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STATEMENT OF
W. H. SHELEY, JR., DIRECTOR
MISSION ANALYSIS AND SYSTEMS ACQUISITION DIVISION
before the
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

on

GAO VIEWS CONCERNING CAUSES AND IMPACT OF COST
GROWTH; PROPOSED BILL S.2397; AND DISCUSSION
OF THE DEPARTMENT OF DEFENSE'S SELECTED
ACQUISITION REPORTING SYSTEM



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Mr. Chairman and Members of the Committee:

I am pleased to be here today to present GAO's position on the causes of cost growth, its impact, and what needs to be done to bring it under control. I will also discuss the proposed bill S.2397 which would establish a requirement for civil agencies to report to the Congress on the status of major acquisitions and what GAO has done to improve upon the integrity and usefulness of information provided by the Department of Defense (DOD) to the Congress in its Selected Acquisition Reporting (SAR) system.

As you know, GAO, as part of its continuing efforts to keep the Congress apprised of the cost and progress of Federal acquisitions, annually reports the latest available financial status of major projects. This practice began in June 1976, when GAO issued its first combined civil and defense major acquisition status report. It showed that through fiscal year 1975, 585 acquisitions had cost growth of \$148 billion, an average of \$253 million per acquisition. Our current report 1/ shows 465 acquisitions had realized cost growth of \$257.5 billion, an average of \$553.8 million per acquisition--more than twice that of 1975.

GAO believes better reporting is an essential first step to controlling cost growth. I hope this hearing will provide the impetus to this end.

1/"Status of Major Federal Acquisitions as of September 30, 1981: Better Reporting Essential to Controlling Cost Growth" (MASAD-82-24, Apr. 22, 1982).

UNDERSTANDING COST GROWTH

There is no one present who does not firmly believe that new major acquisitions, either for the civil sector or DOD, entering the acquisition process today will experience significant cost growth before production is completed. It is an undeniable fact that significant cost growth will occur on every new system that enters the acquisition process unless management resolves to take the logical measures available to correct the situation.

Volumes of material have been written on the subject of cost growth during the past 10 years. Unfortunately, cost growth is still with us, and it is well past the time for some serious efforts to be made to put existing and new machinery into action.

The matter of cost growth on Federal acquisitions is a complex problem involving economics, budget priority decisions, political decisions, and program and project management policies and practices. I think it is important to recognize early on that factors accounting for cost growth are generally interrelated and will vary in importance depending on the type of acquisition being analyzed.

It is important to recognize in any analysis or discussion of cost growth that not all cost growth can reasonably be prevented. For example, unusual periods of inflation may result in cost growth. Also, some cost growth, even though preventable, may be necessary to achieve maximum benefits in a particular program. Changes in technology may make it possible to incorporate modifications that result in an overall increase in the effectiveness of

the acquisition. Such cost growth cannot always be anticipated, particularly when the acquisitions cover long periods of time.

But for the most part, cost growth can be controlled. The facts argue that the Government has, in fact, made some progress in developing a greater capability to make accurate cost estimates, but this progress has not often been put to good use. Today, DOD still recognizes control of cost growth as one of its major problems and has directed specific initiatives to get it under control.

CAUSES OF COST GROWTH

The most essential ingredient to avoid growth is to, at the very outset of a program, be honest in preparing and reporting the cost estimates. There are many other reasons for cost growth, including

- stretching out procurement schedules,
- deferring procurement of a system,
- unanticipated technical problems,
- inflation,
- underestimating technical complexity,
- increasing capability, and
- other issues generally associated with failure or inability to follow established acquisition principles.

Cost estimating is the key ingredient in reducing cost growth because it transcends all of the causes identified above. Typically, cost estimates involve an initial estimate followed in a few years by a development estimate. The Congress gives its approval based on the initial estimate. Therefore, this estimate should be the

best early projection that an agency can make after having considered all pertinent factors. Too often, however, it is nothing more than a rough feel for the potential cost of a project. In many cases, optimistic estimates are used to gain approval of programs. Once Congress has accepted and authorized such programs, it becomes very difficult to terminate them. The development estimate is a refinement of the initial estimate after some degree of project definition work and is usually made at about the time the development contract is awarded.

As far back as the early 1970s, GAO has reported that both initial and development cost estimates on Federal acquisitions in many cases are quite optimistic on technical development problems, cost, and potential performance. Recognizing the technical complexity of research and development projects, GAO believes it is extremely important that adequate project definition be performed to provide as accurate and reliable an estimate as possible of schedule milestones and total project cost.

The desire of program advocates to sell the program to both agency management and the Congress with low cost estimates and high expectations for solving technical problems is understandable. After all, the vitality of an agency depends largely on new program starts. However, this must be balanced against the need for as realistic appraisals as possible of the potential resources needed. One key improvement needed is more candor up front in the initial presentation of programs to the Congress and not promising more than can be realistically delivered.

The major problem with this consistent pattern of underestimation is that the Congress is being placed in an untenable position. The Congress has to make choices and decide for itself what the spending priorities should be. Without good cost estimates, the Congress is making major decisions in a vacuum. GAO believes that agency management and the Congress must have reliable estimates to make informed decisions about initiating, continuing, modifying, and canceling projects.

Estimating the effect of inflation

The use of optimistic inflation rates in developing cost estimates also accounts for considerable cost growth. Whereas, DOD includes inflation in all of its estimates, civil agencies have not followed a uniform practice. For those acquisitions in which inflation is included, the low rates used to project inflation for the duration of the acquisitions have consistently resulted in underestimated project costs.

Estimating the rate of inflation is admittedly speculative and provides no guarantee of actual costs to be incurred, but the Congress should be aware that funds needed for dealing with future budgets and appropriations may be considerably more than the program estimates, as now drawn, would indicate.

Funding uncertainty

In some cases, cost growth can also be aggravated because of the general uncertainty about funding. On weapon systems, the lack of sufficient production funding, for example, can inhibit the use of the most economical production rates. Planning optimism often meets the reality of limited funds available for a given number of projects. Program stretchouts or deferrals can likewise be a cause of cost growth.

IMPACTS OF COST GROWTH

Cost growth has proved to be particularly troublesome and despite much effort, the problem persists. There are some who would shrug it off as a bookkeeping/cost estimating exercise or as a normal cost of doing business. Most, however, including GAO, view cost growth as a serious problem. Although GAO cannot address specifically its impact on the nation as far as civil acquisitions are concerned, GAO is certain the impact is quite detrimental to our economy. For defense acquisitions, it has direct and highly visible effects on our national security. Major cost increases contribute to the procurement of far fewer units of weapons than our military leaders say we need to maintain an adequate defense posture.

Because of cost growth, projects cannot be accomplished with the appropriated funds approved by the Congress. Unless additional funds are authorized to cover funding shortfalls, projects can be adversely affected in terms of

- reduction in scope and quantity;
- program stretchouts;
- reductions in areas such as testing, training, support, and so forth, to maintain program schedules; and
- reprogramming of funds between acquisitions.

More difficult to address is the impact that the accumulation of poor estimates, on many programs over many years, does to the reputation of Government managers who work extremely hard to bring an acquisition program in within established cost, schedule, and performance estimates.

GAO's POSITION ON S.2397

GAO recently provided your Committee written comments on S.1604, an earlier version of S.2397. Basically, our comments are the same as the ones prepared earlier for H.R. 4685, a bill proposed by the Government Operations Committee, House of Representatives. GAO is pleased to note that the current version of the bill encompasses the suggestions contained in our comments. As indicated in our written comments, we support the intent of the bill.

The proposed bill is an attempt to curtail cost growth on major civil acquisitions by requiring civil agencies to periodically report status information on major acquisitions. The bill also provides that when the cost of a major civil acquisition grows by 25 percent or more, no additional funds may be obligated or expended unless special authorizing legislation is enacted by Congress.

GAO believes the reporting of such information is necessary as a first step to controlling cost growth. In 1976, GAO reported on the need to require status reporting of major civil acquisitions. Currently, there is no single reporting system to provide cost, schedule, and quantity data on major civil acquisitions. However, the National Aeronautics and Space Administration does prepare status reports at the request of the Chairman of the Department of Housing and Urban Development (HUD)-Independent Agencies Subcommittee of the Senate Appropriations Committee. Such a system as proposed in the bill will provide the Congress and top agency management with oversight data on the progress and direction of projects and allow them to readily identify possible problem areas and their causes.

In summary, we support the intent of the bill as it now stands. We caution, however, that a reporting system should not be viewed as a panacea. As with any new system, the bugs have to be worked out and that will take time. DOD's selected acquisition reporting system, although in existence for over a decade, still could be improved to provide better information on major system acquisitions. However, the first step to improving the management of any program is to ensure that accurate information is made available to responsible agency officials and to the Congress. With that in mind, I would like to discuss the SAR system's past improvements and potential for additional improvements to make it a more useful source of information.

DOD'S SAR SYSTEM

The SAR system provides useful information, on a quarterly basis, on the status and progress of selected major acquisitions. Through this system some visibility on weapon system cost and cost growth, as well as changes to schedule and technical performance data and reasons therefore, are provided to Committees of the Congress. Just as important, the SAR system provides categories for recording specific causes of cost growth. This type of data, accumulated over a period of years on a wide variety of systems, has provided a valuable insight into such growth. It is also useful in highlighting causes that can be corrected and the extent of growth due to other causes which are more or less beyond the control of a program manager.

Although the SAR system provides useful information, GAO believes it can be improved. GAO issued reports which contained

recommendations to the Secretary of Defense to improve the reports provided to the Congress. DOD agreed with some of our recommendations and identified improvements which have been made; however, it disagreed with several of our other recommendations. DOD takes the view that it is fully complying with the desires of the Congress and, therefore, does not intend to implement the other recommendations. Since GAO is convinced that the recommendations would result in the Congress receiving information that would be valuable in carrying out its oversight responsibilities, GAO recommended to the Congress in a report dated March 2, 1981, that the Secretary of Defense be directed to change the SAR system. Our recommendation would require that the SAR system

- include important systems that are in advance development;
- expand the required mission capability assessment statement to describe shortcomings and limitations of systems in their expected operational environments;
- include planning estimates and a one-time variance analysis for the planning and development estimates in the first report that includes the development estimate;
- include a brief narrative section on technical and operational risks; and
- include cost estimates for categories of logistic support/ additional procurement costs related to the weapon system such as modifications, component improvement, replenishment spares, industrial facilities/production base, simulators, consumables, and modification spares.

Adoption of these recommendations would go far in narrowing the credibility gap that is widely recognized by all the principal players involved in the defense community, including DOD. GAO hopes that these hearings may also lead to some actions on these recommendations.

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As you can see GAO has been deeply involved in systems acquisitions for many years with the ultimate goal of identifying ways management improvement might be made. Through the combined efforts of the Congress, the agencies, and GAO, progress is evident. But still more needs to be done. At your request and also at the request of the Chairman of the Senate Armed Services Committee GAO is currently examining the unit cost exception reports required by Section 917 of Public Law 97-86, referred to as the Nunn Amendment, and the SAR system to identify where further improvements can be made. We will keep you apprised of our progress and report to you later in the year.

Mr. Chairman, this completes my formal statement. I would be pleased to respond to any questions you may have.