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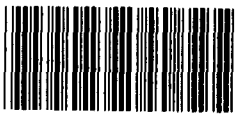

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GAO Comments on the Defense Management Improvement Act

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

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to comment on the Department of Defense's (DOD's) legislative proposal entitled the "Defense Management Improvement Act." The proposal is the product of the legislative task force established by the Secretary of Defense in conjunction with the Defense Management Report. It is intended to bring about improvements in defense management, particularly in defense acquisition management.

My statement today focuses primarily on Title II of the act which contains a number of provisions designed to improve defense acquisition. I will also discuss the elements we believe are essential for an effective acquisition process.

IMPROVEMENTS ARE NEEDED IN DEFENSE ACQUISITION

Problems with defense acquisition have been known for a long time. Over the past 20 years, numerous studies have identified problems in the way DOD acquires its weapon systems and other goods and services. Unfortunately, the problems that have plagued defense acquisition over that period--cost growth, schedule delays, and performance shortfalls--still exist today. Delivering capable and supportable weapons to the user when and where they are needed and at reasonable cost has been the exception in defense acquisition rather than the rule.

The unprecedented peacetime buildup of defense during the past decade, coupled with disclosures of procurement scandals and revelations of other fraud, waste, and abuse has magnified the problems with the acquisition system. Unfortunately, we have reached a point where the public and the Congress seriously question DOD's ability to manage its acquisition programs effectively.

Everyone--DOD, Congress, and industry--agrees that improvements are needed. The next decade will present serious challenges for DOD acquisitions. In light of federal budget deficit pressures, the rapidly changing threat environment, and the taxpayers loss of confidence in the defense acquisition process, it is imperative that real and effective improvement be achieved.

The recent Defense Management Report is the latest attempt to resolve defense acquisition problems. The initiatives DOD proposes in its Defense Management Report are commendable in that they offer opportunities to achieve significant savings. In fact, we have recommended cost saving measures in many of the same areas addressed in the Defense Management Report--including consolidating depots and maintenance facilities, centralizing payroll functions, reducing supply system costs, establishing realistic spares requirements, streamlining the acquisition process, and improving the professionalism of the acquisition workforce. Achieving savings in these areas will require a sustained effort on the part of DOD management over several years.

Before commenting on the specific proposals included in Title II, I would like to discuss the elements we believe are essential to bring about meaningful improvements.

ELEMENTS OF AN EFFECTIVE ACQUISITION PROCESS

Today, we are releasing a report[1] which discusses seven key elements we believe are necessary for an effective acquisition process. The report was prepared at the request of Senator Nunn.

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[1]Defense Acquisition: Perspectives on Key Elements for Effective Management (GAO/NSIAD-90-90, May 14, 1990).

If improvements are going to be made in defense acquisition, we believe there must be

-- strong, sustained leadership by the Secretary of Defense,

-- a highly qualified, technically competent acquisition workforce operating together as a team,

-- a mirrored organization structure between the Office of the Secretary of Defense and the military services,

-- a free flow of current and objective information both up and down the organization,

-- compliance with an effective internal control system,

-- a requirements determinations process that considers fiscal constraints right from the start, and

-- a strong link between DOD's weapon system decision process and its resource allocation process.

We are encouraged by the parallels between the areas addressed in the Defense Management Report and those GAO believes are necessary to resolve long-standing acquisition problems. However, highly publicized initiatives have come and gone without effectively addressing the tough management issues surrounding defense acquisition.

GAO CONCERNS ABOUT LEGISLATIVE PROPOSALS

Let me now turn to Title II of the Defense Management Improvement Act. Title II contains a number of proposals which, among other things, are intended to streamline and simplify the acquisition

process, eliminate unnecessary rules and regulations, reduce the number of government auditors and inspectors in contractor plants, and reduce costs.

We support these goals but are concerned about whether the specific DOD proposals will achieve the goals. We are particularly concerned about DOD's proposals for a pilot program involving six major weapon programs and the use of commercial style procurement practices because the proposals

-- do not specifically identify which laws and regulations will be relaxed, and

-- do not seem to recognize the unique nature of defense acquisition and the corresponding need for strong controls to protect the taxpayers' interests.

We are also concerned because DOD has not demonstrated that existing programs and initiatives in these as well as other areas will not achieve the desired results. Let me briefly discuss some of our concerns about the DOD proposals.

Pilot program for six major weapon systems

According to DOD officials, the pilot program will allow DOD "to create a regulatory environment similar to that facing most businesses in the private sector." DOD's proposal would also significantly reduce government audit and inspection personnel and place more emphasis on having contractors "self-administer" themselves.

DOD, however, has not identified which laws and regulations will be relaxed. The DOD acquisition environment is unlike that facing most businesses in the private sector. In the defense industry, segments of many major contractors depend heavily on a single customer--DOD--for business. There are also only a few suppliers

in the defense industry capable of producing limited quantities of highly complex and specialized, one-of-a-kind products. In the private sector, prices are dictated by the marketplace; while the prices of defense items are determined through extensive negotiations which focus on what defense items should cost. In addition, government procurement is designed to be fair to all potential sellers and often has concomitant social and economic goals.

Because of the absence of the private sector marketplace forces, numerous laws and regulations have evolved over the years to protect the taxpayers' interest and to protect against fraud, waste, and abuse. While there has been a significant number of laws passed in recent years, the Congress enacted each to deal with a specific problem.

The unusual nature of defense acquisition demands an effective system of checks and balances to ensure the appropriate expenditure of the public's funds. Experience in recent years provides little comfort that existing laws and regulations should be relaxed. Spare parts horror stories and the ILL WIND procurement scandal are well known. However, there are other equally serious problems with defense acquisition. For example, the Defense Contract Audit Agency finds that the prices in nearly one of every two negotiated contracts it reviews are inflated because contractors do not comply with the Truth in Negotiations Act. Today, there is approximately $2 billion in outstanding recommendations to reduce inflated contract prices. The DOD Inspector General testified in March of this year that the efforts of the Defense Criminal Investigative Service--an organization which concentrates primarily on procurement fraud--resulted in more than 600 indictments, 500 convictions, and $500 million in monetary recoveries in the past two years.

These facts are not encouraging. Trust and confidence in defense acquisition must be restored. However, we do not believe it can be restored through the overnight relaxation of laws and regulations and significant reductions in oversight and audit resources. DOD's Contractor Risk Assessment Guide program is, we believe, a better approach to restoring trust and confidence and reducing government oversight. The program, established in 1988, is designed to encourage contractors to develop more effective internal control systems and reduce DOD oversight in areas where contractors demonstrate adequate internal control systems.

GAO has long supported the need for effective internal control systems. Accountability for compliance with applicable procurement statutes and regulations must start with industry. 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. We believe broader industry participation in the Contractor Risk Assessment Guide program and other self governance programs would go a long way toward restoring trust and confidence in defense acquisition and result in reduced oversight and audit over time.

Continued reports of weapon systems which exceed cost estimates, are delivered late, and do not perform as intended also do not support DOD's request to relax existing laws, regulations, and oversight. DOD's track record for meeting cost, schedule, and performance goals is no better for systems where oversight and other requirements have been reduced substantially than for those systems where oversight was not reduced. For example, the B-1B bomber program embodied a virtually unprecedented partnership between the Congress and the Air Force. The Congress provided early and consistent support for the program. In return for this "hands-off" policy that avoided congressional "micro-management," DOD and the Air Force promised an effective manned penetrating

bomber that would be fielded in record time and at targeted cost. As we all know, that did not happen.

The same is true of DOD "black" programs--those programs requiring special access security clearances. We can not provide any details in this forum; however, our work has shown that while some such programs have been subjected to less scrutiny and oversight, they nonetheless encountered many of the same (and sometimes worse) cost, schedule, and performance problems found in other defense acquisitions.

There are several initiatives underway in DOD to improve the acquisition process--including efforts to streamline the acquisition structure, increase program managers' accountability and responsibility, and improve the acquisition workforce. In addition, the National Defense Authorization Act for Fiscal Year 1987 authorized the Defense Enterprise Program. Among other things, the legislation specified that weapon systems programs designated as Defense Enterprise Programs would have a streamlined reporting chain; the program manager would have greater control over his own staff; funding would be provided for the entire period between two acquisition milestones; and the Secretary of Defense could waive any acquisition regulations not required by statute. In passing the legislation, Congress expected the Defense Enterprise Programs to serve as models from which demonstrated management improvements could be applied to all DOD acquisition programs. That expectation, however, has not been realized.

The Defense Management Report acknowledges that DOD "should take better advantage of this special authority than it has to date." Also, in its report on the National Defense Authorization Act for Fiscal Years 1990 and 1991, the Senate Committee on Armed Services report described DOD's implementation of Defense Enterprise Programs as "disappointing."

We believe that Defense Enterprise Programs and the other Defense Management Report initiatives offer DOD an opportunity to address many well-recognized defense acquisition problems. Successful resolution of those problems requires stronger DOD management emphasis and more effective implementation of existing statutory authority, not authority for another pilot program.

Commercial style acquisition practices

DOD proposes to improve defense acquisition by placing greater reliance on commercial products and employing "streamlined commercial style procurement procedures." We agree that DOD should buy commercial products where feasible.

The fiscal year 1987 and 1990 DOD Authorization Acts contain a number of provisions which encourage DOD to make greater use of commercial products. However, in 1989, we reported[2] that DOD has not placed the management emphasis needed to ensure that full advantage is taken of opportunities available within the context of existing laws to procure commercially available products. We recommended that DOD expedite guidance, provide training, and collect data on the extent to which it buys commercial items.

While we support the increased use of commercial products, we are concerned about DOD's proposal. DOD contends that existing laws and regulations make it difficult to acquire commercial items in the same way as a commercial buyer. We would not be opposed to removing impediments that may be preventing DOD from buying more commercial products. However, as in the case of the pilot program, DOD does not identify the specific laws that impede its ability to do so. DOD needs to demonstrate what is wrong with the existing laws before the Congress can decide what legislative changes are needed.

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[2]Procurement: DOD Efforts Relating to Nondevelopmental Items (GAO/NSIAD-89-51, February 7, 1989).

One aspect of DOD's proposal is clear. Under it, a bid protest to DOD would be the sole administrative remedy available to contest the Department's contract award decisions.

GAO has been involved in bid protests for many years. Just 6 years ago, the Congress saw the need to strengthen the protest process by legislating our role and creating a new protest venue at the General Services Board of Contract Appeals.

The Congress was concerned that an effective, independent forum be available for those parties who believed they have been treated unfairly in the course of a procurement. DOD's proposal appears to move the process in the opposite direction. If DOD believes that aspects of the existing bid protest process impedes the efficient procurement of commercial products, we should explore ways to improve that process.

Award without discussions

Section 204 of the act would authorize DOD to evaluate competitive proposals and award a contract without discussions to the offeror whose proposal represents the greatest benefit to the Government based upon the evaluation factors set out in the solicitation. According to DOD officials, this proposal would allow DOD to look at a contractor's quality and past performance, not just its price.

I would like to make two points about DOD's proposal. First, there is nothing in law or regulation that precludes DOD from placing more emphasis on quality and performance and less on price. In fact, the Federal Acquisition Regulation clearly recognizes that the "best value" may not be the lowest price. It states:

> "While the lowest price or lowest total cost to the Government is properly the deciding factor in many source selections, in certain acquisitions the Government may

select the source whose proposal offers the greatest value [underscoring added] to the Government in terms of performance and other factors. . ."

Second, under current law, an award without discussions is permitted only when it can be demonstrated clearly that acceptance of an initial proposal would result in the lowest overall cost to the government. The lowest overall cost requirement for awarding a contract without discussions was introduced by the Competition in Contracting Act of 1984. Prior to the Act, such an award need only have been at a fair and reasonable price. Our post-Competition in Contracting Act protest decisions have applied the standard enacted by the Congress and have held that discussions must be conducted in negotiated procurements unless award is made at the lowest overall cost, considering only cost and cost-related factors.

We would not be opposed to a change in the current lowest overall cost standard if there is evidence to indicate that the requirement is proving to be detrimental to the interests of the government. We are not aware, however, that such a problem exists.

I want to emphasize that we do not think the Competition in Contracting Act currently requires the Government to buy goods and services based solely on lowest cost. As we testified last year before this subcommittee, we find nothing in current law that requires agencies to buy goods and services based on the lowest cost, technically acceptable offer, without considering quality and performance. Current law allows agencies to use whatever source selection criteria they believe strike the appropriate balance between price and technical factors.

Multi-year procurement

DOD believes the requirement that multi-year contracts must have a clearly demonstrable savings of at least ten percent should be

eliminated. According to DOD, the "ten percent" threshold is arbitrary and that the savings of under ten percent on a multi-billion dollar program can often be substantial.

We annually assist the appropriations committees in assessing DOD's multi-year candidates and have found that many programs are proposed by DOD--and approved by Congress--even though the savings fall below applicable savings thresholds. The Congressional Budget Office reported last year that 14 of the 35 candidates submitted by DOD in fiscal years 1986 to 1989 did not meet the savings thresholds. Nonetheless, Congress approved 9 of those 14 candidates.

Although we are not aware of any DOD multi-year contracts which have been disapproved solely on the basis of applicable savings thresholds, we would not be opposed to DOD's proposal. Our longstanding position has been that multi-year programs should be evaluated on a case-by-case basis using existing savings and stability criteria as a guide.

Certified Cost or Pricing Data Threshold

DOD proposes raising the threshold for requiring certification of cost or pricing data under the Truth in Negotiations Act from $100,000 to $500,000. The Deputy Secretary believes that raising the threshold would significantly reduce the paperwork that industry finds a major impediment to doing business with DOD.

We do not support DOD's proposal to raise the threshold. The Truth in Negotiations Act is the government's key safeguard against inflated contract prices in sole-source situations. As I stated earlier, the Defense Contract Audit Agency finds that negotiated prices are inflated in one out of every two contracts it audits.

Increasing the threshold for cost or pricing data would unnecessarily raise the government's risk to fraud, waste, and abuse. In fiscal years 1986, 1987, and 1988, more than $17 billion in contract awards fell between the $100,000 and $500,000 range. We are concerned that raising the threshold would send a signal to defense contractors that the government is no longer interested in having lower dollar value noncompetitive contract estimates supported by accurate, complete, and current data. In responding to a requirement[3] that DOD assess the impact and cost effectiveness of raising the threshold, DOD reported in July 1987 that

> ". . . there is little reason to increase the current threshold of $100,000 for the submission and certification of cost or pricing data. Maintaining this threshold encourages contractors to provide accurate, complete and current data and entitles the Government to a price reduction if the data provided by the contractor and relied upon by the contracting officer are later found to be defective."

We believe that is a more prudent position than the one proposed this year.

Mr. Chairman, that completes my statement, I will be glad to answer any questions you, or the members, may have.

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[3]House Armed Services Report No. 99-718 required DOD to report on the impact and cost effectiveness of raising the threshold.