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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-159896

January 3, 1974

The Honorable William Proxmire
Chairman, Subcommittee on Priorities
and Economy in Government
Joint Economic Committee
Congress of the United States

74-0344



Dear Mr. Chairman:

On November 14, 1973, we testified before your Subcommittee on several matters including the application of should-cost concepts by the military services. Mr. A. E. Fitzgerald appeared before the Subcommittee on November 15, 1973, and, among other matters, presented his views on the subject of should-cost. In his prepared statement, Mr. Fitzgerald stated that:

"We know that intense pressure has been applied by the contractors, some elements of the Department of Defense and the GAO to switch emphasis in the should-cost approach from a quick, incisive, quantitative assessment of savings potential to a drawn-out, vague, qualitative review of contractor operations."

Mr. Fitzgerald also expressed the belief that "the emasculating switch of emphasis is all but complete" and suggested that the Subcommittee consider withdrawing its endorsement of the "new-look" should-cost approach.

We strongly disagree with the statement that the General Accounting Office applied pressure to switch emphasis in the should-cost approach along the lines suggested by Mr. Fitzgerald. Although it is not possible to precisely quantify the additional benefits derived from the use of the should-cost approach, we believe there is great potential for the Government to benefit from the proper application of should-cost concepts. As stated in our reports on the Army and the Air Force, we believe the should-cost studies have strengthened the Government's bargaining positions and have contributed to the negotiation of lower contract prices than might otherwise have been achieved.

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Our reports contain a number of recommendations designed to encourage improvements in the military services' use of the approach and to make the studies even more productive in the future. For example, we suggested that the should-cost teams place greater emphasis on analyzing the contractors' operations to identify specific actions needed to improve contractors' efficiency and to reduce costs. In this way we believe the teams will be in a better position to challenge the efficiency of the contractors' operations and to provide specific constructive suggestions to realize cost reductions. We also suggested that the military services improve their practices for monitoring progress by the contractors in implementing improvements in those areas identified by the should-cost teams as in need of attention. We believe these steps will provide a better basis for quantifying the savings resulting from actions taken on the should-cost teams' recommendations.

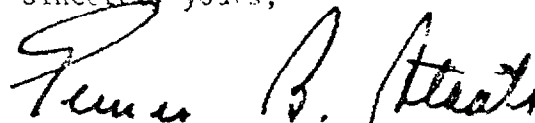
In considering the merits of the should-cost approach, it should be understood that in most cases the military services use should-cost studies as an extension of their traditional cost analysis efforts to evaluate the reasonableness of contractors' proposed prices. The studies are used to develop Government negotiation objectives which recognize the potential reductions in proposed costs based on projections of past experience as well as reductions in areas where the teams feel the contractor can substantially improve current operations. Some of the teams' ideas for improving operations and reducing costs can be applied immediately with a payoff during the term of the current contract. Others require experimentation or changes in plant and equipment requiring some time to accomplish and may have only a small effect on the costs incurred on the current contract. Still others may prove impractical when examined in greater depth. Under those circumstances, it is almost impossible to isolate and price out with any precision the effect of all should-cost proposals on the final contract prices.

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/ We believe the continued interest shown by your Subcommittee in the use of the should-cost approach has been extremely important in encouraging the Department of Defense to take a more active role in reviewing the efficiency and economy of the operations of its contractors. 5

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We request that this letter be included in the record of the recent hearings of your Subcommittee in order to clarify the position of the General Accounting Office on this matter.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Thomas B. Atwater".

Comptroller General
of the United States

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