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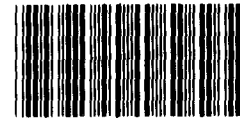
Testimony

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GAO Comments on Defense Industry and Technology
Act of 1988

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



135600

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to present GAO's views on the proposed Defense Industry and Technology Act of 1988. We support the overall thrust of the bill--to promote a healthy, vigorous, effective defense acquisition program and enhance U.S. technological competitiveness. The issues addressed by the bill are important and deserve attention.

Earlier, we provided detailed comments on issues addressed by the ad hoc Defense Industry Advisory Group. As you know, we did not agree with all the solutions proposed by the group. Your bill, however, presents a more balanced approach for dealing with defense acquisition problems.

My statement today covers three areas addressed in the proposed Defense Industry and Technology Act of 1988--contract financing, acquisition personnel, and government oversight activities.

CONTRACT FINANCING

Development of an integrated contract finance, investment, and risk sharing plan

The bill requires that DOD establish an integrated contract finance, investment, and risk sharing plan. The goal of the plan is to enhance industry's ability to invest in technology

innovation, production efficiencies, and capital improvements. GAO supports that goal and agrees that DOD's contract finance, investment, and profit policies need to be integrated. We agree that recent policy changes on matters such as progress payments, risk sharing, and return on investment could impact contractors' overall profitability, and that these, as well as, other changes generally should be integrated in profitability evaluations.

However, the effect on contractor profitability of recent profit policy changes and other revisions is not clear. Data is not collected on a consistent, mandatory basis covering a substantive universe of defense contractor segments to measure profitability. Historically, DOD has conducted infrequent ad hoc studies to assess how its profit policy is working to achieve profit levels that are equitable to industry and provide sufficient incentives for contractors to invest in capital facilities.

Our report, Government Contracting: A Proposal for a Program To Study the Profitability of Government Contractors (GAO/NSIAD-87-175, September 17, 1987), proposes a program that we believe would provide information on a regular basis to measure the impact of policy changes on contractor profitability. Such a reporting program would complement the Defense Industry and Technology Act of 1988 by providing information essential for developing and administering an integrated contract finance, investment, and risk sharing plan.

Limitations on Fixed-Price Development Contracts

The bill limits the use of fixed-price contracts for development efforts. We agree that fixed-price contracts should generally not be used in the development phase or when considerable cost uncertainty exists. Procurement regulations have long required contracting officers to negotiate a contract type and price that will reasonably reimburse contractor risk while protecting the government and providing the contractor the greatest incentive for efficient and economical performance.

In addition, the fiscal year 1988 Defense Appropriation Act restricts DOD's use of fixed-price development contracts and requires approval by the Under Secretary of Defense (Acquisition) when used. In September 1987, DOD revised its regulations to provide that contract selection ". . . shall be consistent with all program characteristics including risk. Fixed-price contracts are normally not appropriate for research and development phases. For such efforts, a cost-reimbursable contract is preferable because it permits an equitable and sensible allocation of program risk between the contracting parties." The Under Secretary reiterated this policy in a December 1987 memorandum.

It appears that DOD actions are addressing the intent of the bill's provision.

ACQUISITION PERSONNEL

DOD Acquisition Officers' Roles and Responsibilities

The bill requires the Secretary of Defense to develop rules which provide program managers and contracting officers decision-making authority commensurate with their responsibilities. The purpose of this provision is to address a concern that numerous regulatory, legislative, and administrative actions have eroded acquisition officers' decision-making authority.

Our report, DOD Acquisition: Strengthening Capabilities of Key Personnel in the Systems Acquisition Workforce, (GAO/NSIAD-86-45, May 12, 1986) discusses the roles and responsibilities of the program manager and contracting officer as well as issues and problems with effectively acquiring major weapon systems. The report contains numerous recommendations to the Secretary of Defense for improving the capabilities of both the contracting officer and the program manager. We support clarifying regulations regarding responsibilities and authority of these key acquisition personnel.

It is important, however, that any regulatory changes maintain an appropriate balance between the decision-making role of acquisition personnel and the advisory role of competition advocates and auditors. We believe it is necessary to ensure adequate documentation and appropriate review of acquisition personnel actions, including the disposition of audit recommendations and other advice.

In February 1988, DOD revised its directives to emphasize that contracting officers are the final authority for determining the governments' contract negotiation position. Under the revision, contracting officers are not required to inform auditors of the disposition of audit findings and recommendations until after the pre-negotiation objective is established. Contracting officers are still required to fully consider audit advice in developing the pre-negotiation objective.

DOD is also reconsidering the contract auditor's role in settling final overhead rates.

Personnel System for Acquisition Workforce

The bill recognizes that a quality workforce is essential for improving the acquisition process and authorizes an alternative personnel system for DOD's acquisition workforce. We agree that the quality of DOD's workforce deserves attention.

It is not clear whether the proposed system will cover entire components of the Department of Defense or certain positions within components. If the proposed system is implemented by selected components within DOD, it could lead to demands by others for equal treatment and result in a proliferation of personnel systems within DOD. The size and dispersion of DOD's acquisition workforce could create administrative problems as varying standards and processes are applied for recruiting, compensating, training, and retaining employees.

The bill requires implementation of the proposed personnel system at no additional cost. We question whether a pay-for-performance system can be effectively implemented in a budget-neutral environment. For example, according to the Office of Personnel Management, as of January 1986, overall salary costs for the Navy's demonstration projects at China Lake and San Diego were about 6 percent higher than at counterpart laboratories not in the projects.

We will be pleased to work with the subcommittee to obtain more information on how the proposed system would affect such a large number of DOD personnel, especially if applied in an untested budget-neutral environment.

GOVERNMENT OVERSIGHT ACTIVITIES

Regulatory Simplification

The Under Secretary of Defense (Acquisition) has established several defense acquisition reform initiatives. The bill requires the Under Secretary to establish a timetable and report progress in effectuating regulatory reform.

Over the years, other initiatives have been implemented to reform defense acquisition. For example, in 1981 DOD implemented a major acquisition improvement program focusing special management attention on initiatives involving (1) program stability, (2) multiyear procurement, (3) economic production rates and (4) competition. In our report, Acquisition: DOD's Defense Acquisition Improvement Program: A Status Report (GAO/NSIAD-86-148, July 23, 1986), we state that when the program was announced DOD made a strong commitment to its implementation. In fact, one of the initiatives was to ensure implementation by establishing plans of action and monitoring progress. We reported, however, that DOD's initial sense of commitment to the program dissipated. DOD had not carried through with action plans on most initiatives, and was not monitoring actions.

A strong DOD commitment is crucial to achieving acquisition reform because the problems are longstanding and not easily

resolved. The bill's reporting requirement would enhance Congressional oversight and ensure DOD attention to acquisition reform measures.

Duplication of Oversight Activities

To deal with concern over duplication in audit and oversight, the bill requires (1) an annual plan for audit and oversight functions, and (2) the Under Secretary of Defense (Acquisition) to report DOD's progress in preventing oversight duplication as required by the Defense Acquisition Improvement Act of 1986.

We support a coordinated plan for audit and oversight activities and agree that such activities should avoid duplication. The DOD Inspector General, Defense Contract Audit Agency and other internal audit agencies currently prepare and coordinate annual audit plans. It is unclear what additional planning would be required by the bill's requirement for an annual audit and oversight plan covering each contracting activity.

As noted in the proposed bill, ~~The~~ Defense Acquisition Improvement Act requires that the Under Secretary, in consultation with the Inspector General, prescribe policies to prevent duplication. The Act does not affect the Inspector General's authority to establish audit policy and we support this. To comply with the act, the Under Secretary, Inspector

General, and Comptroller are jointly reviewing areas where the Packard Commission identified duplication and DOD is considering procedural changes as a result. So, the Under Secretary should be able to comply with the bill's February 1989 reporting date.

DOD Advisory Panel on Government-Industry Relations

The proposed legislation requires that DOD establish an advisory panel consisting of government, private industry, and academia representatives to study and recommend ways to enhance cooperation between DOD and industry. We support this provision because it establishes a forum for DOD and industry to discuss issues of mutual interest. While improving dialogue is healthy, it is essential that DOD continue to maintain an arms-length relationship with industry.

Mr. Chairman, that concludes my statement. I will answer questions you or other members of the subcommittee have.