THE ASSISTANT SECRETARY OF THE NAVY
(RESEARCH, DEVELOPMENT AND ACQUISITION)
1000 NAVY PENTAGON
WASHINGTON DC 20350-1000
JUL 19 2011

MEMORANDUM FOR DISTRIBUTION

SUBJECT: Implementation of Should-Cost Management

References: (a) Under Secretary of Defense (Acquisition Technology & Logistics) Memorandum "Implementation Directive for Better Buying Power – Obtaining Greater Efficiency and Productivity in Defense Spending" November 3, 2010
(b) Under Secretary of Defense (Acquisition Technology & Logistics) Memorandum "Better Buying Power: Guidance for Providing Better Efficiency and Productivity in Defense Spending" dated September 24, 2010
(c) Under Secretary of Defense (Acquisition Technology & Logistics) Memorandum "Implementation of Will-Cost and Should-Cost Management" dated April 22, 2011
(d) Under Secretary of Defense (Acquisition Technology & Logistics) Memorandum on Savings Related to "Should-Cost"
(e) Under Secretary of Defense (Acquisition Technology & Logistics) Memorandum "Better Buying Power: Mandate for Restoring Affordability and Productivity in Defense Spending" dated June 28, 2010
(f) Assistant Secretary of the Navy (Research, Development, and Acquisition) and Assistant Secretary of the Navy (Financial Management and Comptroller) Memorandum "Department of the Navy Service Cost Positions" dated January 7, 2010
(g) SECNAVINST 5223.2 Department of the Navy Cost Analysis dated December 16, 2008

Attachment (1): Should-Cost Management Guidelines

The Department of the Navy (DoN) acquisition community is continuing to implement the 23 principle actions identified in references (a) and (b) to gain greater efficiency and productivity in defense spending. Of particular importance is implementation of "Should-Cost Management," emphasized in reference (c) and (d).

In accordance with references (a) – (e), the DoN is directed to establish Should-Cost targets for all ACAT I – III programs and to use Should-Cost Management to track subsequent performance. Implementation of these directives requires the establishment of a Will-Cost estimate and continual Should-Cost Management activity for all ACAT I,

II, and III programs as defined in the Should-Cost Management Guidelines (attachment (1)). Program managers, through continuous Should-Cost Management, will identify specific, discrete, and measurable actions or initiatives that achieve savings against the Will-Cost estimate. Should-Cost Management challenges program managers to drive productivity improvements in all phases of program execution by scrutinizing every element of government and contractor costs. Reference (c) provides program managers with specific approaches to achieving Should-Cost targets and realizing savings through lower program costs.

The Milestone Decision Authority (MDA) will approve all Should-Cost Management initiatives and targets and will use these to set program execution goals. Program managers will manage, report and track to these targets, as well as defend the validity of the specific initiatives identified that achieve savings against the Will-Cost estimate. For programs that report to the Office of Secretary of Defense, approval by the MDA of Should-Cost Management initiatives is required prior to leaving the DoN. Should-Cost Management reporting will not be external to the Department of Defense (DoD).

Program budget baselines for ACAT I, II, and III programs will be informed by the program Will-Cost estimate. During the year of execution, funds will be available to programs based on their Should-Cost Management targets. Successful execution to the Should-Cost Management estimate will create assets within the DoN for reallocation to the highest priority needs. Initially, the withholding of funds will be limited to the F-35, E-2D, VXX, LCS and Ohio Replacement programs, which will serve as pilots to develop an effective funds management process.

Attachment (1) provides initial guidance and clarifies terms, procedures, and reporting requirements associated with this initiative. The point of contact for this initiative is the Deputy Assistant Secretary of the Navy, Management and Budget (M&B).

Sean J. Stackley

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SUBJECT: Implementation of Should-Cost Management

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SHOULD-COST MANAGEMENT GUIDELINES

Will-Cost Estimates and Should-Cost Management

A transparent, two tiered cost, funding, and management approach using two separate estimates, a Will-Cost estimate to inform the program/budget process and a Should-Cost Management target for program management and execution.

Will-Cost Estimate (Budget Baseline) and Development

The budget baseline will be informed by a Will-Cost estimate that aims to provide sufficient resources to execute the program under normal conditions, encountering appropriate levels of technical, schedule, and programmatic risk and to provide assurance that: 1) the program can be completed within the budgeted program baseline and 2) the program will not encounter a Nunn-McCurdy breach. For ACAT I programs, the Will-Cost estimate is the CAPE Independent Cost Estimate (ICE) or the Service Cost Position (SCP). The Will-Cost estimate will be prepared in accordance with all applicable documents found in Appendix A and the cost estimating procedures noted in references (e) and (f) of this Implementation of Should-Cost Management memorandum. Reference (f) describes specific requirements for DoN Service Cost Positions in support of ACAT I milestone decisions, and these same principles should be applied to ACAT II and III programs. Will-Cost estimates for ACAT II and III programs will be presented at milestone decisions and approved by the appropriate Systems Command (SYSCOM) cost estimating organizations in accordance with reference (g).

As identified in SECNAVINST 5223.3 "Department of the Navy Service Cost Positions" dated December 16, 2008, the Will-Cost estimate should reflect the program of record estimate and the Cost Analysis Requirements Description (CARD). Programs are expected to actively manage the budget baseline using current Will-Cost estimates for all acquisition, budget, and programming decisions.

Processes for Will-Cost estimates are currently in place for ACAT I programs, including a requirement for a SCP at each milestone decision. ACAT II and III programs should present a Will-Cost estimate at milestone decisions that have been approved by the appropriate System Command (SYSCOM) cost estimating organization. Annual ACAT II and III program Will-Cost estimate updates must also be approved by the appropriate SYSCOM cost estimating organization. For all programs, the Will-Cost estimate review/update must assess all Should-Cost Management efficiencies identified for potential incorporation.

Should-Cost Management (Program Execution Targets) and Development

The program execution target will incorporate Should-Cost Management initiatives developed by the program office and will be used as an internal management tool within the DoD to incentivize performance to the target. The Should-Cost target will be based on

realistic technical and schedule baselines and assumes successful outcomes from implementation of efficiencies, lessons learned, and best practices. Targets will be designed to drive productivity improvements in programs, will inform contract negotiations and will incorporate results of contract direct and indirect cost reviews when they are conducted. (See FAR 15.407-4 and DFARS 215.407-4 Should Cost Reviews.) The program office is responsible for developing Should-Cost Management targets and initiatives along with all tracking and reporting requirements. Under Secretary of Defense, (Acquisition Technology & Logistics), USD (AT&L) (ACAT ID and IAMs) and Assistant Secretary of the Navy (Research, Development, and Acquisition), ASN (RD&A) (or delegated MDA or PEO) will approve Should-Cost Management targets at milestones and at annual Gate Reviews/Configuration Steering Boards. Updates resulting from annual reviews for all ACAT I programs are approved by ASN (RD&A) with AT&L notified of these revisions.

Should-Cost targets should consider all Will-Cost estimate excursions and all previously defined Should-Cost targets. Should-Cost Management initiatives will be categorized as either near-term (within the program manager's tenure) or long-term initiatives (e.g. cost related to sustainment); and program driven (within program manager's control), service driven (within the services control), or externally driven (outside service control).

Should-Cost targets should be developed in one of three ways:

- The Should-Cost target is developed using the Will-Cost estimate as the base and applies discrete, measurable items and/or specific initiatives for savings against that base. This is the recommended approach for all programs with an established Will-Cost estimate.

- The Should-Cost target is developed using a bottom-up approach without a formal FAR/DFARS should cost review and includes actionable content that will lead to achieving cost below the Will-Cost estimate or budget baseline. The bottoms-up approach can be performed at the very lowest levels or at higher levels, and is primarily defined as using methods distinctly different from the Will-Cost estimate development.

- The Should-Cost target is developed using a bottom-up approach with a full-up indirect/direct contract should cost review in accordance with FAR 15.407-4 and DFAR 215.407-4 and includes actionable content that will lead to achieving cost below the Will-Cost estimate or budget baseline.

Note: Detailed FAR/DFARS should cost reviews are recommended to support contract negotiations, particularly for sole source production procurements; however, they are often resource and time intensive and require advance coordination with DCMA and Service functional communities.

Should-Cost targets will be developed in collaboration with the appropriate SYSCOM functional organizations and program managers may seek assistance from outside organizations (e.g. ASN (RD&A), the Naval Center for Cost Analysis (NCCA), DCMA and other program offices) as program managers identify Should-Cost initiatives. Unspecified cost reductions (e.g. broad based dollar / percent reductions) against the Will-Cost estimate are not valid Should-Cost targets. Initiatives are expected to have specific actionable content associated with the reductions. Most items outside the control of the program office and inconsistent with the current program of record are outside excursions and not appropriate as Should-Cost Management initiatives. For example, economic production rate excursions or other quantity excursions are not part of the program Should-Cost target. They should be identified and presented separately. Items that require significant up-front investment or a significant change to the program of record (e.g. economic production rates) should not be included as a Should-Cost Management initiative, but should be presented as separate but important excursions for consideration by the MDA.

Should-Cost Management Reporting Processes and Procedures

Will-Cost estimates and Should-Cost Management targets are required for all ACAT I, II and III milestone decisions. Table 1 summarizes when Will-Cost estimates, Should-Cost targets, and Indirect/Direct Contract Cost Reviews are required or recommended.

Table 1: Event Driven Cost Estimate Reporting Requirements

Event	Will-Cost estimate (Initial / Update) (Refer to App. A & B).	**Program Should-Cost Management target** **(Initial / Update)**	Indirect/Direct Contract Cost Reviews (Refer to recommendations IAW FAR 15.407-4 and DFAR 215.407-4)
MS A	Initial	**Initial**	N/A
MS B	Update (Initial setting of Budget Baseline for Nunn-McCurdy metrics)	**Update (Sets Internal Program Execution Baseline)**	Initial to Support Contract Actions (Optional)
MS C / LRIP 1 Contract Award	Update	**Update**	Optional Refer to recommendations IAW FAR 15.407-4 and DFARS 215.407-4.

In addition, consideration should be given to updating Should-Cost Management targets for the following program events:

- FRP (FDDR) Decision / Contract Award.
- In preparation for or immediately following Critical Design Review.
- First LRIP award out of option contracts; in particular, in cases where option production contracts were awarded as part of the development contract award.
- Interim Contractor Support and Contractor Logistic Support first contract awards. At a minimum update the Will-Cost estimate, but consider updating the Should-Cost target and conducting a FAR/DFARS indirect/direct cost reviews. Conducting these updates in conjunction with a sustainment Business Case Analysis (BCA) is beneficial.
- Organic Logistics Infrastructure. Update the Will-Cost estimate, but consider updating the Should-Cost target and conducting a FAR/DFARS indirect/direct cost reviews. Conducting these updates in conjunction with a sustainment BCA is beneficial.

Reporting Methods and Templates

Program offices will be responsible for tracking and reporting all Should-Cost targets and any updates. At a minimum, reporting elements will include the discrete items or specific initiatives, cost savings associated with each individual item, a program timeline or event when the savings is expected to be realized, and the total expected to be saved. Maintaining visibility of the original program execution baseline over time, how it changes and the successes achieved is critical and will provide valuable lessons learned and data for other and future programs.

The Should-Cost target is an internal management tool for incentivizing performance to target, and is, therefore, not to be used for budgeting, programming, or reporting outside the department. Thus, Should-Cost target documentation must be marked and treated as For Official Use Only. For programs that report to the Office of Secretary of Defense, approval by the MDA of Should-Cost Management initiatives is required prior to leaving the DoN. Formal reporting in DASHBOARD will be required in the future and the Should-Cost targets will be reported to the AT&L/ARA through Acquisition Visibility Service Oriented Architecture (AV SOA).

Appendix B contains the approved Will-Cost/Should-Cost DAB template for MS A and MS B, and for DoN Gate Reviews. This template can be tailored as necessary. Appendix C offers recent examples of DoN program Should-Cost Management opportunities for consideration.

With appropriate justification, waivers may be granted for Should-Cost targets or subsequent updates. In rare circumstances, and with appropriate justification, waivers may

be requested from the OUSD (AT&L) for ACAT ID/IAM programs, the ASN (RD&A) for ACAT IC/IAC programs, and by the MDA or PEO for ACAT II and III programs. Waiver requests to the Should-Cost Management requirements should be submitted to DASN (M&B) using the form "Exemption to Should-Cost Management Requirement" found in Appendix D.

Process for withhold and release of the difference between the Will-Cost estimate (budget) and the Should-Cost Management target

During program execution the difference between the funds appropriated annually and Should-Cost Management target will be held at the Secretariat level. The SAE is the decision authority on the distribution of the difference for all ACAT I programs, the MDA for all ACAT II programs and the PEOs are the decision authority for the distribution of the difference for all ACAT III programs. Initial and updated Will-Cost estimates and Should-Cost targets must be promptly provided to ASN (RD&A) DASN (M&B) and OASN (FM&C) DASN (FMB) to manage the funding hold process. The funding hold and release process for the Department of the Navy will be as follows:

- Programs that are funded starting in FY2012 and are limited to expending no more than the Should-Cost Management target. Funds equal to the Should-Cost target will be released to the program manager for execution. The remaining funds representing the difference between the Will-Cost estimate and the Should-Cost target will remain in the program line but be placed on hold at the Secretariat level.

- Each program manager will brief their execution status relative to the Should-Cost Management target at the annual Gate Six Sufficiency Review/ Configuration Steering Board. Program managers will also present their annual Should-Cost target updates during any scheduled SAE reviews.

- Program managers will request any release of funds on hold during the annual Gate Review/CSB (see Appendix B for a template).

- If a program manager requires release of funding between regularly scheduled Gate Six reviews, the Program Executive Officer shall schedule an out-of-cycle Gate Six review through the appropriate product DASN.

- If a program manager requires release of funding between regularly scheduled Gate Six reviews, the Program Executive Officer shall schedule an out-of-cycle Gate Six review through the appropriate product DASN.

NOTE: The process to hold funds that have been appropriated and that represent the difference between the Will-Cost estimate and the Should-Cost Management target will initially be piloted on five DoN programs (i.e., F-35, E-2D, VXX, LCS, Ohio Replacement) and will be fully implemented across all ACAT I, II and III programs upon successful completion of the pilot.

Program managers will share Should-Cost Management information and results among all DoN cost organizations in a transparent and timely manner. Program offices, SYSCOM cost staffs, and NCCA will ensure full incorporation of the achieved savings into updated Will-Cost estimates. Updated Will-Cost estimates incorporating the latest information on release of funds and achieved savings will be provided through the DoN Objective Memorandum (POM) process for inclusion in revised POM positions.

Appendix A

Cost Estimating Policy, Directives, and Guidance

1) Department of Defense (DoD) Instruction 5000.2 dated December 8, 2008

2) OUSD (AT&L)/ARA Policy Memo "Required Signed and Documented Component-level Cost Position for Milestone Reviews," dated March 12, 2009

3) ASN (RD&A) and ASN (FM&C) Memorandum "Department of the Navy Service Cost Positions," dated January 7, 2010

4) Department of Navy Cost Estimating Guide: Compendium of Best Practices

Will Cost/Should Cost

Will / Should Cost Analysis

RDTE + APA Total	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	12-17 Total	To Comp FY18-25	Total FY12-25
Will Cost (ICE)	$805.4	$1,256.0	$1,691.1	$1,260.2	$1,170.5	$973.3	$ 7,156.4	$5,556.0	$12,712.4
Should Cost	$789.4	$1,231.3	$1,675.7	$1,155.8	$ 933.1	$784.5	$ 6,569.8	$4,740.3	$11,310.1

Supporting Evidence for Should Cost:

- **Production rates economical and historically stable ($XXX)**
- **Shorten program timeline**
  - Complete R&D effort in FY16 vs. FY17 as currently planned in ICE **($XXX)**
  - Potential production rate increase **($XXX)**
- **Strong negotiation positions ($XXX)**
  - Historical cost, learning curve, and understanding of production efficiencies **($XXX)**
  - Long-term supplier agreements **($XXX)**
- **Parametric model MOA established with contractor for key routine functions/costs ($XXX)**
- **Open system architecture design eases future enhancements ($XXX)**
- **Aggressive "Breakout" IPT established for appropriate technical data packages (TDP) and data rights ($XXX)**

Recommendation: Keep (DAB Unique) (Navy additions in blue)

Source:

FOUO

APPENDIX B

Examples of Opportunities for Should-Cost Management

- Identify items or services contracted through a second or third party vehicle. Eliminate unnecessary pass-through costs by considering other contracting options

- Identify an alternative technology/material that can potentially reduce development or life cycle costs (IR&D/Lab, etc) for a program. Ensure the prime product contract includes the development of this technology/material at the right time

- Reconstruct the program (government and contractor) team to be more streamlined and efficient

- In the area of test:

    - Take full advantage of integrated Developmental and Operational Testing to reduce overall cost of testing

    - Integrate modeling and simulation into the test construct to reduce overall costs and ensure full use of National test facilities and ranges

- Identify opportunities to breakout Government Furnished Equipment versus prime contractor provided items

- Promote Supply Chain Management to encourage competition at lower tiers

- Changes to ICE (SCP) assumptions
    - Multi year procurement (economic order quantity)
    - Learning curve reduction
    - Reduced change orders
    - Overhead rate reduction
- Focus areas
    - System specifications
    - Design for affordability
    - Build strategy
    - Contracting strategy
    - Schedule reduction
    - Next generation Integrated Product Development Environment (IPDE)
    - Facility/production enhancements
- Other
    - Tandem buy (negotiate two LRIP lots)
    - Second sources
    - Alternative designs
    - Process improvements

Some approaches/items not to include in the Should-Cost estimate:

- Arbitrary reductions against the Will-Cost estimate are not acceptable for Should-Cost estimates. These estimates are expected to have specific actionable content associated with the reductions.

- Choosing a lower confidence level from your Will-cost estimate range is not acceptable for the Should-Cost estimates. These estimates are expected to have specific actionable content associated with the reductions.

- Programs operating under Firm Fixed price (FFP) should use the common sense – focused scrutiny should be on associated other government costs and only reopen FFPs if there is a clear benefit to do so.

EXEMPTION TO THE SHOULD COST REQUIREMENT		Requestor's Name:
DATE:	EXEMPTION REQUEST FORM	Requestor's Number:

DESCRIPTION OF PROGRAM:

JUSTIFICATION FOR EXEMPTION:

**Attach a copy of the program schedule to this request form.

PROGRAM START DATE	YEARS LEFT IN PROGRAM	PERCENTAGE OF FIELDING REMAINING	PROGRAM IN SUSTAINMENT	IS THERE AN APB	PROGRAM BUDGET ALL YEARS	PROGRAM BUDGET REMAINING	REPORTING REQUIRED?

For Authorized Use Only

PLATFORM DASN REVIEW OF REQUEST

Comments/Recommendation:

PEO: _____ Date: _____

PLATFORM DASN: _____ Date: _____

DASN (M&B): _____ Date: _____

ASN RD&A: _____ Date: _____