting Office were requested on the pending legislation. The Comptroller General reported no objections to the proposed legislation. It was enacted as Public Law 90-378 and can only be used by the military departments and certain other agencies for service contracting performed outside of the continental United States.

More recently, we conducted a study in 1977 (PSAD-78-54, January 10, 1978) where we assessed the desirability of

multiyear contracting authority for the Government and the controls needed to make its use effective, much as the Commission on Government Procurement did. We too found that savings were realized by Federal agencies through multiyear contracting. In our review, we identified annual savings of \$3 million--about 21 percent--on a total of 26 Defense Logistics Agency and Air Force multiyear contracts valued at \$14 million. This savings figure excluded any administrative cost savings attributable to the use of this contracting method. Further, estimated savings of \$2 million were identified by the General Services Administration for 70 multi-year public utility contracts.

We recommended in our 1978 report that Federal agencies should be given general multiyear contracting authority for supplies and services and that the Office of Federal Procurement Policy should develop appropriate criteria and procedures for the agencies to follow in using this method of contracting. We are not aware of any such legislation being enacted.

The GAO position still remains that multiyear contracting is a viable acquisition method that should be pursued and used when and where feasible and applicable.

Criteria to Use a Multiyear Contract

(The 1976 Armed Services Procurement Regulation in dealing with multiyear supply contracts listed 5 criteria that should be satisfied for the agency to use multiyear

contracting. These were:

- (1) reduced unit prices can reasonably be anticipated over annual buys;
- (2) there is reasonable expectation that effective competition can be obtained;
- (3) there are known requirements for the quantities to be purchased under the multiyear contract;
- (4) the design and specifications of the item are not expected to change to an extent that would involve a major impact on contract price; and
- (5) the items being procured are not regularly manufactured and offered for sale in substantial quantities in the commercial market.

Similarly, Public Law 90-378 which is used by DOD to contract for services and related supplies outside the continental United States on a multiyear basis contains three main criteria which should apply to most of these contracts. These are:

First, that there will be a continuing requirement for the supplies or services consonant with current plans for the proposed contract period;

Second, that the furnishing of such supplies or services will require substantial initial investment in plant or equipment, or the incurrence of substantial contingent liabilities for the assembly, training, or the transportation of a specialized work force; and

Third, that the use of such a contract will promote the best interests of the United States by encouraging effective competition and promoting economies in operation.

We believe that all of these general criteria should exist in any multiyear contract situation. They are necessary guides that should be adhered to when considering multiyear contracting and the advantages and disadvantages of this contract method.

It should be noted that the multiyear contracting section in the Armed Services Procurement Regulation (now referred to as the Defense Acquisition Regulation) was revised in September 1979 to permit multiyear contracting on a noncompetitive basis, where applicable. We do not agree that this contracting method should be used on a noncompetitive basis.

Impediments to Multiyear Contracting

I would like now to discuss some of the impediments which severely restrict the use of multiyear contracting.

As I alluded to previously, any discussion of multiyear procurement must consider how the contracting authority of Federal agencies is tied to Congressional appropriations. Of the three main types of appropriations--no-year; multiple-year; and annual--the most prevalent form of funding is annual. These appropriations are available for obligation only for the year in which appropriated unless otherwise specified by law. Therefore, Federal agencies must obligate the funds

during the appropriation year for bonafide needs of that year and are precluded from entering into contracts that obligate the Government in excess of those needs. This rule which is engendered in numerous statutes, and has been affirmed in Comptroller General decisions, is probably the main deterrent to multiyear contracting in Federal agencies.

In specific instances, however, the Congress has permitted agencies to use annual appropriations for multiyear contracting. As mentioned previously, Public Law 90-378 allows the military departments, ^{ACC00036} NASA, and the Coast Guard to use annual appropriations for multiyear contracts for services and related supplies outside the 48 contiguous states of the United States.

With regards to the other two types of appropriations, the no-year and multiple-year funds can be used for multiyear contracting. The no-year appropriations are available until expended, while the multiple-year appropriations are limited to a set number of years authorized by the Congress. These two types of multiyear funding are often granted for special projects, research and development and major acquisitions. While these funds are available for multiyear contracting use, there is no assurance that they will be used in this manner. In the absence of express multiyear contracting authority, no-year and multiple-year funds must be adequate to cover the full cost of the multiyear contract.

There is some resistance to authorize additional multiyear contracting and it relates to the Congressional desire to maintain close control and vigilance over agency budgets through annual reviews and annual appropriations. Congress has been reluctant to relinquish this control in the form of extensive multiyear funding. There has always been some concern that abuses may arise and that inefficiency and waste in some programs may go unchecked.

The contractor's recoupment of costs due to cancellation leads to another possible impediment which is specifically related to the DOD and its use of multiyear contracts. ^{AGC 00005} Since 1972, the Congress has prevented DOD from entering into multiyear procurements which contain cancellation charges exceeding \$5 million unless such a contract has been specifically authorized by the Congress. This cancellation ceiling would appear to be fairly insignificant when one considers the large costs involved in most of DOD's major acquisitions.

A final impediment to multiyear contracting represents a dilemma for the office of Management and Budget and top ^{AGC 00027}

officials of executive agencies. While multiyear contracting may provide better program stability and lower costs, it could also reduce the flexibility to meet changing priorities and needs. Consequently, officials may have reservations about this approach.

Advantages and Disadvantages of Multiyear Contracting

Some mention of the advantages and disadvantages of multiyear contracting is in order. One of the greatest advantages in the use of multiyear contracting is of course the potential for savings in contract prices and administrative costs. With regard to contract prices, the contractor who holds a multiyear contract is able to spread his planning, startup, and other pre-production costs over a longer period of time, and more opportunity for increased efficiency and productivity should exist over this extended period. These contractor benefits should be transformed into decreased unit prices to the Government. Likewise, administrative costs are saved by eliminating the costs attributable to repetitively soliciting and evaluating bids and awarding the contract.

Still another advantage which has been repeatedly cited is that the quality of performance and service from contractors should increase. Contractor performance may be improved by reducing the uncertainty of continued Government business; providing continuity in the delivery of recurring service and supply needs; and enabling the contractor to maintain a stable, well-trained workforce.

Another advantage often cited by Federal agency and contractor representatives is that multiyear contracting could lead to increased competition for Government contracts. Many officials feel that with a longer time period for investment amortization allowed by the multiyear contract, a larger number of contractors, including small businesses, would be encouraged to compete for Government contracts.

On the other hand, some of the disadvantages of multiyear contracting cited by the Commission on Government Procurement and by agency and contracting officials interviewed in our 1977 study include the following. First, where a large initial investment is not required, use of the technique may tend to conflict with the advertising statutes. Second, it is more difficult to effect program and quantity changes. Third, early termination of multiyear contracts would require the payment of cancellation charges which may offset any initial savings realized. Finally, effective competition may decrease.

On the latter point, several officials noted that although there may be more competition for multiyear contracts in the year of award, the number of opportunities to bid will be reduced by the number of years the contract is in effect. Also, some officials felt that a contractor who amortizes his initial investment during the multiyear contract period may have a competitive price advantage over new contractors in later solicitations for the same or similar product needs.

As stated earlier, despite some possible disadvantages we continue to believe they are outweighed by the advantages to be gained from multiyear procurement.

Status of DOD Multiyear Contracting

Throughout my testimony, I have referred to DOD and some of its efforts and policies related to multiyear contracting. Since DOD's annual procurement budget is far and away the largest of any Government agency, it is probably safe to say that it is one agency that could benefit greatly from the use of this acquisition method. In fiscal year 1979, the DOD procurement budget was more than \$70.4 billion.

In addition to specific multiyear contracting authority for obtaining services overseas which I have previously mentioned, the DOD has specific authority in other areas such as supplies and services required for the maintenance of family housing; research and development services and facilities; and storage, handling and distribution of liquid fuels. The time limit for these multiyear contracts is five years, except for the maintenance of family housing which is four. These timeframes coincide with and are in support of the DOD Five Year Defense Program.

We recently obtained a DOD multiyear contract listing for fiscal year 1979 from the DOD's computerized procurement information system. It identified 1,129 outstanding DOD multiyear contracts in this fiscal year and about \$1.8 billion spent

against these contracts. This amounts to only 2.6% of the fiscal year 1979 DOD procurement budget. While these multiyear procurements covered a wide range of service and supply categories, the largest dollar expenditures were in the categories listed as radar equipment (7.0%), miscellaneous electrical and electronic components (6.2%), operation of Government facilities (5.3%), and trucks and truck tractors (5.3%). As we have just received this computer listing last week, we have not had time to test the reliability of the data.

While the DOD is the largest contracting agency, other civilian executive agencies do have specific statutory authority to award multiyear contracts in certain instances. For example, the General Services Administration is authorized to enter into contracts for public utility services for periods not exceeding ten years and for inspection, maintenance and repair of fixed equipment in leased Federal buildings not exceeding three years. Also, the ^{DLC 03620} Secretary of Agriculture can enter into research contracts concerning agricultural commodities for periods of not more than four years. In its multiyear contracting study, the Commission on Government Procurement identified 22 statutes which provided for multiyear contracting authority of which 17 were related to various civilian executive agencies. We do not know at this time the extent of multiyear contract expenditures in civilian agencies.

Legislative Changes Needed

You requested that we furnish our views on the legislative changes which would be necessary to allow for multiyear contracting. As I have already indicated in my testimony, many statutes now exist which permit multiyear contracting in specific areas. In addition, multiyear contracting can be used without specific authorization when adequate multi-year funds are provided by Congress. We do not believe, however, that these two combined are reaching a significant number of procurements that could benefit from this contracting method.

In our 1978 report on multiyear contracting, we recommended that the Congress enact legislation which would provide general multiyear contracting authority for Federal agencies. This recommendation, in essence, reiterated what the Commission on Government Procurement had recommended seven years earlier. We continue to believe that (such positive action on the part of the Congress would provide the impetus for greater application of multiyear contracting in the Government, particularly if the restrictions on the use of annual appropriations for multiyear contracting were lifted.)

Congress during its annual budgetary reviews may want agencies to justify their use of multiyear contracting which could provide it some desirable visibility and control

over these efforts. No additional extensive notification or reporting system, however, should be necessary.

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In closing, I do not want to leave the impression that we support the helter-skelter use of multiyear contracting throughout the Government. We, like Congress, do not want to see this form of contracting abused. However, with adequate assurances that the proper criteria are established for multiyear contracting and the conditions for its use are met, this acquisition method could be both beneficial to the Government and the contractors with whom it relies so heavily on to meet its ever increasing needs.)

Mr. Chairman, I will be happy to respond to any questions that you may have at this time.