



United States  
General Accounting Office  
Washington, D.C. 20548

150839

National Security and  
International Affairs Division

B-256000

January 24, 1994

The Honorable John Conyers, Jr.  
Chairman, Committee on Government Operations  
House of Representatives

Dear Mr. Chairman:

As you know, a number of efforts are underway to reform the Department of Defense (DOD), and overall federal, procurement system. To support such efforts, we initiated a study intended to quantify and substantiate the differences in the costs that companies have incurred for products sold for ultimate use by DOD compared to the same or similar products sold to commercial customers. We were also interested in the extent to which federal procurement laws, regulations, and practices, as well as contract specifications, contributed to such differences. We initiated our study because we believed this information, especially data demonstrating the extent of cost differences, would be helpful in decision-making related to these procurement reform efforts.

On several occasions in January 1994, we discussed the results of our study with your staff. As you requested, this letter describes our efforts and the results obtained.

All the companies reported that they incurred some additional costs in doing business with DOD. For the most part, the companies provided us with their best estimates of such costs based on company officials' knowledge and experience. However, the companies could not provide us with documentary support to validate these estimates. Several company officials stated that they did not collect the information we were seeking, primarily because they considered it unnecessary or too costly. Because we were unable to obtain verifiable cost data, we are stopping further work on this effort.

In initiating this study, our first task was to identify companies willing to provide us with their proprietary cost information. Therefore, we held discussions with executives from professional and trade associations and

placed a notice in the Commerce Business Daily. We looked for companies that sold the same or similar products to defense and commercial customers.<sup>1</sup> Twenty-five manufacturing companies (or divisions of companies) volunteered to participate in our study and share their proprietary information. (A list of the companies participating in our study is in app. I.)

We obtained their initial responses through a data collection instrument and then visited 15 of the companies that provided the most extensive cost information to verify their answers. The participants included both DOD prime contractors and subcontractors from various parts of the United States and represented many industry sectors. Because the companies were "self-selecting," however, our results do not necessarily represent all defense suppliers.

Eighteen of the 25 companies in our study provided estimates regarding their added costs of doing business with DOD. Of the 18, 12 provided comparable data. The estimates were based upon company representatives' knowledge of and experience in their businesses but little or no verifiable documentation. Of course, the absence of documented evidence does not invalidate the companies' estimates. It does mean, however, that we cannot have a high degree of confidence that we know the extent of the cost differences. It should also be recognized that the data we obtained represents estimates of the additional costs to the companies and not necessarily the additional costs to DOD.

The estimates by company officials of the additional costs due to federal procurement laws, regulations, practices, and contract specifications ranged from 5 to 60 percent. The variance in the range of estimates was a function of the products companies used as a base for their estimates and the degree of the companies' exposure to DOD requirements. When the 12 companies' estimates are weighted by their total sales to the federal government, the additional costs averaged 19 percent. The unweighted (or simple arithmetic) average of the estimates is 22

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<sup>1</sup>We did not attempt to determine what it would cost a firm that had no prior government business to implement new or changed systems and procedures to respond to government requirements.

percent. On average the 12 companies attributed one-half of the estimated additional costs to federal procurement laws, regulations, and practices and one-half to contract specifications.

Companies had great difficulty relating added costs to particular laws or regulations. However, a few companies provided estimates as follows:

- Three companies estimated that compliance with the Truth in Negotiations Act added an unweighted average of 7 percent to their costs.
- Two companies estimated that compliance with Cost Accounting Standards added an unweighted average of 8 percent to their costs.
- One company estimated that compliance with socioeconomic requirements added 2 percent to its costs.
- One company estimated that compliance with technical data rights requirements added 3 percent to its costs.

In addition, seven companies estimated that an average of 6 additional months (with responses ranging from 2 days to 12 months) was required to negotiate a contract with the federal government.

In conclusion, all the companies we contacted reported some additional cost of doing business with DOD. However, because of the lack of supporting documentation for company officials' estimates of the additional costs, the extent of such cost differences is not verifiable.

As requested, we did not obtain agency comments. On October 21, 1993, however, we briefed the Under Secretary of Defense for Acquisition Reform, who expressed interest in doing similar work. We will provide additional information to DOD for its use in that study.

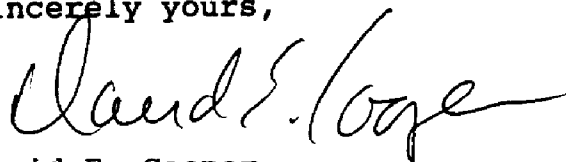
Unless you publicly announce its contents earlier, we plan no further distribution of this report until 5 days from its issue date. At that time, we will send copies to the Deputy Under Secretary of Defense for Acquisition Reform

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and other interested parties. We will also make copies available to others on request.

The principal GAO staff members responsible for this study were Kevin Tansey, Assistant Director; Tom Hopp, Evaluator-in-Charge; and Leslie Schafer, Evaluator. If you have any questions, please call me on (202) 512-4587.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "David E. Cooper".

David E. Cooper  
Director, Acquisition Policy, Technology,  
and Competitiveness Issues

PARTICIPANTS IN GAO'S REVIEW

3M  
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AIW-Alton, Inc.  
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Bell Helicopter-Fort Worth  
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Boeing Company  
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Cadillac Gage  
Textron, Inc.  
Warren, MI

Collins Avionics and Communications Division  
Rockwell International Corporation  
Cedar Rapids, IA

Dow Chemical Company  
Midland, MI

GE Aircraft Engines  
General Electric  
Cincinnati, OH

General Electric-Lighting Division  
Cleveland, OH

General Electric Medical Systems  
Milwaukee, WI

GE Drive Systems-Government Business Operations  
General Electric  
Salem, VA

GE-Navy and Small Steam Turbine Department  
General Electric  
Fitchburg, MA

Grumman Corporation  
Bethpage, NY

Gulfstream Aerospace Corporation  
Savannah, GA

Heath Tecna Aerospace Company  
Kent Structures Division  
Ciba Corporation  
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Honeywell Military Systems/Commercial Flight  
Systems Group  
Honeywell Inc.  
Minneapolis, MN

Intel Corporation  
Hillsboro, OR

Kaman Aerospace Corporation  
Bloomfield, CT

Loral Vought Systems Corporation  
Dallas, TX

LSI Logic Corporation  
Milpitas, CA

Motorola Government and Systems Technology Group  
Motorola Corporation  
Scottsdale, AZ

Precision Castparts Corporation  
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