



OFFICE OF THE SECRETARY OF DEFENSE

1000 DEFENSE PENTAGON  
WASHINGTON, DC 20301-1000

APR 22 2011

MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS  
CHAIRMAN OF THE JOINT CHIEFS OF STAFF  
COMMANDERS OF THE COMBATANT COMMANDS  
DIRECTOR, ADMINISTRATION AND MANAGEMENT  
DIRECTORS OF THE DEFENSE AGENCIES  
DIRECTORS OF THE DOD FIELD ACTIVITIES

SUBJECT: Joint Memorandum on Savings Related to "Should Cost"

The purpose of this memorandum is to establish policy with regard to achieved savings as a result of successful "should-cost" program execution. At some point, Service Acquisition Executives will declare that program should-cost savings have been achieved (for example, the negotiated price of an annual production lot of a system is equal to or better than a should-cost program target). That assertion should be validated by the Service Assistant Secretary (Financial Management and Comptroller). Savings would then generally be retained by the Service and reallocated to the highest priority needs as determined by the Service Secretary or a senior leader designated by the Service Secretary.

An exception to the aforementioned guidance would apply if the Secretary of Defense or appropriate designee determines that the savings are required to meet high-priority Department-wide needs, such as financial requirements generated by Joint Urgent Operational Needs. In that case, the savings would be diverted to these departmental requirements.

A handwritten signature in dark ink, appearing to read "Ashton B. Carter".

Ashton B. Carter  
Under Secretary of Defense  
(Acquisition, Technology and Logistics)

A handwritten signature in dark ink, appearing to read "Robert F. Hale".

Robert F. Hale  
Under Secretary of Defense  
(Comptroller/Chief Financial Officer)





ACQUISITION,  
TECHNOLOGY  
AND LOGISTICS

## THE UNDER SECRETARY OF DEFENSE

3010 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3010

APR 22 2011

### MEMORANDUM FOR ACQUISITION AND LOGISTICS PROFESSIONALS

SUBJECT: Implementation of Will-Cost and Should-Cost Management

Last September, I directed the implementation of an internal management tool for all ACAT I, II, and III programs that I coined Will-Cost and Should-Cost Management. My goal for this initiative is to ensure that Program Managers drive productivity improvements into their programs during contract negotiations and throughout program execution including sustainment. It is essential that we eliminate cost overruns and begin to deliver programs below budget baselines that are set using independent Will-Cost estimates. I believe this is achievable if Program Managers continuously perform Should-Cost analysis that scrutinizes every element of government and contractor cost. This memorandum provides additional direction on the implementation of Will-Cost and Should-Cost Management.

Program Managers will develop, own, track, and report against Should-Cost estimates. In doing so, they should use all relevant resources within the Department to facilitate the development of program Should-Cost estimates (e.g., DCMA assisted overhead and program cost reviews). I expect Program Managers to provide program-level Should-Cost estimates for their ACAT I, II, and III programs as they are reviewed at major milestone decisions. The Defense Acquisition Board templates have recently been updated to reflect the type of information that is expected for Will-Cost and Should-Cost program estimates. In addition, I have directed the Services to each identify five programs to serve as models for Should-Cost implementation.

These programs will be used to communicate and demonstrate to other DoD offices and Congress the intent and advantages associated with managing to a Should-Cost estimate that is lower than the program budget. The delta between Should-Cost and Will-Cost will be managed consistently with the contract type(s) being used in the program. Once a firm-fixed-price contract is negotiated, any delta between budgeted amount and contracted price can be considered to have been "realized" and be reallocated consistent with statutory limitations and DoD/Service policies. For other types of contracts, funds generally can be reallocated after sufficient confidence has been established that contract performance will result in realized savings.

Service and Component Acquisition Executives should develop incentive plans for their Program Managers to reinforce and reward commitment to the Will-Cost and Should-Cost Management process. In addition, an annual report on Should-Cost progress is expected from each Service and Component. The first report is due to me on November 1, 2011. Progress reporting on the Should-Cost estimates will also be required for all Defense Acquisition Executive Summary reviews. Should-Cost estimates are not to be used for official program reporting, to set acquisition program baselines, or to set budgets. The Will-Cost estimate will continue to be the official position of the Department for use in budgeting, programming, setting acquisition program baselines, and for any other program reporting requirements external to the Department.



An essential ingredient of Should-Cost management is the provision of incentives for both of the parties to program execution: government managers, who seek more value for the warfighter and taxpayer; and industry managers, who develop, build and sustain our systems and provide needed services. The key is to seek and eliminate low-value-added ingredients of program cost and to reward appropriately those who succeed in doing this. For government managers, this means additional resources to enhance their programs (for example, by freeing up funds to buy more warfighting capability) and professional recognition. This will be part of how every Program Manager's and Program Executive Officer's performance will be evaluated. For industry, this means sharing in savings realized in the form of increased profit and enhanced corporate recognitions for delivering value to the government.

Service and Component Acquisition Executives, Program Executive Officers, and Program Managers should weigh the best method of meeting the intent of this initiative. Should-Cost estimates can be developed in any of three ways or in a combination. The first is through a bottoms-up estimate. Program offices do not need to form excessively large cross-functional teams to perform detailed bottoms-up assessments on *every* ACAT I, II, and III program. In some cases, however, this level of detailed analysis will be extremely beneficial and desired.

The second method is to identify reductions from "Will-Cost" estimates. At a minimum, I expect each Program Manager to determine specific discrete and measurable items or initiatives that can achieve savings against the Will-Cost estimate. These actionable items will be presented via the Should-Cost estimate and will be tracked and managed as part of Should-Cost estimate progress reporting. Arbitrary reductions and unsubstantiated high-risk goals against the Will-Cost estimate are not acceptable. Should-Cost estimates must be consistent with the defined program of record and have actionable content. Items that require significant up-front investment or significant change to the program of record (e.g., economic production rates) should not be presented in the Should-Cost estimate base, but should be highlighted in separate excursions for consideration by the Milestone Decision Authority.

A third method, where applicable, should use competitive contracting and contract negotiations to identify Should-Cost savings. In all cases, our contracts should reflect our efforts to manage to Should-Cost levels. This includes providing adequate savings sharing for industry to achieve Should-Cost levels that have been identified but not yet realized in incentive-type contracts and negotiating fixed-price contracts that reflect Should-Cost estimates.



Ashton B. Carter

Attachments:

1. Ingredients of Should-Cost Management
2. Will-Cost and Should-Cost Management Example Programs

## ATTACHMENT 1

### **Ingredients of Should-Cost Management**

1. Scrutinize each contributing ingredient of program cost and justify it. Why is it as reported or negotiated? What reasonable measures might reduce it?
2. Particularly challenge the basis for indirect costs in contractor proposals.
3. Track recent program cost, schedule, and performance trends and identify ways to reverse negative trend(s).
4. Benchmark against similar DoD programs and commercial analogues (where possible), and against other programs performed by the same contractor or in the same facilities.
5. Promote Supply Chain Management to encourage competition and incentivize cost performance at lower tiers.
6. Reconstruct the program (government and contractor) team to be more streamlined and efficient.
7. Identify opportunities to breakout Government-Furnished Equipment versus prime contractor-provided items.
8. Identify items or services contracted through a second or third party vehicle. Eliminate unnecessary pass-through costs by considering other contracting options.
9. In the area of test:
  - a. Take full advantage of integrated Developmental and Operational Testing to reduce overall cost of testing;
  - b. Integrate modeling and simulation into the test construct to reduce overall costs and ensure optimal use of National test facilities and ranges.
10. Identify an alternative technology/material that can potentially reduce development or life cycle costs for a program. Ensure the prime product contract includes the development of this technology/material at the right time.



## ATTACHMENT 2

### Will-Cost and Should-Cost Management Example Programs

Air Force	Army	Navy
Joint Strike Fighter (F-35)	Joint Air Ground Missile (JAGM)	Joint Strike Fighter (F-35)
Global Hawk Blocks 30 & 40 (GH BLK 30 & 40)	Black Hawk (UH-60M)	Hawkeye (E-2D)
Space Based Infrared System (SBIRS)	Ground Combat Vehicle (GCV)	Presidential Helo (VXX)
Evolved Expendable Launch Vehicle (EELV)	Paladin Product Improvement (PIM)	Littoral Combat Ship (LCS)
Advanced Extremely High Frequency (AEHF) Satellite System	NETT Warrior	Ohio Replacement Program