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STATEMENT OF

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BEFORE THE

SUBCOMMITTEE ON DEFENSE ACQUISITION POLICY

OF THE

SENATE COMMITTEE ON ARMED SERVICES

ON

S.2151, S.2082, AND S.2196

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before the Subcommittee to discuss our views on S.2151, S.2082, and S.2196 that are intended to strengthen the acquisition process within the Department of Defense (DOD). My comments today will be directed towards selected aspects of these bills with emphasis on organizational structure, the need for independence of the contract auditing function and the reasonableness of prices charged to the government for spare and repair parts.

In the past, we have pointed out the need to improve the management of major defense acquisition programs. DOD's major acquisition process has been characterized by programs that have exceeded cost estimates, slipped schedule milestones, fallen short of stated technical and operational requirements and resulted in the acquisition of fewer systems than originally planned. These problems cannot be solved without making fundamental changes to the way DOD purchases and manages the acquisition of major defense systems.

Last December, in testimony before the President's Blue Ribbon Commission on Defense Management, the Comptroller General emphasized the need to move toward an organizational structure

designed to promote better decisionmaking in the DOD acquisition process. It is encouraging to see the widespread interest in improving the acquisition and management of major weapon programs which is, in part, evidenced by the proposed legislation being considered by the Subcommittee. We believe that the merits of the various organizational proposals, including those contained in the Packard Commission's interim report, require careful consideration by the Subcommittee.

As you know, Mr. Chairman, the Department of Defense Authorization Act of 1986 contains a provision directing GAO to conduct a study of all evidence, studies, reports and analyses concerning the organizational structure for defense procurement. We are to submit a report to Congress by November 8, 1986, identifying the advantages and disadvantages of establishing an agency either within or outside the DOD with the mission of coordinating, supervising, directing and performing all procurement functions for the DOD.

The specific objectives of our study are to (1) assess the feasibility of creating a centralized civilian acquisition agency, (2) determine the advantages and disadvantages of consolidating the military services' buying commands into such an agency, and (3) develop a list identifying the essential elements of an effective and efficient defense acquisition system

and its organizational structure. The purpose of the latter objective is to provide Congress a checklist to measure the relative merits of proposed changes to DOD's organization structure for the acquisition of major systems.

In conducting this work, we are addressing a number of issues that should be considered in any DOD reorganization plans. Some of the more important issues we are trying to address are

--What specific acquisition problems need to be solved and how many can be corrected by an organizational change?

--If a civilian defense acquisition agency were established, how should it be structured, and how would it interface with the Office of the Secretary of Defense and the military services?

--What impact would a centralized acquisition agency have on military buying commands? What is the potential for consolidation? How would military requirements be coordinated with the acquisition agency? By what mechanism would disagreements be resolved?

--What would be the role of the unified commands in the weapon system acquisition process? Could a civilian defense acquisition agency be structured to allow the unified commands to exert more influence over the establishment of weapon system requirements?

S.2151 also calls for the establishment of an Under Secretary for Acquisition. As we understand the bill, the current position of Under Secretary of Defense for Research and Engineering would be retained. As you know, the Blue Ribbon Commission on Defense Management, in its interim report of February 28, 1986, proposed the creation of a new position of Under Secretary of Defense for Acquisition to be responsible for setting overall policy for procurement and research and development, supervising the entire acquisition system, and establishing policy for administrative oversight and auditing of defense contractors.

One major advantage of having the total acquisition responsibility under one office is not having to rely on other activities for successful completion of the various acquisition phases. Accountability would be focused in one place. A potential disadvantage of having one organization responsible for both research and development and procurement is that it could reduce the checks and balances inherent in two separate

organizational elements--one for research and development and the other for production and logistics. We believe the pros and cons of these two approaches should be fully explored.

In addition to the organizational considerations, the necessary investment in people must be made to maintain a competent and professional acquisition work force. The most effective process or system can be brought to a standstill if the people do not have the necessary skills and authority to utilize their skills.

We will soon issue a major report which identifies changes in the training program needed to assure a highly qualified cadre of program managers. Specifically this report will suggest modifications in service career programs in order to provide program managers with adequate intensity and diversity of acquisition experience. The report also discusses changes in the operating environment to enable program managers to more effectively carry out their responsibilities. The thrust of our suggestions are consistent with the objectives of S.2082.

While we support the intent and objectives of S.2151 and S.2082, there is one major area of concern relating to the need to preserve the independence of the contract audit function. In any contemplated realignment of the contract audit function,

there exists the all important consideration that contract auditing remain independent of the procurement function. Any organizational arrangement must ensure that contract audits are conducted independently. This crucial balance could be compromised if the audit function were transferred to or brought under the supervision of an acquisition official. Any pressures on those involved in an audit, whether real or perceived, can reduce the confidence in the integrity and objectivity of the audit results.

The Comptroller General has issued standards for government auditing. The second, and one of the most important general standards states:

> "In all matters relating to the audit work, the audit organization and the individual auditors, whether government or public, must be free from personal or external impairments to independence, must be organizationally independent, and shall maintain an independent attitude and appearance."

We believe that the organizational arrangements contemplated by both S.2082 and S.2151 which would have the auditor working for and reporting to the activity responsible for acquisition would violate the basic auditing standard of independence. The auditor should report to an activity independent of

the system advocate responsible for the program. The auditor should function in an advisory capacity, not as part of the organization responsible for utilizing audit reports. If an acquisition official disagrees with the auditor, the audit report may be suppressed or otherwise not made fully available to those who could benefit from it.

We support the objective of S.2196 which seeks assurances that the government is not being charged more than the lowest price charged to the contractors' most favored customers. We are concerned, however, with the definition of the "lowest commercial price" as outlined in S.2196. In defining "general public", the bill excludes certain customers and the basis for some of the exclusions is not clear.

We believe that the government should be able to buy spare or repair parts at the lowest price at which a contractor sells them. The contractor should submit a certification that this is in fact the case, or a statement specifying the difference between its lowest price and the price offered and provide a justification for the difference. S.2196 allows five exceptions to the definition of "lowest commercial price" which in turn defines the universe of "general public." We believe that four of the five exceptions could be considered commercial customers. The one exception which appears clearly appropriate

is, in our opinion, sales to the contractor's subsidiaries, affiliates, parent business organizations, or other branches of the same business entity since these transactions are not necessarily market based prices. However, with respect to sales to foreign governments and educational institutions, it would seem appropriate for the contracting officer to obtain full disclosure as to whether or not the government is receiving the lowest price available to all customers who are buying these items. We therefore suggest that consideration be given to eliminating all the exclusions except for intra and inter company transactions.

With respect to "Regulations for Allocating Overhead to Parts to Which the Contractor Has Added Little Value", our concern centers on the exception that the regulations shall not apply to manufacturers or regular dealers as those terms are used within the meaning of the Walsh-Healey Act. The impact that this exception has on the universe of the contractors who will be covered by this section is not clear.

Lastly, we are also concerned with the effect that this exception would have on the requirement that a contractor identify supplies which it did not manufacture or to which it did not contribute significant value. In the past, we have issued reports and testified on the importance of breaking out

the procurement of spare and repair parts from the prime contractor who acts as a middleman, versus the procurement of these items from the actual manufacturer. We have also reported on the significant savings that can be achieved through such efforts. If this exception reduces the number of contractors that are required to report whether or not they are the actual manufacturer and thereby makes the practice of breakout more difficult, the current DOD initiatives to increase breakout actions could be hindered.

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This concludes my prepared testimony. I would be happy to answer any questions you may have. Thank you.