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Statement of
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before the
Subcommittee on Defense
House Committee on Appropriations



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Mr. Chairman and Members of the Committee:

I welcome this opportunity to discuss Department of Defense application of the multiyear contracting authority provided under P.L. 97-86. It is slightly over a year since we last appeared before this Committee and testified in support of careful and prudent use of multiyear contracting for major system acquisition. At that time we differentiated between multiyear contracts for supplies and services as opposed to major weapon systems. We stated that major weapon programs require comprehensive and sophisticated planning by Defense and its prime contractors and between prime and subcontractors. We cautioned that the attractiveness of higher potential benefits should not obscure significant risk factors such as changes in force structure, threat, technology, inflation, and domestic priorities.

We remain convinced that multiyear contracting, where appropriate, offers substantial advantages over annual contracting. We continue to advise that a cautious approach should be taken in applying it to major weapon systems.

The criteria established in Public Law 97-86 to guide agency heads in selecting multiyear contract candidates, coupled with the reporting requirements and expanded criteria set forth in the 1982 Defense Appropriations Act and accompanying Committee report, addressed our concerns. The prescribed justification materials and reporting requirements established are essential to permit an assessment of decisions made.

At your request, Mr. Chairman, we analyzed the Department of Defense proposed fiscal year 1983 weapon system multiyear candidates for compliance with the prescribed criteria. Our report was submitted to you on April 29, 1982. We found that while the criteria are sufficiently broad to allow discretion and judgment in their application, there are some questions that need to be clarified before sound judgments can be made on proposed multi-year contract candidates for major weapon systems:

--Is budgetary data sufficient for estimating savings resulting from multiyear contract use versus annual contracting or should estimated savings be based on firm contractor proposals on both bases?

--Should final congressional approval be given for major weapon system multiyear contracts only after review of proposals received from contractors with firm data available for estimating and comparing dollar savings, other benefits, and risks?

--Should estimated savings be discounted as required by Office of Management and Budget Circular A-94?

Since the two alternatives involve different rates of expenditures, estimates associated with each must reflect the additional money cost applicable to earlier expenditures.

--Should escalation avoidance be considered as savings?

--Will the amount of funding required for advance procurement of materials for future contract years unreasonably erode the full funding principle?

--To what extent and under what criteria should enhancement to the industrial base be demonstrated?

In our view, a creditable estimate of savings to be achieved through multiyear contracting generally cannot be made without benefit of firm proposal data from contractors on both a multiyear and an annual basis. Defense estimated savings for fiscal year 1983 were based primarily on budgetary data. Resolution of this problem most likely will require a 2-step process; authority to solicit proposals on both a multiyear and an annual contract basis, with the ultimate decision reserved until the firm proposals are analyzed.

The savings projected by Defense for the fiscal year 1983 candidate systems were not discounted to reflect the time value of money associated with the accelerated expenditure of funds incident to multiyear contracting. In addition, escalation avoidance was considered as a multiyear contracting savings. Department computations of projected savings were inconsistent with the guidance set forth in the Office of Management and Budget Circular A-94. Enclosure II to our April 29, 1982, report to you showed a significant reduction in projected savings for the 9 major systems after applying the discounting factor and eliminating the amount of escalation avoidance.

There is a significant amount of procurement under the proposed multiyear contracts in advance of actual need. There doubtless is a point where the potential savings to be achieved through advance procurement would be outweighed by the risks associated with buying for needs too far into the future.

Several of the fiscal year 1983 multiyear contract candidate systems will have as much as 30 percent or more of the value of future years end items funded through advance procurement. Under annual contracting for these same systems, advance procurement funding ranged from only 1.5 percent to 11.8 percent.

Enhancement of the industrial base was frequently advanced as justification for multiyear contracting. The House Committee on Appropriations directed that multiyear contracting justifications specifically address this issue. In its fiscal year 1983 candidate justifications, the Department of Defense did not suggest any significant enhancement of facilities at the prime or first tier subcontractor levels and lower tier subcontractor levels and lower tier and supplier levels were not addressed. There was no indication as to whether the Department was attempting to sustain a mobilization base or add a surge capability.

This concludes my prepared statement. Mr. Chairman, we would now like to provide you and the Committee members with a more graphic presentation on the principle issues in our analysis of the DOD proposed multiyear contract candidates.