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Statement of
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before the
Subcommittee on Defense of the Committee on Appropriations
United States House of Representatives

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Mr. Chairman and Members of the Committee:

We appreciate this opportunity to discuss [efforts to reduce the cost of Defense weapon systems procurement] by more skillful long-range planning, funding, and contracting.

On January 21, 1981, Comptroller General Staats sent a memorandum to Secretary Weinberger outlining a number of managerial actions which we felt the new Secretary should address early in his tenure. Several of these were concerned with "major procurement economies." We were thus delighted when Secretary Weinberger immediately established a review of acquisition practices which culminated on April 30 in the issuance of a comprehensive program of 31 improvements in the acquisition process. One of these deals with "multi-year procurement."

This subject has been under continuing study and discussion for many years. In 1972 the Commission on Government Procurement, following a 2-year study of all facets of Government procurement, recommended:

--"Authorize all executive agencies to enter into multi-year contracts with annual appropriations."

In January 1978, GAO reported to the Congress that:

--"Federal agencies should be given general multi-year contracting authority for supplies and services."

Secretary Carlucci in the DOD report, issued on April 30, 1981, approved the following recommendation:

--"Encourage extensive use of multi-year procurement based on case-by-case benefit/risk analysis."

Secretary Carlucci cited the potential for "average dollar savings of 10 percent to 20 percent in unit procurement cost through improved economies and efficiencies in production processes, economy-of-scale lot buying, decreased financial borrowing costs, better utilization of industrial facilities, and a reduction in the administrative burden in the placement and administration of contracts."

Despite the apparent benefits, the Government has been slow to act upon these recommendations in the past, generally because of concerns with the loss of flexibility and control which can occur when future appropriations "are fenced in" for specific purposes for several years in advance, thus committing future managements and Congresses.

As we analyze the current status of discussions regarding multi-year contracting, using fiscal year or limited year funds, we believe that they fall into two distinct categories. One of these is the Government-wide opportunity to reduce cost of repetitively used supplies and services through multi-year quantity buying. The second is the opportunity to reduce costs of acquiring major systems, especially in the Department of Defense, by stabilizing long-range plans and contracting for production and delivery over a period of up to five years, without obligating total funds at time of award.

We would like to discuss each of these.

Before doing so I would like to reiterate GAO's support for careful and prudent use of multi-year contracting when:

- Programs are mature and stable.
- Requirements are firm.
- Significant savings (or cost avoidance) is achievable.
- Risks are acceptable compared to advantages.
- Adequate planning and preparation has taken place, with participation of key DOD officials, OMB, and Congress as appropriate.

Our testimony to the above effect has been presented in recent months before the House Armed Services Committee, the House and Senate Budget Committees, and the House Government Operations Committee.

The key question which Congress faces today in our view, is not whether to authorize multi-year contracting, but when and how.

AUTHORITY FOR ALL FEDERAL
AGENCIES TO PROCURE SUPPLIES
AND SERVICES USING MULTI-
YEAR CONTRACTS

Funding statutes now on the books preclude agencies from entering into contracts or other obligations in advance of, or in excess of, sufficient appropriations to cover the costs of these obligations. In addition, agencies may not contract to fulfill the needs of fiscal years beyond the fiscal year or years for which the appropriation was made. These laws do not apply, however, if the Congress enacts specific exceptions to one or more of these funding restrictions. There are today some 22 statutory exceptions. Examples of these include:

- Contracting by the Military, Coast Guard, and NASA for operation and maintenance services outside the 48 contiguous States. (5 years)
- Contracting for storage, handling, and distribution of liquid fuels by the military departments. (5 years)
- Leases in foreign countries by the military departments. (5 years)
- Contracts for research or development services and facilities by the military departments., (5 years)
- Contracts for the maintenance of military family housing. (4 years)

In addition to DOD, special multi-year contracting authorities have been legislated in various limited situations for the Postal Service, GSA, HEW, AEC, Interior, Commerce, HUD, NASA, and Coast Guard.

The findings of the Commission on Government Procurement, and later by GAO, are that if an agency can obtain price comparative quotations based on a single-year and multi-year requirements--even though it is able to fund only the first year with the available appropriation, and even though the accomplishment of the future year buys depends on the availability of appropriations--there are often possibilities for significant cost reductions.

This results from the ability of the contractor to plan for the entire production quantity (or level of Services) in advance so as to achieve savings which can be shared with the Government. This method may also make it possible for a larger number of bidders--including small businesses--to compete since they may be able to afford to gear up for a several-year contract, but

not for a one-year procurement. The Procurement Commission cited average annual savings of \$52 million by DOD based on these limited uses of multi-year contracting in fiscal years 1968-1973.

GAO in 1978 confirmed similar savings in a study of 26 DOD contracts for fuel and services and supplies. Savings of \$3 million were identified on contracts costing \$14 million--a reduction of 21 percent. GAO also pointed to numerous opportunities for such savings in other Federal agency studies. Recently GSA conducted a study of the cost of procuring copying machines by Federal agencies. It estimated that if multi-year authority were available annual savings of \$12 to \$28 million could be achieved just on this one item.

The Office of Federal Procurement Policy is now preparing its report to be submitted to the Congress by October 1981 on improvements in the procurement statutes, in accordance with P.L. 96-83. It recently wrote the Chairman of the Committee on Government Operations that "it appears that OFPP will recommend multi-year contracting in its October 1981 recommendation to the Congress." It is assumed that this will apply broadly to all supplies and services and commodities used repetitively by Federal Agencies--not just operations and maintenance. This would thus accomplish that provision in Section 909 of H.R. 3519 which would extend DOD's authority to contract for operation, maintenance, and other specified services in the continental United States. If section 909 is enacted as now written, it would be desirable to recognize that

OFPP is developing uniform groundrules for all types of services and supplies, procured by all agencies. Among the groundrules we suggest the following be covered by OFPP:

- How this procurement technique will be supervised to assure effective and productive use, and to avoid abuses.
- The cancellation ceiling which may be justified for such procurements, which obviously does not need to be as large as that being considered for major weapon systems.
- The importance of obtaining competition in such procurements.

AUTHORITY FOR DOD TO UTILIZE
MULTI-YEAR CONTRACTING FOR
MAJOR WEAPON SYSTEMS

This is a totally different type of multi-year planning and contracting--and also the area of largest cost reduction opportunities.

Historically, ships have been appropriated and obligated 5 years in advance. Otherwise Defense procurement of hardware items is made from annual procurement appropriations which are available for obligation for 3 years. For most major weapon systems, multi-year contracting would be feasible only when the full production phase has been reached (after one or two initial production runs) and would typically extend up to 5 or more years. Hence DOD simply lacks statutory authority (or funding) to enter into multi-year contracts for major weapon systems using fiscal-year or limited-year funding. In addition, section 810 of the 1976 Appropriation Authorization Act (P.L. 94-106) provides that

no funds may be obligated for a cancellation ceiling in excess of \$5 million for a multi-year procurement without explicit Congressional approval by statute in advance. In any event, such ceilings cover only non-recurring costs today.

Recent Defense studies suggest that multi-year contracting for production of weapons programs where requirements are quite firm can offer opportunities for savings aggregating billions of dollars. To illustrate, there are today some 185 major weapon systems with total program costs at completion now estimated at \$436 billion. Defense authorities estimate that 10 - 20 percent of program costs can be saved in instances where multi-year contracting can be fully justified. Even if only a small number of systems--such as 3 or 4 per year-- qualify, and only in the production stage, savings from year to year could possibly reach or exceed the billion dollar level. As you know, there is discussion today of the possibility of such savings on the F-16 aircraft program.

In order for programs of this type to be accomplished, however, there must be comprehensive and sophisticated planning in full detail by DOD and its prime contractors, and between prime and subcontractors.

The analyses must include the optimum rates of production from the contractor's viewpoint, and the optimum rates of delivery and deployment from the user's viewpoint. From the businessman's

perspective, studies must be conducted of the opportunities for productivity enhancement through acquiring new capital equipment, to be amortized over the multi-year production period; and the most economic plans for buying, in advance, components, parts, and materials; and for recruiting and training the work force. To assure that risks are reasonable, appropriate economic adjustment formulas must be developed, and progress payment schedules established. Based on all of these considerations, the Government's liability in event of cancellation, at the end of each year, must be defined in the form of a cancellation ceiling. Finally, we must be sure that the attractiveness of highly visible benefits do not obscure or override risk factors such as changes in force structure, threat, technology, inflation, or domestic priorities.

From the point of view of statutory authorization, DOD needs three exceptions from present statutes--either as general exceptions or as specific case-by-case exceptions:

- First, authority to enter into multi-year contracts, both for the total system and for materials, parts, or components of it, in advance of appropriations or without having full funding available for the entire program. We continue to support full funding of the number of end items authorized for initiation in each program year.
- Second, advance authority to exceed the statutory cancellation ceiling of \$5 million.
- Third, authority to provide for reimbursement of recurring costs and to include such costs in the cancellation ceiling. This matter is still undergoing considerable discussion from the viewpoint of the most appropriate approach to funding.

We believe that it is highly desirable to encourage DOD to proceed with the selection of candidate weapon systems for multi-year contracts and to work out, in detail, the plans such as those sketched above. The issue at this point is whether Congress wishes to provide general authority for DOD to proceed, as proposed in Section 909 of H.R. 3519, or more limited authority at the outset, such as proposed in the Brooks Amendment to H.R. 3519.

We believe this is a judgment which only Congress can make, as discussed further below. We think it is useful to note that regardless of the statutory approach taken this year, a significant period of learning lies ahead, and we assume that Congress will want to be kept well informed on progress and problems.

COMPARISON OF H.R. 3915, S. 815, AND
THE BROOKS AMENDMENT DEALING WITH DOD
AUTHORITY FOR MULTI-YEAR CONTRACTING

A brief comparison of the provisions of the House and Senate Authorization Bills, and the Brooks Amendment appear as Attachment I.

Excellent progress has been made by the Congress in laying the statutory framework for the next steps by DOD to take advantage of the opportunities which can be attained from wisely-conceived multi-year acquisition plans and contracts. Two basic options are presented by the bills currently before the Congress:

- One option is to grant maximum authority to DOD to develop and consummate multi-year awards for major weapon systems. Both H.R. 3519 and S. 815 address this objective but H.R. 3519 is the only complete bill, since: (1) it fully authorizes such contracts; (2) it authorizes advance procurement of components, parts, and materials in economic lots; (3) it raises the cancellation ceiling to \$100 million and provides for exceeding this ceiling case-by-case upon notification of Congress 30 days in advance; and (4) it authorizes

consideration of recurring costs in computing the cancellation ceiling. The Senate version is much less complete but provides a somewhat greater degree of Congressional oversight (i.e., statutory authorization of all cancellation ceilings of \$50 million or over).

If the House option is adopted by Congress, we recommend that Section 909 of H.R. 3519 be modified to correct a technical defect as explained in Attachment II. If the new contract authority in Section 909 is adopted by Congress, the DOD Appropriations Act which is now being considered for FY 1982 must expressly endorse this authority.

--The second option is to encourage DOD to proceed with selected tests of multi-year contracting for major weapon systems, and to present the detailed proposals for the first candidate systems to the Congress through the regular authorization/appropriation process--beginning with a special request for FY 1982. If this option is desired by Congress, the Brooks Amendment is designed to accomplish this objective.

We will be pleased to comment further on questions which the Congress may wish to pose to us on this significant reform in the DOD procurement process for major weapon systems.

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We will now be pleased to answer the Committee's questions.

Attachments

COMPARISON OF HOUSE AND SENATE AUTHORIZATION BILLS
AND BROOKS AMENDMENT IN REFERENCE TO
MULTI-YEAR CONTRACTING (MYC)

<u>Item</u>	<u>S. 815 (905)</u>	<u>H.R. 3519 (909)</u>	<u>Brooks Substitute for 909</u>
1. Cancellation ceiling	\$50 million	\$100 million	Case-by-case (any amount)
2. Reporting to Congress	In the regular authorization process; cases with cancellation ceiling of \$50 million and over.	Case-by-case contracts with cancellation ceiling over \$100 million. 30 days advance notification prior to award.	In regular authorization process (or supplemental request) with no limit on cancellation ceiling.
3. Scope of authorization	Does not clearly authorize MYC. Requires submission of major weapon systems candidates with \$50 million and over cancellation ceiling. Also raises cancellation ceiling for other existing statutes.	Clearly authorizes multi-year procurement, even with one year money; and advance procurement of components, parts, and materials. Covers property except ADP, construction, and repair of real property. Includes services, weapon systems, plus items and services associated with weapon systems.	Covers major weapon systems only and their various support systems--and advance procurement of related parts, components, and materials. ----- Duration: Time required "to be thoroughly tested."
4. Maximum period of coverage	Not specified.	5 fiscal years.	Open.
5. Source of funds for payment of cancellation amount	Not specified.	Fully described.	Not specified (not needed).
6. Criteria to be considered in justifying a multi-year contract	Well delineated except competition.	Well delineated except competition.	Well delineated <u>including</u> competition.
7. Reference to P.L. 96-83	Not covered.	Not mentioned but has an elaborate policy statement. Might more appropriately reference 96-83	Covered.
8. Fund Availability Restrictions	None.	"To the extent that funds are otherwise available for obligation."	None.
9. Recurring Costs	Not specified.	Authorized	Authorized for test

CORRECTION OF TECHNICAL DEFECT IN H.R. 3519
SECTION 909

We recommend one technical amendment to section 909 of H.R. 3519, on line 21, of page 46, which now reads:

"(h) (1) To the extent that funds are otherwise available for obligation..."

We understand that these words were inserted to comply with section 401(a) of Public Law 93-344 (31 U.S.C. 1351(a)) which deals with bills providing new spending authority. The only requirement of that section is that the new contract authority which section 909 provides be made effective only as provided in applicable appropriation acts. While the meaning is not entirely clear, we believe the words quoted above go far beyond that requirement. They would require a full five year appropriation to be made "up front," before an agency could enter into the five year contract authorized by the rest of the sentence. This requirement would, of course, negate the benefits of the contract authority which we believe the bill intended to provide.

Accordingly, we suggest the following language as a substitute:

"To the extent and in the manner provided in annual appropriation acts for the Department of Defense, ..."