



Acquisition Research Program: Creating Synergy for Informed Change

Panel 12: Budgeting & Acquisition Reform

Chair

Hon. Douglas Brook, PhD, Assistant Secretary of the Navy (Financial Management & Comptroller)

Discussants

RDML Charles Goddard, Program Executive Officer, Ships

Ms. Wendy Kunc, Director, Naval Center for Cost Analysis

Presenter

Philip Candreva, NPS Faculty & Center for Defense Management Reform

“If we expect programs to be executed within budget, programs need to begin with realistic budgets. The foundation of an executable budget is a realistic cost estimate that takes into account the true risk and uncertainty in a program.”

- GAO





Acquisition Research Program: Creating Synergy for Informed Change

Rethinking Acquisition Reform: Cost Growth Solutions may Aggravate More Important Problems

Philip J. Candreva

Senior Lecturer of Budgeting

Acting Director, Center for Defense Management Reform

Naval Postgraduate School

The Problem with Cost Growth

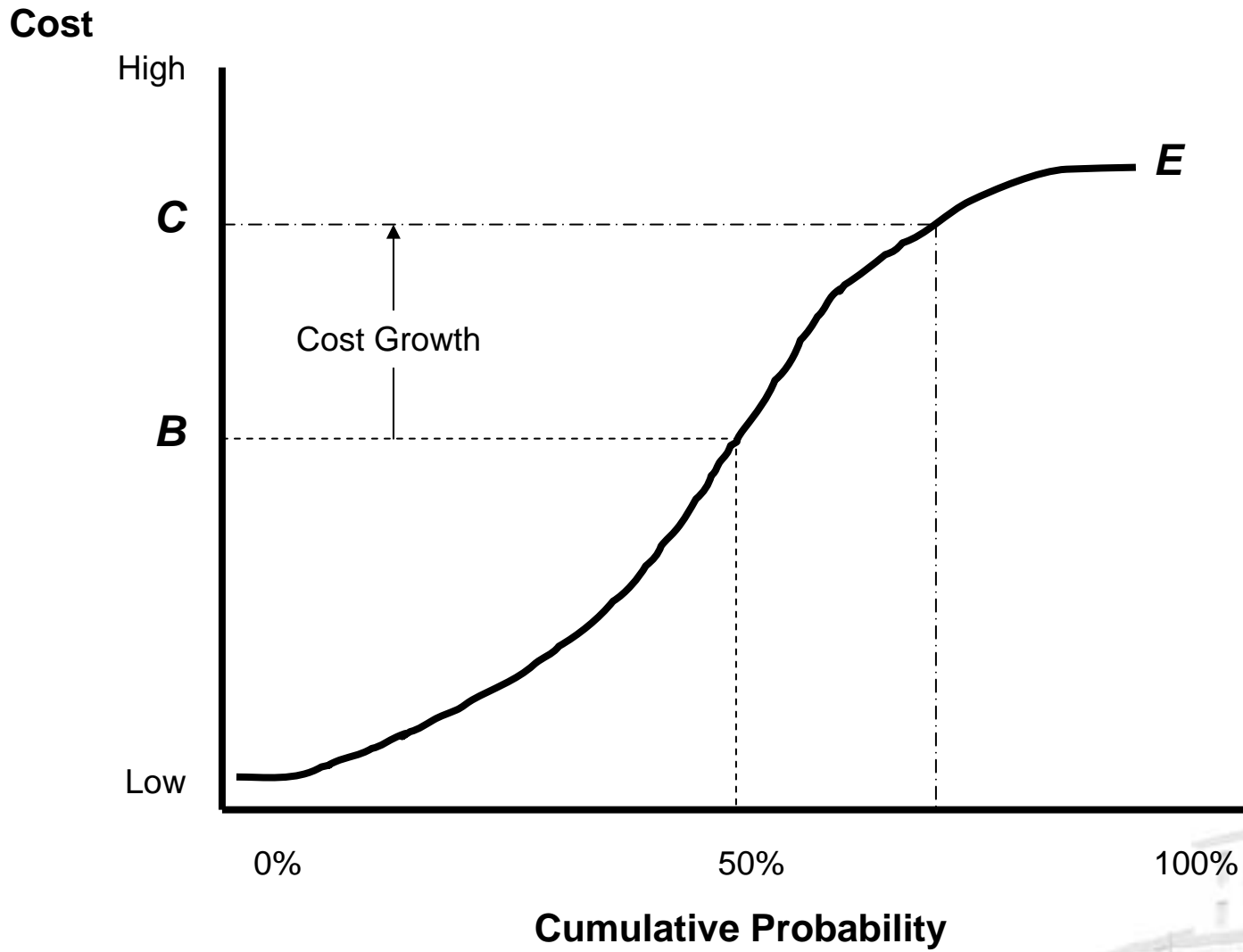
- Stresses the remainder of defense program
- Missed expectations by stakeholders
 - Top line must increase *or*
 - Schedules slip *or*
 - Quantities are reduced *or*
 - Capability is compromised *or*
 - Some combination of the above



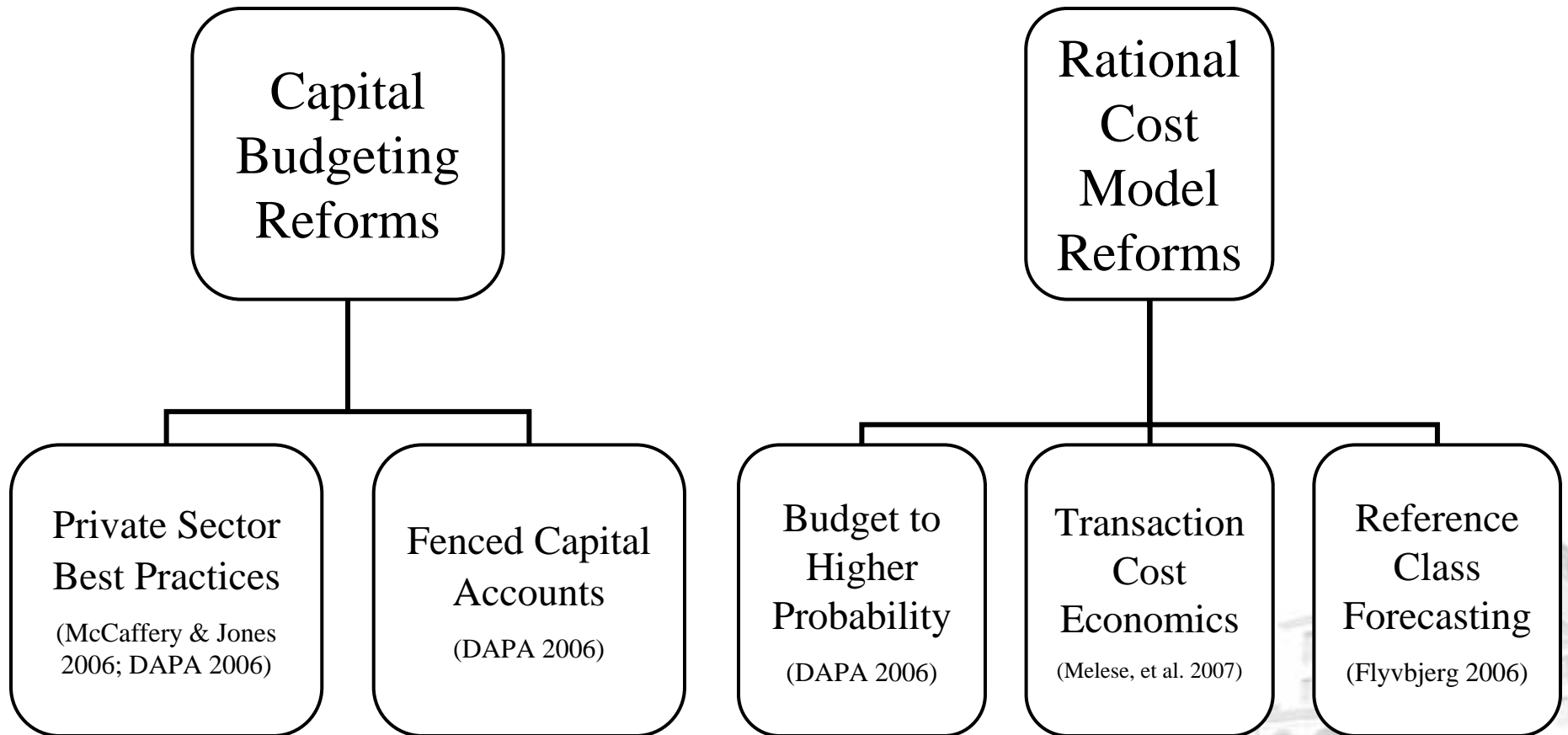
The Nature of Cost Growth

- Historical, Current and Prospective Problem
- Well-studied and understood
- A focus of policy-maker, executive, and local management attention
- A relationship between three variables
 - The cost estimate (E)
 - The resourced / budgeted amount (B)
 - The final cost tally (or latest projection) (C)
- A positive number





Two Categories of Reform



Capital Budgeting Reforms

Private Sector Best Practices

What? Separate capital investment decision from operating budget decision; do not revisit; use NPV, ROI, IRR

So? Appropriateness to federal government, limits portfolio approach, budget as control, definitional problems

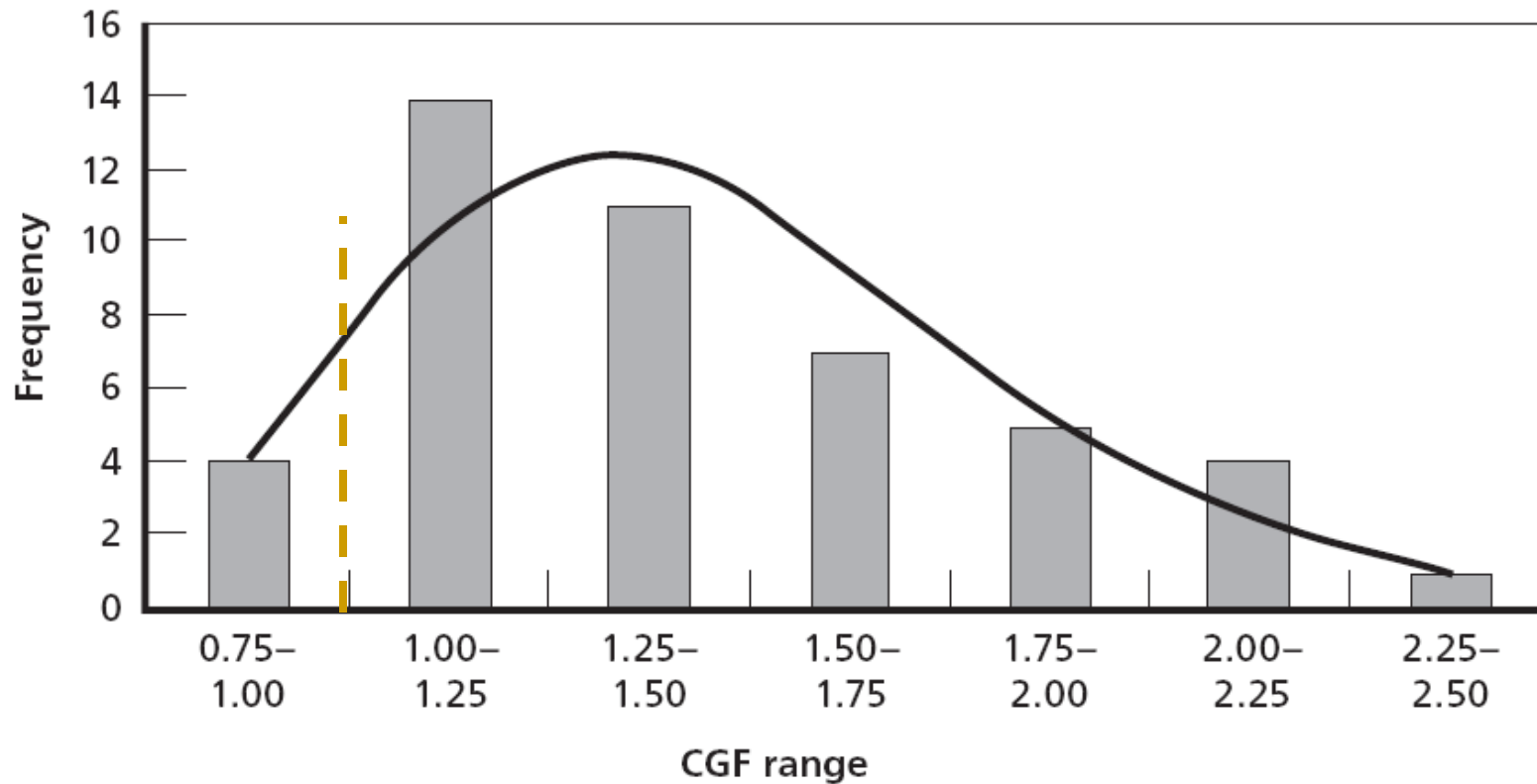
Fenced Capital Accounts

What? Once appropriated, fence program dollars to provide stability

So? Budgetary remedy for execution discipline problem, de facto shift in priority, be careful what you ask for



Cost Growth is (not statistically) normal



Source: RAND



Potential Biases

Estimating Errors	Unlikely – errors are non-normal and not improving
Unrecognized technical issues	Also non-normal
Requirements creep or schedule slip	Program execution discipline matter. Schedule: cause or effect?
Lack of incentives to control cost and schedule	A moderating factor, not a source or cause
Political considerations	A potential bias
Over-optimism (Lake Wobegon)	A potential bias
Strategic misrepresentation	Evidence of the political consideration



Rational Cost Model Reforms

Budget to Higher Probability

What? Move B to the right on Cumulative Probability curve

So? Foreordains higher cost

Transaction Cost Economics

What? Consider transaction cost of changes

So? Tangential issue for both cost and policy reasons

Reference Class Forecasting

What? Base estimate on past performance of reference class

So? Already do that, but tend to ignore the information



Bias has benefits

Camel's Nose in the Tent

Program acceptance and initiation at a realistic estimate is more difficult to obtain than an upward adjustment of an existing program

Target Costing

Using aggressive targets and value engineering efforts in an attempt to reduce cost below original estimates



Critical Thoughts on Cost Growth

- Not so much a technical matter as a psychological or political one
- Absolute costs or relative costs? Dissatisfaction with cost *growth* serves to limit *total* costs
- Is cost growth the problem or the *effects* of cost growth?
 - Effect 1 – impacts on other programs – reforms may aggravate this
 - Effect 2 – missed expectations – already being considered
- About expectations... future research should explore balancing expectations between those held by political leadership and those held by industry

