



Highlights of [GAO-08-379](#), a report to congressional committees

Why GAO Did This Study

The nation's long-term fiscal imbalances will likely make DOD's \$1.6 trillion planned investment in new weapon systems unsustainable. Thus, it is critical that DOD retains the flexibility to end programs and contracts when necessary and appropriate.

Although the federal government generally has the legal right to terminate contracts for convenience, defense stakeholders have sometimes expressed concerns that it will cost more to terminate a contract than to complete it. To address this perception, GAO examined (1) how expected contract termination costs and other factors affect DOD decisions on whether to end programs and contracts; (2) the circumstances under which it would cost more to terminate a contract for convenience than to complete it; and (3) the options DOD has for retaining value or reducing costs, when DOD ends programs or contracts. To do this, GAO examined DOD data on terminated contracts over \$100 million; reviewed laws, regulations, and guidance; and met with key DOD officials.

What GAO Recommends

GAO recommends that DOD review, and as needed amend, guidance on terminations across the military services and DOD agencies to ensure that termination guidance identifies the conditions under which it is appropriate to end programs or contracts, and provides knowledge needed to use terminations as an investment portfolio tool. DOD agreed.

To view the full product, including the scope and methodology, click on [GAO-08-379](#). For more information, contact Cristina Chaplain at (202) 512-4841 or ChaplainC@gao.gov.

DEFENSE ACQUISITIONS

Termination Costs Are Generally Not a Compelling Reason to Continue Programs or Contracts That Otherwise Warrant Ending

What GAO Found

Contract termination costs were generally not a major factor in Department of Defense (DOD) decisions to end programs or contracts for the weapon systems GAO reviewed. GAO found that these program cancellations were driven by factors such as changes in warfighter need and budgetary constraints. In the contract termination decisions GAO reviewed, DOD considered termination costs, but they were generally not as significant as other factors, such as contract cost growth.

For the contracts reviewed, GAO found that it did not cost more to terminate than to complete them. When the government terminates a contract for convenience, it must compensate the contractor for the incurred costs on the completed work, a fee or profit on that work, and the termination costs. Federal regulations place various limits on this compensation for both cost-reimbursement and fixed-price contracts. GAO found eight fully terminated contracts of weapon systems that were over \$100 million in value, terminated after 1995, and for which data were available. Of these, none cost more to terminate than to complete.

When a program or contract ends, DOD can retain some value from the work completed. For example, DOD can end the work immediately and transfer materials or technology to other efforts. Alternatively, DOD can modify the scope of a contract and complete a limited portion of the original work.

GAO's review of DOD's past experience with terminations highlights important lessons for DOD in making decisions to cancel individual programs as well as in managing its broader investment portfolio. For example, when considering cancellation of individual programs, contract termination costs are generally not a compelling reason to continue programs or contracts that otherwise warrant ending. Moreover, while incurred or "sunk" costs in programs being considered for termination may be substantial, they must be paid regardless of whether or not a contract is terminated. Therefore, the decision to terminate a contract or cancel a program should not be driven by sunk costs.

From an investment portfolio perspective, terminations can be a valuable tool in responding to long-term fiscal imbalances as well as unexpected events that could constrain spending. More specifically, they can be used to create more trade space in the over \$850 billion that still remains in outstanding commitments in DOD's planned \$1.6 trillion investment in weapons programs. However, to make the most effective use of this tool, decision-makers need to be able to anticipate and plan for possible terminations and have a sound understanding of costs, benefits, and legal requirements. As a result, guidance on terminations developed by the military services and other DOD entities should be clear, consistent, proactive, and detailed enough to provide the knowledge needed to use terminations as an investment portfolio tool.