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Comments on DOD's Implementation of Recent Procurement Reforms

Statement of
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Subcommittee on Defense Industry and Technology
Committee on Armed Services
United States Senate

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Mr. Chairman and Members of the Subcommittee:

It is a pleasure to be here today to discuss recent changes in DOD procurement policy initiated by the Congress and the Department of Defense.

Principal among the DOD initiatives are the Defense Acquisition Improvement Program, also known as the "Carlucci Initiatives", and the separately administered Spare Parts Pricing Initiatives. Subsequently, the Packard Commission recommended further organizational reforms and procurement policy changes.

Legislation, attempting to deal with procurement problems, enacted since 1984 include:

-- the Competition in Contracting Act of 1984,
-- the Defense Procurement Reform Act of 1984,
-- the Defense Procurement Improvement Act of 1985,
-- the Defense Acquisition Improvement Act of 1986, and
-- the Department of Defense Reorganization Act of 1986.

All of these actions result from a continuing concern that DOD could and should do a better job in managing itself. As should be expected with so much happening in such a relatively short period of time, there is probably some convergence of individual initiatives.

We have not made a comprehensive evaluation of how all the initiatives have been implemented, but over the past few years we have reviewed many of them. The one exception relates to DOD reorganization--an evaluation of which we have deferred to give DOD time to implement the changes.

OBSERVATIONS ON IMPLEMENTATION OF THE INITIATIVES

In general, DOD has done a good job implementing the initiatives even though there is still room for improvement. For the next few minutes, I would like to discuss our observations in five specific areas: competition in contracting, work force, testing, warranties and pricing policy.

COMPETITION IN CONTRACTING

As you know, the Competition in Contracting Act of 1984 (CICA) substantially revised the fundamental legislative structure for defense procurement that had been in place for almost forty years. Among other things, it requires full and open competition, which allows all sources capable of meeting the government's needs to compete, except in seven specified circumstances. Shortly after enactment, GAO began to monitor the extensive regulatory changes that were being developed to effect implementation of this law.[1]

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[1]FEDERAL REGULATIONS NEED TO BE REVISED TO FULLY REALIZE THE PURPOSES OF THE COMPETITION IN CONTRACTING ACT OF 1984 (GAO/OGC-14) AUGUST 21, 1985.

We reported that some Federal Acquisition Regulation (FAR) provisions needed to be revised to be consistent with the act or with congressional intent as expressed in the conference committee's report. Many of our recommended changes were subsequently adopted and took effect in 1986. However, corrective action has not been taken on some of our recommendations. As a result FAR is at variance with the intent of Congress in several respects. For example, FAR permits written justifications under six (of the seven) exceptions to the requirement for full and open competition to be made for a class of contract awards, rather than on a case-by-case basis, contrary to the conference report. Overall, however, the many FAR revisions adopted generally reflect the statute.

We are currently evaluating compliance with CICA at seven procurement activities.

We are reviewing two random samples of contracts to determine whether (1) written justifications for agency officials' decisions not to provide for full and open competition met requirements, including whether these decisions were appropriate, (2) full and open competition was used, as was reported in cases where only one offer was submitted to the government. In both contract samples we are also determining whether requirements for public notices of proposed awards were met.

IMPROVING THE PROCUREMENT WORK FORCE

We cannot overemphasize the need to attract and retain quality personnel if we are to have a sound procurement system. As a step in this direction, the Defense Procurement Reform Act of 1984 requires that military officers assigned as managers of major acquisition programs serve a minimum 4-year tour of duty in that capacity. In addition, the Defense Procurement Improvement Act of 1985 requires that those managers possess at least 8 years of experience in acquisition management before they are appointed and that at least 2 of those years be while assigned to a procurement command. The Defense Acquisition Improvement Act of 1986 directs that DOD develop plans to enhance the professionalism of, and career opportunities available to, acquisition personnel in the Department as well as a plan for coordination of defense acquisition educational programs.

Last year we concluded a comprehensive evaluation of procurement workforce issues. We found that the capabilities of program managers and contracting officers are not what they should be. More specifically, the roles of those officials are not fully defined nor well understood; acquisition strategy development lacks criteria to tailor the extent of competition to individual programs; external factors affecting many programs create a poor climate for logical, planned program development; and career programs do not provide the broad experience, training,

qualification criteria, nor needed incentives to assure sufficient competence.

Subsequent to the issuance of our report we noted a number of responsive actions on the part of DOD. To comply with the Acts DOD now requires program managers to have at least 8 years of experience and be in a program manager position at least 4 years. In addition, DOD directives were revised to require that military and civilian deputy program managers of major acquisition programs have at least 3 years of relevant experience with one year at a procurement command. In addition these individuals should have degrees in technical, scientific managerial fields. DOD now also mandates training, education, and experience levels for contracting, quality assurance, property administration, procurement and industrial specialists, as well as business and financial management personnel assigned to the program offices. Such steps begin to address the problems we observed.

OPERATIONAL TEST AND EVALUATION

In September, 1984, Congress established in DOD the Director of Operational Test and Evaluation to ensure that Operational Test and Evaluation (OT&E) would receive appropriate emphasis and independent oversight in the acquisition of new weapon systems. The director, a civilian, is the principal advisor to the Secretary of Defense for OT&E matters, and he reports to the Congress on the

adequacy of operational testing and the question of whether a particular system will be operationally effective and suitable for combat.

Adequate testing and evaluation of weapon systems has long been a major concern of GAO and the Congress. We recently issued a report identifying the director's contributions to DOD OT&E activities and areas where he needs to place further emphasis to function as a fully reliable, independent oversight official.[2] Our report shows that he made particulary noteworthy contributions in the test planning area. His office has been responsible for improving test and evaluation master plans and has participated in revising the primary DOD directive on test and evaluation, including supplemental test planning guidelines. However, there were several areas where oversight effectiveness could be improved. More specifically, the director's office should be making more on-site observations of operational tests, using test results as the basis for analysis rather than test reports prepared by the military services, providing uniform policy and procedural guidance and maintaining more reliable records of its principal activities. The director's office acknowledged these shortfalls and attributed them to staff limitations.

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[2]OPERATIONAL TEST AND EVALUATION OVERSIGHT: IMPROVING BUT MORE IS NEEDED (GAO/NSIAD-87-108BR, MARCH 18, 1987).

While progress has been made more must be done. In another recent report,[3] we identify the following as the areas of principal concern:

(a) OT&E plans, objectives or criteria, are often inadequate,

(b) test resources are limited and, at times, simply not available,

(c) testing is often not realistic,

(d) decisions to produce new systems are often premature, and

(e) OT&E results as reported are sometimes inadequate.

WARRANTIES

Another quality issue is being addressed by the warranty legislation. Because weapon systems often fail to meet their military missions, are operationally unreliable, have defective and shoddy workmanship, and can imperil the lives of U.S. troops, Congress passed legislation requiring that DOD obtain warranties in its weapon system production contracts. The belief was that warranties would make contractors more accountable and encourage them to build more quality and reliability into their systems.

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[3]OPERATIONAL TEST AND EVALUATION CAN CONTRIBUTE MORE TO DECISIONMAKING (GAO/NSIAD-87-57, DECEMBER 23, 1986).

Warranties are not required on items that are not weapon systems, such as spare parts, and items not used to carry out combat missions.

We found that DOD has generally complied with the warranty legislation but some implementation problems exist. For example,

-- The services obtained many warranties without performing appropriate cost-effectiveness analyses.
-- Most warranties did not identify the performance requirements which would be assessed during the warranty period or identify how and when performance would be assessed.
-- Many warranties did not explicitly state whether the contractor was responsible for redesign if performance requirements were not met.

We believe that DOD is taking the necessary steps to rectify these concerns.

PRICING POLICIES

The last area I would like to address is pricing policy. Much if not all of the recent emphasis on pricing emanated from the spare parts horror stories. There are many subjects which comprise this area, such as, spare parts pricing, contract pricing including

defective pricing, cost principles, unpriced contracts and profit policy. I will limit my discussion to spare parts pricing, contract pricing and cost principles.

Extensive amounts of legislation along with management attention at all levels within DOD have been aimed at addressing concerns over spare parts pricing. Before initiation of corrective actions by DOD in 1983, in its efforts to meet productivity goals and to minimize the amount of resources expended in analyzing low dollar value contracts, our work showed that DOD was performing inadequate price analysis on procurement with severe price growth. We estimate that DOD did not obtain adequate justification for the significant increases on 44.5 percent of the contracts with price increases of 25 percent or more. The Defense Procurement Reform Act of 1984 set forth specific actions that are to be taken by DOD to improve the pricing of spare parts.

Within DOD, the Army, Navy, Air Force, and Defense Logistics Agency now have comprehensive programs consisting of a large number of initiatives. Although early in the implementation phase, we evaluated the impact that these initiatives were having on the growth of spare parts prices and the adequacy of price analysis, and found that conditions have improved. For example, in our earlier report, we found that 15.6 percent of procurements at one Air Force buying activity experienced price growth of 25 percent or more. In our most recent effort, it was 6.5 percent. In addition, in our previous work, this Air Force activity did not obtain

adequate justification for significant price growth in about 44 percent of the cases, while subsequent to the initiatives, this figure was reduced to 35 percent. While this effort provides reasons for optimism, ample opportunity exists for further improvement.

Three years ago, GAO initiated an extensive effort to look at systemic contract pricing issues as well as specific defective pricing cases. The top five issues which we identified and are pursuing are:

-- subcontractor pricing,

-- cost estimating,

-- unpriced contracts,

-- technical evaluations, and

-- overhead-forward pricing rate agreements.

We have performed work on the first three issues and are now initiating work on technical evaluations and forward pricing rate agreements. Our work to date has disclosed a number of problems and raised concerns about whether DOD contracting officers are negotiating fair and reasonable contract prices. For example:

-- Our review of a sample of major subcontracts disclosed that safeguards intended to insure fair and reasonable prices were not effectively implemented. Prime contractors were able to achieve subcontract prices reductions of $42 million below the amounts negotiated with the government in the contracts we reviewed. We believe the price reductions

occurred in large part because DOD contracting officers did not require contractors to either obtain subcontract cost or pricing data, to evaluate the data, or to provide the results of their evaluations before prime contract negotiations. Instead, DOD contracting officers used alternative pricing techniques that were not as effective as subcontract evaluations to establish the reasonableness of subcontract estimates included in prime contract prices.

-- Our work on subcontract pricing also disclosed several defective pricing cases. We have in-process or issued 13 reports with potential recovery value for the government of $28 million. This work demonstrates the difficulty in enforcing the Truth In Negotiations Act. We found many cases where contractors had more accurate, complete, and current data which indicated lower prices than those proposed to the government.

-- We found that the DOD program for surveillance of contractors' cost estimating systems has not been effective. The program suffers from a lack of (1) criteria for judging an acceptable estimating system, (2) clear direction and responsibility for resolving deficiencies, and (3) management emphasis at all levels, including the Defense Contract Audit Agency (DCAA), which is responsible for the program. Nine of the 10 contractors we visited had unresolved estimating deficiencies. The DCAA also identified 72 contractors where significant estimating

deficiencies were unresolved at the end of 1984. Deficiencies at 21 of the 72 contractors had been outstanding for over 2 years.

The message is clear. DOD had become too complacent and changes were necessary.

Concerning unpriced orders, we found that the process in place were not being adhered to and that, in many instances, contracts remained unpriced well beyond the required 180 days. As of September 30, 1985, DOD's use of unpriced contracts was at its highest value ever -- about $28 billion.

The Congress and DOD have taken actions to control the use of unpriced contracts. The Defense Acquisition Improvement Act of 1986 placed a number of restrictions on unpriced contracts including approvals by the agency head, limits on the amount of obligations, and restrictions on their use and the amount of profit contractors can earn on them. In turn, DOD has taken several actions and as a result, as of September 30, 1986, DOD's unpriced contracts totaled $16.4 billion -- an $11.5 billion reduction from the end of previous year. Even though we see the number and value of unpriced contracts decreasing more progress can be made. At this time, we do not see any need for additional legislation or regulations, rather we see a need to enforce and abide by the processes in place.

You may recall the Defense Procurement Improvement Act of 1985 directed DOD to amend its regulations covering the types of costs incurred by contractors that are allowable or reimbursable under defense contracts. These regulations are commonly known as cost principles. The law calls for 10 specific types of costs to be considered unallowable, and DOD was to define in detail and specific terms which of 16 other types were unallowable. The law also required DOD to amend the regulations governing resolution of questioned costs. By the deadline established in the law, DOD had made most of the prescribed changes.

The changes affected 13 of DOD's 51 cost principles, such as cost of alcoholic beverages, contributions and donations, and advertising and public relations. Some changes were notable because the cost principles were either rewritten or a new concept for determining allowability was added. For example the advertising principle was expanded to include public relations costs. This principle contains (1) definitions for the two terms, (2) identification of the specific types of advertising and public relations costs which are allowable, (3) a declaration that all other advertising costs are unallowable, and (4) a list of numerous public relations costs that are unallowable. In addition DOD added a new and important concept to this principle: a declaration that costs which are unallowable under this principle cannot be allowable under any other principle and vice versa.

The full effect of the regulatory changes will not be known for several years because they apply only to contracts resulting from solicitations which were issued after April 6, 1986.

We believe that the cost principles cannot be written in such a way as to remove all ambiguity. However, we also think that the contractor, contracting officer and contract auditor would benefit if certain additional changes were to be made in two cost principles. We have recommended to the Secretary of Defense that the reference in the entertainment principle to other cost principles be removed and that a statement be inserted to the effect that costs specifically unallowable under this principle shall not be allowable under other principles. We also recommended that the executive lobbying principle be structured in a manner similar to the legislative lobbying principle.

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In closing, I would like to address the challenge presented to all of us by reform. In looking into implementation of reform packages,[4] we have found that it is important to the success of such improvement efforts to address (1) the need for a strong continuing top level commitment to reform and (2) the difficulty translating top level commitment into action and results at the

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[4]DOD'S DEFENSE ACQUISITION IMPROVEMENT PROGRAM: A STATUS REPORT (GAO/NSIAD-86-148, JULY 23, 1986).

program level. I think that these are two critical factors we want to keep in mind as we continue to evaluate DOD's implementation of the reforms that have been legislated in the last few years.

That, Mr. Chairman, this completes my prepared remarks. I would be happy to address your questions at this time.