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Defense Management and Procurement Issues

Statement of
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the United States

Before the
Committee on Armed Services
United States Senate



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Mr. Chairman and Members of the Committee:

I appreciate the opportunity to be here today as you consider what action is necessary to deal with the events related to the investigations at the Department of Defense. First, I think it might be useful to step back and look at the environment in which Defense procurement takes place. Then I would like to discuss several areas where improvements could be made.

I have always supported a strong national defense, but for several years I have been expressing concerns about the potential consequences of an uncontrolled rapid defense build up. As we look at the history of Defense procurement since the 1940s, we see the same recurring problems accompanying rapid Defense expansions. We had procurement scandals during World War II, the Korean War, and in the past few years--all during periods of rapid growth in defense spending. The fact that we are having procurement problems today does not necessarily mean that we have not made progress, rather it is testimony to the fact that government oversight and management attention on a continuing basis is essential.

In addition to these scandals, I think the other shoe will probably fall soon, namely, many big cost overruns. I suspect the Stealth airplane program, the Navy shipbuilding program, and the other programs which have to be stretched because of budget constraints will all result in very large cost increases that the Congress and the taxpayer will have to finance.

Before dealing with internal controls, disclosure and those matters that more directly relate to defense fraud, I would like

to briefly discuss a number of troublesome areas that affect the procurement process.

THE PROCUREMENT ENVIRONMENT

Since the mid-sixties, the DOD budget has never had an extended period of stability. Rather we see periods of rapid growth followed by periods of austerity followed by rapid growth again. This cycle inhibits managers within the Department from making sound management decisions. It encourages managers to procure as much as possible when funding is relatively plentiful and not attempt to develop a stable and realistic procurement plan. I think that this is a major problem. History shows that when too much money is being pumped into the acquisition system over a relatively short period of time, we will have problems.

Over the next few years, we will be facing some very difficult decisions involving Defense spending. The Secretary, to his credit has expressed a willingness, as we enter a period of restrained Defense spending to address these issues. However, we believe that the services still have too many systems chasing too few dollars. Additional programs will have to be cut. In such an environment we cannot afford either sloppy or corrupt practices.

More specifically, we cannot afford to invest large sums of money in such programs as AQUILA and DIVAD only to have them terminated. While we applaud the decisions to terminate these programs, they should not have progressed as far as they did in the acquisition process before being terminated. In addition, we cannot afford to allow inventories to exceed requirements by \$20 billion as happened in depot level stocks between 1980 and 1987. Nor can we afford to allow repair parts inventories to become so big that they cannot be managed effectively as happened in Europe. Finally, we cannot afford to pay exorbitant prices for

spare parts and equipment because the management focus is on the number of actions processed rather than the reasonableness of the prices paid. Again from my perspective, these are examples of what happens when too much funding is pumped into the system too quickly.

Another thing is clearly evident, we need to be realistic in projecting the quality, cost and schedule of our systems in relation to the state of the technology involved. We still are unable to get contractors to build things right the first time as is clearly obvious in the case of the B-1B program. It is clear to me that some of what went wrong on the B-1B included concurrency, inadequate testing, a push to deliver on time and at cost-no matter what, while stretching the state of technology. Until we do this better, we will continue to buy into programs which will not achieve their advertised performance capabilities and will continue to exacerbate the affordability issues.

Testing of our weapon systems ties directly with my concerns on quality. Our work has shown that during the later years of program development, weapons historically experience the significant cost growth and schedule slippages as technical and other problems surface. DOD's policy emphasizes the need for early testing to identify and reduce the acquisition risk of costly redesign and modification after deployment. We must perform these tests in a mode which ensures independence and a clear separation of involvement from contractors who have played key roles in a system's development.

As I reflect on my experience in the public and private sectors, I become more and more convinced of the need to have first rate people in key positions. The Defense acquisition process is extremely complex and requires skills and knowledge that can only be developed over an extended period of time. Yet frequently, key acquisition positions are filled with people who are often

unprepared for their assignments. While I believe that this is true at all levels, it is especially true at the program office level.

We have made some progress in this area. For example, the services, in response to Congressional directives, changed the requirements for program managers and made the requirements more stringent. This is a start, but more is needed. We need to raise the status of those individuals in procurement. As I see it, we need to increase the professionalism of the procurement work force and, in so doing, impart greater prestige to the individuals and compensate them accordingly.

CONTROLS AND BETTER DISCLOSURE NEEDED FOR THE PROCUREMENT PROCESS

It is essential that we have full disclosure by DOD and industry regarding the procurement of goods and services. In past years we created entities such as the Cost Accounting Standards Board to help achieve this, but the goals were never fully achieved. This occurred, in part, because DOD and industry failed to provide sufficient support. It distresses me to see continued resistance to such a concept.

Over the past several years there has been a continuing concern involving the reporting of contractor profit data, weapon system cost data as well as DOD and industry compliance with laws such as Federal Managers' Financial Integrity Act (FIA) and the Truth in Negotiations Act. The Congress and GAO have recognized the importance of internal management control systems and have encouraged improvements. Unfortunately, both industry and DOD have resisted many of the proposed improvements. For example, in September, 1986 we issued a report which proposed a program to study the profitability of government contractors. Our proposal

was designed to build upon and improve the methodology DOD used to perform its previous profit studies. Even though several pieces of legislation have been proposed to initiate such a program, segments of which are in the current Defense Authorization bill, DOD and industry opposition is so great that its enactment in a useful form is questionable.

While the effectiveness of the government's profit policy is important, most of GAO's audit efforts over the past several years have focused on costs. In the 1960s Congress passed two laws intended to ensure better information on contractor costs-- Public Law 87-653 which is the Truth in Negotiations Act and Public Law 91-379 which created the Cost Accounting Standards Board.

The Truth in Negotiations Act requires contractors to certify that their cost or pricing data used in negotiations is current, accurate, and complete. Our work has consistently shown that contractor compliance with the Act falls short of full disclosure. Since 1986 we have issued 19 reports which reported on contractors' failures to fully disclose current, accurate and complete data. Further, we have found problems in the systems contractors have used to develop their cost estimates. For example, some contractors did not have written estimating procedures for developing estimates and some had not adequately documented the methods and supporting data which were used to develop the estimates. In the absence of good estimating systems, contracts can be significantly overpriced.

I continue to believe that the cost accounting standards can be a significant aid in establishing the integrity and the credibility of cost data used by DOD and industry. Since the demise of the Cost Accounting Standards Board, there has been no governmental group to amend standards when desirable, or to provide interpretations, waivers, or exemptions to the standards. The capability to perform these functions needs to be established.

Independence was one of the features sought in establishing the original Board and this should continue to be a primary feature for any group selected to assume these functions.

Even though the government has mandated effective internal management controls for over 30 years, the increasing need for information about expanding government activities necessitated that greater attention be directed at the effectiveness of internal controls. As a result, the Congress passed the Federal Managers' Financial Integrity Act which requires government agencies to continuously evaluate their internal controls. The legislation contains a key feature to implement the internal control evaluation process. The head of each agency must submit an annual report to the President and the Congress that describes the internal control weaknesses, and provides a schedule and plan for correcting the weaknesses.

Over the last several years the Internal Management Control Program which was implemented to comply with the Financial Integrity Act has resulted in the identification and correction of a number of significant problems. However, we are concerned that the Department is often too reactive rather than proactive in implementing this program. Too often, it seems, DOD reports weaknesses only after they have been disclosed by others. For example, in one case having a direct bearing on what we are discussing today, the Commander of the Naval Security and Investigative Command, in October 1987, reported instances of procurement fraud, such as conflict of interest and bribery, and that several of the Command's ongoing and recently closed investigations involved high ranking Naval officers and high level Navy Department civilians. The Commander also said that such problems did not indicate that the internal control systems were flawed but that emphasis must continue to be given to compliance with existing systems and assigning personnel responsibility for proper operation of those systems.

Reports, such as the Commander's are provided from all levels within DOD and the weaknesses deemed material are reported annually up to the Secretary of Defense and then to the Congress and to the President. However, in the above case, we were told that in the review process it was decided that this was not a material or systemic weakness so it was not included in the Secretary of the Navy's report to the Secretary of Defense.

I think this is somewhat analogous to the reporting on weaknesses in DOD supply operations. Supply operations weaknesses have been around for years and reported at various levels within DOD. However, it was not reported by DOD as a material weakness until after your Committee's Task Force on Military Inventory Management was formed to review the problems we were finding and reporting. I am afraid that reporting on and dealing with procurement fraud will follow this same reactive scenario.

In testifying before the Packard Commission, I stated that the first line of defense in controlling fraud, waste and abuse is an adequate control system that is fully supported at all levels of a company. An adequate control system permits a company to institute preventive steps as opposed to reacting after the fact. Many Defense contractors are subject to the provisions of the Securities and Exchange Act's recordkeeping and internal accounting control requirements. The control provisions of the Act require that the company devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that certain specified objectives are attained. However, the Act's control and reporting provisions do not specifically cover cost, price, estimates, billing, and performance measurement controls nor do they report on such controls. Recent SEC initiatives, however, begin to address some of these provisions.

A recent initiative flowing out of the Packard Commission and being advanced by DOD is Contractor Self Governance. This concept deals with the responsibility and accountability of top management to assure that defense work is performed in compliance with procurement laws and regulations and is subject to high ethical standards. While I agree that the concept must be developed, I am also discouraged-as was the DOD IG who testified before the House Armed Services Committee last week-that only 46 contractors are signatories to this initiative. I believe that it is time to seriously consider legislation which would require an annual management report on the controls and an independent public accountant's opinion on management's representation.

I think that it is important to note that over the past six months support for less oversight over the defense industry was building. And some of the initiatives I have discussed begin to open a door for greater reliance on the integrity of defense contractors. James Forrestal, the first Secretary of Defense, saw opportunities for maintaining an effective working relationship between industry and government. Yet, as we face the problems of today, I cannot think of a more appropriate time to reexamine this relationship and make it work better. In that regard, we must keep vigilant oversight to assure that industry institutes needed internal control measures.

No matter how many and what type of controls are in place, you are still going to have compliance problems and these have to be dealt with to the full extent of the law. The Attorney General has given a number of crime areas high enforcement and prosecution priority. These include organized crime as well as white collar crime. The investigation of defense procurement fraud is a top priority in the white collar crime area. Despite this, the Justice Department's overall management of its defense procurement fraud investigations could be improved. The Attorney General does not have complete or timely information on a

significant number of defense procurement fraud referrals and does not know the amount of attorney resources spent in the effort.

Neither the Criminal Division nor the U. S. Attorney's offices have developed written plans that identify their defense procurement fraud efforts and allow comparison of planned with actual accomplishments. Officials from both units say that they need additional resources (both attorneys and support staff) to handle defense procurement fraud cases, many of which are highly complex and time consuming. Justice does not have a system to help distinguish the different prosecutive efforts required for different types of cases. Better information could help the Department assess the extent to which this high priority program is using resources effectively and efficiently.

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Mr. Chairman, there will be a tendency by everyone to seek fast remedies for the underlying causes of the recently reported abuses. While the criminal aspects of this investigation are decided within the judicial system, we should focus our attention on the needed controls and reporting. While some steps can be taken along the lines we have just discussed, we must make certain that any initiatives by the Executive and/or the Congress are, in fact, the correct solutions to the problems.

There are two specific areas that we are presently examining. We are reviewing the organizational restructuring of the procurement process in DOD and the services that has taken place in the 1980s. We will focus on whether those changes resulted in a weakening of the internal controls which are needed to curb the types of abuses being reported. In addition, a careful review is needed of what actions are necessary in the consultant area. We will continue our work in this area with a detailed examination

of the role of consultants in the procurement process. This work will take into account the revolving door issue and how the spirit of the recent laws was avoided.

We will also continue to work with this committee and other committees in whatever further study is required into any of the issues I have discussed today.

That, Mr. Chairman, completes my prepared remarks. I would be happy to address any questions the Committee may have at this time.