



**DEPARTMENT OF THE ARMY**  
WASHINGTON DC 20310-0103

JUN 10 2011

SAAL-ZR

**MEMORANDUM FOR SEE DISTRIBUTION**

**SUBJECT: Army Implementation of Under Secretary of Defense (Acquisition, Technology and Logistics) (USD(AT&L)) Affordability Initiatives**

**1. References:**

a. Memorandum, Office of the Secretary of Defense (OSD), Acquisition, Technology and Logistics (AT&L)), 3 November 2010, Subject: Implementation Directive for Better Buying Power-Obtaining Better Efficiency and Productivity in Defense Spending.

b. Memorandum, OSD(AT&L), 14 September 2010, subject: Better Buying Power-Guidance for Obtaining Better Efficiency and Productivity in Defense Spending.

c. Memorandum, OSD(AT&L), 28 June 2010, subject: Better Buying Power: Mandate for Restoring Affordability and Productivity in Defense Spending.

d. Memorandum, Office of the Army Secretary of the Army (Acquisition, Logistics and Technology), 3 January 2010, subject: Clarification of Defense Acquisition Executive (DAE) Policy Regarding Acquisition Category (ACAT) III Program Reviews.

2. In accordance with reference a., this memorandum and the enclosed guidance provide my direction on the implementation of Dr. Carter's affordability initiatives. I fully support these affordability initiatives and expect the Department of Army (DA) acquisition community to embrace the concepts and adjust our management processes immediately. Included in Target Affordability and Cost Growth are five initiatives: (1) mandate affordability as a requirement, (2) drive productivity growth through should-cost/will-cost management, (3) eliminate redundancy within Warfighter portfolios, (4) make production rates economical and hold them stable, and (5) set shorter timelines and manage to them. Each of these is addressed in more detail below.

a. Mandate affordability as a requirement: All programs will use the Defense Acquisition Board (DAB) template for affordability (see enclosure 1). I expect each program at Milestone A to set affordability targets and manage to them in a similar manner as a Key Performance Parameter. At Milestone B you will establish engineering trades showing how each key design feature affects the target cost and then you will perform trade-off analysis.

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(1) Drive productivity growth through should cost/will cost management: In order to gain greater efficiency and productivity in Defense spending, the USD(AT&L) has directed the Military Departments and Directors of Defense Agencies to implement will-cost and should-cost management for all ACAT I, II and III programs. Dr. Carter is challenging program managers to drive productivity improvements into their programs during contract negotiation and program execution by conducting should-cost analysis, whereby every element of Government and contractor costs are scrutinized.

(2) The Department will continue to set program budget baselines using will-cost estimates (through Cost Analysis and Program Evaluation) Independent Cost Estimate or a Department of the Army Service Cost Position) in support of ACAT I and II milestone decisions. While Army ACAT I and Army Acquisition Executive managed ACAT II program will-cost estimating (Army Cost Position development) already follows clear procedural guidelines, our Program Executive Officers (PEOs) managed ACAT II and III programs are less consistent. Effective immediately, all Army ACAT II and III programs are required to develop and have independent verification of will-cost estimates prior to milestone decisions. As with ACAT I programs, the will-cost estimate will be used as the basis for all budgeting and programming decisions. All metrics and reporting external to the Department will be based on the will-cost estimate.

(3) Program managers must begin to drive leanness through should-cost management. The should-cost estimate 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. Rather, will-cost estimates are the official program position for budgeting, programming, and reporting.

(4) Program managers are responsible to identify opportunities for savings and develop should-cost estimates. This effort does not necessarily require large cross-functional teams to perform detailed bottoms-up assessments on every ACAT I, II, and III program. Instead, I expect program managers through continuous Should-cost management review to identify specific discrete measurable items or initiatives that achieve savings against the will-cost estimate. Currently, there is no requirement to provide Should-cost management for Quick Reaction Capabilities.

(5) The Milestone Decision Authority (MDA) will approve all initial should-cost estimates and will use these estimates to set program execution targets. By 1 January 2012 all ACAT I, II, and III programs will have MDA approved should-cost execution targets. In addition, they will be prepared to manage, report, and track to these targets and defend the validity of the specific initiatives identified that achieve savings against

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the will-cost estimate. In the event programs are not scheduled for a major milestone review in 2011, program managers should take appropriate steps to ensure the MDA reviews and approves should-cost targets for all programs. I will approve annual updates to program should-cost targets for ACAT I and those ACAT II programs that I manage and the PEOs will have approval authority for the ACAT II programs delegated to them and ACAT III programs. The PEOs will annually report on their progress to ASA(ALT) (SAAL-RP) and I will provide a consolidated annual report to OUSD(AT&L)/ARA on our progress. For the first year the PEOs will review and submit their should-cost initiatives by program on the following dates: All ACAT I program submissions are required no later than (NLT) 30 October 2011, ACAT II programs NLT 30 December 2011, and ACAT III programs NLT 1 March 2012. After the first year, all submissions are required NLT 30 October of that year.

(6) During the year of execution, funds will be distributed to programs based on their should-cost estimate. The difference between the funds distributed and the program budget baseline will be withheld at the Service level for ACAT I, special interest, and those programs where I am the MDA and at the PEO for those programs where they are the MDA. I will be the decision authority for distribution of any additional funds for ACAT I and those programs where I am the MDA. The PEOs will be the decision authority for the programs where they are the MDA.

(7) As noted above, effective immediately Program Managers are required to develop should-cost estimates and identify opportunities for savings. However, initially, the withholding of funds and the margin management process will be limited to the five DA programs, which will serve as a testing ground toward the development of an effective margin management process. This process, once established and vetted, will apply to all programs regardless of ACAT.

(8) Enclosure 2 provides additional guidance and clarifies terms, procedures, and reporting requirements associated with this initiative. The guidance will be updated and codified in policy as USD(AT&L) and I gain experience with will-cost and should-cost management. Enclosure 3 is a Waiver Request form.

b. Eliminate Redundancy within Warfighter Portfolios: ACAT I, II, and Special Programs are reviewed annually by the Office of the Secretary of Defense and/or the AAE. At that time the health of the program as well as functional requirements are reviewed and assessed. Reference c. above directs each Program Executive Officer (PEO), as Milestone Decision Authority, to conduct annual reviews of their ACAT III

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portfolios to comply with the DAE's instructions. The PEO will provide the ASA(ALT) with a concise report of the results of the review no later than the end of the Fiscal Year and address how they are eliminating redundancy within their respective portfolios.

c. Make production rates economical and hold them stable: Dr. Carter's memorandum further defines OSD(AT&L's) expectations that PEOs and PMs "Make production rates economical and hold them stable". As directed in the USD(AT&L) memorandum, each PM of an ACAT I program prepared a one page description of how the procurement rate and schedule were set. The information was consolidated into an ASA(ALT) package. Deviations from the one page description limits defined above will require OSD(AT&L) review and approval prior to implementation or submission of component Program Objective Memorandum. The Equipping Program Evaluation Group will adjudicate and review as the Army component lead.

d. Set shorter timelines and manage to them: The PEOs will provide the ASA(ALT) their plan for reviewing each ACAT program in development. There will be specific review of the program schedule as part of the cost trade-off analysis at each milestone, beginning with Milestone B. The PEOs will conduct these scheduled sensitivity analyses when setting affordability targets and requirements. Further, the PEO will ensure requirements and program schedules are consistent in the Acquisition Strategy. This schedule compliance justification will be a part of the Acquisition Decision Memorandum authorizing the program to proceed. The MDAs will not grant authority to release requests for proposal until they are confident requirements and schedule compliance are consistent. Deviation from the established schedule at the most recent milestone, without MDA approval, will result in revocation of the Milestone.

4. The point of contact is Ms. Gail Foley, (703) 604-7441, or e-mail: gail.l.foley@us.army.mil.



Heidi Shyu

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Encls

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**DISTRIBUTION:**

**PROGRAM EXECUTIVE OFFICERS:**

**AMMUNITION**

**AVIATION**

**COMBAT SUPPORT AND COMBAT SERVICE SUPPORT**

**COMMAND, CONTROL AND COMMUNICATIONS (TACTICAL)**

**ENTERPRISE INFORMATION SYSTEMS**

**GROUND COMBAT SYSTEMS**

**INTEGRATION**

**INTELLIGENCE, ELECTRONIC WARFARE AND SENSORS**

**MISSILES AND SPACE**

**SIMULATION, TRAINING AND INSTRUMENTATION**

**SOLDIER**

## MS A Affordability

### Basic Questions:

- **Program Related:**
  - What do you (PM/PEO/CAE) think the driving costs in your design concept will be and why?
  - Are the largest drivers related to technical, schedule, or other factors?
- **Portfolio Related:**
  - What adjustments are necessary to the existing portfolio to fit this new program in?
  - What price point for the program would cause reconsideration within the portfolio?

## MS A AFFORDABILITY REQUIREMENT: NOTIONAL SYSTEM

Affordability Targets		Cost Drivers & Trade Excursions Plan		
Description	Cost Target	Description	Trade Excursion	Date
APUC	\$27.8M	- Range Readjustment	Speed/Range Tradeoff Review	2Q FY11
O&S	\$40.3B	- Reliability Growth	RAM Study	3Q FY11
TBD	XXX	- Engine Redesign	NAVAR/CTR Focus Group	3Q FY11
TBD	XXX	- Progression & Health Mgmt.	Independent Logistics Assessment	3Q FY12
TBD	XXX	- F/A-XY Avionics Phase	NAVAR Tiger Team	3Q FY12
TBD	XXX	- Reduced Ordnance Load	JROC Review	4Q FY12

### Discussion Points:

- #1
- #2
- #3

# MS B Affordability

## Basic Questions:

### • Program Related:

- What do you (PM/PEO/CAE) think are the driving costs in your design and why?
- Are the largest drivers related to technical, schedule or other factors? Is there trade space for these factors that can influence affordability? (If not, it does not go on the chart)
  - If the key trades are technical, what are those elements around which some “sweet spots” can be influenced?

### • Portfolio Related:

- What adjustments are necessary to the existing portfolio to fit this new program in?
- What price point for the program would cause reconsideration within the portfolio?

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## MS B AFFORDABILITY REQUIREMENT: NOTIONAL SYSTEM

### Proposed Affordability Requirements

### Cost Drivers & Trade Excursions

Description	Affordability Requirement	Current Estimate	Description	APUC	PAUC	RDT&E	Proc.	O&S	Schedule Impact
APUC	\$22.6M	\$24.4M	Original Cost Estimate	\$26.7M	\$22.9M	\$1.82B	\$15.1B	\$26.1B	N/A
			- Range Readjustment	-\$0.3M	-\$0.4M	+\$2M	-\$75M	-\$100M	None
O&S	\$32.9B	\$36.6B	- Reliability Growth	+\$2.2M	+\$2.3M	+\$15M	+\$50M	-\$1.5B	+8 Months
			- Engine Redesign	-\$0.7M	-\$1.1M	+\$4M	-\$125M	-\$75.0M	+3 Months
TBD	XXX	XXX	- Progression & Health Management	+\$0.2M	\$0.3M	\$0.0M	\$0.0M	-\$2.0B	None
TBD	XXX	XXX	- FIA-ZY Avionics Phase	-\$1.9M	-\$2.4M	-\$16M	-\$50M	+\$200M	-8 Months
TBD	XXX	XXX	- Reduced Onboard Load	-\$1.9M	-\$2.0M	+\$2M	-\$15M	\$0.0M	None
			Current Cost Estimate	\$24.4M	\$29.6M	\$1.91B	\$14.9B	\$35.6B	N/A

### Discussion Points:

- #1
- #2
- #3

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# Will Cost/Should Cost

## Will / Should Cost Analysis

ROTE + 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	\$1,891.1	\$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:

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

## Enclosure 2

### **WILL-COST AND SHOULD-COST ESTIMATING AND MANAGEMENT GUIDELINES**

#### **DEFINITIONS:**

**Will-Cost and Should-Cost Management:** A transparent, two tiered cost, funding, and management approach using two separate cost estimates: a Will-cost for budgeting and a program Should-cost for program execution. During program execution the difference between the funds appropriated annually and the Should-cost management target will be held at the Service or PEO level depending on MDA. The AAE is the decision authority on the distribution of the difference for all ACAT I programs and those ACAT II programs where he is the MDA and the PEOs are the decision authority for the distribution of the difference for those programs where they are the MDA.

#### **Will-Cost Management Baseline (budget baseline) -**

- The budget baseline will be based on a Will-cost estimate (i.e., CAPE, ICE, Army Cost Position, or verified Program Office Estimate ) that aims to provide sufficient resources to execute the program under normal conditions, encountering average levels of technical, schedule, and programmatic risk (usually no less than 50% confidence level). This Will-cost estimate supports the budget and ensures sufficient funding to provide confidence that: 1) the program can be completed without the need for significant adjustment to program budgets, and 2) the program can avoid Nunn-McCurdy or critical change breaches.
  - The Will-cost estimate shall be verified by an office or entity operating outside or above the program management office.
  - Programs are expected to actively manage the budget baseline using current Will-cost estimates for all acquisition, budget and program execution decisions (e.g. source-selection, contract negotiations, IBRs, major reviews, PMB monitoring, annual budget/programming cycle).

#### **Should-Cost Management Baseline (program execution baseline)**

- The program execution target will incorporate Should-cost management initiatives developed by the program office and approved by the MDA. These approved initiatives will be used as a management tool to incentivize performance to the Should-cost target. The Should-cost estimate will be based on realistic technical and schedule baselines and assumes success-oriented outcomes from implementation of efficiencies, lessons learned and best practices. The estimates will be designed to drive productivity improvements in our programs, will inform contract negotiations and incorporate results of contract

direct and indirect cost reviews (See FAR 15.407-4 and DFARS 215.407-4 Should-cost Reviews) when they are conducted.

### **Processes and Procedures:**

#### **Will-Cost Estimate Development:**

An independent verification to establish the Will Cost baseline should happen prior to the first time a program presents their Affordability position to the MDA. For ACAT I and II programs the PM will go through the established process to arrive at an Army Cost Position and/or approved CAPE ICE. This results in the establishment of the approved Will Cost estimate once the MDA approves the program budgeted cost at the Milestone. For delegated ACAT II and III programs, the PM will obtain an independent verification through either an ICE or validation/verification of the POE. This will then be presented to the MDA for approval thereby establishing the Will Cost. When a program modification or event occurs which significantly impacts (e.g., causes a JROC Tripwire process/5% of before unit cost Breach) the approved program baseline and the associated Will Cost, the PM will be expected to update their program office estimate and re-verify through the appropriate independent reviewer. Upon completion of these tasks they will submit the updated documents to the MDA who will approve the revised Will Cost baseline. The PM is encouraged to track interim changes to ensure that the underlying assumptions used in the Will Cost baseline still exist when addressing potential savings in Should Cost initiatives. Examples include 1) A Continuing Resolution Authority (CRA) which holds a program to a prior year budget that would impact the ability to implement Should Cost Initiatives, 2) Underlying economic indices including significant changes to inflation rates, and 3). ACAT I and II presentations at the Configuration Steering Board (CSB) that result in significant cost impacts.

#### **Should-cost Estimate Development:**

- Each program office is responsible for developing Should-cost estimates along with all tracking and reporting requirements. OSD AT&L (ACAT ID and IAMs), and AAE (or delegated PEO) approve Should-cost estimates at milestones. Updates for ACAT II and III programs are approved by the MDA. In cases where the PEO is the MDA, letter notification of the updates will be sent through the PARCA Directorate to the AAE. Annual updates for all ACAT I programs are approved by the AAE and OSD AT&L is notified.
- Should-cost estimates shall consider all Will-cost estimate excursions and all previously defined Should-cost estimates.
- There are various approaches to developing a Should-cost estimate. The recommended approaches are as follows:

- 1) The Should-cost estimate is developed using the Will-cost estimate as the base, and applying 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.
  - 2) The Should-Cost estimate is developed using a bottoms-up approach without a detailed 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.
  - 3) The Should-cost estimate is developed using a bottoms-up approach with a FAR/DFARS Should-cost review and includes actionable content that will lead to achieving cost below the Will-cost estimate or budget baseline. Note: Early, proactive 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 estimates will be developed in collaboration with the appropriate Army functional organizations.
  - Program managers should seek assistance from outside organizations (e.g., the Deputy Assistant Secretary for the Army for Cost and Economics (DASA(CE)), DCMA) as they develop their Should-cost estimates.
  - Should-cost initiatives will be categorized as:
    - Near-term (within the program manager’s tenure) and long-term initiatives; and
    - Program driven (within program manager’s control), “Service Driven” (within the services control), or “Externally Driven” (outside service control).

Broad challenges by management to reduce cost through straight reductions by a specified percentage or dollar value against the Will-Cost estimate are not valid Should-Cost estimates. The Should-cost estimates are expected to have specific actionable content associated with the reductions. However, some initiatives will require support from additional stakeholders to enable successful implementation

- (i.e., the functional, test, or headquarters ASA(ALT) communities). These stakeholders must be included in the development of the Should-cost initiatives and have a coordinated position on their ability to support the initiative. Most items outside the control of the program office and inconsistent with the current program of record are outside excursions and not appropriate for the Should-Cost estimate. For example, economic production rate excursions or other quantity excursions are not part of the program Should-Cost estimate. They should be shown separately. Multi-year assumptions that keep the yearly buy schedule the same would be included in the Should-Cost estimate. Anything requiring significant investment for completion and an increase to the budget is outside the scope of the Should-Cost estimate and should be shown separately.

**Will-cost and Should-cost Reporting Processes and Procedures:**

Will-cost and Should-cost estimates are required for all ACAT I, II and III milestone decisions. Annual updates of the Should-cost estimate are required.

In addition, there are cases where there is limited potential savings for using the Should Cost constructs due to where a program is in the lifecycle, total cost remaining on program, etc. In those cases, an Army waiver process (see Enclosure 3 for format) is being established within this policy memorandum. All requests, for waiver from the requirement to establish a Should-cost estimate, will be filled out and processed through the PARCA office for concurrence prior to submission for approval. Approval authority for all waivers is the ASA (ALT).

Table 1: Event Driven Cost Estimate Reporting Requirements for ACAT I, II and III programs

<b>Event</b>	<b>Will-Cost (Initial /Update/Review)</b>	<b>Program-Level Should-Cost (Initial / Update)</b>	<b>Contract-Level Should-Cost</b>
MS A	Initial	Initial	N/A
Yearly Updates	At PM's discretion	Update	N/A
MS B	Update (Initial setting of Budget Baseline for Nunn-McCurdy metrics)	Update (Sets Program Execution Baseline)	Initial to Support Contract Actions (Optional)
Yearly Updates	At PM's discretion	Update	Optional
MS C Decision / LRIP 1 Contract Award	Update	Update	Optional Recommended IAW FAR 15.407-4

			Should-Cost Review and DFARS 215.407-4 Should-cost review.
Yearly Updates	At PM's discretion	Update	Optional
FRP (FDDR) Decision / Contract Award	Update	Update	Optional Recommended IAW FAR 15.407-4 -- Should-Cost Review and DFARS 215.407-4 Should-cost review.
Yearly Updates	At PM's discretion	Update	Optional

In addition, consideration should be given to updating Will-cost estimates and Should-cost estimates and conducting direct and indirect Should-cost reviews for the following program events:

- 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. Recommend at a minimum a Will-cost estimate update, but also consider updating the Should-cost estimate and conducting a FAR/DFARS indirect/direct cost review. Conducting these updates in conjunction with any sustainment Business Case Analysis (BCA) is beneficial.
- Organic Logistics Infrastructure. At a minimum update the Will-cost estimate, but consider updating the Should-cost estimate and conducting a FAR/DFARS indirect/direct cost review. Conducting these updates in conjunction with a sustainment Business Case Analysis (BCA) is beneficial.

**Process for withhold and release of the difference between the Will-cost and Should-cost estimate:**

Per OSD memorandum dated April 22, 2011, 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.

Initial and updated Will-cost estimates and Should-cost estimates must be promptly provided to the Army DASA Plans, Programs, and Resources (PARCA office) and addressed in the annual program health/milestone briefings who will coordinate with the appropriate Army Comptroller designee in order to manage the funding hold process. The funding hold and release process for the Department of Army will be as follows:

- 1.) Programs that are funded starting in FY2012 and out are limited to expending no more than the Should-cost management target. The remaining funds representing the difference between the Will-cost estimate and Should-cost management target will be placed on hold at the appropriate Army level. Only funds equal to the Should-cost estimate will be released to the program manager for execution.
- 2.) Each program manager will brief their execution status relative to the Should-cost management target at their annual program review. Program managers will also present their annual Should-cost estimate updates during any scheduled AAE reviews. All reviews of Should-cost estimate updates must be vetted by a cross-functional team to include cost, financial management and budget, contracting, engineering, logistics and programming representatives.
- 3.) Program manager will request any release of funds on hold during the annual review.
- 4.) If a program manager requires release of funding between regularly scheduled reviews, the Program Executive Officer shall schedule an out-of-cycle review with all appropriate participants to include the AAE if he is the MDA for that program.
- 5.) The PEO shall provide a monthly report to Army PARCA on any release of delta dollars with a copy of the request(s). A consolidated monthly report will be sent to ASA (ALT) showing all programs using dollars within the delta between the Will-cost and Should-cost estimates.

NOTE: The process to hold funds that have been appropriated that represent the difference between the Will-cost estimate and the Should-cost management target will initially be piloted on 5 Army programs prior to full implementation across all ACAT I, II and III programs.

Information on release of funds and/or achieved savings will be provided to ASA(ALT). Program offices and Army Cost element (DASA CE, PEO Cost Analyst, or AMC LCC) will ensure full incorporation of the information into updated Will-cost estimates. Updated Will-cost estimates incorporating the latest information of achieved savings will be provided through the DA Program Objective Memorandum (POM) process for inclusion in revised POM positions.

**Reporting Methods and Templates:**

Program offices will be responsible for tracking and reporting all Should-cost estimates and any updates. At a minimum, reporting elements will include the discrete items or specific initiatives, cost savings associated with each, and a program timeline or event when the savings is expected to be realized. 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 estimates will be reported to the OUSD(AT&L)/ARA through Acquisition Visibility Service Oriented Architecture (AV SoA). Waiver requests to the Should Cost Management requirements should be submitted through the PARCA office to ASA(ALT) for review and approval.

Enclosure 3 – Request for Waiver from Should-Cost Requirement

<b>WAIVER TO THE SHOULD-COST REQUIREMENT</b>							Requester's Name																																																																
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